June 2023
UK Equity Markets Association (UKEMA)

UKEMA response to FCA consultation paper CP23/10

The UKEMA welcomes the opportunity to respond to the Financial Conduct Authority's consultation paper 23/10 "Primary Markets Effectiveness Review – Feedback to PD 22/2 and proposed equity listing reforms". The UKEMA represents those investment banks and equity brokerage firms that focus on raising capital for SMEs and small and mid-cap quoted companies. Its members trade in the shares of over 2,000 quoted companies, accounting for 57% of London Stock Exchange turnover by volume, and produce research on over 1,700 companies, representing 87% of listed issuers. UKEMA member firms facilitated investment of more than raised £6.7bn in funds for companies in 2021, supporting growth in the real economy, employment, innovation, entrepreneurship and wealth creation.

Summary

UKEMA members broadly welcome the proposals set out in CP23/10 and are encouraged by the vision set out by the FCA which is a radical reform of the UK capital markets regime. We note that the FCA's blueprint is aiming to attract a more diverse range of applicants and to bolster UK competitiveness while maintaining high standards of disclosure and transparency. We are very much in favour of this whilst noting as set out in our response to DP22/2 that we are a member organisation whose issuer clients are mainly SMEs and therefore we are focussed on a solution for the UK capital markets that works for those issuers and is not unduly restrictive and burdensome. We particularly welcome the emphasis that the FCA is placing on a disclosure based regime which is what we advocated for in our response to DP22/2.

As mentioned previously, a majority of our members were in favour of a single market segment regime and we are encouraged that the FCA has listened to respondents to DP22/2 and is now suggesting a true single segment rather than the proposal set out in DP22/2 which in our view was a two segment regime in reality. We note in particular that the proposals set out in CP23/10 mainly focus on the new equity shares for commercial companies category (ESCC) and are keen to hear about the detail of the other categories (for closed ended investment companies, companies with a secondary listing etc) and to see the draft rules as soon as possible in the autumn.

In addition, mindful of the disclosure based nature of the regime, we suggest that the FCA pays particular attention to getting the balance right for issuers that are currently listed on the standard segment who it is hoped will be moving to the new ESCC regime. Moving to a more regulated environment will involve a significant shift in mind set for these issuers.

One area of concern is that we still have no information available as to whether FTSE Russell will be supportive of the proposed regime and will amend its ground rules to include companies with an ESCC listing. As you know, this is crucial to the success of the UK listing regime as new issuers for the most part will want index inclusion in order to have sufficient liquidity in their shares post IPO. We note your comment that index providers may set higher or different standards to those set out in the FCA's listing rules, however, market participants, including sponsors and other financial advisers will need to know FTSE Russell's views from an early stage in order to advise issuers, particularly those who may be thinking of a UK IPO in the near term.

Specific areas of focus

Single segment

As set out above, we are in favour of a single segment regime but do not think it is necessary to have separate categories for SPACs, sovereign companies or strategic investment companies as they should be capable of accommodation within the ESCC category, making clear as necessary if some provisions do not apply. We think the new regime should be as simple and streamlined as possible with a minimum number of categories so that it is appealing to new issuers.

Retail participation in IPOs

We are disappointed that there is very little mention of retail shareholders in CP23/10, given the emphasis placed on allowing retail shareholders greater access to secondary offers in the Secondary Capital Raising Review and the new Pre-Emption Group Guidance. As set out in our response to DP22/2, we are in favour of the FCA's listing rules themselves being amended so that existing retail shareholders are included in an offer of new securities. In addition, we are advocating for a retail tranche of 10 per cent on IPOs so that there is an equal opportunity with institutional investors for retail on primary issuances not just secondary issuances. We would welcome an opportunity to discuss this further with the FCA.

