Joint Listing Authority Advisory Panel (LAAP) and Markets Practitioner Panel (MPP) Response to DP22/2: Primary Markets Effectiveness 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.

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

Firstly, LAAP and MPP would like to note that they consider the FCA's proposal to be a thoughtful response to Lord Hill's recommendation. The DP has kickstarted a much needed and wide-ranging debate amongst market stakeholders as to what the appropriate structure for the main market should be in the coming years.

What is evident is that the UK has a once-in-a-generation opportunity to implement radical reforms to ensure that it not only remains but also advances as a thriving and relevant international listing and capital-raising destination. The Panels nevertheless recognise that reforming the main market's listing segments is only one element of the wider exercise of regulatory reform - which itself is only one of the issues that need to be addressed to keep the UK capital markets relevant on the global stage in the coming years.

This approach should include continued thoughtful collaboration and coordination between regulatory and governmental authorities, including of course the market, as well as bold and brave thinking to ensure that the breadth of policy initiatives do not conflict with or offset the benefits of one another.

Without this essential modernisation, the Panels remain concerned that the UK's status as a global capital market runs a material risk of diminishing to that of a regional exchange and that the size of the UK public capital markets will continue to shrink should the current trend of public to private takeovers continue – given the capital resources available to private equity and current market prices – and if the IPO pipeline is not stimulated materially.

Many of the wider issues that need to be addressed are not in the FCA's purview – but it needs to continue, as it admirably has been, to be bold and brave in moving on those that are. This effort is likely to mean needing to challenge complacent attitudes held by some stakeholders as well as the FCA speaking to stakeholders in the market who it might not normally be able to access, given the importance of obtaining a fully representative view, including from global investors and international issuers.

While the UK was in the EU, for the past couple of decades it was more often than not the default listing venue for international and domestic issuers, including those that chose not to list in NY for whatever reason. Now that the UK is outside the EU, that is no longer necessarily the case. Issuers increasingly consider venues such as Amsterdam but also Paris and Frankfurt – and achieve similar valuations to those achievable in London, similar liquidity and with a similar investor base taking part. Even Warsaw has shown recently that it is able to host large IPOs at attractive valuations and with the participation of global investors in the same way as would be the case in London or any other European venue. And continental European listing venues are not seen as remiss in either corporate governance or regulatory terms, they are seen as pragmatic and flexible.

And we know that they are becoming increasingly focused on being competitive and relevant ahead of other venues. Only recently we have seen the Future Funding Act proposals in Germany and new IPO rules from the EU. We are in a foot race with our competitors, and we cannot afford to be ignorant of that or complacent about what we need to do if we want to stay relevant.

There are many issues that feed into the UK capital markets not being chosen by putative issuers when a decision is made to list elsewhere, many of them outside the FCA's remit, but in the context of PME Review 2 discussions what does this mean?

It means that we as a jurisdiction cannot and should not continue to assume that the 'gold plating' that we currently have in place in regulatory terms is necessarily fit for purpose for our markets if we want to keep them relevant in the coming years. It was relevant in the past couple of decades, but it is unlikely to be in the coming two decades unless we are satisfied with slipping gently into being a relatively mid-market, regional capital market. The Panels consider that we should be much more ambitious than that, particularly given that we were vying with New York as a financial centre not that long ago.

This then leads to the essential baseline question: how we should reform our public capital markets? Amsterdam, Paris and Frankfurt follow the EU minimum standard – our 'standard listing' regime. So, our first question should be to assume that as the default for the UK as well. And justify – objectively and clearly – why anything that is added on top of that is required and what benefit it will bring to the UK capital markets in the future to have it, including considering how it will impact our relevance when compared to other listing venues.

Following that logic, the listing regime should move from being 'restrictive' in philosophy and overly black letter rules-based to being disclosure-based, in line with the holistic and principles-based approach to regulation that the FCA is already espousing and the disclosure-based approach that it is already proposing to follow in relation to track record requirements and working capital statements. This involves, as a principle, assuming a return to the disclosure-based approach that was followed when the FSA, as was, took over the listings function from the LSE.

A 'caveat emptor' approach, where investors can choose whether or not to invest based on the information that has been put in front of them, will also help to ensure that there is no risk of information asymmetry in the public domain. This will help to promote efficient markets and ensure that the requirements for issuers to prepare and provide sufficient information for stakeholders remain proportionate - noting too that there will sometimes be information required by other regulatory jurisdictions.

An Alternative Listing Structure

Priority should be given to the simplification and marketability of a single main market listing segment and reconsideration of the role and utility of the sponsor regime with changes that are well understood by all those in the market from issuers to investors and aligned with third party constituents including FTSE indexation.

