

CAPITAL MARKETS FOR GROWING COMPANIES

A review of the
European listings regime



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FOREWORD

Europe must be more competitive if it is to deliver jobs and growth for its 28 Member States and 500 million people. It is from businesses of all sizes in the private sector that this competitiveness challenge will be met. If firms are able to raise money from a rich variety of sources, including in the form of debt and equity, they will be better able to fulfil their growth potential and compete in the global economy.

Two out of every three employees in the EU work in small and medium enterprises (SMEs), which make up 99% of Europe's firms. SMEs have traditionally relied on bank lending – more than 70% of SME finance comes from bank loans. Banks will continue to play a central role in SME finance, but their ability to lend has been constrained by the necessary post-crisis measures put in place to strengthen the financial system.

The creation of a Single Market for capital would enable businesses to access deep and liquid pools of capital across the whole continent. The European Commission has set itself the task of creating a Capital Markets Union (CMU) to realise the founding principle of free movement of capital for the benefit of businesses and people in every Member State.

In the Budget of March 2015, the Chancellor of the Exchequer invited TheCityUK to conduct a review of the European Listings Regime to inform the CMU debate with an understanding of how markets can work better for firms of all sizes. This report shows how Europe's corporates could be enabled to raise money more quickly, more cheaply and from more diverse sources. As part of a varied ecosystem of business finance, equity, debt and other capital markets can help firms innovate and grow for the benefit of us all.



Chris Cummings

Chief Executive, TheCityUK



1.0 EXECUTIVE SUMMARY

1.1

Capital markets play too small a role in financing growth and European businesses remain heavily reliant on banks, making Europe's economies vulnerable to a tightening of bank lending. This is a particular problem in the small and medium enterprise (SME) sector where over 70% of finance is provided by way of bank loans. Given the importance of SMEs, which account for 99% of businesses across the EU, this problem needs to be addressed urgently. Outside the SME sector, European investment levels remain well below their historic norm and European capital markets are less competitive at the global level.

1.2

By making Europe's capital markets more accessible and fundraising quicker, cheaper and easier, companies of all sizes and levels of maturity would be able to secure long-term capital to sustain their growth. A more integrated capital markets regime, which is a prerequisite to achieving a CMU, would enhance the shock-absorption capacity of the European economy and allow for more investment without increasing levels of indebtedness.

1.3

Capital markets solutions may not be appropriate for all companies and bank lending will continue to play an important role. There is a variety of funding options available on capital markets for SMEs which are currently not being used to their maximum potential; these are examined in Section 2 of this report. Section 3 examines the IPO process and what can be done to improve the process for those companies which achieve the size and maturity required for listing on a regulated market. Section 4 looks beyond the IPO process to secondary fundraisings on the capital markets.

1.4

SMEs' over-reliance on bank finance made them vulnerable during the global financial crisis. Although lending rates are starting to improve, banks are increasingly risk averse and the cost of debt is increasing. SMEs need to be educated about the benefits of raising capital through the capital markets and the range of options available to them. Investors need to be encouraged to provide risk capital by providing them with better information on the creditworthiness of SMEs and appropriate tax and other incentives.



SMEs GENERATED €3.7 TRILLION IN VALUE ADDED IN THE EU28 IN 2013, REPRESENTING JUST OVER HALF (58%) OF EU28 GVA



SME CREDIT GAP IS \$1.5 TRILLION GLOBALLY

(Source: enterprise finance group database IFC 2011).

THE TOTAL VALUE OF CAPITAL RAISED THROUGH IPOs IN THE EU DECREASED FROM AN ANNUAL AVERAGE OF US\$133 BILLION DURING 1993-2000 TO AN ANNUAL AVERAGE OF US\$70 BILLION IN THE FIRST DECADE OF THIS CENTURY

(Source: European IPO Task Force).



US\$133BN
1993-2000



US\$70BN
2001-2009

1.5

The regulatory framework needs to be examined to ensure that SME financing is able to operate in a cost efficient manner. The interests of SMEs and investors need to be balanced to enable SMEs to raise capital without being encumbered by unwieldy legislation whilst at the same time providing some fundamental safeguards to investors in order to protect the integrity of Europe's capital markets.

1.6

Admission to a regulated market can be made less burdensome without lowering standards. The key to unlocking achievable efficiencies is splitting the prospectus and the issuer publishing a core registration statement earlier in the admission process. This would give investors more meaningful access to management; better investor dialogue leading to more robust pricing; shorter, more focused, research; and shorter offering periods further reducing market risk. The current market practice of analyst research on the issuer being published first, to help educate investors, followed by a self-imposed two week 'blackout period' before any form of prospectus is published should be abandoned.

1.7

Once an issuer is listed there are also significant improvements which can be made in relation to follow on issuances. Once listed, a company is required by the Transparency Directive to publish a wealth of information on an on-going basis. Currently much of that information is simply repeated in the prospectus on a follow on issuances. If, instead, the company was able to produce a much shorter document, only updating the information already available then this would be quicker to draft, saving on fees and making launch more flexible with an issuer less likely to reject a pro-rata issue in favour of a cash placing just because of the burden of producing a prospectus.

1.8

The main recommendations of this report are:

- Increase the awareness of capital markets options available to SMEs
- Provide more information and increase incentives to investors in SMEs
- Minimise the regulatory complexity of raising capital and listing on an unregulated market with a view to managing costs
- Within the IPO process, make information available sooner to investors through a core registration statement followed by research, obviating the need for a blackout period
- Broaden investor participation in IPOs to include retail investors
- Increase confidence in pan-European offerings through the harmonisation of the approach of NCAs and the introduction of minimum corporate governance requirements
- Reduce the prospectus disclosure requirements for follow on issuances.

1.9

The recommendations in this report require action from all key stakeholders, from the European Commission and national governments, regulators, stock exchanges, banks and capital markets advisers through to investors and growth companies who will benefit from these recommendations. If a CMU is to be achieved and an equity culture developed within Europe that is capable of providing sustained capital to European businesses, all stakeholders need to work together to implement the recommendations contained in this report to provide a more stable capital base for Europe's economy.

SUMMARY OF RECOMMENDATIONS

INITIAL CAPITAL RAISINGS

INCREASE THE AWARENESS OF CAPITAL MARKETS OPTIONS AVAILABLE TO SMEs

- R1** CREATE NATIONAL REGISTERS AND A CENTRAL EUROPEAN REGISTER OF CAPITAL MARKETS OPTIONS AVAILABLE TO SMEs
- R2** EDUCATE SMEs ABOUT THE DIFFERENT CAPITAL MARKETS OPTIONS AVAILABLE AND HOW TO PREPARE FOR THE FUNDRAISING PROCESS
- R3** DEVELOP CLEAR SIGNPOSTING OF THE MOST APPROPRIATE OPTIONS FOR SMEs AT DIFFERENT STAGES OF DEVELOPMENT

PROVIDE MORE INFORMATION TO POTENTIAL INVESTORS IN SMEs

- R4** CREATE NATIONAL CREDIT REGISTERS TO MAKE AVAILABLE INFORMATION ON THE CREDITWORTHINESS OF SMEs AND ALLOW ACCESS TO THOSE REGISTERS ACROSS THE EU
- R5** LEVERAGE THE CURRENT RATING REGIME TO INTRODUCE A SPECIAL REGIME FOR SMEs
- R6** EDUCATE SMEs ON THE LEVEL OF INFORMATION REQUIRED BY POTENTIAL INVESTORS

INCREASE INCENTIVES TO INVEST IN SMEs

- R7** ENCOURAGE NATIONAL GOVERNMENTS TO MAKE APPROPRIATE TAX INCENTIVES AVAILABLE TO INVESTORS IN SMEs
- R8** EU COMMISSION TO MAINTAIN A FLEXIBLE APPROACH TO THE ENFORCEMENT OF STATE AID RULES IN RESPECT OF SUCH INCENTIVES

MINIMISE THE COMPLEXITY OF LISTING ON AN UNREGULATED MARKET

- R9** LIMIT SCOPE OF THE EU LISTING REGIME TO REGULATED MARKETS
- R10** AMEND DEFINITION OF 'OFFER TO THE PUBLIC' TO PROVIDE GREATER FLEXIBILITY BY MODIFYING FINANCIAL AND OTHER THRESHOLDS
- R11** MAINTAIN AND ENCOURAGE APPROPRIATE SAFEGUARDS ON THE LISTING AND MARKETING OF SECURITIES THROUGHOUT THE EU
- R12** ADOPT GOOD AND CONSISTENT STANDARDS OF DISCLOSURE FOR ADMISSION DOCUMENTATION FOR MTFs TO INCREASE FAMILIARITY ACROSS JURISDICTIONS

FURTHER MEASURES TO MANAGE COSTS

- R13** ESMA TO COMPILE EMPIRICAL DATA ON THE LISTING COSTS OF DIFFERENT VENUES SO THAT SMEs CAN MAKE AN INFORMED CHOICE
- R14** CONSIDERATION TO BE GIVEN TO MAKING EQUITY ISSUANCE COSTS DEDUCTIBLE FOR CORPORATION TAX PURPOSES

IPO: ADMISSION TO A REGULATED MARKET

MAKE INFORMATION AVAILABLE SOONER

R15 SPLIT PROSPECTUS INTO A CORE REGISTRATION STATEMENT PUBLISHED PRIOR TO ANALYST RESEARCH AND A SECURITIES NOTE PUBLISHED LATER

R16 REMOVE THE BLACKOUT PERIOD BETWEEN THE PUBLICATION OF ANALYST RESEARCH AND THE SUBSEQUENT PUBLICATION OF THE PROSPECTUS

INCREASE QUALITY OF INFORMATION

R17 INCREASE AVAILABILITY OF NON-CONNECTED RESEARCH

R18 MAKE PROSPECTUS MORE FOCUSED AND RELEVANT

BROADEN INVESTOR PARTICIPATION

R19 EXTEND THE CURRENT DEFINITION OF 'QUALIFIED INVESTOR' TO INCLUDE A NEW CATEGORY OF PROFESSIONAL INVESTORS

R20 INTRODUCE A CERTIFICATION PROCESS FOR PROFESSIONAL INVESTORS

R21 INCREASE ABILITY TO MOVE PRICE RANGE

INCREASE INVESTOR CONFIDENCE IN PAN-EUROPEAN OFFERINGS

R22 HARMONISE APPROACH OF NCAs TO PROSPECTUS REVIEW AND APPROVAL

R23 ENCOURAGE MINIMUM CORPORATE GOVERNANCE REQUIREMENTS

POST IPO: FOLLOW ON CAPITAL RAISINGS

REDUCE THE PROSPECTUS DISCLOSURE REQUIREMENTS FOR FOLLOW ON ISSUANCES

R24 REDUCE SPECIFIC DISCLOSURE REQUIREMENTS

R25 REVISE ARTICLE 5 GENERAL DISCLOSURE TEST

R26 ELIMINATE NEED TO REPEAT INFORMATION AVAILABLE ON A DEDICATED SECTION OF THE ISSUER'S WEBSITE

2.0 INITIAL CAPITAL RAISINGS

BACKGROUND

There has been much debate in recent years about the importance of finding alternative sources of capital for companies within the SME sector. These companies are the backbone of Europe, with European Commission research suggesting that 99% of businesses across the EU are SMEs.¹

What is a SME?

The standard definition of a SME used by the European Commission is a company that has:

- less than 250 employees; and
- either a turnover of less than €50 million or a balance sheet total of less than €43 million.

Given the breadth of this definition, the sector is often broken down further into medium-sized, small and micro companies (Table A). This distinction is important for the purposes of this report as different funding solutions will be relevant for different sized companies, with the more sophisticated solutions only being a realistic option for large and medium-sized companies.

Table A

Category	Employees	Turnover	or	Balance sheet total
Large	>250	>€50m		>€43m
SMEs	<250	<€50m		<€43m
- Medium	50 to 250	€10m to €50m		€10m to €43m
- Small	10 to 50	€2m to €10m		€2m to €10m
- Micro	Less than 10	Less than €2m		Less than €2m

The importance of SMEs to the European economy

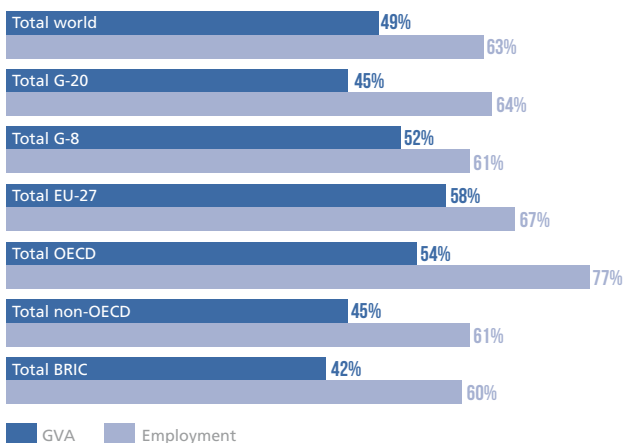
On a global basis, SMEs account for approximately 90% of businesses, which provide more than 60% of employment worldwide and approximately 80% of jobs within the developed world. These businesses contribute approximately 50% of global Gross Value Added (GVA) and a significantly higher percentage in the developed world² (Table B). Within the EU, approximately 67% of the workforce are SME workers and SMEs contribute approximately 58% of GVA.³

In order to survive and grow, SMEs need funding at all stages of their development, from seed capital in the early years through to development and growth capital and ultimately a permanent and stable source of capital.

