



INSIDE AIM

Issue 5 – October 2012

WELCOME TO INSIDE AIM

Welcome to our fifth edition of Inside AIM. In this edition we have focussed on some of the matters relevant to a nomad's consideration of directors, in particular: directors' education; directors' due diligence; and directors' participation in fundraisings.

For ease of reference we have created an index of all rules covered by Inside AIM which can be found together with previous editions of Inside AIM at:

www.londonstockexchange.com/companies-and-advisors/aim/advisers/inside-aim-newsletter/inside-aim-newsletter.htm

EDUCATION OF DIRECTORS ON THEIR AIM RULES OBLIGATIONS

Given the diversity of experience within AIM company boards, education of directors about their AIM Rules obligations can have a hugely beneficial impact on the ability of the board to ensure a robust compliance culture and in mitigating the risk of AIM Rules breaches. For this reason, a nomad is required to ensure an appropriate level of education is provided to directors on their AIM Rules responsibilities.

We would encourage nomads to approach directors' education in a practical and meaningful way, tailoring it to the individual characteristics of each board so that the education can be as effective as possible. We set out below some non-exhaustive guidance:

- As a starting point, the approach to directors' education should be of the same standard whether for new admissions, take-on of existing AIM companies or in relation to the appointment of new directors to existing AIM company clients. For example, a nomad should still undertake an education exercise with the directors of an existing company it is taking-on and not simply make the assumption that the outgoing nomad will have done this previously; it is the incoming nomad that is giving the nomad declaration and it needs to satisfy itself.

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- The education should be led by the nomad so that the nomad can satisfy itself as to the level of understanding and needs of that particular board. We would hope this also presents a nomad with a good opportunity to get to know its client further and establish the basis of their working relationship for the future so that each understands their respective roles.
- In all cases (whether admission or take-on) the nomad should make an assessment as to the most effective way of ensuring that the directors understand their responsibilities. We would suggest that ordinarily this will involve 'in person' education and discussion by the nomad.
- It has occasionally been suggested to us that the education of directors is not always necessary, or may be satisfied by way of an emailed written presentation, on the assumption that directors of an existing AIM company have previous AIM experience and sufficient knowledge and understanding of the AIM Rules. We do not agree this assumption is universally true but do recognise that there may be limited occasions when a nomad may reasonably decide this is sufficient. In such circumstances the nomad should be able to demonstrate to the Exchange how their approach is appropriate and reasonable.
- Education is more effective when it is tailored and the requirements of the individual directors and the board as a whole have been taken into consideration, with appropriate emphasis given to matters such as the size of the board and roles and experience of individual directors. Consideration should also be given to the AIM Notes for Mining and Oil & Gas Companies, and Investing Companies where relevant, and the differences between AIM and other exchanges for dual-listed companies.

DUE DILIGENCE ON AIM DIRECTORS

The nomad's judgement regarding the appropriateness of a company for AIM has a crucial role to play in maintaining the quality of the market. Accordingly, the quality of due diligence on directors and the substantive judgements applied by a nomad in assessing such information is vital.

We set out some general guidance here but would also refer nomads to the important guidance contained in AIM Notice AD11.

Undertaking meaningful due diligence:

- As a starting point, directors' due diligence procedures should be applied consistently for an AIM admission, the take-on of an existing AIM company from another nomad, and the appointment of a new director to an existing AIM company client.
- Due diligence on directors should be a substantive tool in assessing appropriateness rather than a function which is undertaken merely for the purpose of completing a regulatory process.
- Due diligence on directors should be based on a nomad's reasonable judgement as to what information it requires in order to make an informed decision on an individual's suitability to be a director of an AIM company. We refer to AR2 of Schedule Three of the Nomad Rules when considering this.
- We would expect nomads to use a range of sources when undertaking due diligence including a suitable director's questionnaire, web-based general searches, Companies House or similar overseas checks, interviews, reviewing references etc. The nomad should evaluate this information and consider whether it is appropriate to undertake further due diligence from independent sources such as via diligence companies.
- For overseas directors particularly, we would expect it to be the norm rather than the exception for a nomad to undertake third party due diligence. The objective of third party due diligence is to provide substantive and reliable independent information which will be beyond what nomads are able to ascertain from desktop searches.

