Joint Listing Authority Advisory Panel (LAAP) and Markets Practitioner Panel (MPP) Response to the UK Secondary Capital Raising Review

LAAP is an independent non-statutory panel that advises the FCA on policy issues which affect issuers of securities, and on policy and regulation proposals from the FCA listings function. Similarly, MPP is an independent statutory panel that the FCA is required to establish and maintain under FSMA. It advises the FCA on policy issues, regulatory proposals and other strategic matters that are likely to affect wholesale financial markets. The FCA Board appoints Panel Members and not as representatives of any individual firm; they are expected to contribute to the respective Panels from the perspective of wholesale and securities markets or the primary market sub-sector in which they are working, drawing on their personal experience and industry sentiment more generally.

LAAP and MPP would like to note that they welcome the strategic opportunity to improve the efficiency of further capital raisings by listed companies, which as the pandemic has evidenced will help reduce transaction execution risk particularly during times of market volatility. Indeed, Q2 2020 saw the most follow-on operations in a fiscal quarter (212) since Q2 2007 (224). Since March 2020, £14bn has been raised through secondary capital, 15% of total capital raised. Implementing forward-thinking changes without compromising quality will help to further enhance the attractiveness and competitiveness of London's offering as a listing venue and international financial centre.

This joint response reflects views widely held by LAAP and MPP Members and does not necessarily imply unanimity.

Can and should the overall duration and cost of the existing UK rights issue process be reduced? In what ways?

The Panels strongly believe that duration, cost and complexity (most notably disclosure and documentation obligations) should be reduced to deliver a more efficient and de-risked UK rights issues process.

With the current minimum rights issue trading period set at 10 days, it is possible that any reduction in this period may reduce take-up without the introduction of a number of concurrent changes to the process. Given the importance of minority shareholders, particularly those who may hold shares in certificate form, having the opportunity to review all of the documentation and options available to them is essential. However, a shorter trading period would reduce transaction execution risk and the likelihood of external factors having a major impact on the outcome of a capital raising transaction. Institutional and retail shareholders do not necessarily need 10 days as a reasonable time period to gain the comfort they need in order to support a capital-raising. Clearly, this could be done quicker if circumstances, and the shape of a register, permitted. On that basis, key measures that the Review may wish to consider include to:

1) Preserve pre-emption with PEG – codify the ability and freedom to issue 20% (or more) non-pre-emptively even if only in certain prescribed situations to provide safeguards to both wholesale and retail investors. Alternatively, companies could be allowed to seek annual pre-approval from their own shareholders to issue 20% (or more) non pre-emptively again with appropriate safeguards in place to allay investors' concerns. Another alternative might allow 20% (or more) on a 2-year rolling basis with the deployment of a sunset clause.

2) Simplify or remove prospectus requirements - as being considered by the Prospectus Regime Review for pre-emptive issues move the public offer 20% limit (i.e. requiring a prospectus) higher so that a rights can be done without a prospectus for up to 50% of market value or similar. EU prospectus rules require burdensome disclosure for UK listed issuers already subject to DTR and MAR rules. For rescues or larger transactions, firms would still need a prospectus but for a material class one it would be a lot quicker and cheaper. On retail offerings, equity offers of over €8 million or to more than 150 retail investors triggers the prospectus requirement hindering the levelling up of access to those investors and the broadening of the shareholder base.

3) More proportionate documentation requirements – noting the breadth and complexity of ongoing disclosure requirements that both need to be satisfied by existing listed companies and remain accessible to shareholders and potential investors. The production of disproportionate documentation and comfort packages cause considerable difficulties when executing rights issues, especially in situations when firms need certainty in pursuing an acquisition or emergency refinancing. The Panels recognise however, that the drive for a more efficient and quicker rights issue process needs to be balanced with liability concerns. A 'light' prospectus and reduced documentation has the capacity to increase liability if important details have not been disclosed or investors perceive as much.

