



Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

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

www.theqca.com

Future Regulatory Framework Review
Financial Services Strategy
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

FRF.Review@hmtreasury.gov.uk

Wednesday 9 February 2022

Dear HM Treasury colleagues,

Financial Services Future Regulatory Framework Review: Proposals for Reform

We welcome the opportunity to respond to your Financial Services Future Regulatory Framework Review.

The Quoted Companies Alliance has examined the proposals and provides this response from the viewpoint of small and mid-sized quoted companies.

Overall, we support HM Treasury's Financial Services Future Regulatory Framework Review. As you know, we are the independent membership organisation that represents the interests of small and mid-sized quoted companies. We have over 200 quoted companies as members, drawn from across the Main Market, AIM and the Aquis Stock Exchange (AQSE), as well as over 80 advisory members, including market participants, such as investors, brokers, Nominated Advisers, accountants, and law firms.

There are approximately 1,250 small and mid-sized quoted companies in the UK, representing 93 per cent of all quoted companies. These companies employ over 3 million people, constituting 11 per cent of private sector employment in the UK and contribute £26.5 billion in annual taxes¹.

The value of small and mid-sized quoted companies to the UK economy is vast, and we seek to create an environment where their potential can be fulfilled. The principle of **proportionality** is at the forefront of our policy work. We aim to ensure that any new regulatory or legislative action is appropriate in its approach, having regard to the smaller size and more limited resources of the companies we represent, as well as balancing the costs and benefits of these developments.

For this reason, our key message is that, in addition to the new growth and international competitiveness secondary objectives for the regulators, a new proportionality objective should be added. The Government

¹ Hardman & CO. and the QCA, May 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, available at: <https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf>

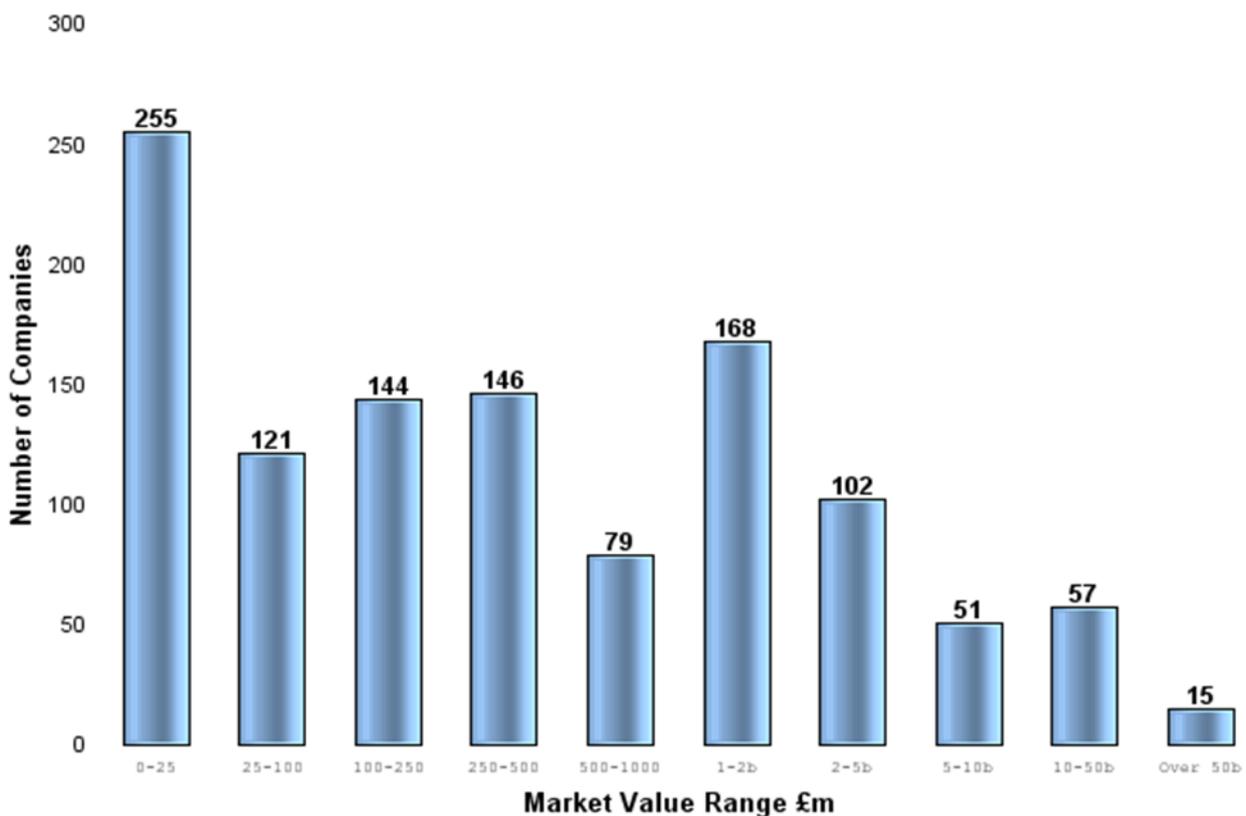
and regulators have an important role to play in ensuring financial services regulation is appropriate, fit for purpose and proportionate. There is a balance to be reached, between protecting investors and allowing companies to thrive so they can offer returns to their investors and positive outcomes for the wider economy.

