



INSIDE AIM

Issue 3 - February 2011

WELCOME TO INSIDE AIM

Welcome to our third edition of Inside AIM.

This issue covers some common themes that are often raised with us by nomads.

In particular we focus on Rule 13, which is a key protection for AIM shareholders given that related party transactions are common in companies of the type and size typically found on AIM, and because directors and founders are often major AIM shareholders.

When considering this rule (as with all AIM Rules) nomads should keep in mind the underlying spirit in its application: the rule is designed to protect shareholders by ensuring that there is no exploitation or perception of exploitation of the close relationship between a related party and the AIM company.

Rule 13 does not require that related party transactions receive shareholder consent, the intention being to find a proportionate means to protect shareholders. This makes the nomad's role in assessing the fair and reasonable statement central to the underlying protection afforded by this rule.

This rule is a good example of how the nomad role is clearly different from other corporate finance advisory roles and requires nomads to exercise the delegated regulatory responsibility that has been given to them by the Exchange.

We trust that 'Inside AIM' continues to provide a useful source of reference for nomads.

Nilam Statham – Head of AIM Regulation

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AIM RULE 13 – RELATED PARTY TRANSACTIONS

Wording of fair and reasonable statements

The wording of the fair and reasonable statement as stated in Rule 13 should not be amended or caveated in any way, in either the same sentence or in surrounding paragraphs. Recently we have received requests from nomads to caveat the statement, something which is not acceptable. The rule contains the specific wording that must be used, to provide a consistent mechanism by which a transaction is assessed in lieu of shareholder approval.

Rule 13 derogation requests

We frequently receive requests to derogate on the requirement to provide a fair and reasonable statement on the basis that the transaction cannot be said to be the best possible one for a company or because the nomad feels unable to give such a statement. In particular, this appears to be a concern where the company is in a distressed situation.

Rule 13 requires a nomad to consider whether a transaction is fair and reasonable (with a view to protecting shareholders against the influence the relevant related party may have on the company) and it may not necessarily solely be a matter of considering whether it is the best deal that possibly could be made.

In circumstances where a related party transaction is being made in a distressed scenario or where few other options are available, shareholders arguably rely even more than usual on the confirmation that the transaction is fair and reasonable. Whilst the company might be in a difficult situation, nomads must consider carefully all of the reasonable options that are open to the company in the time available to it.

Lack of independent directors

In instances where there are no independent directors to provide the fair and reasonable statement, the nomad should contact AIM Regulation with a proposed alternative. Appropriate solutions can sometimes include the provision of a relevant statement by the nomad instead of the directors or shareholder approval of the transaction.

Directors' remuneration

In circumstances where directors are granted bonuses or options which are not part of their standard remuneration package, or where the terms of their remuneration package are revised, such transactions are caught by Rule 13 if they could be seen not to be within usual remuneration parameters. In addition, directors' participation should be aggregated in some situations, for example where there is a related option issued to directors.

RELEASE OF SCHEDULE ONE'S

We were pleased to see an increase in the level of Schedule Ones released towards the end of last year, something we hope continues throughout 2011 as market conditions continue to improve.

In the following FAQ we note some more routine matters that should be taken into account before submission of a Schedule One to help AIM Regulation release it in a timely manner.

We expect nomads to alert us well ahead of the submission of a Schedule One and ideally as soon as they become aware of any issue that might be of concern to the Exchange. In particular we expect nomads to highlight to us any individuals (directors, shareholders or key employees) who could cause the Exchange to question whether the reputation or integrity of AIM could be affected by the admission. Similarly, nomads should make AIM Regulation aware of applicants from jurisdictions or sectors that may be considered to carry a higher than normal risk.

We remind all nomads of the powers the Exchange has, pursuant to AIM Rule 9, to delay or refuse admission to AIM. Any potential issues of concern are therefore best dealt with at an early stage before significant work has been completed.

FAQ

Q. What are some of the matters I should be aware of before submitting a Schedule One?

A. Some matters to be aware of are:

Omitting data required by the form: only the following fields can be left as TBC:

- Details of securities to be admitted including any restrictions as to transfer of the securities (except the type of shares);
- Capital to be raised and market capitalisation (however an accurate estimate must be disclosed to AIM Regulation);
- Percentage of securities not in public hands (however an accurate estimate must be disclosed to AIM Regulation);
- Significant shareholders post admission (pre-admission shareholders must be included and any changes can be notified in a Schedule One update).

Accounting reference date: any changes to the company's financial reporting timetable including where stub periods will be reported on must be agreed with AIM Regulation at the point the Schedule One is submitted or prior to admission. This ensures the market is clearly informed about what financial information it can expect to receive and when.

