Rights and Accountability in Development

AIM's proposed new *Disciplinary and Appeals Handbook*

Response to consultation

September 2018

Introduction

Rights and Accountability in Development (RAID) is a UK based non-governmental organization which promotes responsible conduct and respect for human rights by companies in Africa and around the world. RAID has published three detailed reports raising serious concerns about non-compliance by AIM mining companies.[1] RAID's 2017 report *'Bribery in its purest form': Och-Ziff, asset laundering and the London connection,* details how AIM companies were instrumental in a corruption scheme in the Democratic Republic of Congo (DRC), as set out in an action bought by the US Department of Justice under the Foreign and Corrupt Practices Act against the Och-Ziff hedge fund. Och-Ziff, in collaboration with its DRC partner, had used AIM to consolidate corruptly acquired assets. The same AIM companies had routinely flouted the AIM rulebooks.

RAID responded to the Exchange's July 2017 review of its rulebooks, advocating a root and branch overhaul of the AIM regulatory regime.[2] Nominated advisers ('nomads'), with vested interests, have proved unwilling or unable to prevent a series of scandals on London's junior market while AIM Regulation and the Exchange have failed to intervene directly or publicly in the vast majority of cases where the rules have been broken. RAID and other advocacy groups were disappointed by the minimal nature of the revisions finally confirmed by the Exchange, which broadly boil down to a new rule and guidance on early notification to consider 'appropriateness' and a rule to 'comply or explain' against a recognised corporate governance code.

As part of the consultation, the Exchange sought views on disciplinary measures and is seeking comment on the detail of proposed changes to its *Disciplinary Procedures and Appeals Handbook* ("the Handbook"). The context for the proposals is clearly set out by the Exchange in its response to the consultation and in its notice about the revised Handbook:

> Respondents supported the current approach, allowing London Stock Exchange to determine the appropriate course of disciplinary action based upon the circumstances of an individual case. [*AIM Rules Review - Feedback Statement & Consultation*]
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> The proposed changes to the Handbook...are not intended to represent a change to our overall approach to investigation and enforcement. [*Consultation on changes to the AIM Disciplinary Procedures and Appeals Handbook*]

[1] *Questions of compliance: The Conduct of the Central African Mining & Exploration Company (CAMEC) plc and its Nominated Adviser, Seymour Pierce Limited* (June 2011), http://www.raid-uk.org/sites/default/files/aim-submission.pdf, a comprehensive 162 page submission on CAMEC and its nomad covering some 78 issues of non-compliance; *Asset Laundering and AIM: Congo, corporate misconduct and the market value of human rights* (July 2012), http://raiduk.org/docs/AIM/AIM_Report_2012.pdf concerning regulatory compliance of certain London-traded mining companies and; *'Bribery in its purest form': Och-Ziff, asset laundering and the London connection* (January 2017), http://www.raiduk.org/documents/ozbriberyinitspurestformfullreport-pdf.

[2] *Overhauling AIM: Submission to the AIM Rules Review* (September 2017), http://www.raid-uk.org/sites/default/files/raid_submission_to_aim_rule_review.pdf.

The Exchange had asked an open-ended question on 'other changes to the Disciplinary Handbook that you think London Stock Exchange should consider'. RAID previously urged that all breaches by nomads be made public to end the private censure of both nomads and companies behind closed doors. We also called for transparent procedures on the handling of complaints, including to support the standing given by the Exchange to third parties and the public in submitting complaints on company and nomad conduct and compliance with the AIM rules. Proposals included in the consultation on the introduction of automatic fines for the breach of AIM rules were rejected.

The detailed revisions proposed in the Handbook are given further consideration below. RAID's view is that the key changes proposed by the Exchange help to clarify procedures, but they do not result in increased public acknowledgement of wrong-doing in order that companies and their advisers are held to account.

The Exchange acknowledged in its response to the consultation that '[p]ublicising outcomes of material disciplinary cases was also supported'. However, while the Exchange will now name those who break the rules in contested cases, the new Handbook also provides for fixed and attractive discounts on any fines for those who settle early, while retaining the option for private censure (as well as a whole host of 'initial steps' – discrete interventions behind closed doors).

