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UK Equity Markets Association (UKEMA)

UK Equity Markets Association (UKEMA) response to the Primary Markets Effectiveness Review: DP22/2

The UKEMA welcomes the opportunity to respond to DP22/2. As a member organisation made up of mid-cap and small equity brokerage firms whose issuer clients are mainly SMEs, we are particularly focussed on a vision for UK capital markets that works for those issuers and is not unduly restrictive or burdensome.

We note the FCA's policy outcomes set out below and are very supportive of these. We have borne these outcomes in mind when formulating our proposal for a single segment market. The outcomes are as follows:

- To ensure the value of being listed is simpler to understand by removing complexity that is not serving a genuine and defined purpose
- To promote broad access to listing for a wider range of companies, while continuing to set clear, simple, and robust minimum ongoing standards for listed companies
- To empower investors to conduct their own decision-making over the suitability of listed issuers to meet their needs through clear, high-quality disclosures
- To allow issuers and investors flexibility to agree where additional shareholder engagement, overseen by the FCA, is appropriate

However, taking a step back from the FCA's policy outcomes, we think it is important to adopt a new approach to UK capital markets, focussed on the key theme of a market which is attractive to both investors and issuers without unnecessary complexity. In our view the market has become overly complex and consequently unattractive. The FCA's discussion paper (following on from Lord Hill's Review) is an ideal opportunity to refocus the debate and consider some fundamental questions.

The FCA needs to consider on how it can make the UK market more attractive, given the competition faced from other global jurisdictions and create a simple and clear regulatory framework, which is understood by all those in the market ie issuers, investors, professional advisers and the regulator and is also aligned with third party constituents ie FTSE Indexation.

With this in mind, a substantial majority of members are very much in favour of the FCA's proposal to have a single market segment for equity securities rather than two. Having considered the position further since our response to CP21/21, we are of the view that the standard segment is not achieving the goal of attracting commercial companies to the London main market who are seeking a more flexible regulatory structure and is contributing to an unnecessarily complex listing regime. We would therefore advocate the removal of both premium and standard listing segments and the creation of a new single market segment. However, we are not in favour of the FCA's proposal set out in the DP for a single segment with a mandatory and supplementary

continuing obligations. Our view is that the FCA's proposal creates a de facto two tier segment (particularly given the requirement to have a shareholder vote to move between mandatory and supplementary obligations) and therefore does not meet all of the objectives set out above, specifically removing complexity and promoting broad access to listing.

In particular we are concerned that there is no information available as to FTSE Russell's view of index inclusion within the FCA's two tier segment. It is possible that FTSE will require companies to follow the supplementary obligations regime which would then create a premium and standard approach by stealth which presumably is not the FCA's intention. Conversely, if FTSE were to include all issuers who follow the mandatory obligations then arguably there would be no incentive for issuers to follow the supplementary obligations. In addition, we are very concerned that the FCA's proposals create additional complexity rather than simplifying the regime as there would still be a standard listing segment for debt and GDRs and a standard listing segment for equities that are not being required to move over to the new single segment.

Our view is that there should be a fundamental shift in how eligibility requirements and continuing obligations are viewed by market participants and that the core tenets of the new single segment regime should be market led through (1) adequate disclosure and (2) choice ie, investors can choose whether to invest once they have appropriate disclosure. Our vision for a single segment and its key aspects are set out below:

- Move to "disclosure" based approach rather than the current prescriptive "rule based" approach

- Significant transactions
  - the class test threshold should be 75% or more so only material transactions require shareholder approval
  - remove requirement for working capital statements from class 1 circulars
  - remove requirement for approval of class 1 circulars by the FCA

- Sponsor regime
  - a sponsor would be required for an IPO or reverse takeover but not a class 1 circular or a related party transaction

- Corporate governance code – "comply or explain" with UK CGC or appropriate overseas code

- Eligibility requirements for listing – we agree with the FCA's proposals regarding removal of the revenue track record and 3 year HFI as well as removing the requirement for a clean working capital statement thereby placing greater emphasis on disclosure

- Related party transactions

- should be disclosed as set out in DTR 7.3
- no need for a separate regime or a sponsor

- Controlling shareholders and independent business
  - should be disclosed in IPO prospectus but no need for additional requirements

- Dual class share structures – should be based on current standard listing approach (not premium)

- Listing Principles – to be retained (including Premium ones)

- Closed ended investment funds
  - retain existing Chapter 15 regime within the new one segment as this works in practice (noting changes above re significant transactions and related party transactions)

- Incorporate into the Listing Rules a requirement for existing retail shareholders to be included in any issue of securities