Release of the form: nomads should not expect a Schedule One to be released immediately or at a specified time and should submit the form with sufficient time for any issues to be discussed with AIM Regulation. AIM Regulation does not review draft Schedule One forms, so please only submit final form documents in good time ahead of desired release.

AIM RULE 10 AND 11 – DEALING WITH INSIDERS

Compliance with the general disclosure Rules 10 and 11, which must be considered in conjunction with each other, is crucial to ensure the market is updated accurately and in a timely manner to avoid the risk of a disorderly or false market.

In Market Watch 37 (Sept 10), the FSA commented on the need to prevent information leaks. In addition to market abuse requirements AIM Rule 10 requires that regulatory information required by the AIM Rules is not published elsewhere before it is formally notified. AIM companies are expected to keep confidential impending developments and matters in the course of negotiation and must ensure they have in place effective systems and controls to ensure confidentiality of price sensitive information and prevent the risk of a leak (pursuant to AIM Rule 31).

Nomads to those AIM companies having dual quotations need to be particularly mindful of this requirement, given the two sets of rules the companies must comply with.

We expect nomads to monitor their AIM clients' share prices and trading volumes especially when there are forthcoming regulatory announcements to be made for significant events and they should have draft holding announcements prepared in advance to discuss with AIM Regulation should a potential leak situation arise.

Furthermore, care needs to be taken when AIM companies are making progressive updates about a matter that is yet to be concluded, to ensure that AIM Rules 10 and 11 are complied with and a misleading impression of the status of the matter is not given. The sequence of events which needs to occur before final conclusion/results/settlement must be clearly explained.

NOTE

Change to standard suspension and restoration times

Please note that AIM Regulation now usually suspends and restores AIM companies from 07:30hrs rather than 07:00hrs. We are still able to suspend and restore AIM companies intra-day where deemed appropriate. Usual practice is for a company's announcement about either of these events to occur at the same time as suspension / restoration, however if a nomad considers the market requires more time to assess the information an announcement can be released at 07:00hrs followed by our suspension/restoration notice at 07:30hrs. This should always be pre-agreed with AIM Regulation.

AIM RULE 14 – SUSPENSION ON ANNOUNCEMENT OR LEAK OF A REVERSE TAKEOVER

Our approach towards suspending companies pursuant to Rule 14, which are in the process of a reverse takeover that has leaked or been announced, has not changed despite amendments to the UKLA's approach for listed companies as communicated in LIST! 25 (July 2010).

If a reverse takeover has been announced or leaked, the requirement remains that an admission document must be published in respect of the enlarged AIM entity in order to avoid suspension of the company's shares. We have not changed this approach and continue to require audited financial information on the target.

It continues to be the case that we will not suspend an AIM company if the target is on the Main Market or is another AIM company. If the target is on an AIM Designated Market or other EU Regulated Market we will consider maintaining continuous trading where the nomad can demonstrate that information equivalent to that required by an admission document is publicly available, in English. In such circumstances the admission document for the enlarged entity can then be published at a later date. However, if only part of the target is being acquired suspension may still be required, depending on how the target's results have been presented. AIM Regulation should be contacted in advance in all cases to ascertain whether suspension is required.

The different nature of most companies on AIM from those on the Main Market means that a different approach remains sensible. Factors such as the market impact of a leak of information or a suspension, the nature of information available on a target entity and the requirements for admission documents (versus a prospectus) all differ for AIM compared to the Main Market.

FAQ

Q. When concluding queries and derogation requests, is AIM Regulation bound by precedent to follow previous decisions?

A. No. AIM Regulation deals with matters on a case-by-case basis. Nomads are welcome to make reference to previous cases but should not assume that the outcome will be the same in every case. Whilst previous decisions are considered to ensure consistency, the merits of each case are considered separately and our decision making takes into account wider policy decisions.

AIM RULE 15 – INVESTING POLICIES

Companies which become Rule 15 investing companies following a fundamental disposal must ensure their investing policy complies with the AIM Rules.

We are aware that some Rule 15 companies may be adopting a policy to develop organically into a trading business. This does not comply with the overall requirement that an investing company must have as its primary business or objective, the *investing* of its funds in securities, businesses or assets of any description. Rule 15 companies are not able to avoid the reverse takeover rules by seeking to implement a policy to develop into a trading business in small incremental steps. An investing company which wishes to become a trading company should either make an acquisition or acquisitions which constitute a reverse takeover or cancel and seek re-admission as a new operating entity.