The Exchange has described the AIM rulebooks as 'providing comprehensive standards of disclosure', stating that it is this very disclosure that 'enables investors to fully understand the businesses in which they are investing and the relevant risks attached to such investments'.[3] Yet, when it comes to disclosure of the most vital information to investors, concerning breaches of the rules and misconduct and the serious risk this represents, the Exchange itself has codified and written into the Handbook the means to withhold such information.

Not only is this secretive approach out of step with the stance adopted by other regulators (see below on the Financial Conduct Authority's move to curtail private censure), but it ultimately allows companies with opaque and dubious controlling interests to use AIM to attract investment while, for example, engaging in fraud or laundering illicitly acquired assets (including those secured through bribery), with little risk of exposure under AIM's opaque regulatory regime.

The Exchange may argue that combatting bribery and fraud does not fall within its remit, but it is RAID's experience that those companies engaged in these crimes are also engaged in flouting AIM rules. That is why AIM companies have proved attractive, as in the Och-Ziff case, to those intent on finding vehicles for illegal activity. The repercussions are felt across the world, no more so than in the kind of communities with whom RAID works, where people are denied even a basic standard of living, health, security and a clean environment as a consequence of this exploitation.

AIM companies abandoned in a regulatory vacuum

Recent analysis shows, in the year to mid-2017, 14 out of the 82 companies that left AIM did so because their nomad resigned.[4] To be on AIM, companies are required to retain a nomad. According to the accountants who carried out the research,

> The London Stock Exchange can levy significant fines against NOMADs if they or the companies they advise break any of AIM's rules. This places significant responsibility on NOMADs to regulate the activities of businesses they advise, some of which may be relatively small or young businesses, or based in emerging markets.

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[3] *Discussion Paper – AIM Rules Review* (July 2017), https://www.londonstockexchange.com/companies-and-advisors/aim/advisers/aim-notices/aim-discussion-paper-july-2017.pdf.

[4] UHY Hacker Young, 'AIM shrinks as NOMADs continue to drop higher-risk clients,' 24 July 2017, https://www.uhy-uk.com/news-events/news/aim-shrinks-as-nomads-continue-to-drop-higher-risk-clients/.

In December 2016, an unnamed NOMAD was fined £75,000 for failing to ensure their AIM listed client was compliant. This risk, combined with the limited fees available to NOMADs, has reduced the number of NOMADs available to act for AIM companies.

RAID has criticised the Exchange for being less than transparent about the blocking of AIM applicants by exerting pressure on nomads to withdraw. Part of the rule review was to look at the power of the Exchange to exclude inappropriate companies under rule 9. RAID recommended that the Exchange publish information on how many times, and in what circumstances, it has had cause to resort to its rule 9 powers. RAID recommended that the Exchange should refuse to admit companies to AIM whose directors and/or executives and/or significant shareholders have a dubious reputation or track record or where existing assets are of dubious provenance. While it is useful for the Exchange to provide guidance on 'appropriateness' to nomads, the failure of the Exchange to openly use rule 9 powers leaves a vacuum at the heart of AIM. The fact that nervous nomads, for commercial reasons, have been abandoning risky companies, does nothing to enhance transparency or the reputation of AIM regulation for decisive action.

As shareholder value is destroyed when a nomad leaves, and as AIM suffers from higher numbers of delistings, it is hardly surprising that AIM prefers to discipline and sanction nomads secretly behind closed doors. Even when disciplinary notices are issued, AIM generally does so without naming the perpetrator. The revised Handbook keeps the option of private interventions and private censure at the heart of AIM's disciplinary regime.

Wide discretion over disciplinary action

RAID has criticised the breadth of discretion open to the Exchange in deciding whether to take disciplinary action at all for non-compliance with AIM rulebooks as well as the opaque nature of this determination which is made behind closed doors. The new Handbook does nothing to reduce or shed light upon the exercise of this discretion, stating that '[t]he decision to bring disciplinary action is at the sole discretion of the Exchange' [A9].

The revised Handbook makes it clear that a range of informal and private measures, from instructing a company or nomad to take remedial action, through 'education', to recording an incidence of non compliance on the formal compliance record held by the Exchange ('for the purposes of monitoring conduct and for further consideration in the event of future non compliance'), all constitute an 'initial step' [A6]. The Exchange is clear that '[n]one of these steps constitute disciplinary action pursuant to the AIM Rules' [A9].

The revised Handbook distinguishes between all such 'non disciplinary decisions' and formal disciplinary action 'in the form of a warning notice, private censure or public censure, all of which may also include a fine' [E7].