APPLICATION FORMS

When applying for admission of new companies and / or further issues of shares to AIM, please ensure the latest forms and documents are used. Submitting old forms may cause a delay in the application process. The current forms are available to download from the Exchange's website.

Delays to admission are likely to occur if forms are not submitted in time. Accordingly, a nomad should contact the Admissions Team as soon as possible where an application might be lodged late to understand the implications to the admission timetable.

Consideration of due diligence:

- Having gathered the results of a due diligence exercise, a nomad should take a step back and consider all the issues arising from the information it has assembled.
- There should be an appropriate forum within each nomad firm where risks are identified and the issues substantively considered and challenged by experienced members of the firm who are independent from the transaction team, where possible.
- Where issues of concern are raised from due diligence, a nomad must reconcile those concerns by way of further reasonable enquiry and upon a verifiable basis.
- If any concerns arise that cannot be reconciled, a nomad should consider how they impact upon appropriateness. It is of key importance that if the concerns are material and cannot be resolved, then a nomad may be unable to conclude that the individual is suitable to be a director. Depending on the circumstances, this may extend to concerns that remain unproven.
- In circumstances where a nomad is required to conduct due diligence into substantial shareholders or an individual able to exert significant influence or control over the company, the principles regarding due diligence on directors above can be equally applied as guidance.

DIRECTORS' PARTICIPATION IN A FUNDRAISE

Where a forthcoming fundraising itself constitutes unpublished price sensitive information the company will be in a close period and Rule 21 will apply in relation to dealings by directors and applicable employees. In this context, the commitment to deal prior to any announcement will constitute a "deal" as defined by the AIM Rules.

In such instances, and where the company has satisfied all other relevant legal requirements, the company's nomad may seek a derogation from Rule 21 from AIM Regulation in advance, in order to enable directors and applicable employees to participate in the fundraising. It should be noted that AIM Regulation routinely grants derogations from Rule 21 in the following circumstances:

- where the only existing close period is due to the fundraising itself; or
- where the company is in a close period for accounts provided those accounts do not contain unpublished price sensitive information; or
- where the company is in a close period in connection with a transaction which is inextricably linked to the fundraising, such as an acquisition for which the fundraising is being undertaken, provided announcement of all matters such as the fundraising, acquisition and dealings by directors or applicable employees take place concurrently.

Please note that notwithstanding the above, AIM Regulation will still consider each submission for a derogation on a case by case basis. When making a submission to AIM Regulation, nomads should supply some brief background to the fundraising including for example:

- whether the directors or applicable employees will participate in the fundraising on exactly the same terms as the other investors; and
- whether the company is in a close period for any other reason apart from the fundraising itself (e.g. for accounts or a corporate transaction) together with details of any such matter; and
- whether the investors in the fundraising require the directors to participate.

A nomad will also need to consider the implications of Rule 13 (related party transactions), Rule 16 (aggregation of transactions) and Rules 18 & 19 (interim and annual accounts) in respect of any directors' participation in a fundraising.

CAPITAL REORGANISATIONS

When an AIM client company is undertaking any form of capital reorganisation, nomads are reminded that they should contact Stock Situations, in accordance with AIM Rules 24 and 25, in order to clarify the company's corporate action obligations. Please also note that an application for admission of shares arising from such an event needs to be lodged with the Admissions Team.