FAQ

Q. What details about a QE applicant's role on a Relevant Transaction should be included in an NA2 application?

A. A nomad should ensure that sufficient information is included on an NA2 application in order for the Exchange to assess an applicant's role and responsibilities on the transactions cited.

The "details of work undertaken by applicant" section should detail the main tasks the applicant was responsible for, tailored for each transaction cited (as it is rarely the case that an applicant will have performed exactly the same tasks on every transaction cited). Reference to some of the key areas set out in Schedule 3 of the Nomad Rules is often helpful.

The role and responsibilities of the QE, or any other senior individuals involved in the transaction, should also be stated.

Where the nomad firm was engaged in a joint role, eg joint sponsor, please also indicate the areas of responsibility that each firm took.

AIM RULE 3 – WORKING CAPITAL STATEMENT IN ADMISSION DOCUMENTS

The working capital statement specified by Schedule Two and required to be included in an admission document pursuant to AIM Rule 3, requires the directors to confirm that, in their opinion having made due and careful enquiry, the working capital available to it and its group will be sufficient for its present requirements, that is for at least twelve months from the date of admission of its securities. We should like to make it clear that, similar to the statement required by Rule 13, amendments and caveats to this statement are not permitted.

FAQ

Q. Can we obtain a derogation from the need to perform a site visit to a potential new MO&G AIM client for example if there are no physical assets to see or if a Competent Person has visited the site on the Nomad's behalf.

A. No derogation is given in these situations. The matter is for the nomad to determine. Site visits are part of the nomad's due diligence and we cannot derogate on due diligence requirements. We generally expect a nomad to conduct a site visit as indicated in the Nomad Rules (AR1) and the Guidance Note for Mining Oil and Gas Companies. However, there may be circumstances (which would be exceptional) when the nomad needs to decide whether a site visit is possible in order for it to conclude on an applicant's suitability. The conclusions from all visits should be documented and similarly where a nomad has concluded that a site visit is not reasonably possible, or rarely where it is not required, a record should be made noting the reasons supporting that decision.

NOTE

Nomad change of control

Nomad firms that are considering any significant change of ownership, including a change of control or sale of assets, are reminded of the need to make advance notification of any potential material changes under Nomad Rule 13. In cases where a change of ownership is being contemplated, the Exchange will consider whether the overall group entity of which the Nomad firm will be part will continue to meet the criteria, including having a 2 year corporate finance background and an appropriate reputation, in order for Nomad status to continue. A Nomad licence cannot be 'sold' or transferred but is individual to a firm in its current form. The Exchange has the ability to remove Nomad status if it believes the firm no longer meets the criteria, and so early liaison with AIM Regulation on any proposed changes in ownership is vital to ensure firms' continuing eligibility.

INVESTIGATIONS & ENFORCEMENT UPDATE

Since Issue 2 of Inside AIM (July 2010), one AIM company has been privately censured and fined by the AIM Executive Panel for breaches of AIM Rules 10, 11, 22 and 31. Points of interest in this case are:

- The AIM company released an announcement confirming that further to its previous release it was still expecting to meet market expectations. However, at the time of its announcement the company was in possession of additional material information which if disclosed would have affected the import of that announcement. AIM companies and their nomads should ensure that all relevant facts are included in announcements (per Rule 10).
- Although aware of material trading under-performance, the AIM company failed to update the market about the significant change in the financial performance of its business for at least 2 months.
- Despite the fact that the board was aware of the material underperformance, the AIM company confirmed to its nomad on numerous occasions that it was still on track to meet market expectations.

In this case, the final sanction imposed was a fine of £5,000 and a private censure, a size of fine which reflected the AIM company's extremely poor financial condition.

It is important to note that in other circumstances AIM Regulation expects that the AIM Executive Panel would have imposed a more severe sanction for these rule breaches including a fine in the region of £75,000 and potentially a public censure, to reflect matters such as poor co-operation by the AIM company during the investigation and difficulties caused by the provision, on a number of occasions, of incomplete and misleading information.

The Exchange would emphasise that it expects AIM companies and nomads to deal with it in an open and honest manner as supported by the Nomad Rules and takes a breach of this obligation seriously.

AIM POLICY UPDATE

THE UK FUNDING ENVIRONMENT

In July, the Coalition Government published its green paper on *Financing a private sector recovery*. The consultation recognised the importance of small and growing businesses to the UK's economic recovery.