What constitutes a warning notice (picked out in bold in the text) is not further defined in the glossary to the revised Handbook. The AIM Rules for Companies define a warning notice as a private letter issued by the Exchange to a company of nomad for a breach of the rulebooks. Warning notices from part of the formal compliance record. The distinction between a disciplinary warning notice [A7] and a non-disciplinary 'incidence of non-compliance' [A6 (iii)] is unclear.

The revised Handbook therefore codifies a distinction between informal/private initial steps and formal action (which may be public or private) which the Exchange has always employed, except it is now made even clearer that the former is not considered to have a disciplinary element. This accords with an approach to the regulation of AIM that goes out of its way to avoid identifying and sanctioning those who break the rules. The Exchange has even stated: 'We are not enforcement-

led; the emphasis is on education, deterrence and providing a proportionate and appropriate response for all market participants.'[5] RAID questions the deterrence value of such a stance.

RAID has long been highly critical of the opaque regulation of AIM, which gives the impression that the junior market is beset by non-compliance that the Exchange wishes to keep hidden from scrutiny. As RAID noted in its original response to the AIM rule review, a tipping point undoubtedly exists whereby findings of serious and repeated non-compliance bring the whole nomad-led regulatory system into question. The stakes may be too high for further and repeated public censure of companies and nomads, which is perhaps why the Exchange has chosen to rely upon, and even reinforce, its reliance on private measures.

Indeed, the Exchange's use of private interventions (which is now explicitly characterises as 'non disciplinary') and anonymised warnings and private censure is out of step with the Financial Conduct Authority's stated intention to review its use of private warnings:

> Given our desire to be more transparent we will review use of 'private warnings'. A private warning does not provide a determination that a breach has occurred and may give the impression that fair process has not been followed. [FCA, *Our Future Mission*, October 2016]

AIM's disciplinary record

Formal disciplinary action is extremely rare: over AIM's entire existence, only eight companies and four nomads have been publicly censured, with four of these companies and three nomads also being fined between £75,000 and £600,000. The last public censure of a nomad was in 2011. Subsequent disciplinary notices against four nomads have all taken the form of anonymised censures, imposing fines of between £75,000 and £130,000. From 2014-2018, two companies have faced public censure (included in the above total), with another five companies being privately censured. Fines levied on companies over this period have ranged from £50,000 to £90,000.

The Exchange's discussion paper on the AIM rules review confirms its secretive and opaque approach to holding companies and nomads to account. Between 2013-2016 the vast majority of cases (93) were dealt with at the lowest level of action through private Recorded Breaches and Education, while there were 16 Private Censures/Fines. Despite all the scandals, the Exchange continually fails to publicly name the wrongdoers.

To place this record of disciplinary action in context, AIM has been in existence for over 20 years, admitting over 3700 companies (of which less than one thousand are currently trading), advised by over 35 (at one time, over 50) approved nomads.

Appeals and independence

The decision by the Exchange to treat non-compliance as a disciplinary or non disciplinary matter determines which set of procedures will be followed. The procedures to be followed are codified in more detail in the new Handbook.[6]

All non disciplinary cases and the lesser category of disciplinary warning notices are dealt with in-house by the AIM Executive Panel ("AEP") and the AIM Executive Appeals Panel ("AEAP"), made up of senior Exchange staff. As non disciplinary decisions and warning notices are both issued by the Exchange, both the AEP and the AEAP serve as appellate bodies, giving a nomad or company two

[5] *Inside AIM*, Issue 4, September 2011, https://www.londonstockexchange.com/companies-and-advisors/aim/advisers/inside-aim-newsletter/inside-aim-issue-4.pdf.

[6] For example, the handling of disciplinary cases by AIM Disciplinary Committee is clarified and made more consistent by the introduction of a Case Management Memorandum and an Indicative Standard Directions and Timetable for Disciplinary Proceedings is included in the Handbook. Standard forms for bringing appeals are also provided in the revised Handbook.

opportunities to challenge the Exchange. For non disciplinary matters, a new practice is to return upheld appeals for re-consideration by the Exchange rather than the appeal body substituting its own determination.

Given that informal steps on non-compliance by the Exchange or even warning notices are kept private, there is an undue emphasis on the right of companies and nomads to appeal when no consideration is given to alerting shareholders or other affected stakeholders of breaches.