Table B

SMEs account for 67% of European employment and 58% of GVA

Employment and GVA contributions of SMEs



Source: ACCA Small business: a global agenda 2010 report
Oliver Wyman

¹ Information derived from the European Commission's Eurostat Website

² Towards Better Capital Markets Solutions for SME Financing: Oliver Wyman, 2014

³ Information derived from European Commission's Eurostat Website

The SME funding gap

In a recent report, restricted access to finance was cited by SMEs worldwide as the greatest constraint on their growth.⁴ The International Finance Corporation (IFC) has estimated the **SME credit gap to be \$1.5 TN** globally.⁵ Traditionally, SMEs have relied on bank lending and other forms of credit as their principal source of finance. The reach of the major banks through their branch networks and the close links between SMEs and their relationship manager has been a major factor in shaping SME financing, as has the deductibility of debt interest costs

for corporation tax purposes. The global financial crisis demonstrated the short-comings of this financing strategy.

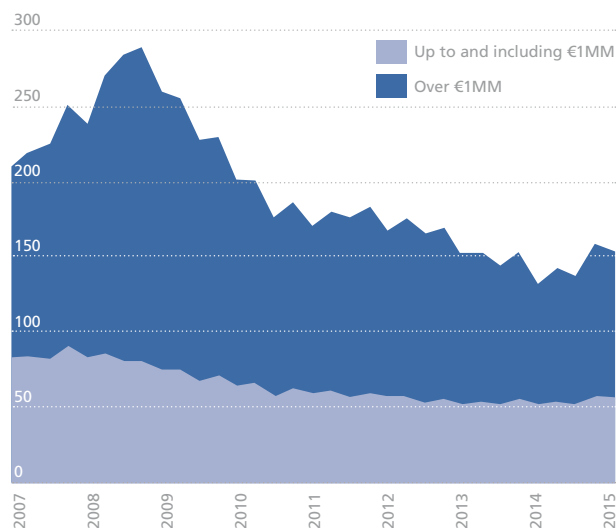
Banks are having to contend with increasing regulation, in particular through the implementation of Basel III. As a result, SMEs are now having to contend with banks that are increasingly risk averse and, as a result, lending has not returned to pre-crisis levels (although there has been a slight upturn since mid-2014) whilst the cost of debt, particularly in respect of small loans, has risen (see Tables C and D).

Table C

Lending has not yet recovered to pre-crisis levels

European loans to Non-Financial Corporations by loan amount

2007-2015, New business volume, €BN



Note: Loans other than revolving loans and overdrafts, convenience and extended credit card debt, Total maturity/period of notice/initial rate fixation, Outstanding amount / new business; 3 month average of monthly data taken to smoothen out the series
Source: ECB statistical website

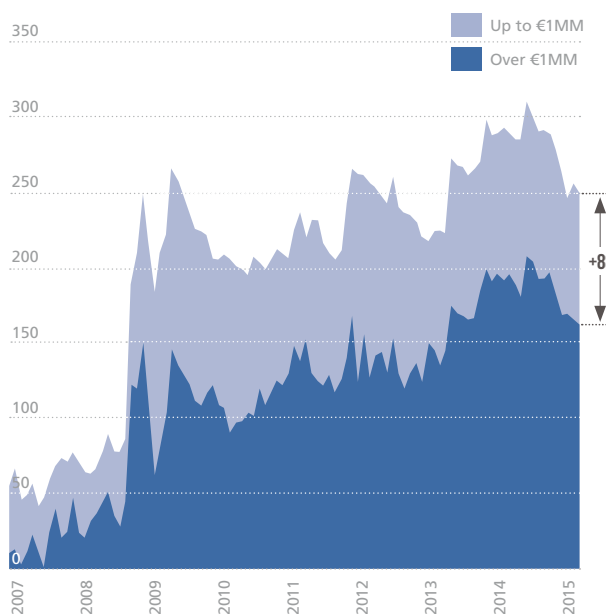
Oliver Wyman Analysis

Table D

Loans up to €1MM cost 88 bps more than larger loans

Cost¹ of new loans in Europe by ticket size

2007-2015, bps



¹ Averaged across tenor, spread calculated as corporate loan interest rates minus Euro area base rate;

Source: ECB, Oliver Wyman analysis

Oliver Wyman Analysis

⁴ Analysis undertaken by IFC, AFME and Oliver Wyman

⁵ Enterprise Finance Group Database: IFC, 2011

If SMEs are to reduce their dependence on bank lending and become less vulnerable to any future banking crisis, they need to diversify their funding sources and focus on other options which are capable of providing long-term financing solutions.

The capital markets solution

There are a growing number of options available to SMEs which are prepared to consider forms of finance other than traditional bank lending, including those provided by the private equity and venture capital industries. Whilst these may provide medium- to long-term equity funding, they are unlikely to provide the long-term, flexible source of capital required by SMEs.

Capital markets are an obvious alternative to bank lending and other sources of equity capital as they give SMEs access to the permanent source of capital they require in order to secure sustained growth.

The term 'capital markets' is used in its widest sense in this report and is not limited to the primary European markets such as the Main Market of the London Stock Exchange, Euronext and the Deutsche Börse and other overseas markets which typically attract European issuers (for example NASDAQ). These are only likely to be appropriate for larger and more mature companies and are unlikely to be a viable option for the majority of SMEs. In this report, the term is also used to describe the growing number of secondary equity markets (multi-lateral trading facilities or MTFs) which are aimed at smaller, growing companies and SME debt markets which enable funds to be raised through the issue of debt instruments. Although it is not a primary focus of this report, there are also a number of alternative funding platforms in existence which match investors with SMEs which are seeking debt or equity without providing a trading facility. The full range of options is summarised in Table E.

Table E

Capital market options available to SMEs

<p>1</p> <p>Alternative funding platforms</p> <p>Pure match model: direct contact between investors and borrowers</p> <ul style="list-style-type: none"> • Deal Market • FinPoint <p>Marketplace model: lenders fund borrowers at defined interest rates</p> <ul style="list-style-type: none"> • Lending Club <p>Auction model: lenders bid on loans, and lowest rate wins</p> <ul style="list-style-type: none"> • Funding Circle <p>Crowd-funding: investors fund start up projects to obtain unlisted equity share</p> <ul style="list-style-type: none"> • Kickstarter • Indiegogo 	<p>2</p> <p>MTFs with primary market functions</p> <p>AIM – LSE's international market for smaller growing companies</p> <p>Alternext – Euronext's subsidiary supporting growth of SMEs across Europe</p> <p>Freiverkehr – Frankfurt Stock Exchange's 'open market' segment for foreign shares and German SMEs</p> <p>AIM Italia – Borsa Italiana's market for SMEs</p> <p>BX Swiss – Swiss exchange focusing on small and medium-cap stock</p> <p>BATS Chi-X Europe – Europe's largest alternative trading venue</p>	<p>3</p> <p>SME debt markets</p> <p>ORB – LSE's order-driven trading service for retail investors</p> <p>MARF – alternative market in Spain for SMEs to issue fixed-income securities</p> <p>Entry Standard for corporate bonds – Deutsche Börse's platform for SMEs to raise debt</p>	<p>4</p> <p>Primary exchanges</p> <p>Established exchanges, such as:</p> <ul style="list-style-type: none"> • London Stock Exchange • Euronext • Deutsche Börse • BME Spanish Exchanges • NASDAQ • NYSE
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Alternative funding platforms can provide SMEs with access to capital relatively quickly and easily, but they are only suitable for raising small amounts of capital, as current legislation restricts the amount that can be raised and the number of investors that can be approached. Equity fundraisings on primary exchanges and MTFs and debt issuances on SME debt markets give access to larger amounts of capital but the complex regulatory regime and high transaction costs are often seen as barriers to entry.

The number of companies seeking finance through capital markets appears to be falling. The recent EU IPO Report issued by the European IPO Task Force⁶ noted that the annual average number of IPOs dropped to about 670 during the period 2001 – 2011, compared to an annual average of 1,170 during 1993 – 2000. The decrease in new listings was accompanied by a decrease in the amount of equity that companies raised. The total value of capital raised decreased from an annual average of US\$132.7 billion during 1993 – 2000 to an annual average of US\$69.9 billion in the first decade of this century.

Exchanges have attributed the decline in the number of IPOs to the decline of smaller companies coming to market. The European IPO taskforce concluded that whilst IPO markets continue to function well for larger companies, they are becoming increasingly inaccessible to smaller companies, thereby bringing down the number of IPOs.

Immediate action is required to stimulate both supply and demand in the capital markets. SMEs should be encouraged to access alternative sources of finance (by issuing equity and debt instruments) and investors to commit funding to SMEs. This report highlights the principal barriers for both SMEs and investors and makes proposals for addressing these issues. Whilst the focus of this report is on capital markets and, in particular, IPOs, it should be noted that many of the issues that have been identified, and the proposals that are made, will benefit SMEs at all stages of their development and not only those which are ready to access the capital markets.

RECOMMENDATIONS

2.1 INCREASE THE AWARENESS OF CAPITAL MARKETS OPTIONS AVAILABLE TO SMEs

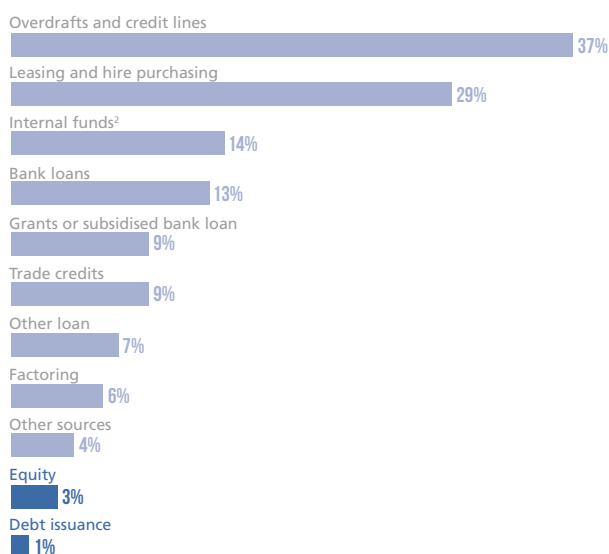
The majority of SMEs do not look beyond their relationship bank manager to satisfy their financing needs, with over half of SME financing requirements being met by bank loans, overdrafts and other credit facilities (see Table F below). The reach of the major lending banks through their branch networks and the close links, often built up over many years, between SMEs and their relationship

Table F

European SMEs should be made more aware of equity and debt issuance as an alternative to bank lending

European¹ SME financing sources use between April and September 2014

2014, % of SMEs



¹ EU-28 SMEs; ² Retained earnings or sales of assets

Source: SAFE analytical report 2014

Oliver Wyman

⁶ EU IPO Report – Rebuilding IPOs in Europe: European IPO Task Force, 2015

manager means that many SMEs look no further when financing is required. This lack of awareness is highlighted by BDRC Continental in their quarterly publication, *SME Finance Monitor*: 5,000 businesses were questioned about alternative sources of finance for the Q1 2015 report; only 31% indicated an awareness of government and other initiatives designed to help make funding available to SMEs and only 38% were aware of the possibilities offered by crowdfunding⁷.

The variety of funding options available to SMEs is confusing, ranging from alternative platforms through to established stock exchanges for large and more mature companies with many options in between. Many SMEs do not understand the various options and the benefits and requirements of each. They may dismiss debt and equity issuance as being too expensive and complicated. To address this, SMEs need information on the range of options available to them and the benefits and requirements of each platform.

R1 CREATE NATIONAL REGISTERS AND A CENTRAL EUROPEAN REGISTER OF CAPITAL MARKETS OPTIONS AVAILABLE TO SMEs

As part of their supervisory function, the National Competent Authority (NCA) within each Member State should maintain a register of the capital markets funding options available within their territory. This should include a summary of the admission requirements and regulatory regime governing the relevant platform and information as to where further guidance can be obtained.

These national registers should link into a central register of all the European platforms that are available for fundraising by SMEs so that the information is available on a pan-European basis. This central European register could be maintained either by the European Commission or delegated to another appropriate body, such as the European Central Bank. This would enable SMEs to understand the options available to them not only within their own Member State but across the EU.

R2 EDUCATE SMEs ABOUT THE DIFFERENT CAPITAL MARKETS OPTIONS AVAILABLE AND HOW TO PREPARE FOR THE FUNDRAISING PROCESS

Stock exchanges, which are the operators of many of the funding platforms, should also do more to promote the options that are available for SMEs. In the UK AIM, which over its 20 year history has been energetic in promoting the benefits of AIM both within the UK and internationally, has attracted companies from more than 100 countries and 40 different sectors which have raised over £90 billion to support their growth and development.

Promoting exchanges not only benefits SMEs, which are able to make better-informed decisions once they understand the full range of options available to them, but also benefits the exchanges themselves in terms of the increased fees and stability that comes with an increased number of market participants; a recent report by Oliver Wyman suggests that a critical mass of 150-200 listings is required before a platform becomes profitable.⁸

ELITE programme – Borsa Italiana/London Stock Exchange

Launched in Italy in April 2012, the UK in April 2014 and pan-Europe in December 2014, ELITE is a community of entrepreneurs, business leaders, advisers, investors, public sector and academics to support businesses as they grow for the long term.

The goals of ELITE are to drive cultural and organisational change and become more attractive to a wider range of investors – not all IPOs, but capital neutral e.g. outcomes have included 10 bond issuances (€300m raised); 13 private equity deals; 35 M&A/joint venture deals; €170m public sector investment. ELITE has an established presence, with 200+ companies, 150+ stakeholder partners, 70+ investors, 88,000 employees and €22.6bn total revenues of ELITE companies.