Specific areas of focus

Disclosure based approach rather than rules

As set out above, we think there needs to be fundamental shift in how regulators and investors perceive the market and how it operates. The current listing regime is constructed on a complex set of rules with which companies have to comply, many of which are arguably of little benefit. For example, the Listing Rules were extensively rewritten in 2014 to introduce complex rules regarding controlling shareholders. In our view, the fact of a controlling shareholder should be disclosed in an IPO prospectus and investors left to make up their own minds as to whether they should invest, knowing what those risks are. Rules should only be required in limited circumstances (see below our comments on related party transactions for example). Similarly on dual class share structures, our preference would be for the standard segment approach rather than the new premium segment rules which again add considerable complexity and a rules based approach to a topic which is actually conceptually quite simple. Investors have chosen to invest in certain standard segment companies knowing that there is a founder investor (for example The Hut Group and Deliveroo) and that is a choice for those investors. A further example is the requirement in LR 9.5.10R for the discount on an open offer to be not more than 10% without shareholder approval. Whilst we can see the benefit of this for investors is this not something that could be left to investors ultimately to decide whether or not to subscribe if the discount is more than 10%?

Significant transactions

We note the FCA's observations on significant transactions in DP22/2 and the suggestion from one trade association that the threshold be raised to 33%. In our view, this change is not sufficiently material to have much effect on issuers and our suggestion would be that the threshold is raised to 75%. This would align with the requirement for special resolutions under the Companies Act and reinforce the concept that only truly significant transactions should need approval. In our view the current system is not working in the way it is intended to given that anecdotally no-one has heard of a class 1 transaction being turned down, perhaps because often key shareholders are wall crossed in advance before the transaction proceeds very far and are given the opportunity to provide feedback on potential acquisitions or disposals. Another way of addressing the same issue could be for companies to publish their acquisition and disposal policy in their annual report (in the same way that investment companies have a published investment policy) with the company required to seek shareholder approval for any acquisitions or disposals outside that policy.

In addition, with the objective of simplifying the regime, we suggest that the requirements for the class 1 circular to be approved by the FCA and include a working capital statement could be removed. We think that removing these requirements would assist with some of the concerns regarding timing expressed in paragraphs 3.76 and 3.77 of the DP which can disadvantage UK premium listed issuers in an auction sale process whilst retaining the requirement for shareholder approval for larger transactions as set out above.

Sponsors

We acknowledge that the topic of sponsors is one that is being extensively debated in the market at the moment and we note the views of the FCA as set out in paragraph 4.4 of the DP ie that the sponsor regime is a fundamental part of meeting the FCA's strategic objective of markets that function well. Equally we are cognisant that a key attraction of the standard market for some is the lack of a sponsor, noting that a standard listing is "EU minimum" equivalent and that equivalent European markets do not have a requirement for a sponsor thus potentially disadvantaging London when say compared to Paris, Frankfurt or Amsterdam. Our suggested compromise would therefore be to reduce the number of "touchpoints" as referred to in paragraph 4.42 of the DP so that a sponsor is only required for listing applications such as IPOs or reverse takeovers. We agree with the reasoning set out in paragraphs 4.7 following as to why a sponsor is required for such transactions and also agree that a sponsor may be needed to provide bespoke advice on the Listing Rules and other regulatory requirements post listing. A sponsor would not be required for a class 1 circular (although might be required to give limited advice on the Listing Rules) and would not be required for a related party transaction (see below). We also query why a sponsor needs to give a working capital statement given that it is the reporting accountants who produce the working capital report that assists the issuer in giving the working capital statement. This is a very good example of where the UK has added further onerous requirements onto the European

standard listing baseline which arguably are not justified. This is not a requirement of other European markets, for example Frankfurt, Paris or Amsterdam.

Corporate governance code

As set out above, we suggest that a new single segment retains the requirement for UK incorporated companies to comply and explain against the UK Corporate Governance Code and that overseas companies should disclose their equivalent corporate governance code as required by DTR 7.2. In this instance, our view is that the London market is highly regarded for its standards of corporate governance and that changes are not required. As set out above, our view is that disclosure is a key tenet and this is borne out by the success of the UK regime where companies are required to explain why they do not comply with aspects of the code, leaving investors to decide whether or not to invest on that basis rather than being penalised for non compliance.