Significant transactions

We note that the FCA's proposals go beyond what we suggested in our response to DP22/2 (75 per cent for shareholder consent and changes to the circular requirements). We do not in principle oppose the proposals that shareholder consent is not needed and that a class 2 style announcement is the only requirement. We appreciate that these changes will bring the UK into line with EU jurisdictions where no shareholder consent is needed and disclosure is purely based on the Market Abuse Regulation. We are in favour of deleting the profits test as in members' experience it often leads to anomalous results which then need to be discussed via lengthy submissions with the FCA. We are also in favour of allowing sponsors more discretion to apply appropriate modifications to the class tests (including substituting the specified tests with other appropriate measures) without having to submit a request for the FCA to modify the tests as sponsors are sector experts and will be familiar with other types of test which would be helpful to use, noting as pointed out by the FCA that class tests will no longer be used for the purposes of determining whether shareholder consent is required unless it is a reverse takeover. We would however welcome more clarity on the role sponsors are expected to play and what this means for sponsor due diligence (given the regulatory framework that currently supports a sponsor in carrying out its due diligence will be removed).

Related party transactions

The FCA is suggesting that related party transactions (RPTs) which meet the five per cent test on the class tests are no longer subject to a requirement to obtain shareholder consent but instead are announced to the market with the announcement containing a fair and reasonable opinion that states that the directors have been advised by a sponsor. Smaller RPTs (i.e. below five per cent in the class tests) would not need to be disclosed. Whilst this is a relaxation of the current position, members are still of the view (as set out in our response to DP22/2) that there would still be too much overlap between chapter 11 of the Listing Rules and the European disclosure based requirements set out in DTR 7.3. As mentioned previously, DTR 7.3 adopts the accounting framework definition of a "related party" set out in International Financial Reporting Standards under International Accounting Standard 24 thus providing consistency between regulatory and accounting standards. We do not see the need for two separate regimes, bearing in mind the new disclosure based approach advocated by the FCA and that the FCA's approach will still require a sponsor's "fair and reasonable "opinion. It should be for investors to decide whether they want to invest in an issuer once a transaction is disclosed to the market and in the issuer's accounts. In addition, deleting Chapter 11 would also put UK listed issuers in the same position as issuers listed in the EU which have similar requirements and level the playing field.

Dual class share structures

The FCA is proposing further relaxations to the regime for dual class share structures (DCSS) which currently apply to premium listed issuers. As set out above, the expectation is that standard listed issuers who are not currently subject to any DCSS restrictions would be moving to the new ESCC. The proposals would therefore mean that some issuers would not be able to migrate to the new listing category as they would not be able to comply with them. We do not see the need for these rules (i.e. 10 year sunset provision, enhanced voting rights for shares held by directors etc) as the regime should be the same as for standard listing with no restrictions at all. Deleting these requirements would put UK issuers in the same position as issuers listed in the US where both NYSE and NASDAQ permit dual class share structures. As set out in our response to DP22/2, members are in favour of a disclosure based approach to DCSS. DCSSs should be disclosed in an IPO prospectus, giving investors information to enable them to choose whether to invest or not.

Changes to the controlling shareholders regime

Members are in favour of the proposals set out in CP23/10 which broadly remove the requirement for a relationship agreement and instead rely on a disclosure based regime. In our view this is the correct approach as the current regime is too complex. Issuers should disclose whether there is a controlling shareholder and a relationship agreement (or not) and investors can then decide whether to invest in that issuer on that basis (in the same way as they can in relation to an issuer which has a DCSS). With that point in mind, the provisions in LR9.2.2D to 9.2.2F requiring a separate shareholder vote for the election of independent directors in certain circumstances should be deleted.

Independence and control of business

We note the FCA's proposals to modify the current requirements so that the ESCC category is able to welcome issuers with more diverse business models and more complex corporate structures. It appears that in future the key eligibility requirements would primarily be around ensuring that issuers have the ability to keep the market up to date with information around their business operations etc together with ability to comply with the continuing obligations. We would be in favour of such an approach as it agrees with our fundamental point regarding a disclosure based market.