The involvement of exchanges in promoting the various options available to SMEs could also help to introduce SMEs to professional service providers such as corporate finance advisers, accountants and legal advisers who can assist in the education process. Many SMEs which seek to access the capital markets are unprepared for the level and quality of disclosure that is required by certain

⁷ SME Financing Monitor: BDRC Continental, Q1 2015

⁸ Towards Better Capital Markets Solutions for SME Financing: Oliver Wyman, 2014

markets. The early involvement of external advisers could help address this by, for example, increasing the quality of financial reporting, helping to put in place non-executive directors and an appropriate corporate governance regime at an early stage, as well as educating directors on the fundraising process. The '10,000 Small Businesses UK' programme, launched by Goldman Sachs in 2010 and the ELITE programme launched by the London Stock Exchange in 2014 are good examples of the type of support programmes which SMEs need to realise their potential. This kind of support is particularly important for those companies that are seriously considering a bond issue or an IPO. Whether this is on one of the primary exchanges or an MTF, it is advisable for the planning process to start up to two years in advance of the proposed listing.

R3 DEVELOP CLEAR SIGNPOSTING OF THE MOST APPROPRIATE OPTIONS FOR SMEs AT DIFFERENT STAGES OF DEVELOPMENT

Greater transparency is needed as to the entry requirements for the different platforms as is clear signposting as to the most appropriate platform for SMEs at different stages of their development. Capital markets are driven by supply and demand, SMEs need to have the right information to enable them to access the type of investor most likely to commit funds through the provision of either debt or equity capital. A small, early stage SME is unlikely to attract investment from large institutional shareholders,

and might be best advised to access smaller investors through one of the alternative listing platforms. A listing on one of the European primary markets is only likely to be realistic for large companies or those at the top end of the SME sector with a market capitalisation in excess of £100 million. Small to mid-sized companies may be better suited to raising equity through a listing on a MTF or through the retail bond market which provides a route for bond issues of £25m to £300m which can then be traded on a SME debt market such as the Order Book for Retail Bonds (ORB) which is operated by the London Stock Exchange. Companies need to be educated about how the different platforms can provide capital for them at different stages in their development (see Table G).

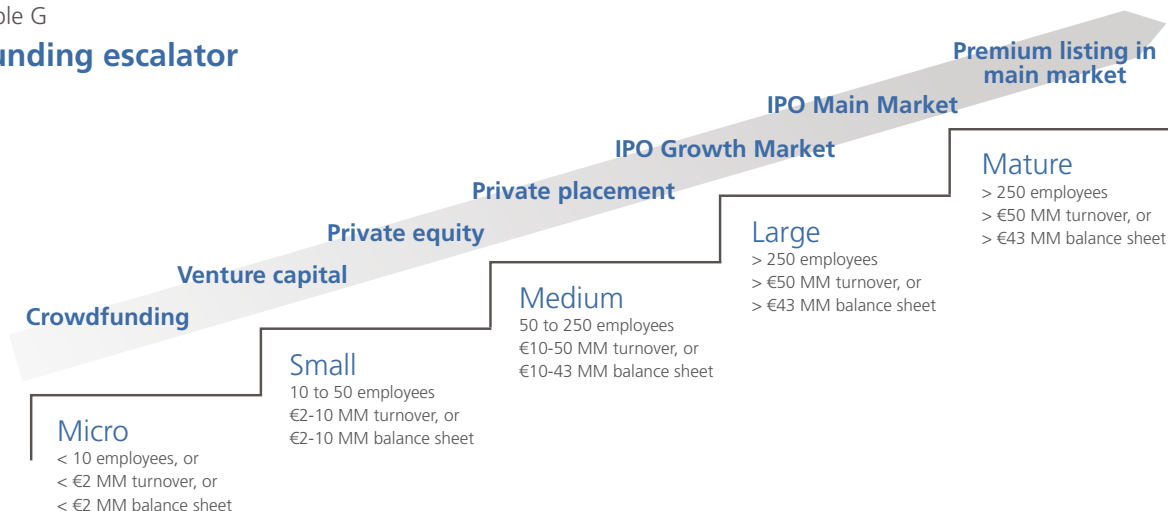
SUMMARY OF RECOMMENDATIONS

Increase the awareness of capital markets options available to SMEs

- R1** Create national registers and a central European register of capital markets options available to SMEs
- R2** Educate SMEs about the different capital markets options available and how to prepare for the fundraising process
- R3** Develop clear signposting of the most appropriate options for SMEs at different stages of development

Table G

Funding escalator



Source: Oliver Wyman

2.2 PROVIDE MORE INFORMATION TO POTENTIAL INVESTORS IN SMEs

The availability of alternative non-bank finance will only become viable if a sufficient number of investors are prepared to commit funding to SMEs. Investors need a minimum level of information on the company and its business before making an investment decision. Investors will want to understand the company's business model and receive up-to-date financial information, in order to be able to assess the financial stability and risk profile of the business and become familiar with its management team.

Where a SME is seeking to raise capital on a primary market, this information will be contained within the prospectus. Most institutional investors will have the opportunity to meet and question the management team at investor presentations. A similar level of information may be available where a SME is seeking to raise capital on a MTF or SME debt market, but because of differing requirements between the various platforms, there is no guarantee that this will be the case. Some platforms require only limited disclosure. Even less information may be required of SMEs seeking capital through an alternative funding platform.

Information that is publicly available on SMEs is limited and the financial information that is available from public registers is often out-of-date and, in some cases, not audited. Whilst venture capital and private equity investors are able to plug this gap by undertaking detailed due-diligence on investment opportunities, this is not viable where SMEs are seeking capital from a number of investors on the capital markets.

This information gap needs to be addressed in order to encourage investors to invest the necessary capital in SMEs and to establish trust and confidence in the funding platforms that are available.

R4 CREATE NATIONAL CREDIT REGISTERS TO MAKE AVAILABLE INFORMATION ON THE CREDITWORTHINESS OF SMEs AND ALLOW ACCESS TO THOSE REGISTERS ACROSS THE EU

Much of the information about an SME's past financial performance and creditworthiness is held by its relationship bank and is not widely shared. This information is necessary for any potential investor in trying to assess the creditworthiness of an investment proposal. Other important factors, such as confidence in the management team or the innovative nature of the business are often sufficient to attract investment.

The Bank of Italy has established a Central Credit Register which collects data on the credit facilities granted to the customers of the banks and financial companies it supervises. Currently, 16 out of the 28 Member States have or are in the process of setting up central credit registers⁹. Each Member State should be encouraged to do the same, either through its central bank or another public or private body (dependent on the Member State's existing credit reporting structure) and to increase the amount of data captured in this central register. In this regard, the threshold above which data is required to be reported could be harmonised across the EU.

The data gathered by the relevant entity in each Member State should then be capable of being accessed by investors not just in that Member State but across the EU, so that potential investors are able to access data on potential investments wherever they are situated in the EU. The availability of such information on a pan-European basis is a pre-requisite to achieving a true CMU.

R5 LEVERAGE THE CURRENT RATING REGIME TO INTRODUCE A SPECIAL REGIME FOR SMEs

Existing providers of credit ratings could be encouraged to extend their current ratings system to SMEs. This would provide an objective judgment on the creditworthiness of SMEs and would assist potential investors. Standard and Poors announced in 2013 that it would offer a credit evaluation service to mid-market companies, initially in

⁹ Long-term Finance for Infrastructure and Growth Companies in Europe: TheCityUK/IRSG, 2015

¹⁰ The squeezed middle: S&P says Europe's mid-sized companies need up to €3.5 trillion funding by 2018: Standard & Poor's, 2013

France, Germany and the UK¹⁰. Although this appeared to be a step in the right direction, the service is not widely used and the cost is seen as prohibitive. Lessons should be learned from this experiment and the rating agencies should be encouraged to think of ways in which information on the creditworthiness of SMEs could be made available in a cost-effective manner. Investments in SMEs are not solely based on the creditworthiness of the company.

In the US, credit scores are available from the National Association of Insurance Commissioners (NAIC). The NAIC, a central body for state-level insurance regulators, provides rating services to US insurers investing in private placements. Issuers are not charged for these ratings and the upfront cost to investors is low. NAIC ratings are provided post-transaction and so are not a like-for-like substitute for ratings provided by private sector rating agencies, but they provide investors with clear and standardised information. Such a model has the potential to provide EU investors with similar certainty, particularly if the scheme were to operate on a pan-European basis with a standard set of criteria. The European Commission should carry out a further analysis on the benefits of introducing an equivalent regime in the EU.

R6 EDUCATE SMEs ON THE LEVEL OF INFORMATION REQUIRED BY POTENTIAL INVESTORS

An increased awareness, developed through the measures suggested above, should result in SMEs becoming more aware of the information required by investors. This would enable them to better prepare and present the relevant data to potential investors. A well-prepared investment case, containing all the necessary financial data, would greatly assist the investment process and lead to greater investor confidence.

SUMMARY OF RECOMMENDATIONS

Provide more information to potential investors in SMEs

- R4** Create national credit registers to make available information on the creditworthiness of SMEs and allow access to those registers across the EU
- R5** Leverage the current rating regime to introduce a special regime for SMEs
- R6** Educate SMEs on the level of information required by potential investors

21.6 MILLION
21.6 MILLION SMEs IN THE
NON-FINANCIAL BUSINESS
SECTOR IN THE EU28 IN 2013.



**SMEs EMPLOY TWO IN EVERY
THREE EU EMPLOYEES AND
MAKE UP 99% OF ALL EURO
AREA FIRMS.**

88.8 MILLION



THESE FIRMS EMPLOYED 88.8 MILLION PEOPLE.

€3.7
TRILLION

**GENERATE ALMOST €3.7 TRILLION
OF VALUE ADDED**

(Source: European Commission, Annual report on European SMEs 2013/2014).

(ECB)

2.3 INCREASE INCENTIVES TO INVEST IN SMEs

High-quality financial information about an investment opportunity cannot provide a guarantee against failure. Investing in SMEs is inherently risky and there is a high level of failure, particularly for early-stage businesses. A recent US report concluded that many business start-ups close or fail within the first 10 years.¹¹ There will inevitably be some failures amongst those small and/or early-stage companies which raise funds on the alternative listing platforms identified in Table E, the majority of which are too early-stage to be able to publish reliable data on their track record. Even those markets which attract slightly larger and/or longer established SMEs are not immune to failure.

The crash that followed the technology boom of the late 1990s saw a number of casualties on AIM and other secondary markets across the EU. The most high-profile casualty was Germany's Neuermarkt, a market for technology shares and other high-growth stocks often described as the European equivalent of NASDAQ. This closed in 2002 after the combined market value of the 264 companies listed fell by approximately 96% following the height of the market in early 2000. AIM in the UK was

badly hit during the recent crisis, with 95 companies delisting at the height of the recession in the 12 months to 31 December 2009 due to financial stress and insolvency.

Investors in SMEs run a higher risk of losing some, if not all, of their investment than investors in larger, more mature businesses. Therefore, there needs to be some financial incentive offered to investors who are prepared to take this risk.

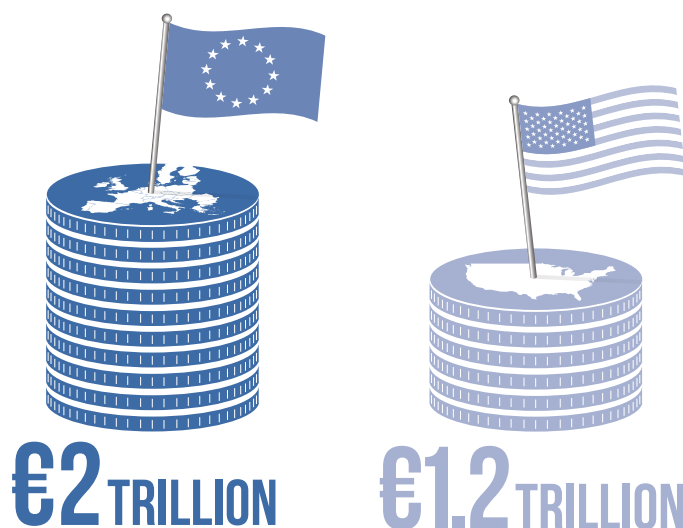
R7 ENCOURAGE NATIONAL GOVERNMENTS TO MAKE APPROPRIATE TAX INCENTIVES AVAILABLE TO INVESTORS IN SMEs

In the UK, the Enterprise Investment Schemes (EIS) have provided incentives in the form of income tax relief on subscriptions and capital gains exemptions on profits made on the disposal of shares for UK tax paying investors who invest either directly into unlisted qualifying SMEs or indirectly through EIS funds which in turn invest in qualifying SMEs. There are similar reliefs for investments in smaller qualifying companies under the seed enterprise investment scheme provisions (SEIS). Income tax relief on subscriptions for shares in venture capital trusts, which in turn invest in qualifying SMEs, is also available together with an exemption for capital gains on the disposal of shares in venture capital trusts.

THE LATEST IEG REPORT ON CMU NOTED:

“...IN 2013 THE STOCK OF OUTSTANDING FINANCING FOR SMEs IN THE EU STOOD AT €2TRN, COMPARED TO €1.2TRN IN THE US, AND THE FLOW OF NEW FINANCING IN THAT YEAR WAS €926BN IN THE EU COMPARED TO €571BN IN THE US.”

(Source 2015 BCG/AFME report Bridging the growth gap: Investor views on Europe and US Capital markets and how they drive investment and economic growth).



¹¹ The Role of Entrepreneurship in US Job Creation and Economic Dynamism: Duke, Haltiwanger, Jarmin and Javier, 2014

AIM also offers significant tax advantages for UK investors, with qualifying shares listed on AIM being exempt from inheritance tax once they have been held for two years and AIM shares being permitted investments under the ISA regime. Investors were given a further incentive with the abolition of stamp duty on the purchase of AIM shares in the secondary market. It is perhaps no coincidence that in the 12 months following the abolition of stamp duty on the purchase of shares on AIM, trading in AIM companies increased by nearly 50% with average daily trading per company reaching £156,000 in 2014 compared to £107,000 in 2013 (and this in spite of the fact that the FTSE AIM All-Share Index dropped to 702 in December 2014, its lowest level in three years).