Related party transactions

Our view is that the related party regime set out in chapter 11 of the Listing Rules overlaps with the disclosure regime set out in DTR 7.3R. Looking at the FCA's first policy objective we query whether the requirement for a sponsor and the requirement for a shareholder vote in certain circumstances serves a genuine purpose that justifies the complexity of having two separate regimes. We note that DTR 7.3R was introduced by the Shareholder Rights Directive in 2019 and is therefore part of the European regime referred to above and we therefore are of the view that including UK "gold plating" does not assist with making London more attractive to outside investors. Even though the requirement for shareholder approval for related party transactions of 5% or over appears attractive for investors, again we are not aware of any serious challenge by shareholders to any such transactions or of any transactions being turned down by shareholders. In our view, disclosure in the way envisaged by DTR7.3R is sufficient to protect investors. In addition, DTR 7.3R adopts the accounting framework definition of a 'related party' in the International Financial Reporting Standards (IFRS) under International Accounting Standard 24. This provides consistency across the regulatory and accounting standards and therefore a separate regime set out in chapter 11 of the Listing Rules would seem to create additional complexity not required in this area.

Eligibility requirements

We are very much in favour of the proposals to remove the financial eligibility requirements set out at LRs 6.2, 6.3 and 6.7 being the requirement for 3 years' audited accounts representing at least 75% of the issuer's business, the 3 year revenue earning track record and the requirement for a clean working capital statement. These requirements have to some extent acted as a barrier for entry for certain type of company who have then listed on the standard segment and removing these requirements to some extent will remove the need for a "lesser" listed segment. As set out above we are very much in favour of a disclosure based regime rather than one based on rigid rules. As set out in paragraphs 3.37 and 3.42 potential issuers that had an unusual financial history would explain it in the listing prospectus leaving it up to investors to choose whether to invest.

Retail shareholders

We very much support the conclusion set out in the Secondary Capital Markets Review that due consideration should be given to the interests of retail shareholders on all capital raisings. However, our preference would be for this requirement to be set out in the Listing Rules rather than set out in the Pre-Emption Group Guidance. In our view this would be an instance where a rule rather than guidance would be justified. Further, in relation to IPOs, our view is that on all Main Market IPOs there should be a retail tranche of 10% (as there is in Hong Kong) so that retail investors have an equal opportunity with institutions on primary issuances not just on follow ons.

Q1 Do you think that a single segment regime would meet the outcomes we have described? Are there any changes or enhancements that could be included to enhance the effectiveness of a future regime?

As discussed in our introduction, we strongly believe that a single segment regime will assist in making UK primary markets more attractive, however, we believe the current proposal in the Discussion Paper may lead to a de facto 'two-tier' segment regime as is currently in place. We therefore have set out a number of suggestions to amend the current proposals in respect of:

- Significant Transactions
- Related Party Transactions
- Controlling Shareholders and Independent business
- Dual Class Share Structures
- Listing Principles

We believe that the single segment regime should be disclosure based rather than rules based. This will allow investors to choose whether to invest with appropriate disclosures.

Q2 Do you agree that revenue track record, historical financial information and the requirement for a "clean" working capital statement can be replaced by disclosure in listing documentation such as prospectuses?

We agree with the FCA's proposals regarding removal of the revenue track record and historical financial information as well as removing the requirement for a clean working capital statement thereby placing greater emphasis on disclosure. We do not believe that removal of this requirement will threaten the reputation of the segment as the inherent nature of a disclosure based regime will mean that investors are able to differentiate accordingly.

These requirements have to some extent acted as a barrier for entry for certain type of company who have then listed on the standard segment and removing these requirements to some extent will remove the need for a "lesser" listed segment. As set out above we are very much in favour of a disclosure-based regime rather than one based on rigid rules. As set out in paragraphs 3.37 and 3.42 potential issuers that had an unusual financial history would explain it in the listing prospectus leaving it up to investors to choose whether to invest.

If a disclosure-based regime is chosen, consideration should be given to how prominence is given to the key information disclosed in the document as this will necessarily become more important to retail based investors. This could be achieved by providing an additional summary using a similar format as is used in Key Investor Information Documents (KIID) for retail investors and the simplified prospectus regime for secondary issuances.

Q3 Under a disclosure-based regime, are there any elements of the listing regime that should be incorporated into future changes to the prospectus regime to ensure that investors receive appropriate information upon which to base their investment decisions?

Yes. As set out above, we believe that the current listing rule requirements around controlling shareholders and the requirement for an independent business can be dealt with by way of disclosure rather than by way of continuing obligations and eligibility requirements respectively.

Q4 Do you agree with extending the Premium Listing Principles to all issuers of equity shares in commercial companies under a single segment regime? Would any specific changes to the principles be necessary to do so?

We believe extension of the premium listing principles to all issuers of equity shares in commercial companies under a single segment regime would be a positive step. This would help to maintain the UK's status as a listing location with appropriately high standards, whilst other changes to the UK listing regime are implemented.