Reduced role for sponsors

We note that the new regime would radically reduce the role of sponsors, however, members are in favour of this as set out in our response to DP 22/2, noting the desire to make the UK regime less complex and onerous for issuers and to remove unnecessary obstacles to listing and bearing in mind that there is no comparable role in EU and other jurisdictions. We note that sponsors will have an enhanced role on listing given the more diverse group of companies who will be eligible for listing and the new continuing obligations around record keeping etc but would expect the FCA to assist sponsors with this, for example by way of guidance set out in new technical notes. In addition, members are concerned as to how the competency requirements will work in future but again would expect the FCA to work with sponsors so that sponsors are not prejudiced and suitable comparable corporate finance tests are identified.

Discounts on placings and open offers/Pre-emption rights

We note that the FCA is suggesting that the current rules around issuing shares at a discount set out in LR 9.5.10R are retained. As set out previously, our view is that these rules are unnecessary as the question of whether to invest in a new issue of shares where the discount is more than 10 per cent is ultimately one for investors. We do not agree with the FCA's view that LR 9.5.10R is not burdensome for issuers as it can constrain the way a transaction is structured due to the fear that the discount could reach more than 10 per cent if a placing is done in a live market. On a related point, we note that there is no question in the CP about retaining LR 9.3.11R as a continuing obligation for ESCC (see paragraph 5.51). Our view is that this does merit discussion notwithstanding that retaining pre-emption rights is a cornerstone of the Secondary Capital Raising Review. LR3.11R and LR9.5.10R are both anti-dilution measures, are likely to interact and so should be considered together.

We set out below our answers to the specific questions; where a question/answer is not set out members do not have a view.

Q1: Do you agree with the proposal to remove specific financial information eligibility requirements for a single ESCC category? If not, please explain why and any alternative preferred approach.

Yes, we agree with the proposal as set out in our response to DP22/2. We are assuming that prospectus content will remain the same notwithstanding the change to the eligibility requirements and the FCA appears to be taking that approach in its first prospectus engagement paper on admission to trading (i.e. if an issuer has three years' historic financial information that information should be included in the prospectus but it is not a requirement for all prospectuses to include three years' historic financial information).

Q2: Do you agree with a proposal to explore a modified approach to the independence of business and control of business provisions for a single ECSS category, with a view to enhancing flexibility, alongside ensuring clear categories for funds and other investment vehicles?

As set out above, we agree with this approach.

Q4: Do you agree with our proposed approach to dual class share structures for the single ESCC category and the proposed parameters? If you disagree, please explain why and provide any alternative proposals.

As set out above, our view is that the approach to DCSS for the ESCC should be the same as it is for standard listing currently i.e. no restrictions. The proposals are unnecessarily restrictive and investors should be able to choose whether to invest in an issuer that has a DCSS provided that the structure is set out clearly in the IPO prospectus and the investor has full disclosure.

Q5: Do you agree with our proposed approach to the controlling shareholder regime for a single ESCC category? Do you have any views on the suitability of alternative approaches to the one proposed?

Yes as set out above. Given that the FCA is moving to a disclosure based regime we think that disclosure as to whether there is a relationship agreement in the IPO prospectus and annual report together with a notification to the market if there are any changes to the agreement post IPO should be sufficient. As set out above, our view is that the provisions in LR9.2.2D to 9.2.2F requiring a separate shareholder vote for the election of independent directors in certain circumstances should be deleted.

Q6: Do you agree that our proposals as regards controlling shareholders align with our need to act, as far as is reasonably possible, in a way which is compatible with our strategic objective of ensuring markets work well and advances our market integrity and consumer protection objectives? If you don't agree, how do you believe these should be balanced differently?

Yes, we agree.

Q7: Do you agree with the proposed approach to significant transactions for a single ESCC category? If not, please explain why and any alternative proposals.

We do not have any objections.

Q8: Do you consider that additional disclosure could be considered to further support transparency to shareholders on significant transactions and, if so, what (e.g., considering current circulars)?

We consider this to be a matter for the buyside.

Q9: Should we consider further mechanisms prior to a significant transaction being formally completed (for example, a mandatory period of delay between exchange and completion) to support shareholder engagement with listed commercial company equity issuers in place of shareholder approval? What should those mechanisms be and why?

