BEIS - Audit and corporate governance review – Consultation

UK Equity Markets Association (UKEMA) Consultation Response Submission

Introduction

The UK has a proud history as a location where many of the world's best companies have chosen to list and do business. The Government has, through Lord Hill's Listings Review, undertaken a comprehensive look at how London's markets can remain among the most deep and liquid internationally.

We believe it is crucial that a range of investors can access public markets and be exposed to exciting growth companies, which in turn drives investment, supports businesses and jobs, and leads to growth across the United Kingdom. Efficient, liquid and well-stocked public markets have never been more important for Britain as they are today, and will help maintain the UK's standing as a global financial centre outside the European Union.

The reforms that the Government is undertaking, including through the recently announced consultations on the UK Prospectus Regime and the Wholesale Markets Review, all aim to support this objective, ensuring that we continue to attract high growth listings to London.

Yet more needs to be done to ensure that the UK remains an attractive place to list, and we are concerned that some of the proposals contained in this consultation may inadvertently undermine the very positive reforms proposed by the Government following the Hill Review.

In recent years there has been a trend of de-equitisation on the London markets. During 2019 more companies left the main market than joined it, while the number of companies on AIM ended the year at a 15-year low. In 2019 there were just 10 IPOs on the AIM market, increasing only to 16 in 2020, well down on the 42 in 2018 and 50 in 2017.

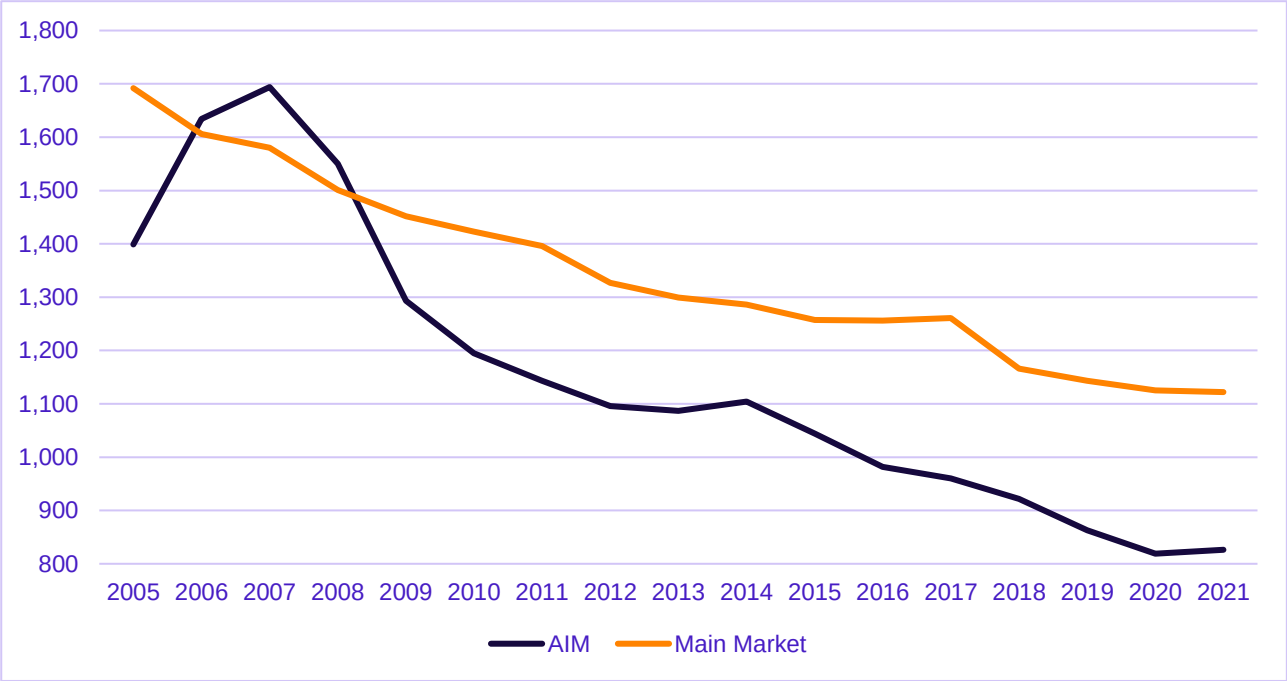
Publicly quoted companies were able to use equity markets when needed, shoring up balance sheets, saving jobs, protecting the economy and accessing significant and flexible pools of capital when needed, seeing them through the hard times with a long-term view to the future.

For the period 1st March 2020 to 30th June 2021 (over £5m where Peel Hunt, Shore Capital, Winterflood, Numis, Arden Partners, Stifel, Liberum or finnCap were bookrunner) there were 222 transactions raising £19,558m (AIM: 121 transactions raising £3,587m; Main: 101 transactions raising £15,971m).

For the period 1st April 2020 - 30th June 2020 (i.e. the first part of the Covid pandemic), 63 transactions were announced (over £5m and where Peel Hunt, Shore Capital, Winterflood, Numis, Arden Partners, Stifel, Liberum or finnCap were bookrunner) raising £4,243m, 31 transactions on the Main Market raising £3,362m and 32 transaction on AIM raising £881m.

A survey by the Quoted Companies Alliance (QCA) and Peel Hunt in 2019 found that 75% of companies & investors were concerned over the de-equitisation of UK stock markets. Recent large numbers of M&As and 'take privates' have increased concerns. This year's survey by the same organisations showed that only 21% of investors and 5% of companies think the number of companies listed on UK markets will rise.

Number of AIM and Main Market companies over time



We are noticing an increasing divide between those raising capital through private means or listing, and motivation for companies to stay private. This restricts the ability of a range of investors who wish to access public markets and access exciting growth companies.