Our response to this highlighted the importance of equity finance for smaller businesses and included a number of policy recommendations to help ensure that such companies can efficiently access the capital they need to grow:

- *Capital gains tax regime:* A reduced CGT rate or roll-over relief for capital gains on investment in companies on growth markets would not only boost liquidity but also encourage investors to re-invest their gains into smaller companies creating a more vibrant market for the longer term.
- *Venture Capital Trust scheme:* Allowing VCT participation in the secondary market would provide urgently needed liquidity through funds that are already accounted for by the Treasury, while increasing the gross assets limit on investee companies from £7 million to £15 million and the employee test limit from 50 to 250 employees would make investment capital available to a wider pool of growth companies.
- *ISAs:* To bring a wider set of investors and boost liquidity in the secondary market, the Exchange called for ISA rules to allow investment in unlisted companies, like those on AIM.
- *Stamp Duty:* Phasing out or abolishing Stamp Duty as part of a five year corporate tax strategy would further boost the efficiency of equity markets for UK companies, savers and investors. As a reduced measure, the Exchange would welcome a targeted abolition of Stamp Duty for SMEs as a means of supporting growth companies' access to equity capital.
- *Regional finance:* We highlighted the need to understand at what level and stage of development regional businesses struggle to raise capital and the importance of ensuring a central pool of investors and liquidity to ensure efficient access to capital.

The Government published its response on 1 November 2010, recognising the importance of ensuring businesses continue to have access to appropriate and diverse sources of finance at different stages of their business life cycle. Going forward, it will seek to expand the support available to SMEs; extend existing tax schemes; and help bring together investors and businesses.

We expect more specific details around tax policies to be announced in the Budget statement expected on 23 March 2011. Our Budget submission made on 4 February repeats many of the above recommendations and highlights their relevance to the wider UK funding environment and growth agenda.

PROSPECTUS DIRECTIVE REVIEW

In its response to *Financing a private sector recovery*, the Government has also committed to early implementation of the following amendments to the Prospectus Directive (PD):

- The consideration limit of offers to which the Directive does not apply is to increase from EUR 2.5 million to EUR 5 million.
- Increase in the limit of natural / legal persons to which an offer can be made without the requirement to publish a prospectus has increased from 100 to 150.

This is a hugely positive outcome following our extensive lobbying efforts first at the EU level to amend the PD (Level I) and subsequently at the UK level to ensure earliest implementation as part of the Government's efforts to help smaller companies raise capital efficiently.

We also continue to feed into the further development of the amended PD at the EU level, in particular to the request for technical advice by the European Securities and Market Authority on the delegated acts of PD (Level II). Most relevant to AIM companies, these will include details on the proportionate disclosure regime in relation to offers by companies whose shares are already admitted to trading on a regulated market or Multi-lateral Trading Facility provided that the issuer has not disapplied pre-emption rights. The deadline for this call for evidence is on 25 February and the formal consultation is planned for July 2011.

MIFID CONSULTATION

The recently closed EU Commission review of MiFID recognises the role of existing specialist SME markets and asks whether a new definition of 'SME market' and framework for such markets under MiFID would be welcome.

Given the primary and secondary market functions provided by such SME markets, we agree that their default regulatory status as Multi-lateral Trading Facilities (MTFs) does not appropriately reflect their function. We would therefore welcome a new definition of an 'SME market' on the basis that a separate regime would help increase investor interest in SMEs as an asset class rather than seeking to reduce disclosure and transparency requirements.

It is also critical that an SME market framework allows appropriate flexibility at a Member State and market operator level to enable domestic markets to account for local practices.

At this stage, our suggestion to the Commission is to bring together an industry group of exchanges that operate growth markets or who would be interested in doing so, together with the investor and advisory community.

The Exchange's full response to the consultation can be found at:

<http://www.londonstockexchange.com/policy>

If you would like to feed into our lobbying efforts at the UK or European level, please contact Umerah Akram at uakram@londonstockexchange.com.

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Please note requests for derogations from the AIM Rules should be submitted in writing (including email) from the company's nomad.

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REGULATORY STATUS OF INSIDE AIM

The guidance provided in this newsletter should be regarded as illustrative only. It is intended to give an indication of how AIM Regulation would usually expect certain aspects of the AIM Rules to be interpreted and this guidance is not definitive or binding. AIM Regulation should be contacted by a company's nomad if clarification or derogation from the rules is required in a specific situation.

Furthermore, AIM companies should continue to seek the guidance of their nomad when considering the application of the AIM Rules.

Any amendments to existing AIM Rules will continue to be communicated via AIM Notices and will be subject to the usual public consultation process where appropriate. Amendments to our rules will not be introduced through Inside AIM.

FEEDBACK

We would welcome any feedback on this edition of Inside AIM and any suggestions for issues that you would like us to address in future editions.

Please email any comments to:
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