CLOSE PERIODS FOR ACCOUNTS

Further to the publication of *Inside AIM, Issue 4*, a number of nomads have requested agreement to end a close period for accounts upon the publication of preliminary results. AIM Regulation is routinely able to agree this. To assist nomads we have set out below some further guidance in relation to common questions we have received:

- If a company ends its close period for accounts at the point of notification of preliminary results (with the prior approval of AIM Regulation), the directors will still need to consider whether the company remains in a close period by reason of it being in possession of any other unpublished price sensitive information.
- Regardless of whether a company has published preliminary results, if a company fails to publish its annual audited accounts within 6 months from the end of the financial period to which they relate, the Exchange will suspend trading in that company's AIM securities in accordance with Rule 40. AIM Regulation should be contacted as soon as possible by the nomad if this is a possibility.
- If a company is intending for its preliminary results to end the close period for accounts (having sought prior approval from AIM Regulation), the directors and / or applicable employees should not have dealt in the company's AIM securities in the two months prior to the intended notification of the preliminary results. This does not override the prohibition on dealing for any extended period where the company is in a close period due to the possession of any other unpublished price sensitive information. Accordingly, it is important that an AIM company determines its financial reporting timetable at any early stage so that directors and applicable employees are clear about the timing of the close period for accounts.

Where a nomad is in any doubt about the application of the close period rules for accounts, it should contact the AIM Regulation team for further guidance.

AIM RULE 41 – CANCELLATION OF AN AIM COMPANY

Rule 41 outlines the circumstances in which a company can cancel its admission from AIM and requires, amongst other things, that cancellation is conditional upon the consent of not less than 75% of the votes cast by the holders of AIM securities in a general meeting.

The threshold is set to ensure that shareholders cannot seek to take a company off market without the support of a 75% majority.

The cancellation of a company from market can have a significant impact upon shareholders, especially where there is no comparable dealing facility in place and accordingly the company and nomad should be mindful the importance of Rule 41 in protecting the rights of shareholders, together with the underlying spirit of the rule.

Comparable dealing facilities

Pursuant to the Guidance Notes to Rule 41, AIM Regulation may use its discretion to waive the requirement for shareholder consent if an AIM company's securities will continue to be traded on a comparable dealing facility. For example, an EU Regulated Market.

The waiver is not an automatic carve out and a submission to AIM Regulation is required from the nomad. AIM Regulation will take into account all the relevant circumstances including, for example, the cancellation policy of the other dealing facility and the stated intentions of the company to remain trading on that dealing facility.

Local legislation

A company admitted to AIM must take care to ensure that it can comply in full with its AIM obligations, including Rule 41. Any less stringent rules which may

apply under the laws of another jurisdiction do not override Rule 41. Accordingly, where local laws do impact, nomads should seek to ensure that where possible, a company's AIM obligations are enshrined in its constitutional documents (pursuant to Nomad Rule 14).

Takeover offers

Where an AIM company is the subject of a takeover offer which requires less than 75% of its shareholders to accept the offer for it to become wholly unconditional, holders of AIM securities must still pass a vote of at least 75% in favour in order to cancel from AIM in order to comply with Rule 41.

Members' Voluntary Liquidation

AIM Regulation will consider requests to waive the shareholder consent requirement in Rule 41 where 75% of votes cast at a general meeting of the company are required to approve the appointment of the liquidator *and* the fact that approving the Members' Voluntary Liquidation will result in cancellation of the company.

Twenty business day period

The Exchange does not provide derogations from the full twenty business day requirement. The twenty business day period cannot start running until a company has notified both the Exchange and the market of its intention to cancel. This is an important protection for shareholders.

Schemes of arrangement

A nomad should consider the guidance in *Inside AIM, Issue 2 (page 2)*, as regards schemes of arrangement.

If in doubt, a nomad should contact AIM Regulation at the earliest opportunity for guidance on the application of Rule 41.

NOMAD NOTIFICATION REQUIREMENTS

We would like to remind all nomads of the requirements of Nomad Rule 13, in particular the requirement that a nomad must inform AIM Regulation as soon as possible of any matters that may affect it being a nomad. This includes, for example:

- any material adverse change in its financial or operating position; or
- any changes in controlling shareholders or partners (see *Inside AIM, Issue 3* for further details); or
- receipt of any written warning or disciplinary communication from another regulator.