It is vitally important that the Government continues its drive to make London a competitive place for growth companies to raise money, however there are elements of this consultation which will contradict these ambitions. Any additional burden or obligations placed on public listings will help to discourage companies from considering this route, and may exacerbate the push to private that has taken place in recent years.

Detailed comments

Definition of Public Interest Entity (PIE)

- Currently only entities listed on the London Stock Exchange, banks and insurers are considered PIEs under the current UK regime. However, the Government is proposing to expand the PIE definition to include large private companies and large AIM companies as well as potentially some 'Third Sector' organisations.
- There are two options: either to adopt the test already used to identify those large private companies that are required to include a corporate governance statement in their directors' report, or to adopt a narrower test based on the threshold for additional non-financial reporting requirements for existing PIEs.
- The proposed threshold for an AIM company to become a PIE is that it has a market capitalisation of over €200million.
- The Government has also said it will consider an appropriate period over which the thresholds must be met in determining whether an organisation has become a PIE, but there is no definitive indication of what that period will be.

UKEMA view:

- While we recognise the Government's desire to avoid additional complications as a result of this reform, existing thresholds are somewhat arbitrary, especially as financial metrics don't capture the whole picture. The employee threshold, for example, has not changed since at least the Companies Act 1989, whereas other thresholds on turnover and balance sheet have been periodically updated since then.
- We would question therefore whether market valuation is the right metric to be using given wide range of the external factors that affect market valuations rather than the actual scale and complexity of the organisation [e.g. employee balance sheet] which is more relevant.
- Under the current PIE regime, PIEs are defined at an entity level. If an entity is designated a PIE, then that entity must apply all of the PIE requirements regardless of whether there are other PIEs in the same group. If this same approach were to be applied in respect of the new requirements, there would be some additional complexity. The consultation acknowledges that where there is more than one PIE in a group, there may need to be differences in how individual requirements apply to PIEs that are part of a group, but at this stage there is no clarity on what the approach may be.
- The consultation suggests that AIM companies that would qualify as PIEs under the new regime would face the same requirements as any other PIE. While some AIM companies are already considered to be OEPIs, and restrictions on non-audit services will not be new, AIM companies are not currently subject to a mandatory audit firm rotation regime. This, together with the new PIE requirements, will create new demands on AIM companies that are designated as PIEs.
- A company should not be treated as PIE and therefore captured by the additional Sox-style requirements, which will be costly and burdensome, solely due to the fact they are

listed, which is a possibility under these proposed rules. This will serve as yet another incentive for growth companies to avoid going public.
- The consultation also does not take into account the impact on small cap, as the £200 million market cap on AIM suffers from a lack of liquidity and interest. This adds to the regulatory burden of being on AIM (rather than remaining a private entity) exacerbating the lesser liquidity of small cap companies compared to larger companies.
- There is a risk that using the market cap thresholds captures a significant cohort of companies, adding to the regulatory burdens required of any company that seeks to list on the public markets and further exacerbating the push to private.

Director accountability

- The Government has concluded that the current regulatory framework is inadequate in holding directors to account for high quality corporate reporting. The Secretary of State has stated that there is a need to ensure "that those who prepare and assure reports are held to the highest standards, including the directors who sign off the reports of the largest companies."

UKEMA view

- We have concerns that the proposals would raise risks associated with being a Non-Executive Director, negatively impacting on the attractiveness of the role and reducing the talent pool, alongside new reporting requirements. Particularly if the proposals to expand the definition of a PIE would include large AIM listed companies, this could make listing even less attractive. Proportionality would be key to ensuring companies are not disincentivised to list as a means of raising capital, particularly should they be captured by the PIE definition. A sliding scale or implementation period could be a sensible approach for those with smaller or medium size capitalisation.

Conclusion

One of the reasons why the US stock market has outperformed the UK stock market to the significant extent it has is due to the attractiveness to high growth tech companies of listing in New York. Recent independent reports and Government consultations and proposals have recognized the critical importance of addressing this and of positioning London as an attractive alternative option for this cohort of companies.

UKEMA is supportive of this objective, but is keen to ensure that policy approaches avoid creating additional divisions between public and private companies that encourages companies to stay private, rather than go public, or to opt against listing in the UK in preference of other markets should they decide to list.

About the UKEMA:

About the UK Equity Markets Association (UKEMA)

The UK Equity Markets Association (UKEMA) is a newly established and growing group of small and mid-cap investment banks and equity brokerage firms. UKEMA represents its members by increasing awareness of small and mid-cap equity investment brokers' value in supporting SMEs to access capital to reach their potential and improve regulation by engaging with policy makers and regulatory bodies.

UKEMA members trade in over 2,000 companies shares, representing 57% of shares traded by volume, and 12% by value of all shares on the LSE. Members write research on over 1,700 companies' shares, representing 87% of all UK listed issuers.

Its membership includes Peel Hunt, Shore Capital, Winterflood, Numis, Arden Partners, Stifel, Liberum and finnCap.

What does UKEMA do?

UKEMA's members work together to reduce market access barriers and help policymakers as they develop new frameworks to support and develop the regulation of equity markets. To do this UKEMA seeks to ensure domestic regulation provides appropriate protections without being overly burdensome in order to support public markets and the essential liquidity they provide.

UKEMA supports economic growth

Small and mid-cap equity brokerage firms help SMEs reach their potential, supporting the UK's post-pandemic economic recovery. UKEMA promotes solutions to allow UK equity markets to thrive, supporting the drive to grow the number of listed companies and increase competition, and helping to make the market more resilient to crises.

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