4) Utilise investor protection bodies –to provide greater flexibility and/or clarity on what is acceptable or not in terms of market practice to give greater clarity on likely voting intentions. Precedent exists here in the Investment Trusts sector where specific guidelines have been issued by the pre-emption group and a number of institutional investors are open to approving properly justified waivers even if beyond these guidelines.

5) Introduce greater flexibility for M&A – particularly in relation to reducing the complexity, costs and timing of rights issues conducted to finance accretive M&A. UK Plc is too often counted out of auction processes because of being less flexible and competitive to private and non-UK listed bidders in respect of timing. Standby underwritings are one structure used to help mitigate this issue, but this approach is generally unfavoured by UK institutional investors. The Pre-emption Group could potentially consider a relaxation to 20% or greater if equity placing is specifically to finance M&A and help UK listed companies to be more competitive in an M&A process.

Other measures that the Review may wish to consider include to:

- Promote the standardisation of equity market agreements to drive efficiencies across underwriting, placing and sponsor agreements akin to debt markets could help reduce legal costs.
- Establish more standard market practice in terms of observing soft pre-emption on non-pre-emptive offerings.
- Reduce the nil-paid trading period.
- Replace the Pre-emption Group with an alternative consultative body or rules.
- In relation to acquisitions, amend the requirements for financial disclosure on targets under IFRS to allow GAAP disclosure (potentially with reconciliation) or incorporation by reference would reduce time scales to compile disclosure.
- Greater promotion of sub-underwriting, which has reduced in frequency and quantum in recent years.

Should new technology be used in the process to ensure that shareholders receive relevant information in a timely fashion and are able to exercise their rights and, if so, how?

The pandemic further evidenced that technological advances can and should be leveraged to allow for shareholders to exercise their rights. The temporary CIGA relaxation of certain requirements in relation to AGMs with meetings held virtually and votes cast electronically illustrates the potential to democratise retail investment. The Panels acknowledge that legislative clarity is required to address legal doubts about the validity of digitisation and the concerns of some investor bodies.

UK listed companies can encounter difficulties when trying to access shareholders who hold shares within a nominee account, particularly retail investors. This limits their ability to offer soft pre-emption to this group when conducting accelerated capital raisings. Alternative methods of reaching this investor base quickly during a capital raising could be explored. When UK retail investors hold their shares on digital broker platforms, these platforms should have the ability to provide near real time access to individuals who hold shares in a company which is raising capital and allow them to make digital purchases accordingly. For digital broker platforms to invest in building this capability to connect and offer out to clients, it remains important that they are confident that sufficient issuance would occur to warrant this investment in democratising retail investment access. The existence of PEG guidelines could provide them with this comfort.

A similar opportunity exists to accelerate and future-proof the transition to the full dematerialisation of both quoted and unquoted (especially as paper certificates will remain in circulation) issuances by incentivising the adoption of Distributed Ledger Technology (DLT). This could allow for issuers to more readily obtain information about the shareholder register in accordance with Companies Law and formulate an accurate plan on who reach out to, potentially reducing discounts on rights issues.

It may be worth modifying existing legislation to enable even greater clarity on shareholder identity and register analysis to identify institutional/retail split of registers and facilitation of equity fundraising structures. The ability to more easily distinguish between retail and institutional investors can add transparency around short selling in an increasingly coordinated retail trading environment. This may curtail the potential for market abuse with the Gamestop short-selling incident demonstrating the emerging challenges facing market oversight and maintaining market integrity when opening up capital markets.

There is also a clear potential for the use of some form of online portal for shareholders to receive requisite information and vote/elect their desired intentions in relation to their rights. This adoption will reduce friction, allow easier responses and potentially allow reduction in either notice or nil-paid trading periods.

Are there fund-raising models in other jurisdictions that should be considered for use in the UK? For example, the use of cleansing notices in lieu of prospectuses on secondary capital raisings in Australia and also the Australian ANREO, AREO (or RAPIDS), SAREO and PAITREO structures?