In order to adopt a new proportionality objective into the secondary objectives of the regulators, a deeper understanding of the UK's markets and the companies that operate on them is needed.

Firstly, it is essential to ensure that there is a common understanding of the significant size differences between the companies on the UK's exchanges. There are vast differences in size and resources of public companies and regulation should be considerate of these differences in order to be proportionate.

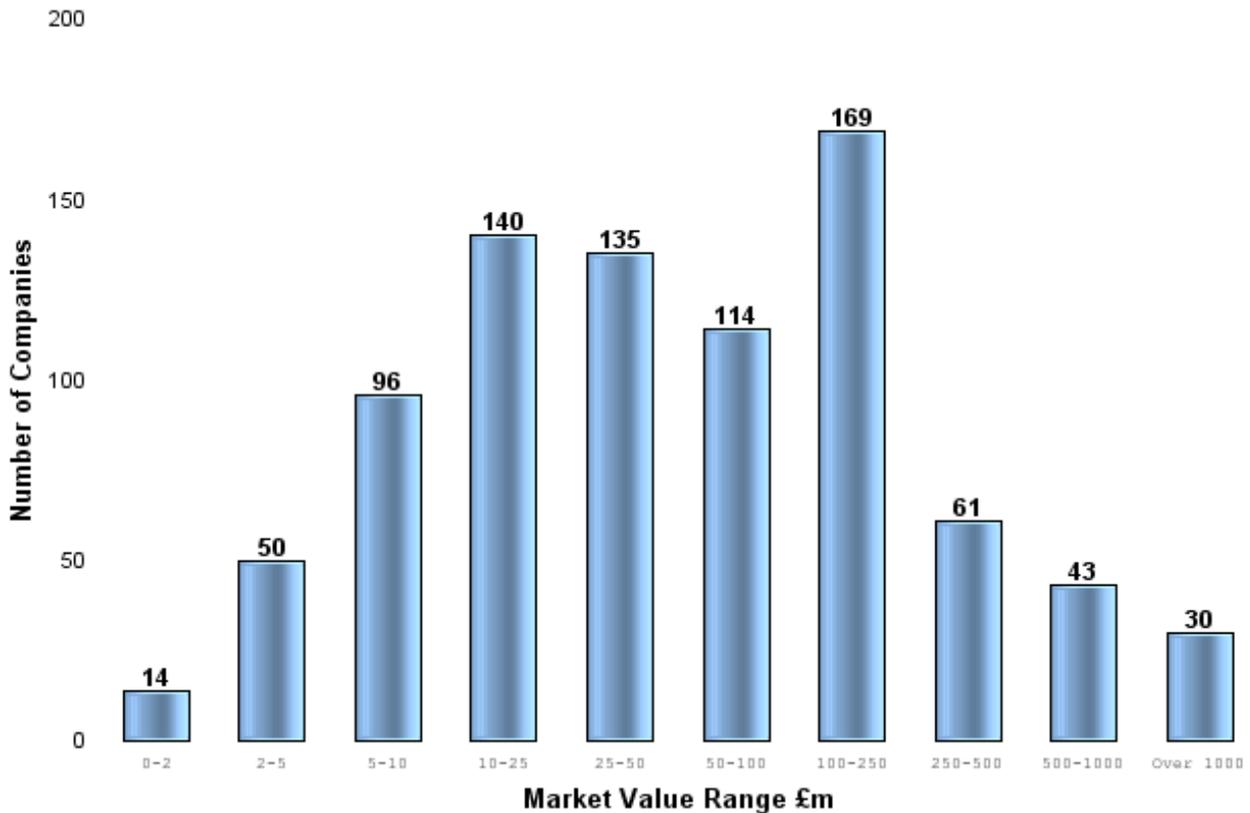
The two graphs below show the distribution of companies by equity market value for the Main Market and AIM. They demonstrate the significant disparities in size between the few largest companies and the many smaller companies. For instance, the largest companies on the Main Market (those with a market capitalisation over £10 billion) represent just 6.4% of the total number of companies, yet represent 73.2% of the total market capitalisation. Conversely, the smallest companies on the Main Market (those with a market capitalisation of less than £250 million) represent 46.1% of the total number of companies, yet represent just 0.08% of total market capitalisation. It is too often the case that these smaller companies find themselves having to comply with regulation that is targeted at the largest companies, but which captures them too.