INVESTIGATIONS & ENFORCEMENT UPDATE

Public Censure

On 21 December 2011, the Exchange issued a public censure within AIM Notice AD11. The Exchange's case related to two key areas of the Nomad Rules:

- a nomad's obligation to provide advice and guidance to an AIM company in respect of its obligations to make announcements without delay, specifically relating to its changing financial situation and liabilities; and
- a nomad's obligation to the Exchange to undertake adequate due diligence and to properly assess the appropriateness of a company seeking admission to AIM.

In light of the key issues arising from AIM Notice AD11, we have set out some further guidance relating to due diligence on directors above on page 2.

To assist nomads, we also set out below some guidance in relation to the contact between a nomad and its AIM clients:

Contact between AIM companies and their nomads

The quality of a nomad's communication with its AIM company clients is an important aspect of the AIM regulatory framework and the obligations are set out in OR1 of Schedule Three of the Nomad Rules. Regular contact with an AIM company enables the nomad to keep up-to-date with the company's developments and also allows it to be satisfied that the company continues to understand and comply with its obligations under the AIM Rules.

The level and nature of contact with AIM clients is something we leave to nomads to determine on a case by case basis. Where a nomad has active and meaningful contact with its clients, then it should follow that in circumstances where a company's financial position is deteriorating, the nomad will be well placed to assist the company to fulfil its regulatory obligations to make timely and full disclosure to the market.

By way of general guidance, AIM Regulation would usually consider the following to be relevant:

- The nomad should consider asking pertinent questions of the board and consider requesting further information particularly where 'red flags' or concerns are raised by those discussions.
- A nomad should consider following up on matters or requests for information in a meaningful way.

- When reviewing notifications, we would encourage a nomad to consider in particular the spirit and underlying purpose of Rules 10 and 11, which are intended to provide a clear and meaningful update to the market. Nomads should advise their AIM clients to update the market on or before the expiry of any previously notified deadlines as previously set out in *Inside AIM, Issue 1 (page 7)*.
- In cases where an AIM company's financial position looks uncertain, or where a company cannot make an announcement which fully complies with Rule 10, nomads should contact AIM Regulation for guidance.

Private Censures

Two AIM companies have been privately censured and fined a total of £120,000 by the AIM Executive Panel. Both cases demonstrate the seriousness with which the Exchange views the failure of an AIM company to properly communicate with its nomad.

Case 1

The private censure against one of the companies involved an £80,000 fine for breaches of Rules 3, 10, 11, and 31. In summary:

- In breach of Rule 3, the historical financial information in the company's admission document failed to disclose significant loans to a third party that was a related party prior to admission.
- After admission, the company continued to provide loans to the third party. In breach of Rules 10 and 11, these loans were not properly disclosed in the company's notifications.
- In breach of Rule 31, the company did not inform its nomad about the continued funding for a substantive period after admission. The Exchange did not accept the company's argument that it was justified in breaching Rule 31 based on legal advice and would note that Rule 31 clearly requires a company to seek guidance on regulatory matters from its nomad.

Case 2

A second private censure involved a £40,000 fine for breaches of Rules 10 and 31. In summary:

- The company had received urgent enquiries from its nomad regarding press speculation and a corresponding rise in the company's share price. In response to these enquiries, the company

confirmed to its nomad that there were no new developments or corporate activity to announce.

- However, at the time of the nomad's enquiries, the company was undertaking a transaction that constituted unpublished price sensitive information (the "Transaction"). In breach of Rule 31, the Company failed to (i) let the nomad know about the Transaction upon being asked the specific question whether there were any undisclosed corporate transactions in the context of a price movement and (ii) further had failed to inform the

nomad previously that it had been in discussions to imminently close the Transaction.

- In breach of Rule 10, a misleading notification was issued (with no reference to the imminent Transaction) which created the impression that the company had no news to announce. The Transaction was completed and was disclosed in a notification soon after. The news was accompanied by a significant change in the company's share price.

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

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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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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.