We do not think this would be helpful to the broader objectives of the reforms as this would put UK listed issuers at a disadvantage compared to issuers listed in other jurisdictions which do not have such rules in place. Shareholder engagement will take place prior to exchange when selective disclosure to major shareholders is likely to take place and shareholders will be wall crossed, following the guidance set out in DTR 2.5.7G.

Q10: Should the sponsor's advisory role in assessing whether a potentially significant transaction meets the proposed disclosure threshold be mandatory or optional, and what are your reasons? Do you agree with our proposal that sponsors have more discretion to modify the class tests, including substituting the tests with alternative measures, without seeking formal FCA agreement to the modifications? If you disagree, please provide your reasons and alternative proposals.

We note that there is a similar question in relation to RPTs (Q14). We do not have strong views in relation to whether seeking a sponsor's advice should be mandatory but we think the approach to both types of transaction should be the same. It is not clear to members why RPTs should be treated differently to significant transactions in this respect.

We agree that sponsors should have more discretion to modify the class tests, including substituting the tests with alternative measures, without seeking formal FCA agreement to the modifications as sponsors are sector experts with sufficient knowledge to apply different appropriate tests where required.

Q11: Should we consider expanding the sponsor's role further on any aspects of significant transactions?

Sponsors should not need to be further involved in significant transactions other than giving advice on the class tests if the requirement for shareholder consent and a circular is deleted.

Q12: Do you agree with the proposed approach to RPTs for a single ESCC category, which is based on a mandatory announcement at and above the 5% threshold, supported by the 'fair and reasonable' assurance model which includes the sponsor's confirmation as described above? If not, please explain why and any alternative proposals in the context of a single ESCC category.

As set out above, we do not agree with this proposal. Currently the Chapter 11 rules overlap with the regime set out in DTR 7.3R (which comes from the EU in contrast to the UK Chapter 11 rules) and our preference is that LR11 should be deleted with the regime in DTR 7.3R retained This approach would also be consistent with the accounting rules on RPTs which are disclosure based. The FCA's requirement for a sponsor opinion is imposing an additional obligation on UK issuers without sufficient justification. Deleting Chapter 11 would also put UK listed issuers in the same position as issuers listed in the EU which have similar requirements and level the playing field.

Q13: Do you consider that additional disclosure requirements could be considered to further support transparency to shareholders on RPTs, and should we consider requiring certain mechanisms prior to a deal being completed (for example, a mandatory period of delay between exchange and completion) to support shareholder engagement with listed companies to replace the requirement for independent shareholder approval?

We do not think that additional disclosure requirements are required. As set out above, requiring a delay between exchange and completion would make a UK listing unattractive and issuers have the ability to wall cross shareholders on material RPTs in any event (in the same way as they do for significant transactions as set out above). We should not be imposing requirements which do not exist in other jurisdictions without very good justification.

Q14: Should it be mandatory for a listed company in the single ESCC category to obtain guidance from a sponsor on the application of the LR, DTR and MAR whenever it is proposing to enter into a related party transaction (irrespective of the size of the transaction), or should it be at the company's discretion?

Please see our answer to Q10.

Q15: Should it be mandatory for the sponsor to consult with the FCA and agree any modifications to the class tests and classification of a proposed RPT, or should the sponsor have more discretion? Please explain your reasons.

Again, we do not see why RPTs should be different from significant transactions. If sponsors can modify the class tests for a significant transaction the same approach should be adopted for RPTs.

Q16: Are there any broader, alternative mechanisms that existing shareholders or prospective investors would want to see in place of, or made use of, in order to strengthen shareholder protection in relation to RPTs in the event that these changes are made to our LR? If so, would these be matters for inclusion in our LR or are they found, for example, in legislation or market practice?

See answers to questions above. DTR7.3 is sufficient.

Q20: Do you agree with retaining shareholder approval provisions on discounted share issuance and on share buy-backs, as currently required by the premium LR, as part of a single ESCC category, or would these be problematic for certain issuers?