Main Market²



² Source: London Stock Exchange, Main Market Factsheet (December 2021), available at: <https://www.londonstockexchange.com/reports?tab=main-market>

Alternative Investment Market³



Similar to the Main Market, the largest companies on AIM (those with a market capitalisation over £1 billion) represent 3.5% of the total number of companies, yet represent 37.3% of the total market capitalisation.

For these reasons, it is essential that the regulators are required to work within a proportionality objective as an operating objective to ensure any new requirements are proportionate in their approach. That is, the extent to which a company is expected to adhere to new requirements or comply with regulation should be commensurate to size, complexity and available resources. We go into further detail on the proportionality objective in our response to Question 1 below.

Please note that, as the independent membership organisation representing the interests of small and mid-sized quoted companies, our response is only concerned with issues that relate to companies quoted on public equity markets.

We look forward to continuing to work with HM Treasury on this very important subject.

Yours sincerely,

³ Source: London Stock Exchange, AIM Factsheet (December 2021), available at: <https://www.londonstockexchange.com/reports?tab=aim>

Tim Ward
Chief Executive

Please note that our responses to the questions below are only concerned on the issues relevant to small and mid-sized quoted companies.

Q1 Do you agree with the government's approach to add new growth and international competitiveness secondary objectives for the PRA and the FCA?

While we agree with the addition of new growth and international competitiveness secondary objectives for the FCA, we strongly believe that proportionality should also be hard-coded into the FCA's secondary objectives.

We strongly disagree with the Government's view that the principle of proportionality should not be employed on the basis that "proportionality is already sufficiently embedded in the regulators' statutory principles". It is a strongly held view amongst our membership that the statutory principle simply does not go far enough and is not applied consistently or rigorously.

Adding proportionality to the regulators secondary objectives would place it on a proper footing and ensure the regulators are properly accountable against this objective and can be subjected to sufficient scrutiny. Introducing a proportionality objective would give market participants increased confidence that the markets are suitable for their needs and help to attract companies to the markets at an earlier stage in their growth, as well as reverse the decline of companies leaving the markets.

In its simplest terms, the proportionality objective should ensure that any burden imposed as a result of the implementation of new regulation should be proportionate to the benefits. However, the objective should also go further than this to take account of the relative burden of regulation on different market participants.

By this, we mean that the proportionality principles should include consideration of the relative impact of regulation on market participants of different sizes and complexities. This should then allow the regulators to determine whether the regulation should apply on a blanket basis, covering all market participants, or whether it should just cover the largest companies and those with the ability to comply in a manner that does not disproportionately impact them. This will help the UK's markets move away from the harmful one-size-fits-all approach to regulation that has had a detrimental impact to our markets and resulted in the decline in use of them. We discuss further, in our responses to Question 7 and Question 8 regarding cost-benefit analysis, how the regulator can achieve this.

Regulators should ensure that they have meaningfully and effectively consulted relevant stakeholder groups to help make sure that regulation is flexible enough to accommodate entities of all sizes.

The Government and the regulators must take into consideration the additional administrative burden and costs that new regulation would have on smaller companies. Failing to bear this in mind could limit the growth of companies critical to the future success of the UK economy, and, ultimately, may result in companies not listing or delisting to seek less-burdensome means of gaining access to finance.

This would be at odds with the social benefit that public markets can deliver, such as in relation to job creation, wealth distribution and an increased tax take for the Treasury.