Given that taxation remains the preserve of national governments rather than the EU Commission, the governments in each Member State need to be encouraged to introduce appropriate incentives to stimulate investment in SMEs within their territory.

R8 EU COMMISSION TO MAINTAIN A FLEXIBLE APPROACH TO THE ENFORCEMENT OF STATE AID RULES IN RESPECT OF SUCH INCENTIVES

Given the importance of stimulating investment in SMEs, the availability of such incentives should be encouraged by the EU Commission and national governments should be allowed a reasonable degree of flexibility in determining what is appropriate for their own market. The Commission can assist in this respect by maintaining a flexible attitude towards European State Aid rules, thereby ensuring that SMEs are able to continue benefitting from the incentives made available at a national level without undue constraints from Europe.

SUMMARY OF RECOMMENDATIONS

Increase incentives to invest in SMEs

- R7** Encourage national governments to make appropriate tax incentives available to investors in SMEs
- R8** EU Commission to maintain a flexible approach to the enforcement of state aid rules in respect of such incentives

2.4 **MINIMISE THE COMPLEXITY OF LISTING ON AN UNREGULATED MARKET**

SMEs wishing to access the capital markets to raise debt or equity capital must navigate a complex regulatory framework. Companies seeking a listing on an EU regulated market (these include the principal primary European markets, such as the Main Market of the London Stock Exchange, Euronext and the Deutsche Börse) are required to prepare a prospectus which complies with the requirements of the EU Prospectus Directive. The same applies to bond issues on certain markets; ORB, for example, is a regulated market and requires a full prospectus, even for relatively small bond issuances. Prospectuses are increasingly long and complicated documents and must be pre-approved by the National Competent Authority in the issuer's home state. SMEs seeking to raise capital on other markets and platforms are not automatically required to produce a prospectus but may be required to do so if they are seeking to offer their shares or debt instruments to the public. Further restrictions on a company's ability to market the investment opportunity to certain categories of investor may be imposed by national legislation such as the Financial Services and Markets Act 2000 (FSMA) in the UK.

R9 LIMIT SCOPE OF THE EU LISTING REGIME TO REGULATED MARKETS

Companies seeking to list on an EU regulated market should be obliged to prepare a prospectus. The level of disclosure required (and the preparatory work to produce the necessary information) is justified and appropriate for a company seeking a listing on one of Europe's primary markets. Such companies tend to be large or medium sized companies and are more likely to raising relatively large amounts across several jurisdictions.

However, it is generally felt that companies seeking to access capital through admission to one of the many MTFs or other platforms should not be required to produce a prospectus. The European Commission's recent Prospectus Directive consultation included questions about the

possibility of extending the current prospectus regime to companies seeking admission to trading on a MTF. This would significantly increase the barriers for SMEs seeking to raise capital. MTFs currently provide a useful alternative for companies which either cannot satisfy the requirements for admission to a regulated market or which are seeking a more flexible regime. Any extension of the Prospectus Directive to MTFs would reduce the attractiveness of secondary markets such as AIM, Alternext and the Freiverkehr, significantly limiting access to capital for many European SMEs.

R10 AMEND DEFINITION OF 'OFFER TO THE PUBLIC' TO PROVIDE GREATER FLEXIBILITY BY MODIFYING FINANCIAL AND OTHER THRESHOLDS

Currently, SMEs which seek to raise capital through a listing other than on an EU regulated exchange are only required to produce a prospectus if they undertake an offer to the public. This term is widely defined as any offer of tradable debt or equity securities subject to certain carve outs. These carve outs focus on the size of the issue and the identity of potential investors such that the following offers are not deemed to be public offers for the purposes of the Prospectus Directive and therefore do not require a prospectus:

- offers addressed solely to qualified investors (being certain large financial and institutional investors) – this is generally used by SMEs raising capital on a MTF;
- small offers of less than €5 million – this is most commonly used by SMEs seeking to raise small amounts of capital either on a MTF or an alternative funding platform;
- offers made to less than 150 persons in each Member State – again, this is used by SMEs for small offers on a MTF or alternative listing platform; and
- offers where the securities being offered are denominated in amounts of at least €100,000 – this exemption is commonly used by bond issuers in the debt markets.

These exemptions are of paramount importance for SMEs seeking to raise capital and are the principal considerations that determine the type of capital raising they are able to undertake. As a result, most companies whose shares

are traded on one of Europe's MTFs have a predominantly institutional shareholder base which limits the pool of capital available to such companies and affects the liquidity of their shares in the secondary market. Bonds issued on the SME debt markets are typically issued in units of €100,000, which again leads to a predominantly institutional investor base and means that these markets are relatively illiquid. Fundraising on alternative listing platforms is limited to small amounts of capital raised from a restricted circle of investors.

Whilst it is tempting to recommend that the above exemptions are significantly widened, there obviously still need to be some limits on the ability to raise funds from the public without the need for a prospectus. Some changes could be made to the current exemptions without significantly increasing the risk for investors.

For example, the €100,000 threshold could be significantly lowered. Decreasing this threshold to €10,000 would enable bonds to be issued and traded in denominations of €10,000, which would potentially attract investment from sophisticated retail investors, thereby increasing the pool of capital available and stimulating trading in the secondary bond market, but would still have the effect of excluding unsophisticated investors from non-prospectus offers.

The current €5 million threshold, which exempts small offers from the requirement for a prospectus, seems inadequate in 2015 and could be raised to a more realistic level. The US, whose securities regime is in many ways more onerous and complex than the European regime, has recently introduced its Reg A+ regime which, subject to the fulfilment of certain conditions and the publication of a simplified offering document, allows fundraisings of up to US\$50 million without the requirement for a full prospectus. Consideration should be given to the implementation of a similar regime in Europe. In the meantime, the current €5 million threshold should be raised to a more meaningful level, which is comparable to the level established in Reg A+, in order to increase the flexibility for SMEs to raise capital.

The 150 persons exemption should also be reviewed, particularly in light of the proposals for CMU. Looking at the number of potential investors in each Member State individually seems contrary to the principles of CMU and the EU should be viewed as a single marketplace with

a larger aggregate threshold applying across the whole of the EU. Further proposals to extend the definition of 'qualified investors' to include certain sophisticated investors are discussed later in this report.

R11 MAINTAIN AND ENCOURAGE APPROPRIATE SAFEGUARDS ON THE LISTING AND MARKETING OF SECURITIES THROUGHOUT THE EU

Care needs to be taken to balance the interests of SMEs and investors. If the exemptions referred to above are to be widened, there need to be checks and balances to protect investors and the integrity of the markets on which they invest. This, in turn, benefits the companies which seek to raise finance on such markets.

National restrictions on the marketing of securities should remain in place in order to provide a degree of protection for investors. In the UK, such protection is currently provided through FSMA which requires financial promotions to be approved by persons authorised by the Financial Conduct Authority (FCA) to conduct investment business. Similar safeguards exist in certain other EU Member States. Where these safeguards do not exist at a national level, Member States should be encouraged by the EU Commission to introduce a minimum level of safeguards in order to protect investors and ensure the integrity of the capital markets in Europe.

The sponsor or nominated adviser regime which is the foundation of certain European markets is also felt by many investors to provide important safeguards which instil confidence in the investment community. Sponsors and nominated advisers are the effective gatekeepers of the markets on which they operate. The level of due diligence they undertake on new entrants ensures that SMEs which are unready for listing are not able to access the markets. They therefore play an important role in protecting investors and ensuring the integrity of the markets. European markets which do not currently have such a regime should be encouraged to consider the merit of introducing one.

R12 ADOPT GOOD AND CONSISTENT STANDARDS OF DISCLOSURE FOR ADMISSION DOCUMENTATION FOR MTFs TO INCREASE FAMILIARITY ACROSS JURISDICTIONS

Admission documents for MTFs vary across Europe from ones with almost as much detail as a prospectus to those that consist of little more than the applicant's report and accounts and some limited additional disclosures. Whilst not advocating a prescribed template for such admission documents, which would risk introducing an element of rigidity (which would destroy the current flexibility which is the attraction of many MTFs) the adoption of good and consistent standards of disclosure would be beneficial. In particular, it is believed that investors would be more likely to invest in SMEs on a pan-European basis if they were confident that all MTFs were working towards good and consistent standards of disclosure that would facilitate the creation of an SME equity culture. NCAs should therefore be encouraged to work with market operators to determine appropriate minimum standards.

SUMMARY OF RECOMMENDATIONS

Minimise the complexity of listing on an unregulated market

- R9** Limit scope of the EU listing regime to regulated markets
- R10** Amend definition of 'offer to the public' to provide greater flexibility by modifying the financial and other thresholds
- R11** Maintain and encourage appropriate safeguards on the listing and marketing of securities throughout the EU
- R12** Adopt good and consistent standards of disclosure for admission documentation for MTFs to increase familiarity across jurisdictions

2.5 FURTHER MEASURES TO MANAGE COSTS

For many SMEs, the cost of raising finance on capital markets is considered to be prohibitive and may lead them to seek other sources of finance. This is particularly the case for SMEs seeking to raise finance on a regulated market, MTF or through the debt markets, especially as the relatively high execution risk in raising capital may well result in costs being incurred in vain. Evidence suggests that fundraising on one of the many alternative listing platforms remains relatively cost-effective.

The biggest cost for most companies on an IPO or bond issue is the fee payable to underwriters, which is a fixed cost calculated as a percentage of the funds raised. Fees are also payable to other advisers who are involved in the due diligence process and preparation of the prospectus or admission document, including corporate finance advisers, reporting accountants, lawyers, registrars, PR advisers and printers. Admission costs will also be payable to the relevant market and, if a prospectus is required, vetting fees may be payable to the relevant NCA.

In addition to these third party costs, there are certain hidden internal costs which are much harder to identify and quantify, such as lost management time for those executives who are closely involved in the process and the additional liability assumed by the company and its directors on the listing.

Post-listing, there will be ongoing costs payable to the relevant market as well as to advisers whose assistance will be required to assist the SME in complying with its continuing obligations under the relevant market rules, the increased corporate governance requirements that come with any listing and the additional financial reporting and disclosure requirements that are required of public companies.

These costs are to some extent offset by the benefits of listing. The key benefit is the ability to access risk capital which does not have to be repaid by a specified date and that can be used to finance long-term growth and innovation. Listing can also potentially result in companies being able to raise larger amounts of money than would

be possible through bank lending or other forms of debt finance. Once the company has obtained a listing, it is relatively cheap and easy to raise further capital through follow on fundraisings (of the £90 billion raised by AIM companies over the last 20 years, 60% was raised in the secondary market). Unlike debt finance, there are no servicing costs, as dividend payments, (unlike interest on outstanding debt amounts) are discretionary. Listing also brings with it other intangible benefits such as the opportunity of incentivising employees through share schemes and an increased corporate profile. It should also be noted that certain costs incurred on a listing, in particular those relating to due-diligence, would also be incurred on a debt transaction or a private equity investment. However, for many, cost/benefit analysis does not support a listing.

Whilst the adoption of many of their recommendations in this report (for example, increasing regularity flexibility and reducing the length of IPO timetables) will help reduce costs, the effect is likely to be marginal. More therefore needs to be done to make costs more transparent and to make them more palatable, particularly for SMEs.

R13 ESMA TO COMPILE EMPIRICAL DATA ON THE LISTING COSTS OF DIFFERENT VENUES SO THAT SMES CAN MAKE AN INFORMED CHOICE

Listing costs vary greatly between different markets. Markets may have differing views as to what should be included within the definition of listing costs. The lack of empirical data is not helpful for SMEs considering a listing and the disparity in the costs between different platforms can be confusing, particularly for an issuer which does not fully understand the different requirements of certain markets and the impact this can have on costs. The lack of transparency on costs also leads many SMEs to feel dissatisfied at the end of the listing process, which may cost more than they had envisaged.

ESMA has previously recommended that IPO costs, which are currently required to be disclosed in a prospectus as a global figure, should be broken down to provide greater transparency. The recommendation has not been widely adopted and some advisers have concerns about disclosing the level of their fees. However, reliable costs information

cannot be collated without this level of transparency and ESMA's recommendation on costs disclosure should be adopted as a firm requirement and ESMA should clearly define what costs should be included in this disclosure. MTFs and other markets should also be encouraged to adopt this requirement. This would enable ESMA to compile empirical data on the costs of listing on different markets (and, potentially the costs of different forms of financing) across Europe so that SMEs are able to make an informed choice.

R14 CONSIDERATION TO BE GIVEN TO MAKING EQUITY ISSUANCE COSTS DEDUCTIBLE FOR CORPORATION TAX PURPOSES

Consideration should be given to the fiscal treatment of costs incurred in connection with capital raising. The current bias towards debt is driven by the fact that debt interest costs are deductible for corporation tax purposes. There is no similar treatment for companies which raise capital by issuing equity, even though this could lead to greater long term financial stability.

In its recent EU IPO report, the European IPO Taskforce noted the relatively high costs of raising smaller amounts compared to the costs of larger transactions. Based on estimates by the Federation of European Securities Exchanges, costs were believed to be approximately:

- 10 - 15% of the amount raised from an initial offering of less than €6 million;
- 6 - 10% from between €6 million and €50 million;
- 5 - 8% from between €50 million and €100 million; and
- 3 - 7.5% from more than €100 million.

For an SME the cost in terms of the percentage of capital raised is higher where relatively small amounts of money are raised: whilst underwriting costs will be lower, advisory costs are likely to be at a similar level to those for larger transactions. This is because the same amount of due diligence is required and the disclosure obligations in the prospectus or admission document are the same regardless of the size of offering. Consideration should be given to allowing the deduction of costs incurred through equity fundraisings for corporation tax purposes, at least for SMEs if not for all companies, in order to incentivise greater use of capital markets.