On that basis, the Panels propose an alternative listing structure consisting of one genuine single segment for equity shares in commercial companies instead of the proposed mandatory and supplementary split. This would prevent the creation of what would effectively be a two-tier segment given the requirement to have a shareholder vote to move between mandatory and supplementary obligations.

The FCA's current proposed criteria, both at the eligibility stage and post-listing, remain in some respects onerous and could operate as a competitive disadvantage when put side by side with other listing venues with which the UK competes.

The core tenets of the new single segment regime should be market led through adequate disclosure and choice – namely that investors can choose whether to invest once they have appropriate disclosures.

Index eligibility – with indexation as the default for the new segment - will of course necessarily need to be reviewed upon the introduction of a single listing segment given that only premium listed issuers are eligible for FTSE UK index inclusion under current FTSE Russell policies. As was said in the Hill Review, there is a strong case for breaking the link between the premium listing regime and FTSE UK indices inclusion. That is a matter for FTSE Russell, but the FCA can seek to neuter the point by simply having one listing segment, based on standard (and with very little added to it) and then leaving it to FTSE Russell to decide whether issuers on the segment are index-eligible or not. Ideally, going even further, the desire for issuers to feel the need to seek UK index inclusion – the importance of which is very much debatable these days and in relation to which the Panels will source further data for the FCA - would be weakened or removed entirely as the link / perception of the need and value of such inclusion currently holds back sensible and necessary reform and modernisation of the UK public capital markets.

It is difficult to quantify the benefit of index inclusion in terms of valuation or otherwise and whether index inclusion solely drives valuation and/or liquidity. However, a key question is what the role of indexation is and whether indexation should be a driver on the debate for reform to create relevance or rather whether it should be the product of reform, as the Panels consider should be the case.

We reiterate that the preference for a single segment does not however necessarily mean abandoning the requirements of the premium listing segment in their entirety and a wholesale adoption of the rules of the standard listing segment. Reform needs to be carefully balanced with the need for appropriate governance standards, in particular recognising that some investors are active and some passive. But, as said above, anything that is retained over and above the standard listing requirements should be rigorously justified in terms of why it is relevant to be kept.

In the above context, the Panels propose the following changes to maximise the opportunity to stay relevant offered by the introduction of a genuine single segment:

Significant Transactions regime

If the regime is to be retained at all, changing the significant transactions threshold and/or class tests (with particular thought around the profits test) would both decrease the burden on the FCA, issuers and sponsor banks whilst ensuring that shareholders are only voting on transformational transactions outside of the remit shareholders have already given management. Amongst other things, the current class tests can be a significant obstacle for UK companies competing in an M&A situation versus private equity or other bidders without similar governance and/or in overseas deals.

To that effect, we suggest:

- Raising the class test threshold to 100% so that only material transactions - i.e., a fundamental change in the nature of the business that are outside the scope of the company's existing stated strategy - require further shareholder approval. As mentioned, amongst other things, the current class test threshold puts UK-listed companies at a material disadvantage versus private buyers of target assets (especially private equity bidders) as well as when making acquisitions of listed companies outside of the UK, particularly in the US. The execution risk associated with having to prepare a circular, running a general meeting notice period and the need for shareholder approval makes both UK-listed bidders and the UK, more generally, unattractive. Raising the threshold to a genuinely material level would help to address this. It also aligns with the AIM approach that only reverse takeovers require shareholder approval. The Panels will also provide the FCA with some data around the prevalence of such transactions on AIM.

- Removing the requirements for working capital statements from class 1 circulars in their entirety on the basis that the going concern requirements and the Board's assessment that there will be no change to the going concern statement following the transaction remains.

- Removing the need for approval of class 1 circulars by the FCA.

- Consideration of whether the effective statutory PBT measure is appropriate for all companies and/or whether EBITDA or another measure on the face of the income statement is more appropriate or, at most the class tests are restricted to only one metric, for example market capitalisation/consideration.

In addition, it is worth considering whether or not there is a need for shareholder approval for significant transactions at all and/or for the FCA to review any circulars because it is market practice to wall-cross investors ahead of significant transactions and as such were key shareholders not supportive, the announcement and transaction would not proceed to announcement or circular publication, so the market is self-policing board decisions in this respect given how UK MAR works.

Related party transactions regime

We suggest the regime be based on DTR 7.3 not LR 11, removing the need for a separate regime or sponsor with the alignment in well understood materiality requirements.

Closed ended investment funds

We suggest that the FCA retain the existing Chapter 15 regime within the new single segment as this works in practice - noting the suggested changes to the significant transactions and related party transactions as above.

Eligibility Criteria

The Panels strongly agree with the FCA's proposals regarding the removal of the revenue track record, 3-year historical financial information and clean working capital statements, thereby placing greater emphasis on market-led disclosures.

We also suggest that the FCA recast and simplify the sometimes-confusing terminology around eligibility criteria to help stakeholders better understand what shareholder protections are trying to achieve.