As set out above, the shareholder approval requirement for issuances at a discount of more than 10 per cent should be deleted. There is no equivalent provision in other jurisdictions and again this is putting the UK capital markets at a disadvantage. Similarly, Chapter 12 of the Listing Rules should be deleted as it goldplates the buyback regime beyond what is set out in the Market Abuse Regulation and the delegated regulation on buybacks and stabilisation which seem to adequately deal with buybacks in European jurisdictions. Again, this places UK capital markets at a disadvantage.

Q21: Do you agree with our proposed approach to reporting against the UK Corporate Governance Code for companies listed in the single ESCC category, and are there any other mechanisms the FCA could consider to promote corporate governance standards?

We agree that "comply or explain" with the UKGC should be the appropriate benchmark for most issuers with the ability for overseas issuers to comply with an appropriate overseas corporate governance code. However, given that the new eligibility requirements are likely to attract SMEs, we think that these issuers should be permitted to comply with an appropriate SME corporate governance code such as the QCA code, should they wish to do so. Alternatively, the UKCGC could be adapted to alleviate the burden on SMEs.

Q23: Do you agree with our proposed changes to the LR principles? If not, please explain why and provide details of any alternative suggested approach.

Yes, we agree that there should be a single set of listing principles. We would appreciate further detail on the role of directors in ensuring compliance by listed issuers and note that this will be set out in the autumn consultation.

Q24: We are considering applying the principles as eligibility criteria, to clarify expected standards and reflect the fact that in practice these requirements need to be complied with at the point of listing. Please provide details if you foresee any issues with this approach.

We agree with this approach.

Q25: Do you agree with our proposed changes to strengthen co-operation and information gathering provisions as outlined in this section? If not, please explain why and any alternative suggested approach to addressing the issue identified.

Subject to our answer to question 27 below, we agree with these proposals which seem sensible.

Q26: In relation to our proposal to ask issuers to provide contact details of their key persons, do you think this should include details of the CEO, CFO and COO? Do you have any other suggestions as to other key roles that we should consider? Also, are there circumstances where it would be appropriate for an issuer to nominate a third party (such as an FCA authorised advisor), as a key person and, if so, why?

We agree with this proposal which seems sensible. We would not be in favour of an issuer nominating a third party as a listed issuer should be able to nominate someone at the company to perform this role which does not seem appropriate to delegate.

Q27: Are there specific considerations we need to take into account for different issuer or security types, in relation to our proposals in this section, that we should take into account as we develop our proposals further?

Information gathering is typically more challenging for companies whose control relies on contractual arrangements (i.e. franchise-type companies and royalty companies) and that it would be detrimental to the market if the new rules around co-operation and information gathering precluded such companies from being eligible for listing on the ESCC if they were able to comply with all other continuing obligations.

Q29: We welcome views from sponsors on whether they would be able to adapt or willing to provide services to a potentially wider and more diverse range of issuers? We particularly welcome any information or data on the implementation and ongoing costs sponsors may incur as a result of our proposals.

In principle, members would be willing to provide services to a wider and more diverse range of issuers but note that this topic needs to be discussed further with the FCA in terms of what guidance and support could be offered (perhaps in the form of new technical notes) when the new regime comes into force given that some aspects of the new regime will be more onerous for sponsors. The new role needs to be clearly defined from a sponsor's perspective.

Q30: Do sponsors have any concerns about performing the sponsor role and providing sponsor assurances within the model proposed? Please provide details.

See answer to question 29.

Q31: Do you have any concerns that sponsors will be able to demonstrate continued competence under our proposed approach? What matters should the FCA take into account when assessing sponsor competence?

Members do have concerns regarding how competence would be demonstrated in the new regime and would anticipate further discussions with the FCA on the topic, particularly around the type of corporate finance transactions which might be deemed equivalent. We would be in favour of AIM transactions being deemed equivalent as our most of our members are nominated advisers and are experts on the AIM regime.

Q32: We welcome views on proposed restructure of the listing regime set out above. In particular, do you agree with our preliminary proposals for dealing with issuers that are not issuers of equity share in commercial companies?

As set out above, we do not consider that SPACs, sovereign companies or strategic investment companies need a separate listing category. The new regime should be as simple as possible with the minimum number of categories.