Q5 Do you agree that we should consider allowing dual class share structures in the single segment? Do you agree that the only form of dual class share structure that should be permitted within a single segment regime should be the regime recently introduced in PS21/22?

Yes, we believe that DCSS should be permitted but in the way currently permitted in the standard segment. In our view, the regime introduced to the premium segment by the recent changes is overly complex. As set out above, we advocate a disclosure based approach. A DCSS should be disclosed in an IPO prospectus giving investors both on the IPO and going forwards the information they require in order to assist them with their decisions to invest (see FCA objective 3 as set out above).

Q6 Do you think the eligibility requirements for the single segment regime described will broaden access to listing to a wider range of companies?

Yes – however, certain elements of the eligibility criteria need further consideration. For example, providing a minimum market capitalisation of £30m is a relatively low threshold for companies that may be better suited to the junior markets which are already available in the UK. Whilst we appreciate that this topic has been consulted on recently, we consider that a higher threshold, such as £100m, may be appropriate for such companies.

In addition, we support the removal of the financial eligibility requirements set out at LRs 6.2, 6.3 and 6.7 being the requirement for 3 years' audited accounts representing at least 75% of the issuer's business, the 3 year revenue earning track record and the requirement for a clean working capital statement. These requirements have to some extent acted as a barrier for entry for certain type of company who have then listed on the standard segment and removing these requirements to some extent will remove the need for a "lesser" listed segment.

Q7 Does the suggested division between the mandatory and supplementary continuing obligations provide enough flexibility for issuers, alongside appropriate investor protection? Please provide any evidence and examples where possible.

As discussed in our introduction, our view is that the FCA's proposal with mandatory and supplementary obligations creates a de facto two-tier segment (particularly given the requirement to have a shareholder vote to move between mandatory and supplementary obligations). We believe an appropriate disclosure based regime with an appropriate prominence given to key disclosure points as discussed in Question 2.

Q8 Should more be done to ensure there is a genuine choice for issuers to decide whether the supplementary continuing obligations are suited to their business model and strategy?

As discussed, we do not believe there is a need for mandatory and supplementary obligations in a single segment regime.

Q9 What sort of labelling would be most helpful to ensure investors are aware of whether an issuer is opted into the supplementary continuing obligations? e.g. Annual reports, noted on the Official List, or made clear by the trading venue.

As discussed, we do not believe there is a need for mandatory and supplementary obligations in a single segment regime.

Q10 What factors should we take into account when considering the level of the threshold for Class 1 transactions within the significant transactions regime? What threshold would be appropriate?

As mentioned in the discussion paper, the requirements for proposed transactions that are classified as Class 1 are significant. Of course, this is appropriate to notify shareholders of certain transactions entered into by the listed company. However, we believe the current level of 25% should be increased to [75]%. As discussed in the effectiveness review, preparation of certain elements, such as the working capital statement can be particularly time consuming and therefore by increasing the Class 1 level to [75]% this will ensure less transactions are subject to these requirements.

Q11 Do you consider the scope of the single segment to be appropriate? Should any additional instruments be eligible to list there? e.g. Depository Receipts (DRs).

We don't have any particular views on this question.

Q12 Do you think the current regime for listing close ended investment funds is fit for purpose?

We believe the current regime for listing closed ended investment funds is fit for purpose, the Chapter 15 eligibility requirements and continuing obligations provide an appropriate framework.

Under any amendments to the listing regime, closed ended investment funds should continue to be categorised alongside commercial companies within the new single listing segment (as is the case with the current premium segment) and should benefit in the same way as commercial companies from any alignment between the single listing segment and the UK indices.

Q13 Do you agree that 'UK listing' could be used to describe the possible regime described?

We don't have any particular views on how to describe the new listing segment.

Q14 Are there any other factors we should take into account when considering the treatment of existing standard listed issuers?

We don't have any particular views on this question.

Q15 What transition arrangements should we put in place for premium listed companies in order to optimise the benefits of a single segment regime?

We don't have any particular views on this topic at the moment but we agree that the transitional arrangements for premium listed companies will require further careful thought once it is clearer what the new structure will look like.

Q16 Given the purpose of record-keeping requirements, are there specific elements of the rules or the FCA's approach that you think could be more proportionate?

At present, the record-keeping obligation on sponsors is significant and recent guidance has resulted in an increase how record keeping is actually achieved in practice. Record-keeping is an essential part of a sponsor's role but further effort is required to move away from a "one size fits all" approach.