A recent report by the Quoted Companies Alliance (QCA)¹² highlights that 19 Member States already have some form of tax relief for the costs of raising equity. Governments in other Member States, including the UK, should be encouraged to allow similar reliefs in order to create a level playing field for debt and equity throughout the EU. While this may not be the right time for such a change to be introduced in the UK, it should be kept on the Treasury's agenda. The QCA estimates the cost to the UK Treasury would be as little as £60 million based on current levels of fundraising.

SUMMARY OF RECOMMENDATIONS

Further measures to manage costs

- R13** ESMA to compile empirical data on the listing costs of different venues so that SMEs can make an informed choice
- R14** Consideration to be given to making equity issuance costs deductible for corporation tax purposes

¹² Proposals for Taxation Reform – 2015 Budget : QCA, 2015

3.0 IPO: ADMISSION TO A REGULATED MARKET

BACKGROUND

There are various paths a company may take to admission to trading on a regulated market. It may:

- list initially on an MTF where it can grow and strengthen its governance structure before seeking to move to a regulated market; or
- be nurtured by private equity investors until it is ready to go direct to a regulated market.

For some companies admission to trading on a regulated market may not be appropriate. However, to encourage those issuers for which it may be the right move, the process for raising capital on a regulated market should be as efficient as possible.

The more issuers which growth companies see progressing from an MTF to a regulated market, the more growth companies will be encouraged to look to the capital markets at an earlier stage. The benefit which established companies are seen to derive from being listed on a regulated market will encourage growth companies to follow them from an MTF.

How the current requirements for capital raisings on a regulated market can be improved should be shaped by the relative objectives of both issuers and investors (see Table H).

While these objectives apply equally to:

- initial public offers – in this context any offer made by a company at the same time it first applies for admission to trading on a regulated market; and
- follow on offers – any subsequent capital raising by a company after it has been admitted to trading on a regulated market (such as a rights issue, an open offer or a placing),

how they can be achieved in relation to each differs considerably. It is therefore best to look at initial public offers and follow on offers in turn.

Table H

Issuer objectives	
Reduce timetable	Reduce the timetable for any capital raising – make the overall process quicker
Reduce cost	Reduce the cost to the issuer of undertaking the capital raising
Reduce risk	Reduce the market risk so that the capital raising does not proceed for reasons beyond the issuer’s control
Best price	Achieve the best price possible from investors for the benefit of the company and any selling shareholders
Successful IPO	Trades well in the aftermarket with supportive long term investor base
Investor objectives	
Information earlier	Information and access to management earlier in any process so that investors have more time to consider whether they want to invest and at what price
Better quality information	Shorter more relevant documents. Wider range of research where possible
Ability to participate	Going forwards if they have invested in a company they want the ability to participate in any future capital raising by that company

PREVIOUS STUDIES

The question of how the process for initial public offers (IPOs) can be improved has been considered in recent years by both:

- the ABI report 'Encouraging Equity Investment' published on 11 July 2013 ('the ABI Report'); and
- the independent review for the Secretary of State for Business, Innovation & Skills 'IPOs and Bookbuilding in Future HM Government Primary Share Disposals' undertaken by a panel chaired by Lord Myners and published on 16 December 2014 ('the Royal Mail Review').

These reports were prepared in slightly different contexts but both made recommendations on improving IPOs. These recommendations included (but were not limited to) those set out in Table I.

This report aims to build on those recommendations. It is hoped to do more than just add to the already considerable weight of support for these recommendations and that real action will follow.

The recommendations in the two previous reports are achievable, require only limited regulatory change and are very strongly supported.

Table I

	ABI Report	Royal Mail Review
Earlier prospectus	A prospectus approved by the UKLA, which is complete apart from pricing or price range and related information, should be issued at least one week earlier than the Pathfinder or Price Range prospectus is issued in current practice.	Publication of a prospectus as early as possible in the process.
Revisiting blackout	... eliminating the delay between publication of connected research and the offering document.	Changing the current approach to research blackout periods to enable better investor education.
Independent research	The IPO process should allow at least one of two alternatives to promote the publication of independent research: <ol style="list-style-type: none"> 1. Issuers and underwriters should allow greater access for non-connected analysts to the IPO analysts' presentation or a subsequent similar presentation, such that they are able to have the same information as connected analysts 2. Alternatively, non-connected analysts should be able to publish and distribute research with reference to a prospectus published immediately after the ITF that has been duly approved by the UKLA 	Enabling research by as broad a range of research firms as possible, including unconnected analysts.
Price range flexibility		More flexibility to set a wider price range and ability to move the price range.
Withdrawal rights		Revising withdrawal rights requirements, particularly as technology enables faster response time

PROPOSALS

3.1 MAKE INFORMATION AVAILABLE SOONER

The prospectus is the document on which investors base their decision whether or not to invest and at what price. Under the timetable on a typical IPO as set out in Table J, it is arguable whether the prospectus fulfils this role as fully as it could.

In the UK, if a company wishes to undertake an IPO, it normally makes an Intention to Float (ITF) announcement. From this point the company's plans are public.

Currently the period between a company announcing its intention to float and the pricing and allocation of the offer will typically be four weeks. For the first two of these weeks connected analysts (that is research analysts from the financial institutions who are acting as lead underwriter(s) for the IPO) will brief potential investors on the company. The issuer/vendor and lead underwriter(s) will also visit key potential investors and receive initial feedback from those investors as to price. This process is referred to as 'pilot fishing'.

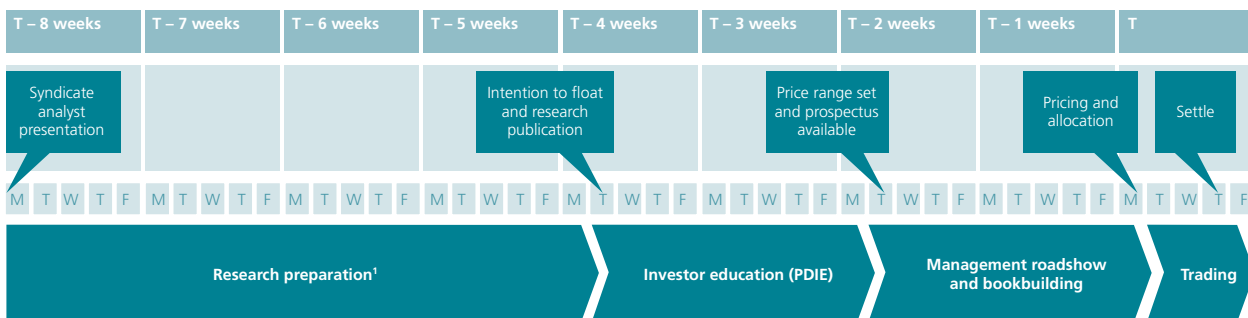
At the end of these two weeks the company will publish a pathfinder prospectus and then commence a further two week period of management presentations to potential investors. During these second two weeks the lead underwriter(s) will:

- set the price range for the offer; and
- run the bookbuild process which will determine final pricing and allocation.

At the time the issuer/vendor and lead underwriter(s) set the price range, any pricing feedback they have received will not have been based on a review of the pathfinder prospectus. This might be less of a problem if it were easier for the lead underwriter(s) to amend the price range if, (once investors had had the chance to review the pathfinder prospectus and the bookbuild process had commenced), it became obvious that the price range had been set too low or too high. However, changes to the price range are very rare in the UK or in Europe. This point was highlighted in the Royal Mail Review, according to which there have only been four IPOs in the UK since 2000 where the price range was revised.

While the practice of pilot fishing has developed to enable issuers to receive as well-informed pricing feedback as possible in the absence of a prospectus, the availability of a prospectus would enhance this process. It would also potentially enable feedback from a wider pool of investors.

Table J



¹ Research publication could be accelerated through use of draft accounts for the syndicate analyst presentation with a subsequent update once accounts are finalised prior to research publication

Separately many of the investor meetings and management presentations will happen earlier rather than later in the second two week period (where possible investors will want to factor in time after the meeting to decide what bids to submit as part of the bookbuild process). In this situation, investors will only receive the pathfinder prospectus shortly before the management meetings and have limited time to review the prospectus prior to those meetings. This means that investors may not be able to get as much out of those meetings as may otherwise have been the case following a thorough review of the prospectus.

The prospectus needs to be published earlier. This would go towards meeting the objectives of:

- investors to receive information earlier in the process; and
- issuers achieving best price. Investors will have had the opportunity to review the prospectus prior to providing pricing feedback to the lead underwriter(s).

R15 SPLIT PROSPECTUS INTO A CORE REGISTRATION STATEMENT PUBLISHED PRIOR TO ANALYST RESEARCH AND A SECURITIES NOTE PUBLISHED LATER

The best way to publish the prospectus earlier would be to split it into two parts:

- a core document (registration document) which contains all information about the company; and
- a much shorter securities note which sets out details of the particular securities being offered and the price/price range.

Unlike the alternative options below, the registration document could be reviewed and approved by the relevant NCA. This would allow it to be used as a basis for independent research (see R17). The securities note could be published much later once investors have had the opportunity to review the registration statement and provide pricing feedback which takes account of that review.

Alternative option	Comment
Simply publish a pathfinder prospectus earlier in the period of investor education	The pathfinder prospectus is still only a draft document. It has not been approved by an NCA and so could not be used as a basis for independent research (see R17).
Publish a formal price range prospectus earlier in the period of investor education and a subsequent supplementary prospectus closer to the offer period (if necessary)	Problem of the price range being set before investors have reviewed the prospectus remains and reluctance to subsequently move the price range

Issuers are already able, under the Prospectus Directive, to publish a prospectus comprising of up to three separate documents (otherwise known as tripartite prospectus): a registration statement; a securities note; and a summary.

It is largely because of prior market practice that equity prospectuses in the EU (with the exception of France) continue to be published as a single document. The only real barrier is the current market practice of maintaining a gap in time between the publication of connected analyst research and the publication of the prospectus. This gap is often referred to as the 'blackout period'.

R16 REMOVE THE BLACKOUT PERIOD BETWEEN THE PUBLICATION OF ANALYST RESEARCH AND THE SUBSEQUENT PUBLICATION OF THE PROSPECTUS

The current market practice of requiring an appropriate time gap between the publication of the connected research and the subsequent publication of the prospectus means that a registration statement style prospectus cannot be published earlier in the IPO timetable in a way which benefits the issuer.

The publication of the connected research could be moved forward as well but this would just lengthen the IPO timetable for an issuer. The aim is to make the process shorter. This is not just to reduce actual and management time costs, but also to reduce the risk of missing the market window when the offer can be launched.

The simplest answer would be to overcome the perceived need for a blackout period. The market practice of a blackout period developed in connection with the UK Government privatisations in the 1980s and 1990s. It

was designed to address the concerns that the connected research may be:

- seen as a mouthpiece for the company, with the company effectively telling the analysts what to write; or
- confused with, and relied upon to the exclusion of, the formal prospectus.

The potential consequence in each case would be that the company and the lead underwriter(s) may be held liable for the contents of the connected research and any inaccuracies in it.

Initially the self imposed gap was at least two to three months. Over time it has shrunk and is now typically in the region of two weeks.

There appears to be an overwhelming desire to abandon the blackout period and recognition that it does not legitimately address the concerns which it is meant to guard against. However no one has felt able to break ranks and make the first move. It is acknowledged that the practice was introduced at a time when there was much less regulation in relation to the independence of analysts than there is now. Yet some now point to guidance in those rules in relation to conflicts of interest as being a reason why they feel they cannot unilaterally eliminate the gap altogether.

Chapter 12 (Investment Research) of the FCA's Conduct of Business Sourcebook states at paragraph 12.2.12 that:

"The FCA would expect a firm to consider whether or not other business activities of the firm could create the reasonable perception that its investment research may not be an impartial analysis of the market in, or the value or prospects of, a financial instrument. A firm would therefore be expected to consider whether its conflicts of interest policy should contain any restrictions on the timing of the publication of investment research. For example, a firm might consider whether it should restrict publication of relevant investment research around the time of an investment offering."

The ABI Report recommended that parties could be made comfortable with abandoning the blackout period by obtaining regulatory clarification from the FCA that:

- *they [the FCA] will not regard connected research, if prepared and identified appropriately, as part of the prospectus;*
- *publication close to the time of the prospectus will not necessarily compromise its independence (in the sense that it is independent of the company);*
- *therefore, temporal separation between connected research and prospectus publication is unnecessary; and*
- *this should eliminate any residual United Kingdom risk for issuers and underwriters and it will, as a matter of evidence, reduce the likelihood of any successful action in jurisdictions outside the United Kingdom.*

This would be extremely helpful, but no visible progress has been made. As a result this report recommends four further proposals. Not all of these need to be implemented in order to have the desired effect. In fact any one of them should arguably be sufficient to allow the current practice to change. But all of them should be progressed.

R16.1 ISSUERS SHOULD PUBLISH THEIR REGISTRATION STATEMENT PROSPECTUS PRIOR TO THE PUBLICATION OF EVEN ANY CONNECTED RESEARCH

This would, by itself, eliminate the blackout period as the prospectus comes first. One perceived disadvantage may be that this signals an issuer's intention to float earlier than an ITF announcement would normally be published in the UK. In reality, the registration statement prospectus will not be published much earlier than the ITF announcement would have been published (although earlier publication as already happens in the US and France is very much to be encouraged). Much of the work necessary to be in a position to brief analysts and make any ITF announcement would overlap with the work necessary to publish the registration statement prospectus so it is not bringing that work forward. The advantage to the issuer is that it would then be in a position to launch the IPO much more quickly at a time over the following months when conditions are most suitable.

