QUOTED COMPANIES ALLIANCE

Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

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

www.theqca.com

The European Securities and Markets Authority (ESMA)
CS 60747
103 rue de Grenelle
75345 Paris Cedex 07
France

19 February 2015

Dear Sirs,

ESMA Consultation Paper on Technical Standards under the CSD Regulation

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Secondary Markets Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Response

We welcome the opportunity to respond to this consultation. We have responded to the questions below that we believe will have an impact on our members, small and mid-size quoted companies.

Q6: What are your views on the proposed draft RTS related to the penalty mechanism? Do you agree that when CSDs use a common settlement infrastructure, the procedures for cash penalties should be jointly managed?

We agree that the proposed procedures for calculation of fines would create a relatively simple process to facilitate settlement.

We noted in our response to ESMA's Discussion Paper on the Draft Technical Standards for the Regulation on improving securities settlement in the EU and on CSD in May 2014 and continue to note that there needs to be flexibility in the settlement discipline for both shares on a SME Growth Market and also those equally less liquid shares on regulated markets.

We believe that ESMA should put forward an efficient settlement regime, while recognising that less liquid small and mid-size quoted company stocks both on SME Growth Markets and on regulated markets need this to be calibrated differently to ensure that they can continue to grow and create jobs throughout Europe.

In the UK, there are around 580 companies listed on the regulated market outside of the major UK indices with market capitalisations below £1bn, which are less liquid than the very largest companies. Furthermore, as noted in our response to ESMA's Consultation Paper on Technical Advice under the CSD Regulation, there is usually no active stock borrowing market for these less liquid shares.

As a result of ESMA's proposed Technical Standards, small and mid-size quoted companies could see liquidity in their shares drop dramatically if liquidity providers, such as market makers, are disincentivised from trading and making a market in these less liquid shares (which are likely to take longer to settle) through a severe penalty regime.

We agree that the charges/fees should not be extracted from the fine amount, but instead should be on a reasonable basis and not be profit-generating. We also agree that payments due to a CCP should traverse the CCP and be provided to the onward recipient from the CCP.

Q7: What are your views on the proposed draft RTS related to the buy-in process? In particular, what are your views on applying partial settlement at the end of the extension period? Do you consider that the partialling of the settlement instruction would impact the rights and obligations of the participants? What do you think about the proposed approach for limiting multiple buy-in and the timing for the participant to provide the information to the CSD?

Providing data on transactions to CSDs may assist in limiting the execution of buy-ins. This would need to be relatively systematic though to facilitate effective data provision and processing by the CSD. This must allow for any future purchase settlement to be used to satisfy the delivery. If a market maker provides liquidity over a period of time (i.e. sells short as obliged and cannot repurchase until a period later on, or similar situations regarding small and mid-size quoted company stocks that are unborrowable), they should not be penalised for this. While the penalty regime as proposed will not accommodate this, the buy-in regime should be the option of last resort.

We note that ESMA has not given indications as to how the auction will be conducted, which we believe could be open to abuse.

Q8: What are your views on the proposed draft RTS related to the buy-in timeframe and extension period?

As noted, we believe that ESMA's proposed Technical Standards and Advice do not take into account the illiquid nature of trading in small and mid-size quoted companies' stocks, and we urge ESMA to reconsider both its Advice and Standards.

We support that the buy-in mechanism period may need to be longer for less liquid securities. The execution period should be appropriate to facilitate the execution of buy-in trades without significantly impacting the market. ESMA should not allow buy-ins to have a distortive price effect, not representative of investment.

To achieve this, **we believe that SME Growth Markets, which are susceptible to more significant volatility due to the lack of liquidity, be granted a 15 day buy-in period**. We note the definition of SME used to define markets is inadequate and that the majority of companies have a market capitalisation below the €200m level set in MiFID II and do not have liquid shares. As such, we disagree with the logic applied within

paragraph 92 that the presence of 49.9% of potentially non-SMEs in a market negates the need for protection.

We do recognise, however, that liquid stocks should not be subject to such forbearance. Should a 15 day buy-in period be implemented, it is a necessity that the following points also be implemented, as failure to do so will exacerbate any market impact of the settlement penalty regime and potentially decrease liquidity in small and mid-size quoted companies:

1. **A pro-rated penalty schedule should implemented**, as outlined in our response to Q2 of ESMA's Consultation Paper on the Technical Advice under CSD Regulation. Failure to implement a pro-rated penalty schedule would increase the maximum fine for SME Growth Market securities.