In addition to the above, we note that the Government established the Taskforce on Innovation, Growth and Regulatory Reform (TIGRR) in 2021, which clearly demonstrates its commitment to and recognition of the importance of growth. In a recent report issued by the TIGRR, there is a specific recommendation to

“mandate a new Proportionality Principle”⁴. The Proportionality Principle is described as absolutely vital to a new framework, with *“one of the longstanding issues with traditional regulation is that it has a disproportionate negative impact on smaller businesses”*⁵.

In a letter in response to the report, the Prime Minister specifically states that the UK “can lead the world in the economy of the future, creating new opportunities and greater prosperity”, but that this can only be achieved *“if we clear a path through the thicket of burdensome and restrictive regulation that has grown up around our industries”*⁶.

We agree with this, and the “Proportionality Principle” proposed in the TIGRR’s paper. The UK’s withdrawal from the EU provides us with the opportunity to recalibrate our markets and provide a world-leading market offering that is attractive to entities of all sizes and all complexities. It is essential that any new regulatory or legislative action is proportionate in its approach, having regard to the smaller size and more limited resources of these companies, as well as balancing the subsequent costs and benefits of these developments. This can be achieved through the adoption of a proportionality objective.

Not only this, but we strongly believe that incorporating a proportionality objective into the regulators secondary objectives would assist the realisation of the growth and international competitiveness objectives.

We agree with the Government’s approach to add new growth and international competitiveness secondary objectives for the FCA. We welcome the Government’s approach to take on board Lord Hill’s recommendation to implement a growth and competitiveness objective, particularly in light of other financial regulators across the world, such as Australia, Singapore, Japan and Hong Kong, as well as some institutions across the EU, having similar objectives. As it has proved to be effective in other jurisdictions, there is no concrete reason to believe that embedding these objectives would undermine financial stability and protection in the UK.

Ensuring long-term economic growth and international competitiveness are imperative for the UK to cement itself as a global financial centre in the post-Brexit era. In order for this to occur, however, the regulators must deliver on creating an environment that is conducive to entrepreneurialism and innovation to allow our markets, and the constituents of these markets, to thrive. For these objectives to be effective they must be underpinned by a drive to increase flexibility, simplify processes, remove prescription, enhance speed and efficiency and encourage choice. Once this is achieved, setting these objectives will help to foster a greater long-term culture in our markets and redress the regulatory imbalance which will have the greatest impact in encouraging deeper and more liquid markets that will ultimately lead to economic growth and the emboldening of the UK’s competitiveness.

We also agree with the Government’s proposal to require the regulators to report on their performance against their growth and international competitiveness secondary objectives on an annual basis. This is

⁴ Taskforce on Innovation, Growth and Regulatory Reform, May 2021, page 17, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994125/FINAL_TIGRR_REPORT_1_.pdf

⁵ Ibid.

⁶ The Prime Minister’s letter to the TIGRR, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994141/Iain_Duncan_Smith_Theresa_Villiers_George_Freeman_signed_letter.pdf

important in encouraging transparency, accountability and appropriate scrutiny to ensure the objectives are being achieved. We would expect such reporting to be done against the new proportionality objective also.

Q2 Do you agree that the regulatory principle for sustainable growth should be updated to reference climate change and a net zero economy?

Yes – we agree that the regulatory principle for sustainable growth should be updated to reference climate change and a net zero economy insofar that the regulators take on board the proportionality objective set out above.

Broadly, the QCA welcomes recent developments to help tackle climate change. We recognise the need to take action on climate change and broadly welcome developments in relation to reporting on climate-related issues. The QCA acknowledges that climate change will have a significant impact on companies, shareholders, stakeholders, and the UK economy as a whole. The QCA, and our members, are mindful that it is important that their climate-related financial risks and opportunities are assessed, understood and ultimately disclosed to provide useful information to shareholders, regulators and other stakeholders.

Notwithstanding the above, there are inherent difficulties that companies, and in particular smaller companies, will face in adhering to new requirements. The myriad of rules, requirements and regulations, combined with the many competing methodologies used for the calculation of metrics, often makes climate change seem a difficult subject to navigate. This is especially the case for smaller companies, who typically have more limited resources and may not have the capacity to dedicate departments/teams to focus on ESG.

For this reason, we support the support the updating of the principle of sustainable growth to reference climate change and net zero economy only where the regulators act in a proportionate manner.

Q3 Do you agree that the proposed power for HM Treasury to require the regulators to review their rules offers an appropriate mechanism to review rules when necessary?