R16.2 CLARIFICATION OF THE ISSUE AS PART OF THE CURRENT REVIEW OF THE PROSPECTUS DIRECTIVE BY THE EU COMMISSION

The blackout period as a concept is not unique to the UK. Due to the international nature of transactions and the international nature of the lead underwriter(s) involved, the market practice has spread across Europe. The EU Commission is currently reviewing the operation of the Prospectus Directive. The Commission's review should clarify that such research does not constitute a prospectus.

More specifically it could provide that connected research which:

- has been prepared and identified appropriately by a person authorised to conduct investment business; and
- has been provided only to MiFID professional investors who have elected to receive that research,

does not constitute a prospectus or part of a prospectus and cannot be relied upon as part of any investment decision.

R16.3 FCA TO CLARIFY THAT THE COMMENTS IN COBS 12.2.12 DO NOT APPLY TO CONNECTED RESEARCH PRODUCED IN CONNECTION WITH AN IPO

If the FCA were able to provide the guidance originally recommended by the ABI Report and the Royal Mail Review, it would be of great benefit to both issuers and investors.

Separately the FCA should consider clarifying COBS 12.2.12. COBS 12.2.12 is in itself guidance provided by the FCA. If that guidance is unclear or is being misinterpreted it would not seem out of the place for the FCA to clarify the terms of that guidance. Similarly the competent authorities in other jurisdictions where blackout periods are an issue should examine what guidance they may be able to give.

R16.4 MEMBER STATE GOVERNMENTS SHOULD PROVIDE A LEAD

Member State Governments should consider what measures they could take such as:

- in preparation for the next IPO of a public asset, commissioning advice from a selection of law firms and on the back of that advice, announcing no blackout period will be required in connection with a future IPO; and
- insisting there is no blackout period on the next IPO of a public asset.

Tables K and L illustrate the benefits that would flow from these measures.

Table K

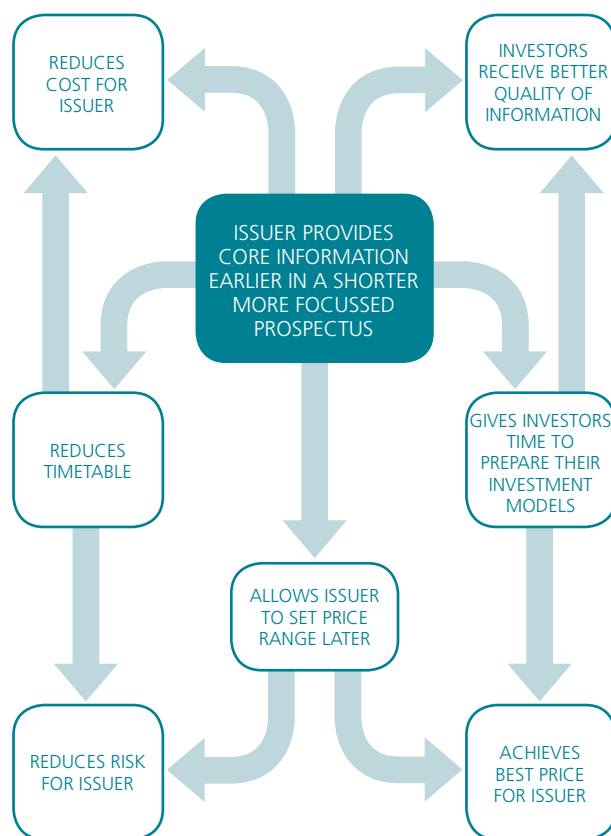


Table L

Objective	Effect
Shorter timetable	Eliminating the blackout period and publishing a prospectus registration statement earlier does not mean that the period for investor education is then simply cut back. Investors still need that period of time. Instead the timetable gains are with respect to the preparation of the connected research. The connected research can be significantly shorter and more focused. It no longer needs to anticipate and attempt to reproduce what the analysts believe will subsequently be produced in the pathfinder prospectus. The prospectus will be available simultaneously and speak to those matters. As a result it will be possible for the connected research to be produced more quickly bringing the whole timetable forward.
Shorter timetable	This being said, as investors will have both connected research and a prospectus registration statement from the start of the investor education period it should be possible to start management roadshows slightly earlier than previously.
Better quality of information	Investors will have more meaningful access to management as they will have the benefit of connected research, the prospectus registration statement and potentially also independent research before they meet with management.
Better pricing	The price range does not need to be announced before the management roadshow starts. It can be set later based on more informed feedback. This leads to more robust transaction terms.
Less risk	By shortening the overall timetable this gives greater flexibility around the timing of launch before the documents go stale – helping to mitigate market risk.
Less risk	The greater certainty around the price range results in less transaction risk. In some circumstances it may also allow a shorter bookbuilding window again reducing market risk.

SUMMARY OF RECOMMENDATIONS

Make information available sooner

- R15** Split prospectus into a core registration statement published prior to analyst research and a securities note published later
- R16** Remove the blackout period between the publication of analyst research and the subsequent publication of the prospectus

3.2 INCREASE QUALITY OF INFORMATION

The benefits referred to in Tables K and L will be amplified if investors not only receive information earlier but also feel that they have received better quality of information.

R17 INCREASE AVAILABILITY OF NON-CONNECTED RESEARCH

The availability of research written by analysts who are independent of the lead underwriter(s) should be increased.

Non-connected analysts are commonly restricted by the fact that they are not able to publish research based on the pathfinder prospectus. The pathfinder prospectus is effectively only a draft prospectus. It has not yet been approved (in the UK by the UKLA) and as such is distributed solely to institutional investors in reliance on various exemptions under the financial promotion regime.

The pathfinder prospectus is also currently only published at the start of the two week management presentation and bookbuild process. This leaves very limited time for an unconnected analyst to review the pathfinder prospectus, produce informed research and for that research to then be read and digested by potential investors.

The ABI Report recommended that the IPO process should allow at least one of two alternatives to promote the publication of independent research:

- 1 *“Issuers and underwriters should allow greater access for non-connected analysts to the IPO analysts’ presentation or a subsequent similar presentation, such that they are able to have the same information as connected analysts.”*
- 2 *“Alternatively, non-connected analysts should be able to publish and distribute research with reference to a prospectus published immediately after the ITF that has been fully approved by the UKLA.”*

If the blackout period were to be abandoned and issuers published a prospectus in the form of a ‘stamped’

registration statement at the start of the investor education period then option 2 would immediately be permitted.

Separately if an issuer wanted to invite independent analysts to the connected analysts' briefing or to hold a further briefing just for independent analysts then it would be free to do so.

Neither of these measures would ensure that independent analysts would prepare research on a particular issuer. Except in relation to the large, liquid issuers it is to be questioned from where the potential financial return would come. However, these measures could make it possible.

To achieve complete equality of information, not just for independent analysts but for all investors, issuers could consider allowing even wider internet-based access to the relevant presentations. It is recognised that, (certainly in the UK), there would be regulatory concerns with communicating such presentations to retail investors. The presentation would be a financial promotion and would need to be authorised for the purposes of the financial promotion regime by an FCA authorised firm.

R18 MAKE PROSPECTUS MORE FOCUSED AND RELEVANT

It is acknowledged that prospectuses have grown in length to the extent that they are now unwieldy. The current Prospectus Directive review and the proposal to make better use of the tripartite regime both provide an opportunity to instigate change and break the cycle of issuers feeling reluctant to do anything else but simply replicate what others have done in previous transactions.

R18.1 INCORPORATE BY REFERENCE INFORMATION FROM A DISTINCT DESIGNATED PAGE ON THE ISSUER'S WEBSITE

If issuers were required to publish and maintain certain documents and information on a distinct designated page on their website (similar to Rule 26 of the AIM Rules) then this information could, in turn be incorporated by reference into a prospectus. The easier it is to access the

information the more familiar an investor will be with the information and the more comfortable both the issuer and the investor will be about information being incorporated by reference rather than set out in full. If the information is on an ascertainable page on the website, rather than spread over the site then this will assist the issuer and its advisers in verifying the information and being comfortable with the overall disclosure package. It would also assist investors who are looking for the information. Incorporation in this way is particularly suited to documents and information which is fixed as at a particular date such as an issuer's articles of association dated 'X date'.

R18.2 SUMMARY TO BE FREE FORM AND HAVE A WORD LIMIT

Currently the prospectus summary is in a mandated grid format. The requirement to retain elements which are not applicable to an issuer makes it long and potentially confusing for an unsophisticated retail investor. It should instead be in a free form, required to address pre-determined key issues and subject to limitations as to length. It should be a maximum of 3,000 to 4,000 words.

The liability regime for the summary should be considered in parallel with any amendments to the required content and length of the summary. Issuers and their advisers will be better able to embrace any new shorter, more focused approach if the liability regime recognises that: it is only a summary; it needs to be read in conjunction with the prospectus as a whole; and issuers are subject to restrictions on what they can include.

R18.3 RISK FACTORS TO BE SPECIFIC TO THE ISSUER OR THE OFFER

The body of the prospectus should only set out in full risks which are specific to the issuer or to the offer. It could still be open to an issuer to publish a more general set of risks on the relevant dedicated page on its website and incorporate that risk statement by reference. However those more general risks should not be set out in full in the prospectus.

R18.4 IMPROVE QUALITY OF FINANCIAL STATEMENTS AND ANNUAL REPORT PRE-IPO AND UTILISE INFORMATION ALREADY IN ANNUAL REPORT

Greater use should be made of an issuer's annual report. For companies which are already subject to the Transparency Directive it includes not just the audited accounts but also a large amount of information which is then reproduced in full in the prospectus (such as director details, board committees, incentive plans and the principal risks facing the issuer).

In the case of an IPO, an issuer will not already be subject to the Transparency Directive. However this goes to planning ahead for the IPO.

Issuers should start to plan for an IPO much earlier. They should start to improve the quality of their annual report and the disclosures in it. Most importantly, they should ensure that their financial statements are prepared and audited to a standard that will allow them to be used for the purposes of the prospectus.

The advantages which can be unlocked by the split prospectus approach will be offset if the issuer does not have appropriate audited financial information available for the purposes of preparing the registration statement prospectus.

R18.5 GENERAL DISCLOSURE TEST IN ARTICLE 5 TO BE MODIFIED TO ALLOW MORE TARGETED DISCLOSURE

Article 5 of the Prospectus Directive sets out a general disclosure test. Currently the same test applies in all circumstances. The test should be modified to reflect the circumstances of the offer where it is a follow on issuance (see R25 below). In the course of reviewing Article 5 to specifically accommodate follow on issuances consideration should be given as to how the test could be more focussed in other situations.

SUMMARY OF RECOMMENDATIONS

Increase quality of information

R17 Increase availability of non-connected research

R18 Make prospectus more focussed and relevant

3.3 BROADEN INVESTOR PARTICIPATION

Many fundraisings are not available to a retail investor. From a SME's perspective, if it is seeking to raise an amount of capital in excess of the current threshold contained in the Prospectus Directive, it is reliant upon attracting investment from institutional investors. Currently, if the offer were extended to retail investors it would trigger the need for a full prospectus. This means it is unable to access the huge body of European retail investors. This can result in some SMEs failing to raise any capital at all, either because they are too small or too early stage to appeal to institutional investors or because they do not operate in the right sector for certain funds which have a specific sector focus.

IPOs on a regulated market are often similarly restricted to institutional investors only. This is not because it means the production of a prospectus can be avoided. Instead it allows the issuer to stick to the current model of producing connected research and a pathfinder prospectus (which cannot be circulated to retail investors as it is not a formal prospectus). It also means that the issuer has far fewer orders to consider as part of the pricing and allocation process or if withdrawal rights are triggered as part of the offer.

The retail investor is left with few opportunities to invest in SMEs, save for:

- the limited options available through alternative listing platforms and 'business angel' type investment in the private equity sector; or
- directly in larger IPOs, unless there is a simultaneous intermediaries' offer and the investor has access to a stock broker.

Paradoxically, the regulations that prevent such investors from participating in primary issues by listed companies do not prevent them from buying shares in the secondary market should shares become available. This leads to frustrations for SMEs, which are unable to access a significant source of capital within Europe. It also leads to frustrations for retail investors who are prevented from providing much needed capital to SMEs or participating in more high profile IPOs.

The merits of opening up capital raisings by SMEs to all retail investors is debatable. The risk profile for issuers who raise capital from large numbers of retail investors is undoubtedly increased and one of the down sides of the relatively large retail component in many US issues is the frequency of large class actions against companies from disgruntled groups of investors. Some SMEs may also be ill-prepared to deal with large numbers of small shareholders, which increases the costs and complexity of financial reporting and shareholder meetings. There clearly also needs to be some level of protection for retail investors to ensure that only those with the requisite experience and understanding are able to provide risk capital to SMEs.

The risks are less where it is a more established company seeking admission to a regulated market.

R19 EXTEND THE CURRENT DEFINITION OF 'QUALIFIED INVESTOR' TO INCLUDE A NEW CATEGORY OF PROFESSIONAL INVESTOR

One suggestion that has previously been made is that the definition of 'qualified investor' should be extended to include those investors who would qualify as elective professional clients under MiFID. In order to qualify as an elective professional client, the individual has to satisfy both a qualitative and quantitative test. The qualitative test requires the firm with which the individual is dealing to undertake an adequate assessment of the expertise, experience and knowledge of the person to give reasonable assurance, in light of the nature of the transaction envisaged, that the individual is capable of making his or her own investment decisions and understanding the risks involved. The quantitative test requires at least two of the following criteria to be satisfied:

- that the individual has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;
- the size of the individual's portfolio of cash deposits and financial instruments exceeds €500,000; and
- the individual works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transaction or services envisaged.