2. **Failing participants should be entitled to intervene in the buy-in process where they have obtained adequate stock to satisfy the delivery obligation**. This achieves the objective of reducing the number of executed buy-ins. It also reduces the possible market impact from the penalty regime by preventing unnecessary buy-in execution.

ESMA's draft Technical Standards on cash penalties for failure in settlement will negatively affect the trading of small and mid-size quoted companies' securities. As noted in our response to Q2 of ESMA's Consultation Paper on Technical Standards under CSD Regulation, proposing a penalty of the same amount of basis points both for liquid and illiquid shares, while providing for a longer execution period, can result in higher total amount of penalties for illiquid shares (in addition to significant buy in costs and administrative costs). These added costs will act as a disincentive for liquidity providers to make a market and trade these less liquid stocks, such as those of small and mid-size quoted companies. This will have a wider impact on the market, with increased costs for retail investors and a further reduction in liquidity in small and mid-size quoted companies' stocks.

Small and mid-size quoted companies tend to have low free floats. We believe that the liquidity definition of free float should capture more stocks. With the current draft, ESMA is providing less incentive to trade those stocks. A broader definition would make it more likely to have an effective buy-in process.

We also note that, when the cash compensation phase is reached there is a great possibility for an abusive squeeze on price to occur, as the RTS is currently drafted. ESMA has provided very little detail on how cash compensation would work in practice and has provided no cap, which is not helpful, as we explain in more detail in Q10. We suggest that, where settlement is totally frozen in the market, then no cash compensation would apply.

Overall, we believe that ESMA's draft Technical Advice and Standards will create a less hospitable environment for small and mid-size quoted companies to raise finance on public equity markets.

Q10: What are your views on the proposed draft RTS related to the calculation of the cash compensation?

We are particularly concerned that the proposed cash compensation mechanism in less liquid securities will lead to short squeeze situations, either as a result of a natural technical situation or a deliberate case of market abuse.

Under various circumstances (such as market makers being obliged to sell naked short as permitted by the Short Selling Regulation, the stock being held tightly or insufficient liquidity), a market maker would likely have to increase the price of the stock to identify sellers. The price will continue to rise if no sellers come forward. In a correctly operating market, the buy-in will be impossible in these circumstances, as the market maker who is central to the market of the security has been unable to source stock. This leads to the cash compensation pay-out being based on a price generated by an short squeeze. We believe that there is a material risk of this becoming a significant feature of less liquid markets under the proposed regime.

We do not agree with the cash compensation mechanism as a means to settle trades on principle; however, we would like to note the right for buyers to keep the trade open during a 'deferral period'. ESMA has not consulted on which rules will be applicable to the deferral period. We would propose that the RTS formally prevents penalties applying in the deferral period so as to avoid abusive situations being even more profitable for the abuser. We believe that ESMA should give no incentive to maintain a trade other than the desire to receive the securities purchased.

Q14: Do you agree that 18 months would be an appropriate timeframe for the implementation of the settlement discipline regime under CSDR? If not, what would be an appropriate timeframe in your opinion? Please provide concrete data and evidence justifying a phase-in for the settlement discipline measures and supporting your proposals.

These rules will have an impact on investment firms, trading venues and CSDs and are to be enforced 18 months after the RTS are finalised. This means that the systems could be required to be up and running by 2016. We would like to point out that this could allow very little time for these systems to be designed and implemented accordingly, as they cannot be created before the requirements are known. This is particularly important as the regime will cover all markets, including SME Growth Markets.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Secondary Markets Expert Group

Simon Rafferty (Chairman)	Winterflood Securities Ltd
Jon Gerty (Deputy Chairman)	Shore Capital Group Ltd
Paul Arathoon Andrew Collins William Garner	Charles Russell Speechlys LLP
Jessica Reed	Farrer & Co
Mark Tubby	finnCap
Nick Anderson Clare Forster	Henderson Global Investors
Fraser Elms Katie Potts	Herald Investment Management Ltd
William Lynne Claire Noyce	Hybridan LLP
Peter Swabey	ICSA
Jeremy Phillips	Nabarro LLP
Ian Wright	Numis Securities Limited
Sunil Dhall Andrew Palmer	Peel Hunt LLP
James Stapleton	Winterflood Securities Ltd