



Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

T +44 (0)20 7600 3745

F +44 (0)20 7600 8288

mail@theqca.com

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

FRF.Review@hmtreasury.gov.uk

Wednesday 17 February 2021

To whom it may concern,

Financial Services Future Regulatory Framework Review

As the independent membership organisation that represents the interests of small to mid-sized quoted companies, we support HM Treasury's review into the future of financial services. We have over 200 quoted companies as members, drawn from across the Main Market, AIM and the Aquis Stock Exchange, 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.

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 listed on public equity markets.

If you would like to discuss our response in more detail, please do not hesitate to contact us.

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>

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'TW', with a horizontal line extending to the right.

Tim Ward
Chief Executive

Q1 How do you view the operation of the FSMA model over the last 20 years? Do you agree that the model works well and provides a reliable approach which can be adapted to the UK's position outside of the EU?

Broadly, the QCA believes that the operation of the FSMA model has worked well, and we agree that it provides a reliable approach which can be adapted to the UK's position outside of the EU. The UK's withdrawal from the EU provides Government with the opportunity to diverge from the regulatory approach to financial services which was prescribed by EU legislation to ensure that it is fit for purpose for UK markets. Adapting the current model to address the challenges of managing the onshored regime and creating a more flexible, coherent and accountable framework for new financial services regulation is important in ensuring the UK remains a global financial centre where businesses are allowed to grow and seize opportunities.

Q2 What is your view of the proposed post-EU framework blueprint for adapting the FSMA model? In particular:

Overall, the QCA agrees with the proposed post EU-framework blueprint for adapting the FSMA model.

- **What are your views on the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators?**

The QCA believes that the proposed division of responsibilities between Parliament, HM Treasury and the financial services regulators creates a clear allocation of responsibilities between the different bodies.

However, we would like to stress the importance of coherence where there are multiple levels and sources of regulation. The respective remits of each of the bodies should be clearly demarcated to avoid regulatory overlap. The statutory hierarchies and the principles set out in FSMA are a useful starting point in this regard. However, mechanisms must be put in place to ensure consistency in how they are interpreted and applied and that this is transparent to all market participants.

A particular challenge to coherence will be the onshoring process which fragments responsibility for certain pieces of related legislation. For instance, the Markets in Financial Instruments Directive (MiFID II) consists of several different levels, including a Level 1 directive, Level 1 regulation, delegated acts and several binding technical standards. The practicalities of managing this division of powers between Parliament, HM Treasury and the regulators and coordinating rule changes is difficult and needs to be transparent and clearly articulated so that the relevant body can be held to account.

- **What is your view of the proposal for high-level policy framework legislation for government and Parliament to set the overall policy approach in key areas of regulation?**

The QCA believes that the proposal for the high-level policy framework legislation will allow the Government and Parliament to establish the key public policy issues and ensure these are addressed in the development and implementation of new regulatory standards. The Government and Parliament now needs to balance policymaking autonomy against the requirements for international market access. The challenge will be to ensure growth and global competitiveness on the one hand and financial stability and consumer protection on the other hand.

This needs to be managed transparently. In particular, how the regulators take into account the high-level policy framework is essential.

Finally, we believe that there is merit in considering whether a relevant Minister should be required to account to Parliament annually as to the quality and integrity of the public equity markets taking into account the need for a proportionate approach. This would help to inform Parliament of the nature of markets as well as exert pressure on the market players to consider the social and economic benefits of the UK's public equity markets.

- **Do you have views on how the regulators should be obliged to explain how they have had regard to activity-specific regulatory principles when making policy or rule proposals?**

The QCA welcomes the proposals to subject the regulators to enhanced transparency requirements which obliges them to explain how they have regard to public policy issues. This will allow Parliament to more effectively scrutinise the work of the regulators and will support effective engagement between the regulator and market participants and other stakeholders.

Q3 Do you have views on whether and how the existing general regulatory principles in FSMA should be updated?

Regarding the existing general regulatory principles as contained in section 3B of FSMA, we believe that principle 2 – the “proportionality” principle – should be reframed. Whilst we agree with the principle in its current format inasmuch as any burden imposed should be proportionate to the benefits, we do not believe that this goes far enough. There should instead be an extension of the principle of proportionality to take account of the relative burden of regulation on different market participants. The principle should include considering the relative impact of regulation on market participants of different sizes and complexities and determining whether the regulation should apply on a blanket basis covering all market participants, or whether it should just cover the largest and those with the most systemic influence.