Yes – we agree that the proposed power for HM Treasury to require the regulators to review their rules offers an appropriate mechanism to review rules when necessary. The present system whereby the regulators decide for themselves whether and how to review their rules does not provide any means for someone to sufficiently and robustly challenge their rules even when it may be in the public interest to do so.

This will be particularly important in light of recent reviews, such as the UK Prospectus Regime Review whereby the FCA will, subject to the conclusion of the consultation, be granted greater powers and ownership of the rules. It is important that the Government has the ability to challenge the regulator when it is in the public interest and when it believes there is sufficient cause to do so.

Q4 Do you agree with the proposed approach to resolve the interaction between the regulators' responsibilities under FSMA and the government's overseas arrangements and agreements?

We have no comments.

Q5 Do you agree that these measures require the regulators to provide the necessary information to Parliament on an appropriate statutory basis to conduct its scrutiny?

Yes – we agree that the proposed measures to require the regulators to provide the necessary information to Parliament are on an appropriate statutory basis to conduct its scrutiny. At present, there are limitations to the ability of Parliament to effectively scrutinise financial services policy due to there being no specific requirement on the regulators to provide it with the necessary information.

Q6 Do you agree with the proposals to strengthen the role of the panels in providing important and diverse stakeholder input into the development of policy and regulation?

Yes – we agree with the proposed measures to strengthen the role of the FCA’s Listing Authority Advisory Panel (LAAP). Increasing the FCA’s interaction with the LAAP, as well as the associated transparency and accountability of these interactions, is important. The LAAP makes an important contribution to policy development and the regulators decision-making processes following consultation with various stakeholders.

However, in so doing, the LAAP must ensure that its constituents are representative of the market and not dominated by large cap companies and their advisors.

Q7 Do you agree that the proposed requirement for regulators to publish and maintain frameworks for CBA provides improved transparency for stakeholders?

Yes – we agree that the proposed requirement for regulators to publish and maintain frameworks for cost-benefit analysis (CBA) provides transparency for stakeholders. The inclusion of CBA in the regulators consultations is useful and additional clarity around when and how the regulators conduct CBA will be beneficial.

However, we strongly believe that the regulator should be required, by law, to conduct CBA on both a segmented basis and looking at the market as a whole. As demonstrated in the introductory segment to this response, looking at the market as a whole does not reflect the significant disparities in size of the companies on the UK’s markets. This means that regulation can often be implemented and have a significantly disproportionate impact on smaller companies. The current weighting of the market where the largest 72 companies represent 73.2% of total market capitalisation means that any regulation that creates strong regulatory safeguards will be seen as a net benefit for the market overall. However, the impact of the same regulation on smaller companies will be seriously inhibitive. The FCA must conduct extensive and thorough CBA with entities at the smaller end of the market.

Moreover, it is essential that equal weighting is given to the analysis of the expected benefits of regulatory implementation as there is given to the costs and disbenefits that would have to be incurred by the markets and their constituents.

We would also argue that a CBA should take account of the behavioural impact and market sentiment towards a proposed rule change. Given the extent of regulation in the markets today, there is increasing concern that attitudes and behaviours are turning away from public markets and looking towards other, less burdensome means of gaining access to finance. It is important that this does not occur and that the underpinning culture of these markets is positive so that they can help to foster deeper and more affluent markets.

Q8 Should the role of the new CBA Panel be to provide pre-publication comment on CBA, or to provide review of CBA post-publication?

We believe that the role of the new CBA Panel should be to provide pre-publication comment on the CBA conducted by the regulator. This will serve to increase stakeholders' confidence that the quality and accuracy of the CBA has been assessed and challenged, and then, where appropriate, amended in order to capture the effect of the proposed regulatory change more accurately.

Q9 Do you agree that the proposed requirement for regulators to publish and maintain frameworks for how the regulators review their rules provides improved transparency to stakeholders?

Yes – we agree that the proposed requirement for regulators to publish and maintain frameworks for how they review their rules provides improved transparency to stakeholders and will likely have the effect of increasing the quality of the reviews conducted.

Q10 Do you agree with the government's proposal to establish a new Designated Activities Regime to regulate certain activities outside the RAO?

We have no comments.

Q11 Do you agree with the government's proposal for HM Treasury to have the ability to apply "have regards" and to place obligations on the regulators to make rules in relation to specific areas of regulation?

We have no comments.