Corporate Governance Code

It would be appropriate to distinguish between UK and non-UK issuers in this context as creating additional hurdles for entry to listing for overseas companies would be contrary to the overall aim of maintaining and enhancing the UK as a competitive and relevant listing venue.

We therefore suggest that issuers continue to have to comply or explain with the UK Code on the understanding that overseas issuers can comply or explain against their own code, which is in line with wider disclosure-based approach.

Dual Class Share Structures

The Panels suggest that DCSS should be based on the current standard listing approach, not premium. Issuers would be able to decide on the particular structure of DCSS that suited their needs – which may go further than the conditions applied to DCSS in the current standard segment – with index providers then able to specify any criteria they may expect to see in order to permit index inclusion.

Controlling shareholders and independent business

We suggest that the arrangements put in place to address these points should be disclosed in an IPO prospectus and on an ongoing basis in an issuer's annual report but the formal need for any additional requirements including existing Listing Rules requirements such as LR6 should be removed given that there is disclosure and therefore investors are aware of the situation of individual issuers and will be able to engage with them if they feel the arrangements proposed require amendment or further discussion.

Overseas Issuers

We suggest the FCA accepts international issuers defaulting to home market rules where there is a clash, for example with pre-emption. Standard listed issuers would not need to continue to apply for secondary listings.

We remain conscious that the treatment of GDRs needs to be finely balanced. Almost exclusively they are dual listed and would therefore operate under a foreign legislative and regulatory framework. The difference between a share and a GDR is one of settlement, not fundamental economic or structural design of security.

Retail Investors

To facilitate the participation of retail investors at ground level, we suggest the inclusion of a mandatory minimum 10% retail tranche for IPOs. This would be a minimum to be offered, not a minimum to be allocated. As recommended in the UK Secondary Capital Raising Review (UK SCRR), alongside this the current six working day period for a retail offer to have to be open on an IPO should be reduced to a maximum of three days.

Discount limit for placings

We suggest that the 10% limit for placings should be removed. A significant price discovery process is embarked upon in connection with a placing including pre-marketing meetings with key shareholders and (unless it is a fixed price offering) a book-build process. It is worth noting that there is no equivalent restriction on AIM or in many other jurisdictions.

Sponsor regime

The sponsor regime needs to be clearly understood and proportionate with no room for hidden costs (actual and/or frictional) for issuers or sponsor firms to deliver transparency and best advice to demonstrate benefit to all stakeholders.

The regime remains poorly understood or even known about by investors, who ascribe little or no value to it. If it is to be kept at all, it should be a regime where it is clear to directors and the sponsor, and of course investors, what exactly are the expectations of applicants and consequently appropriate diligence for any statements made for the purposes of listing.

The regime is also not a feature of many peer listing venues such as the NYSE, Euronext or NASDAQ and they are not considered to have inferior governance standards – this reality can have a negative impact on attracting listings to the UK's public capital markets.

Whilst the Panels continue to question the whether the regime should be retained by default given our support for the UK SCRR's recommendation that no sponsor should be required on a secondary fundraising - if it is to be retained, going forward there should be a more principles-based and simplified sponsor regime to further enhance the deal making effectiveness of UK plc and sponsors utility to the market and the FCA.

Having a sponsor for new applicants with a defined role might help achieve the FCA's objectives and reduce the number of transactions requiring its oversight as a third party providing 'expert' diligence on suitability for listing. To achieve this the FCA should be clear about which areas of diligence sponsor firms are responsible for and why the sponsor is needed – particularly in relation to LRs10/11 whilst considering a disclosure-based regime in terms of investment decision making.

To clarify the role and maximise the utility of sponsors, we suggest that:

- Sponsors are only required for an IPO or a reverse takeover (unless the target is already listed as per the distinction drawn in the existing Listing Rules) but not a class 1 circular or related party transactions.

- Sponsors should not be required to support issuers in areas where they do not have subject matter experience or expertise. For example, the requirement to diligence the ability of issuers to make climate related disclosures in order to comply with LRs 8.2 and 8.4 where issuers will already have engaged third party experts. This is different from challenging the work of third parties such as reporting accountants or CPR providers where sponsors will have considerable experience of these areas.
- In order to ensure that appropriate levels of diligence standards are maintained - including for example, with respect to working capital statements if they are required - the FCA could publish guidance on its expectations in relation to these standards and the comfort that should be provided by advisers, including accountants.

- The onus should be on issuers to provide the necessary disclosures. Consideration should also be given to the role of brokers on a listing and on an ongoing basis and the potential combination of roles to further reduce costs and complexity.

SIGNED

Mark Austin

Chair

FCA Listing Authority Advisory Panel

SIGNED

Michael Findlay

Chair

FCA Markets Practitioner Panel