While RAID would certainly not deny wronged parties the right to appeal, this should be balanced by publication, as a minimum, of the names of those companies and nomads that have received a warning notice, including the outcome of any appeal. RAID is disappointed that the revised Handbook makes no such provision (see below on confidentiality and the publication of findings).

Disciplinary cases and related appeals are dealt with before the AIM Disciplinary Committee ("ADC") and the AIM Disciplinary Appeals Committee ("ADAC"), the members of which are independent of the Exchange. Both these disciplinary Committees will continue, as before, to consider those cases where breaches are considered by the Exchange to be more serious. However, new arrangements around early settlement are likely to see fewer cases coming before these independent bodies.

Fixed discounts for early settlement

Key changes set out in the revised Handbook are designed to introduce a clearer framework for the settlement of disciplinary cases, with fixed discounting of financial penalties available to AIM companies and nomads who reach early settlement. While the Exchange already heavily discounts fines for early settlement, the revised Handbook codifies this practice.

- Provision is made for a party to settle, on terms offered by the Exchange, prior to commencement of disciplinary proceedings, which will attract a 30% discount off any proposed financial penalty.
- Where a party does not initially settle, but later accepts, post commencement of disciplinary proceedings, the alleged breaches set out in the Statement of Case at least 10 business days prior to the date set for a Case Management Conference, a reduced discount of 15% will apply.

RAID has two concerns about such discounts. Firstly, setting out fixed discounts, even in cases of serious breaches, means that compliance with AIM rules can be perceived as a 'risk/reward' exercise, whereby potential gains (for example, the decision when and what material information to disclose because of its effect upon share price) will be set against the certainty of a discount, should a fine be levied.

Secondly, early cooperation at the outset means that the Exchange retains the power to settle a case privately. Although public censure remains an option in settled cases, given its track record in issuing very few public censures to date, coupled with proposed changes around contested cases (see below), it is likely that early settlement will mean not only a reduced fine, but no public accountability.

While there is no explicit reference to private or public censure in the section on settlement post commencement of disciplinary proceedings, it is assumed that the options (set out at E1.1 – E1.3 in the preceding section) will apply.

Public naming in contested cases

For contested cases that are to be decided by the AIM Disciplinary Committee, the Exchange proposes to publically name the party/parties and summarise the alleged breach in an AIM Disciplinary Commencement Notice when the Statement of Case is served. An Outcome Notice will also name the party/parties and summarise the decision of the Committee.

It remains to be seen how comprehensive the Commencement and Outcome notices will be, but RAID would advocate that both should contain full details of all breaches.

RAID has long criticised the Exchange for failing to name both companies and nomads, even in serious cases of misconduct. But RAID believes that limiting such disclosure to contested cases is a missed opportunity. The party/parties should be named in all cases when proceedings are to be commenced, even where these are resolved through settlement.

Expeditious determination and proportionate cost

Decision-making bodies are to follow a new overriding objective 'to ensure the just, efficient and expeditious presentation and determination of the matters in issue at proportionate cost, and to act fairly between the parties at all times' [B6].

The revised Handbook is clearer on setting out a presumption that parties who are found to have breached the rules or failed in their appeal will be ordered to pay the Exchange's costs [G1 – G9]. Complainants who settle early with the Exchange will, of course, have the added incentive of reducing this cost burden. The Exchange will only be liable for the other party's costs when it can be shown to have acted in bad faith [G10].

While it is sensible to avoid the kind of costs associated with Court-based litigation, RAID would be concerned if this was at the expense of a properly resourced and thorough investigation. The public censure of nomad Seymour Pierce was based on 'illustrative' cases.[7] Such a practice leaves questions in the minds of other client companies as to the extent of a nomad's non-compliance and its level of competence, making it hard to reach a decision whether to change nomad.

Much depends on the onus being placed upon companies and nomads to cooperate and voluntarily disclose all relevant information and what sanction is available to discourage recalcitrance. Rule A10 sets out the expectation that companies and nomads 'will act responsibly and reasonably during an investigation and any subsequent disciplinary process', but reference is made only to how a Panel or Committee may 'draw an adverse inference in respect of a party's failure to respond to any questions or further information requests' [C26, C61, D24, D58]. This contrasts with sanctions in respect of breaching confidentiality (see below), which will be taken into account when determining any order for costs and could trigger additional disciplinary action.