In practice it is very challenging to satisfy both the qualitative test and quantitative test. It is recommended that in order to extend the definition of a qualified investor in a meaningful way and to assist with the practical certification process, it should be extended to persons who satisfy at least one of the quantitative criteria. On an offer by a SME not admitted to trading on a regulated market this would mean that the offer could be extended to such persons without triggering the current requirement for a prospectus.

It would not in itself have any immediate impact on the ability of retail investors to participate in a regulated market IPO. This would still depend on how the issuer decided to structure the offer and who it then decided to extend the offer to. However various new measures could flow from it which, when combined, could make a direct offer to such individuals much more attractive:

- they would have full access to all necessary information;
- if the split prospectus approach is adopted then they will be entitled to receive the registration statement prospectus as a matter of course. There would not be the current issue of not being able to distribute to pathfinder prospectus to them;
- similarly this new status should allow them to receive analyst research which is produced; and
- a new, shorter electronic notice period for withdrawal rights for 'qualified investors' could be put in place.

R20 INTRODUCE A CERTIFICATION PROCESS FOR PROFESSIONAL INVESTORS

The principal drawback to previous suggestions to extend the definition of qualified investor was that it would involve an assessment by the issuer and its advisers of an investor's capability and understanding. In view of the potential liability issues some advisers may not be prepared to take on this additional responsibility. Nor may they want to risk alienating potential investors by subjecting them to such a testing process. Similar problems are apparent in the UK market where the sophisticated investors regime under the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 is seldom used because it depends upon a qualitative judgement having been made by an authorised person that the investor is sufficiently

knowledgeable to understand the risks associated with the investment in question.

One way of addressing this issue would be to have a register (as was previously the case), either maintained at an EU or Member State level, of investors who have satisfied the necessary quantitative tests. The existence of such a register would remove the element of uncertainty that would be inherent were the MiFID definition of elective professional client to be adopted as part of the definition of 'qualified investor'. However, individuals may have concerns about who would be able to access that register and whether it could be abused rather than utilised solely for the purposes it is intended.

These concerns could be addressed by instead having a certification process where, for example:

- the individual's accountant or independent financial adviser (provided such adviser is subject to the supervision and rules of a specified regulatory body) can certify that the individual satisfies the quantitative tests;
- the certificate is obtained in advance in relation to generic categories of securities (such as shares to be admitted to trading on a regulated market) and does not need to be in relation to the specific issuer undertaking the offer;
- the certificate can be provided by the relevant accountant or independent financial adviser without liability other than fraud; and
- the certificate is valid for a set period of 12 months from the date it is issued.

R21 INCREASE ABILITY TO MOVE PRICE RANGE

One of the factors which makes extending regulated market IPOs to retail investors unattractive is that under Article 8 and Article 16 of the Prospective Directive withdrawal rights are triggered if:

- the price range is revised; or
- there is a significant new factor which requires a supplementary prospectus to be published.

These withdrawal rights are not unique to retail investors. All investors have a 48 hour withdrawal period. The problem is that when the offer is made to retail investors the number of potential investors involved is likely to be much larger and it is also more likely that applications may have been made by post. Both of these increase the time it takes to communicate the withdrawal period to all relevant investors, allow for any withdrawal applications to be returned and process those applications.

It should not always be necessary for withdrawal rights to apply if an offer is priced outside of the price range. If the offer is priced within a set percentage of the outer limits of the range, then no such rights should apply.

If issuers have greater flexibility as regards the final price then this will also allow them to adjust the price range earlier in the process. Any such adjustment to the price range would not reset what final price could be set without triggering withdrawal rights but would facilitate better dialogue with investors around the level of the final price.

This would remove one of the current concerns associated with extending an offer to individual investors. To further address these concerns in relation to supplementary prospectuses, if the qualified investor test was broadened to include individual investors who satisfied certain wealth and/or experience tests, the withdrawal period tests could be modified so that the withdrawal period is much shorter where:

- the offer is only made to qualified investors; and
- those investors have agreed to receive electronic communications in connection with the offer.

SUMMARY OF RECOMMENDATIONS

Broaden investor participation

- R19** Extend the current definition of 'qualified investor' to include a new category of professional investors
- R20** Introduce a certification process for professional investors
- R21** Increase ability to move price range

3.4 INCREASE INVESTOR CONFIDENCE IN PAN-EUROPEAN OFFERINGS

For there to be a Single Market for capital, a company incorporated and listed in one EU jurisdiction must be able to market its securities throughout the rest of the EU. The Prospectus Directive put in place the legislative framework for an issuer to achieve this, but in order for investors to continue to have confidence in that framework it must be applied to at least the same minimum standard across the EU.

It is clear from our consultations that there currently exists a degree of NCA forum shopping when an issuer is considering which regulated market it wishes to list its securities on. NCA forum shopping is particularly prevalent where an issuer is looking to list debt securities.

This can be for positive reasons. It is clear that certain respondents favour particular NCAs because of their high service standards, in particular:

- ability to speak to the NCA at an early stage regarding eligibility or classification;
- ability to speak directly to the NCA to discuss comments the NCA has made on the draft prospectus or specific issues in relation to the draft prospectus;
- turnaround times and overall timetables;
- willingness to accept early drafts of the prospectus and willingness to accept additional amendments to specific pages rather than complete re-submission; and
- consistency.

However it also appears that issuers choose particular NCAs for other reasons including:

- that they will grant derogations in circumstances where other NCAs will not (areas cited include in relation to complex financial history and the information required to be provided in relation to guarantors); and
- in general are considered to only conduct a 'light touch' review.

R22 HARMONISE APPROACH OF NCAs TO PROSPECTUS REVIEW AND APPROVAL

A situation where a regulated market attracted more issuers because the relevant NCA did not apply the Prospectus Directive correctly would clearly be unhealthy. To avoid this happening ESMA should ensure through its peer review process that all regulated market NCAs apply the same rules to approving prospectuses.

As part of the peer review process NCAs should provide information to ESMA about derogations.

Separately, it is important that European NCAs not only continue to review documents submitted to them to the highest standards but that their service standards are also high in the face of worldwide competition – to the benefit of EU issuers.

The UKLA remains in regular contact with interested user groups in order to receive feedback. Action taken by the UKLA in response to this feedback appears to have been positive. Prior to the Financial Services Act 2012 the UKLA was required by section 73(1)(d) of FSMA to have regard to 'the international character of the capital markets and the desirability of maintaining the competitive position of the United Kingdom'. Some respondents have suggested that reinstating this requirement would assist in maintaining these standards. We would agree and believe that higher standards across all NCAs will benefit issuers, reducing costs, encouraging more issuers to market and ultimately enhancing the CMU.

R23 ENCOURAGE MINIMUM CORPORATE GOVERNANCE REQUIREMENTS

Where an issuer from one jurisdiction is offering securities to investors in another jurisdiction those investors will be able to have confidence in the offer documentation as a result of the Prospectus Directive and confidence in on-going information flow post-admission as a result of the Transparency Directive. One area where an investor cannot take such immediate comfort is in relation to the rules and standards which apply to the corporate governance of the issuer.

This Report:

- endorses the recommendations in the ABI Report that any independent directors are appointed earlier in the IPO process rather than right at the end at admission; and
- believes that developments should continue to be a 'comply or explain' basis.

Again the earlier appointment of an independent board may be a further by-product of publishing the registration statement prospectus earlier. The best approach would be for all directors to be in place in order for information in relation to them to be included in the registration statement prospectus and for them to be able to take responsibility for that document

Corporate governance is an area which is complicated by national elements such as different board structures which exist in different jurisdictions. It is an area of study in itself. As a result, while this Report tries to be as specific as possible with its recommendations, this is an issue which it can only highlight as being relevant to promoting cross border capital raisings. The Commission should encourage consultation and co-ordination between Member States with a view to Member States taking their own action to ensure there are minimum standards in place.

SUMMARY OF RECOMMENDATIONS

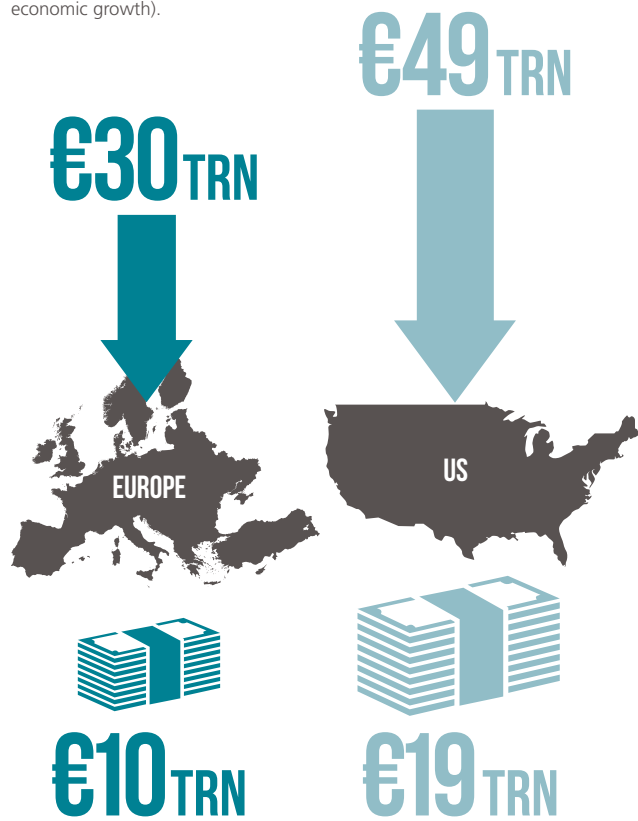
Increase investor confidence in pan-European listings

R22 Harmonise approach of NCAs to prospectus review and approval

R23 Encourage minimum corporate governance requirements

EUROPE ONLY HAS TWO-THIRDS OF THE INVESTABLE ASSETS OF THE US. IN OTHER WORDS, IT HAS APPROXIMATELY €30TN OF EXTERNAL FUNDING, AGAINST APPROXIMATELY €49TN IN THE US. SIMILARLY, EUROPE HAS ONLY APPROXIMATELY HALF AS MUCH EQUITY CAPITAL: €10TN VS €19TN IN THE US.

(Source 2015 BCG/AFME report Bridging the growth gap: Investor views on Europe and US Capital markets and how they drive investment and economic growth).



4.0 POST IPO: FOLLOW ON CAPITAL RAISINGS

BACKGROUND

Once a company is admitted to trading on a regulated market there are a number of different methods by which it may raise further capital (see Table M).

The objectives of issuers and investors have a subtly different emphasis when seeking to improve the secondary issuance process as opposed to the IPO process. In large part this is because existing shareholders and other potential investors already have access to a large amount of information in relation to the company.

Therefore while eliminating the blackout period is key to unlocking various potential improvements in relation to an initial public offer, reducing the length of (or the requirement for) a prospectus is equally central to improving secondary issuances (see Table N).

Under the Prospectus Directive there already exists a proportionate regime for rights issues. This aims to reduce the prospectus disclosure requirements for a rights issue. However it is unclear whether any issuer has ever taken advantage of the regime rather than produce a full prospectus. It is thought this is because:

- the current regime does not exempt an issuer from sufficient of the prospectus disclosure requirements to make any real difference in time or cost;
- this lack of differentiation is further eroded by the fact that the general disclosure requirement in Article 5(1) of the Prospectus Directive applies unamended (see section 4.1 below); and
- the current regime does not apply to all secondary issues only rights issues.

Table M

Method	Description
Rights Issue	<p>Pro-rata offer to existing shareholders to subscribe for further shares in the company. Shareholders are able to trade their entitlement to subscribe for shares under the offer.</p> <p>Will almost inevitably require a prospectus. Regardless of the nature of the company's shareholder base it will be very hard for a company to be comfortable that it comes within an exemption for the requirement to produce a prospectus where there is an offer to the public. A prospectus will be required in any event if the number of new shares being offered is more than 10% of the company's existing share capital.</p>
Placing and open offer	<p>Shares are conditionally placed with institutional investors subject to clawback by existing shareholders. These shares are then offered pro-rata to existing shareholders. The difference to a rights issue is that shareholders cannot trade their entitlement to participate in the Open Offer. If a shareholder does not take up his shares under the Open Offer then those shares are issued to the institutional placees.</p> <p>Again a prospectus will be required as (i) the offer will inevitably constitute an offer to the public and/or (ii) for the admission of the shares if the new shares which will be issued comprise more than 10% of the existing issued share capital.</p>
Cash placing	<p>Shares are placed with specific subscribers who may or may not be existing members of the company. These subscribers are likely to come within an exemption from the public offer test such that a prospectus is only required if the new shares which will be issued comprise more than 10% of the existing issued share capital.</p>

Table N

Issuer	
Reduce timetable	Where a prospectus is required a much shorter document will be quicker to prepare and will also be subject to shorter review times by the relevant NCA. Both of which will assist in reducing overall timetable.
Reduce risk	Where a prospectus is required, if a shorter document can lead to a shorter timetable then this will reduce the risk of missing relevant capital markets windows.
Reduce cost	Shorter document, shorter timetable and less risk all help to reduce cost.
Investor	
Better quality of information	If the company is required to produce a prospectus then shareholders do not want a lengthy document which repeats information they already know or which is available elsewhere. Needs to be much more user friendly
Ability to participate	Shareholders want the ability, if they so choose, to be able to participate. Key aspects for an issuer when considering the method of capital raising include speed and whether a prospectus is required. If it is made much quicker and easier to produce a prospectus then an issuer is more likely to choose a pro-rata issuance which an existing shareholder can then participate in

PROPOSALS

4.1 REDUCE DISCLOSURE REQUIREMENTS FOR FOLLOW ON ISSUANCES

The current proportionate disclosure regime does not work and should be replaced with a regime which requires substantially less information to be set out in full in the relevant offer document sent to investors.