Q4 Do you have views on whether the existing statutory objectives for the regulators should be changed or added to? What do you see as the benefits and risks of changing the existing objectives? How would changing the objectives compare with the proposal for new activity-specific regulatory principles?

We believe that the operating objectives of the FCA should include a requirement for the organisation to take into consideration economic growth and also be held to account for ensuring the future health of public equity markets.

Too often EU regulations have been brought in on a piecemeal basis and are not looked at on a holistic basis. MiFID II, MAR, the Transparency Directive, and the Prospectus Regulation have all been considered separately and have been applied without taking account of the existing UK framework such as the Financial Promotion Rules. The result of this is a patchwork of regulatory burden delivering a disproportionate burden for smaller listed companies as well as a detrimental impact on the quality of public equity markets.

Q5 Do you think there are alternative models that the government should consider? Are there international examples of alternative models that should be examined?

We have no comments.

Q6 Do you think the focus for review and adaptation of key accountability, scrutiny and public engagement mechanisms for the regulators, as set out in the consultation, is the right one? Are there other issues that should be reviewed?

It is essential that an enhanced framework for accountability, scrutiny and stakeholder engagement is developed in order to ensure that the regulators are accountable for their actions and all stakeholders are engaged in the policy-making process for new financial services regulation.

It is important that the development and implementation of financial regulation is properly scrutinised. If we expect to see a new wave of growth companies joining our equity markets and developing into significant contributors to our economy, any cost benefit analysis of a proposed regulation should be looked at with these companies in mind. The current weighting of the market where the largest 100 companies on the UK's markets account for 80 per cent of total market capitalisation² 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 growth companies can often be seriously detrimental to the UK's growth prospects. Therefore, any cost benefit analysis, by law, should be conducted on a segmented basis as well as looking at the market as a whole. As the UK has now left the EU, the regulatory regime must be less prescriptive and more agile than has been the case within the EU.

The regulators must be accountable and subject to an appropriate level of scrutiny. Additional mechanisms and controls are needed to ensure Government and regulators' policy decisions are made in the interests of the UK economy and that their actions in this regard are held to account. A framework should be established whereby both legislation and the performance of the regulators in looking at the market on a segmented basis are assessed. In addition to this, it is important to increase the transparency of Government and the regulators in their decision-making.

Q7 How do you think the role of Parliament in scrutinising financial services policy and regulation might be adapted?

The QCA believes that Parliament has an important role to play in influencing new financial services regulation in order to ensure that it is appropriate, fit for purpose and proportionate. However, in order to effectively influence financial services regulation, it is first important that Parliament develops a deeper understanding of public equity markets and the companies that operate on them.

Firstly, it is important 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.

By way of illustrating the size differences, we commissioned independent research provider, Hardman & Co., to conduct a study into the make-up of the UK's public markets. The study found that the largest 100 companies on the UK's markets account for 80 per cent of total market capitalisation, with the other 1,249 small and mid-size quoted companies accounting for just 20 per cent³.

The smallest company in the FTSE All-Share is just 0.025% of the size of the largest with a market cap of £27 million. The largest company has a market cap of £107,720 million⁴.