The Australian accelerated rights issue models differentiate and tailor the documentation (shorter form) requirements and book building between institutional and retail shareholders imbuing the process with an appropriate

amount of flexibility. This in turn enables the offer to institutions to complete in a few days compared to the UK with the offer to retail shareholders proportionately open for a longer period.

It is therefore worth contemplating Australian structures, particularly on the question of introducing a shorter rights issue trading period in the UK. The dual tranche institutional and retail offers facilitated by some of the precedent Australian structures are sensible and effective in reducing costs of underwriting.

The Panels recognise that the former FSA[1] expressed concerns around the adoption of the RAPIDs model including around shareholder authority, equality of treatment and compensation as well as splitting the register in the shortened period. The leveraging of DLT technology should, however, address a number of these concerns with digitisation enabling the issuer to effectively set the criteria for splitting the register and categorise investors correctly. Combining the RAPIDs model with SAREO can also help address retail investor concerns that institutional shareholders may receive more favourable compensation.

Has the greater transparency around short selling that was introduced after the financial crisis benefited the rights issue process and is there more that can and should be done in this area?

The Panels believe the current transparency is fit-for-purpose.

Are there any refinements that should be made to the undocumented secondary capital raising process in light of recent experiences during the Covid-19 pandemic?

The majority of Covid-19 placings worked incredibly effectively and clearly demonstrate the benefits of permanently relaxing the Pre-emption Group limit to 20% (or more). Sustaining this flexibility in helping companies access growth and emergency capital can enhance the UK's ability to attract more high-tech and other growth company IPOs.

During the pandemic, between 1 April and 30 November 2020, 38 Main Market companies raised a total of £7.9bn through Accelerated Book Builds, where between 10 and 20% of the company was sold, showing how the relaxation allowed companies to raise larger amounts of capital when they needed it most. On that basis, a differentiated approach based on level of capital raisings could be set up:

- For issuances below 10% of existing issued share capital, the issuance of capital on a non-pre-emptive undocumented basis should be maintained.

- For issuances between 10-20% of issued share capital, alternatives to a fully pre-emptive documented structure could provide sufficient comfort and safeguards to investors regarding pre-emption, whilst allowing companies to access capital markets on an accelerated basis.

- During the pandemic, soft pre-emption was broadly observed by issuers who also made efforts to include retail investors in capital raisings. This approach could be maintained in a system where issuers raising capital between these levels on an accelerated basis must make reasonable efforts to reach their shareholder base and offer soft pre-emption. This change would require a

[1] *Report to HM Treasury on the implementation of the recommendations of the Rights Issue Review Group*, Financial Services Authority, April 2010

permanent relaxation of the PEG guidelines (moving from their current 10% guidelines to 20%). How issuers achieve the objective of observing soft pre-emption could be set out in guidelines, which could be produced and overseen by the PEG.

- For pre-emptive issuances above 20%, the goal should be to reduce the cost and time taken for issuers to access the capital markets, while providing full pre-emption to all existing shareholders. A rights issue process can currently take up to 4 months to execute. The Prospectus Review will highlight circumstances under which a Prospectus is required to be produced, including when conducting a follow-on offering. This could in turn discourage the blocking of retail investors by default with proportionate documentation that meets MAR requirements for shareholder disclosure.

Are there any other recommendations or points made by the Rights Issue Review Group in 2008 that should be investigated further?

The Panels do not believe so.

In what other ways should the secondary capital raising process in the UK be reformed?

The Panels believe that the historical financial information requirements on target companies for Class 1 and/or Prospectus disclosure can be a huge impediment to the ability for UK listed companies to be competitive in auction processes or preclude participation entirely. Changes should be made here to increase flexibility of UK listed companies in competitive M&A processes

Similarly, pricing limits imposed by the Listing Rules on non pre-emptive cash placings with rules currently forcing some companies to launch ABBs in live markets, rather than post-market close. There remains the situation in volatile markets where deals cannot be launched at all and the Panels advocate that consideration should be given to this as part of the Review. Finally, the limits and restrictions on pre-placing of nil-paid rights should be also considered for reform.

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