Confidentiality and public hearings

Given that the naming of parties only occurs automatically in contested cases, it is unsurprising that the revised Handbook re-asserts confidentiality on 'any matters relating to any proceedings' as a general provision [B30]. While the Exchange reserves the right to publish the findings of any Committee, details of any public or private censure, or details of a warning notice, this is immediately qualified to protect the identity of any party concerned in the latter two instances

[7] Stock Exchange AIM Disciplinary Notice - Public Censure and Fine - Seymour Pierce Limited, AD 11, 21 December 2011, https://www.londonstockexchange.com/companies-and-advisors/aim/advisers/aim-notices/aim-notice-ad11.pdf.

[B32 and subparagraphs]. Furthermore, the right of the Exchange to publish is far removed from its practice of withholding all such details, except in rare cases of public censure.

All hearings by any Panel or Committee will be conducted in private [B11]. Previously, provision had been made to allow a nomad or company to request that the AIM Disciplinary Committee conduct a hearing in public. A nomad that had been denied its request for a public hearing ultimately took its case to the Court of Appeal, but the discretionary right of AIM to determine whether a hearing should be private or public was upheld.[8] The revised Handbook now precludes even the possibility of a public hearing. RAID considers this to be a retrograde step. While there may be good reasons to conduct a private hearing, transparency and accountability is not served by denying a public hearing in all circumstances.

Other matters: the standing of complainants and the use of rule 43

In its response to the consultation on the review of AIM rules, RAID raised two further issues that concern disciplinary action. The first is the standing of complainants who provide information about non compliance to the Exchange. The second is clarification on the application of rule 43 of the AIM Rules for Companies regarding jurisdiction of the Exchange over companies that have ceased to trade on AIM.

Anyone with a complaint relating to an AIM company or a nomad's compliance with the AIM Rules is invited, via the Exchange's website, to contact AIM investigations. However, once a complaint has been made, blanket confidentiality cloaks any subsequent process and excludes the complainant, even to the extent that AIM Regulation refuses to seek further information or clarification about the complaint.

RAID had called for rules and transparent procedures to be drawn up on the handling of complaints, to support the standing given by the Exchange to third parties and the public in submitting complaints. The revised Handbook does not even consider this matter.

Rule 43 was introduced in May 2014 to retain the Exchange's jurisdiction over companies who have ceased to trade on AIM 'for the purpose of investigating and taking disciplinary action in relation to breaches or suspected breaches of these rules at a time when that company was an applicant or had a class of securities admitted to trading on AIM'.

RAID wrote to AIM Regulation in January 2017 about the applicability of rule 43. In response, AIM Regulation confirmed 'this rule was proposed to clarify the position regarding our investigative and enforcement jurisdiction over cancelled companies'. The Exchange should state explicitly whether or not rule 43 – which made explicit the Exchange's existing position on jurisdiction – applies to companies who ceased trading on AIM before rule 43 was introduced.

To RAID's knowledge, rule 43 has not been invoked in order to take disciplinary action over rule breaches by former AIM companies. No special provision is made in the revised Handbook to deal with such cases and it is therefore assumed that they can be accommodated under the proposed rules and procedures.

As noted at the beginning of this response, the US authorities have detailed the role of AIM companies in the DRC corruption scheme set out in the recent US action against hedge fund Och-

[8] Zai Corporate Finance Ltd v AIM Disciplinary Committee of the London Stock Exchange Plc & Anor, Court of Appeal - Civil Division, August 30, 2017, [2017] EWCA Civ 1294.

Ziff.[9] The Israeli businessman, also described as the hedge fund's DRC Partner in the corruption scheme, had significant and controlling interests in two AIM mining companies. Given the detailed information available, even in the public domain, on the suspected non-compliance of these same companies with AIM rules, RAID will continue to press for the Exchange launch an immediate investigation.

[9] United States of America against Och-Ziff capital Management Group LLC, *Deferred Prosecution Agreement*, Cr. No. 16-516 (NGG), United States District Court Eastern District of New York, 29 September 2016, https://www.justice.gov/opa/file/899306/download. The Securities and Exchange Commission also took action (see https://www.sec.gov/litigation/admin/2016/34-78989.pdf). A Department of Justice press release summarising the action taken by the US authorities against Och-Ziff is available at: https://www.justice.gov/opa/pr/och-ziff-capital-management-admits-role-africa-bribery-conspiracies-and-agrees-pay-213.