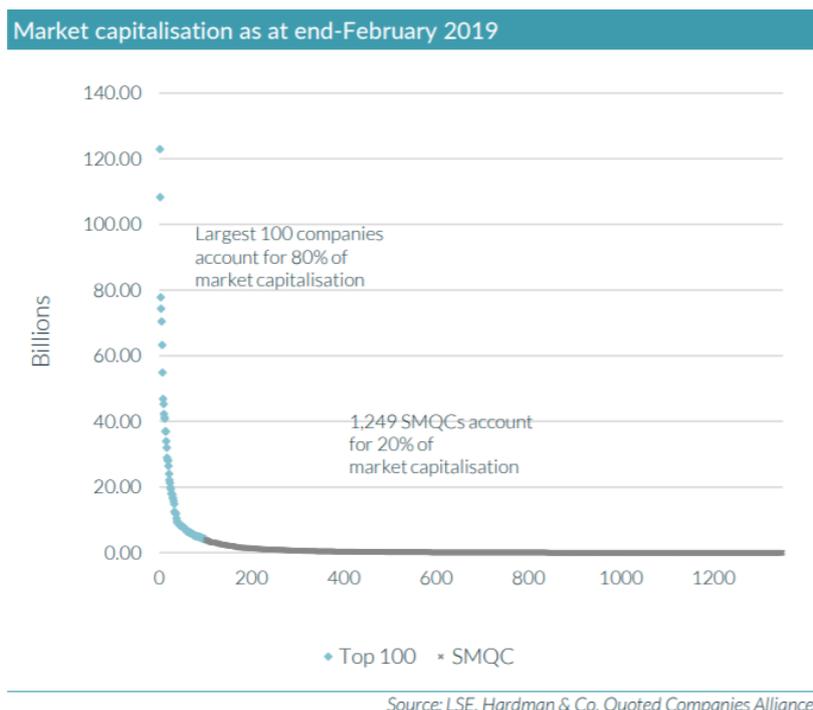
² Report by Hardman & Co. and the QCA, May 2019, *How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues*, <https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf>

³ Report by Hardman & Co. and the QCA, May 2019, *How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues*, <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>

⁴ FTSE Russell, January 2021, FTSE All-Share Indexes, available at: <https://www.ftserussell.com/analytics/factsheets/home/search>

These smaller companies too often find themselves needing to adhere to regulation that is targeted at larger companies but which encompasses them too, they are therefore overburdened. The significant volume of regulation, combined with a one-size-fits-all approach, has been enormously damaging to public equity markets in the UK in recent years. The overall decline in use of public equity markets in the last few decades is stark and deeply concerning.

This chart shows all companies quoted on London Stock Exchange's Main Market and AIM by market capitalisation. It illustrates the huge disparities in size between the largest 100 companies and the remaining 1,249 small and mid-sized quoted companies:



Secondly, it is important to stress the social and economic benefits of public equity markets. The UK should seek to celebrate and encourage the role of public companies and their significant contribution, both regionally and nationally, to the UK economy.

As we highlighted in our introductory letter, the significant contribution of public equity markets to private sector employment and the Exchequer's tax take. In addition to this, it is estimated that the small and mid-sized quoted company community alone directly employs nearly 1.5 million people outside London and across the UK's nations and regions⁵. This demonstrates their potential importance in addressing regional inequality, and creating jobs and wealth throughout the economy.

In light of this, the role of Parliament should be to influence new financial services regulation to ensure that any new requirements are proportionate. 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. Parliament 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 these

⁵ 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>

companies, and, ultimately, 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.

As already highlighted above in our response to Q2, we believe that there is merit in considering whether a relevant Minister should be required to report to Parliament annually as to the quality and integrity of the public equity markets. This would help to inform Parliament of the nature of markets as well as exert pressure on the market players to consider the social and economic benefits of the UK's public equity markets.

Q8 What are your views on how the policy work of HM Treasury and the regulators should be coordinated, particularly in the early stages of policy making?

The QCA believes that enhanced cooperation and coordination arrangements at an early stage in the policy-making process are welcome to ensure Ministers are able to feed into proposals before they are finalised for consultation.

However, it is important to ensure that upon publishing a consultation, the proposals contained within it are not final nor irrevocable despite having the input of Ministers. It is imperative that the proposals contained within it can be meaningfully scrutinised by stakeholders, with there being adequate scope for the proposals to be revised or rejected where there is significant feedback from market participants that those proposals would be detrimental overall.

Q9 Do you think there are ways of further improving the regulators' policy-making processes, and in particular, ensuring that stakeholders are sufficiently involved in those processes?

Yes – the QCA believes that there are ways of further improving the regulators' policy-making processes, and in particular, ensuring that stakeholders are sufficiently involved in the processes. Historically, the retrieval of feedback and information from entities and market participants at the smaller end of the market has been a challenge for the regulators.

Smaller listed companies find the existing regulatory framework unduly complex at times and can often find the implementation and application of regulation difficult.

For this reason, it is absolutely essential that the regulators take into consideration the needs of smaller entities and market participants during the policy-making process. The policy making-process must go further to ensure it has meaningfully and effectively consulted these stakeholder groups. This will go some way to making sure that regulation is flexible enough to accommodate entities of all sizes.