The current level of record-keeping enables a non-practitioner to pick up the files and follow a transaction from inception to completion. Greater emphasis should be placed on the material decisions and/or issues. Further, the emphasis of a reader's understanding should be moved to that of a practitioner. This approach would result in no loss of key record-keeping but would substantially reduce the non-value adding record-keeping that, in practice, is being kept.

Q17 Do you think a reduction in record-keeping requirements could be achieved without undermining the benefits of the sponsor regime to the FCA, listed companies and investors? If so, please explain how and why.

Yes, see the answer to Q16 above. For example there is a requirement for Market Abuse regime records to be kept however in an IPO this is likely to be not applicable. In these circumstances there is no benefit to recording a nil return and the ability to use judgement should be available to the sponsor.

Q18 Is the record keeping guidance in our Technical Note (entitled 'Sponsors: Record Keeping Requirements') helpful or not in seeking to be clearer on the record keeping thresholds and the types of information that should be recorded about material judgements (noting that there will always be differences depending on individual circumstances of a case)? If not, what would be helpful?

The Technical Note is helpful in that it added clarity to certain areas, however it did not assist in reducing the non-value adding record-keeping burden in practice. A more principles based approach rather than specific requirements would be a straight-forward and welcome approach and we would welcome further practical guidance from the FCA.

Q19 Is market practice aligned with the record keeping requirements or is market practice driving disproportionate record-keeping standards and costs? For example, by sponsors not adjusting their record keeping processes to reflect the circumstances of a specific transaction.

See the answers to Q16, Q17 and Q18 above.

Q20 If you consider there is misalignment between the record keeping requirements and market practice, do you have any suggestions as to what changes could be made to meet the record-keeping requirements more efficiently?

A formal move to record-keeping based on the assumed knowledge level being that of a market practitioner would be a significant step in reducing some record-keeping which we perceive to have little value. This move could be justified by the reliance placed on the sponsor and the individuals concerned – the sponsor is reviewed by the FCA via the annual regime and the individual's competency and experience is a key component of that sponsor review process (and both sponsor and individual are assessed on an ongoing transaction by transaction basis as part of that process).

This approach would then justify the principle-based approach suggested above.

Further, the key record keeping moments are typically the identification of issues or material decisions and the resolutions thereof. Detailed record keeping of the intermediate steps is not necessarily helpful and could be an easy reduction that would have little to no effect on record-keeping. It is also consistent with a principles-based approach.

Q21 Would more transparency of how sponsor fees are calculated help issuers and investors to better understand sponsor services and the role of a sponsor?

Yes, it would help parties understand the work and complexity involved in a sponsor transaction. However, the fees themselves are often disclosed as a material contract so this could involve greater detail on the role rather than the (already disclosed) fee arrangement.

Q22 Would it also help to be able to differentiate more clearly between the sponsor services and non-sponsor services that may be provided by the same provider? How might this clearer differentiation be achieved?

The Takeover Code has adopted a fee/provider approach that has worked well in practice. It could be supplemented by a brief overview of the core services supplied by each provider.

Q23 What more could be done to better align a sponsor's incentives with the long-term interests of an issuer, and the interests of their investors, to seek to maximise the benefits to be gained from the sponsor regime? Is there more information regarding the performance of a sponsor and of the performance of an issuer, at IPO and thereafter, that could be used to demonstrate this?

This is an approach that is possibly more relevant to the bookrunner and/or broker than the sponsor. It also has the potential to raise conflict issues.

Q24 Are there any specific modifications to the role of sponsor that you think would be needed, if the sponsor regime were applied to all issuers of equity shares in commercial companies under a single segment regime? For example, are there risks that may arise from longer periods of time between sponsor engagement with a company and the provision of assurances to the FCA and, if so, how might they be mitigated?

Please see our suggestions in the introduction to this response, in particular our comments relating to the single segment and amendments to the type of transaction requiring a sponsor appointment. At present, the issuer is responsible for its own continuing obligations and we are not suggesting any amendments to this.

Q25 Are there any circumstances where the role of a sponsor after initial listing could be reduced, without materially impacting the benefits gained from the sponsor regime? If so, please provide details and explain how investor protections would or would not be impacted.

The current sponsor regime is primarily a transactional role at present. Our suggestions as to developing the circumstances requiring a sponsor are set out in the introduction to this response where we suggested relaxations around Related Party and Class 1 transactions. A permanently retained sponsor is unlikely to be an attractive solution to a competitive, attractive platform and would put London out of step with Paris, Frankfurt and Amsterdam.

Q26 Are there other circumstances in which the sponsor regime should be extended/applied more widely? For example, to any issuers of securities currently listed in the standard listing segment.

See answer to Q25 above.