A company which is already admitted to trading on a regulated market is subject to, among other things, the continuous disclosure obligations imposed by the Transparency Directive. The company is already under strict obligations to make public information necessary to allow unbiased trading in its shares.

Where different views exist is on how much of this is already public information, and how much additional information, a company should be required to disclose in connection with a follow on issuance.

There is a view that, given the information which is already available to investors, it should be possible to undertake a follow on issuance simply on the basis of an announcement made via a Regulatory Information Service (RIS) which sets out the terms of the offer. Alternatively, an issuer should only need to produce a five-or six-page offer document which sets out the terms of the offer and which also sets out any risk factors specific to the offer, but which incorporates by reference all other relevant information already disclosed by the issuer.

The issue these approaches raise is whether whatever document or announcement is produced is a prospectus or not? There are certainly jurisdictions where an issuer can carry out a follow on issuance based on a market announcement which does not constitute a prospectus (see below – ‘Australian low doc rights issues’). Moving follow on issuances outside of the prospectus regime altogether might be viewed as too radical by some and it could be hard to reach the necessary consensus required for implementation. Particular areas of focus would be:

- **Liability** – if whatever document or announcement is produced is not a prospectus then what liability regime applies to it? What recourse does an investor have if that document or announcement contains misleading information?
- **Admission to trading** – what additional document (if any) is required to be produced in order for the new securities to be admitted to trading. If it is nothing then this means that (subject to necessary shareholder approval to issue the relevant shares) an issuer could theoretically undertake a secondary issuance which doubles the number of shares it has in issue but it is not required to produce anything more than an announcement on a Regulatory Information Service (RIS) for them to be admitted to trading. Alternatively if a prospectus is required (then unless the follow on issue falls within the current exemptions for up to 10% of the issuer’s issued share capital) this undoes the benefits of not having to produce a prospectus to offer the shares and pushes issuers back towards a non pro-rata placing.

Australian ‘low doc’ rights issues

In Australia if an issuer wants to undertake a pro rata rights issue, it must prepare and lodge a disclosure document unless an exemption applies. One exemption that has become very popular with companies listed on the Australian Securities Exchange (ASX) is lodging a “one pager” cleansing notice in place of a disclosure document (provided that certain criteria are met). This is known as a “low doc” or “undocumented” rights issue, the regime for which was first introduced in Australia in 2007.

In order to undertake a low doc offering, the following conditions must be satisfied:

- **Pro rata rights issue** – The relevant securities must be offered to existing securityholders under a rights issue.
- **Quotation** – The class of the relevant securities being offered must be quoted securities at the time the offer is made, and trading in that class of securities on ASX must not have been suspended for more than a total of 5 days during the period of 12 months before the day on which the offer is made.
- **No exemptions** – The issuer (or any director or auditor of the issuer) must not have been covered by exemptions from the enhanced disclosure provisions or the financial reporting provisions of the Australian Corporations Act at any time during the previous 12 months.

- **No determination** – There must be no determination by ASX in force in relation to the issuer at the time the relevant securities are offered relating to contraventions in the previous 12 months of key disclosure provisions of the Corporations Act.
- **Cleansing Notice** – The issuer must give ASX a cleansing notice within the 24 hour period before the offer is made (Cleansing Notice).

The Cleansing Notice must (among other things):

- **no disclosure document:** state that the issuer will offer the relevant securities for issue without disclosure to investors under a disclosure document;
- **compliance:** state that, as at the date of the notice, the issuer has complied with the financial reporting and audit requirements under the Australian Corporations Act as they apply to the issuer, as well as the statutory continuous disclosure obligations;
- **control:** state the potential effect that the issue of the relevant securities will have on the control of the issuer and the consequences of that effect; and
- **excluded information:** as the low doc regime is premised on all relevant price sensitive information being in the market (whether or not it satisfies a carve-out to the continuous disclosure standard), there is also a requirement in the Cleansing Notice to confirm that these disclosures have already been made to ASX (eg through previous announcements) or are being made in the Cleansing Notice. In practice, issuers will often make any requisite disclosure in the ASX announcement for the rights issue and then confirm in the Cleansing Notice that all relevant information has been disclosed.

If the issuer becomes aware that the Cleansing Notice is defective within a 12 month period after the relevant securities are issued, the issuer is under an obligation to correct the defect within a reasonable time after becoming aware of the defect.

A Cleansing Notice is considered defective if it does not comply with the above content requirements, is false or misleading in a material particular, or has omitted a matter or thing the omission of which renders the notice misleading in a material respect. If a Cleansing Notice is defective, the issuer, its directors and others involved in the contravention may be liable for contravening a number of the fundraising provisions under the Australian Corporations Act as well as face civil and criminal liability.

PROSPECTUS

On this basis it is submitted that the working parameters are:

- the document which is produced by the issuer should be significantly shorter (in the region of 10% of the size of current documents) in order to deliver the benefits in Table N. In normal circumstances amending a regime designed to protect investors just to achieve a shorter document could be viewed as reversing the priorities. However in this case the information is already public and available and so having it as an objective is not emphasising the wrong issue;
- such document should continue to be a prospectus for the purposes of, and continue to exist within, the Prospectus Directive regime; and
- investors should still have access to all information they require in order to make an informed assessment as to whether to participate in the secondary offer.

There are a number of measures which could be considered in combination to achieve an outcome which is within these parameters.

R24 REDUCE SPECIFIC DISCLOSURE REQUIREMENTS

The specific disclosures required under the annexures to the Prospectus Regulation could be heavily reduced. Rather than keeping the majority of the requirements and the obligation being on an issuer to incorporate the relevant information into the prospectus in order to satisfy the requirements, the emphasis should be reversed. The annex requirements could be reviewed with the intention of removing those disclosure requirements which an issuer is already required to comply with under the Transparency Directive.

It is already possible for an issuer to incorporate information into a prospectus. However, with the exception of financial information, issuers rarely take full advantage and simply repeat the information in the prospectus.

R25 REVISE ARTICLE 5 GENERAL DISCLOSURE TEST

Article 5 of the Prospectus Directive sets out a general disclosure requirement that:

“the prospectus shall contain all information which, according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, and of the rights attaching to such securities.”

The experience from the current proportionate regime is that there is no point reducing the specific annex disclosures without also amending the general disclosure test.

The general disclosure test could be amended to provide a different test where it is a secondary issue. That test could specifically take account of the information which an issuer already admitted to trading on a regulated market is required to publish under the Transparency Directive.

R26 ELIMINATE NEED TO REPEAT INFORMATION AVAILABLE ON A DEDICATED SECTION OF THE ISSUER'S WEBSITE

An issuer should not be required to repeat information in the prospectus to the extent it has already disclosed that information to the relevant market and that information is still accurate.

If only certain items of information in a document already disclosed by the issuer are out of date that should not mean that the issuer cannot utilise the vast majority of that disclosure which is still accurate. The issuer should be able to use the prospectus to update just the information which is no longer accurate and not repeat the rest of the relevant disclosure. In other words, the prospectus could act in relation to the information which is already disclosed to the market in a similar way a supplementary prospectus acts to a prospectus already published.

None of these measures are intended to eliminate the due diligence an issuer would normally undertake in relation to a secondary issue to ensure that investors have all relevant information. Investors' interests should not be affected. The benefits to the issuer are purely through having a shorter document which takes less time to draft, less time to verify and less time to be vetted by the relevant NCA.

SUMMARY OF RECOMMENDATIONS

Reduce disclosure requirements for follow on issuances

R24 Reduce specific disclosure requirements

R25 Revise Article 5 general disclosure test

R26 Eliminate need to repeat information available on a dedicated section of the issuer's website

5.0 CLOSING COMMENTS

If there is to be a wholesale shift in the approach to financing, there needs to be a cultural shift within Europe. Compared with the US and certain parts of Asia, Europe does not have an 'equity culture' which encourages widespread investment by individuals as well as institutional investors. The US has a much more diversified financing structure than Europe and is less reliant on banks (see Table O below). Capital markets are substantially larger, fuelled by institutional investors with a spending power much larger than that of their European counterparts. As a result, listed equity and debt also constitutes a much larger portion of funding for US companies than those in the EU (see Table P below).

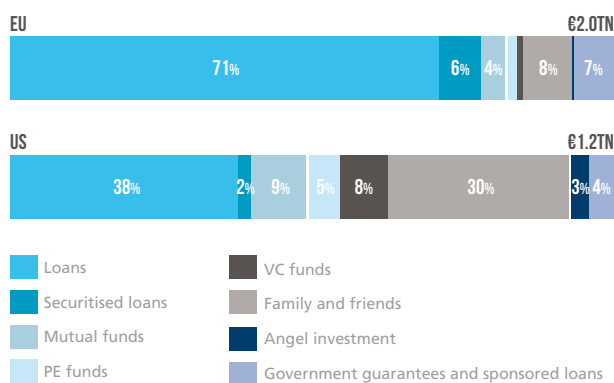
Compared with the US, the EU remains a collection of sovereign nations with differing currencies and widely different approaches to fundamental issues such as taxation, pensions and savings, the effect of which is that fundraising and investment tend to be conducted on a largely domestic basis.

By addressing the issues identified in this report, important steps will be taken towards achieving CMU and, indeed, creating a greater equity culture within Europe.

Table O

European SMEs are almost twice as reliant on banks for financing as their US counterparts

Outstanding market sources of SME finance¹
2013, % of total SME financing



¹ Desk research and investor interviews indicate only marginal investments in Bonds / Equity, and via Pension Funds, mandates or securitisation

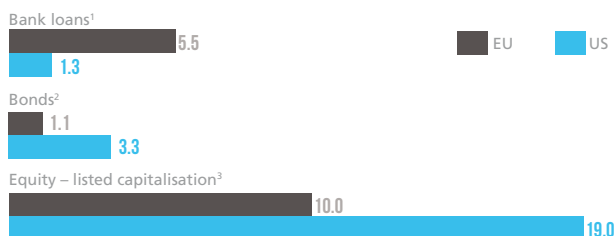
Source: AFME – Bridging the growth gap – Feb 2015

Oliver Wyman

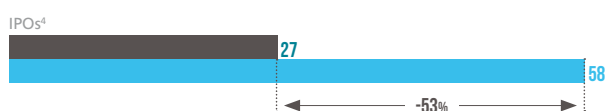
Table P

Equity and debt constitute larger portion of funding for US companies than EU companies

Outstanding market sources of finance
€TN, 2013



Flow sources of finance
€BN, 2013



¹ Bank loans to NFC outstanding – Fed Economic data, ECB (EU-18);

² Bonds outstanding to NFC – SIFMA, ECB (EU-18);

³ Listed US and EU Market Cap – WFE; ⁴ New issuance of IPO – Thompson One;

Source: AFME – Bridging the growth gap – Feb 2015

Oliver Wyman

DEFINITIONS AND GLOSSARY

ABI Report	the ABI report “Encouraging Equity Investment”, published on 11 July 2013
AIM	the Alternative Investment Market, the London Stock Exchange’s international MTF for smaller growing companies
blackout period	the period which, in accordance with current market practice, falls between the publication of analyst research and subsequent publication of a prospectus
bookbuild	the process of generating, capturing and recording investor demand for shares
BRIC	Brazil, Russia, India and China
CMU	Capital Markets Union
COBS	the FCA’s Conduct of Business Sourcebook
debt financing	the raising of capital by a firm for working capital or capital expenditures by selling bonds, bills, or notes to individual and/or institutional investors. In return for lending the money, the individuals or institutions become creditors and receive a promise that the principal and interest on the debt will be repaid
ECB	European Central Bank
EIS	the Enterprise Investment Scheme, a scheme in the UK designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors
equity financing	the raising of capital through the sale of shares in an enterprise. Equity financing essentially refers to the sale of an ownership interest to raise funds for business purposes. While the term is generally associated with financings by public companies listed on an exchange, it includes financings by private companies as well. Equity financing is distinct from debt financing, which refers to funds borrowed by a business
FCA	the Financial Conduct Authority of the UK
FSMA	the UK Financial Services and Markets Act 2002
growth companies	companies within the SME sector which have the potential and appetite to expand, innovate and take on more workers
GVA	Gross Value Added, which measures the contribution to the economy of each individual producer, industry or sector in a specific country or region and is used in the estimation of Gross Domestic Product
IPO	an initial public offering of shares – the first listing of a company’s shares on a stock exchange

ISA	an individual savings account which qualifies for favourable tax status in the UK
ITF	intention to float (i.e. an intention to IPO)
MiFID	the Markets in Financial Instruments Directive
MTF	multilateral trading facility, a system operated by an investment firm or market operator, and which brings together multiple third-party buying and selling interests in financial instruments in a way that results in a contract
NCA	national competent authority
pathfinder prospectus	a preliminary offering document or draft prospectus which is used to assess the level of demand from potential investors for the shares on offer
Primary exchange	a regulated exchange
RIS or RNS	a Regulatory Information Service or a Regulatory News Service
qualified investor	a person who falls into one of the relevant categories under MiFID, principally institutions
Royal Mail Review	the independent review for the Secretary of State for Business, Innovation & Skills entitled "IPOs and Bookbuilding in Future HM Government Primary Share Disposals" undertaken by a panel chaired by Lord Myners and published on 16 December 2014
follow on issuance	an offer of securities by a company following its IPO
SME	small or medium sized enterprise
SME Growth Market	specialist markets to cater for the needs of SME issuers falling within the requirements of MiFID II, which includes MTFs and other non-regulated trading facilities
UKLA	the UK Listing Authority
venture capital	financing provided by investors to start-up firms and small businesses with perceived long-term growth potential. It typically entails high risk for the investor, but it has the potential for above-average returns.

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