The Right Hon. Lord Hill
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

8 January 2021

Dear Lord Hill

FCA Listing Authority Advisory Panel (LAAP) response to the Call for Evidence by Lord Hill's Listings Review

LAAP is an independent non-statutory practitioner Panel that advises the FCA on policy issues which affect issuers of securities, and on policy and regulation proposals from the FCA listings function. The FCA Board appoints Panel Members and not as representatives of any individual firm; they are expected to contribute to the Panel from the perspective of the primary market subsector in which they are working, drawing on their personal experience and industry sentiment more generally.

Please find below the Panel's response to the Call for Evidence, which does not seek to answer all the specific questions raised but does address each of the subject areas mentioned. It also provides thoughts on some other areas, noting the Review's update to the Call for Evidence on 16 December 2020 to clarify that it is keen to encourage a broad discussion as to how the UK's capital markets and the City's role in developing them might be strengthened.

Free float

Definition of free float

There is often a debate about what constitutes "shares in public hands". Companies undertaking an IPO often have much more diversified pre-IPO shareholder registers than in the past and the lines between a public investor and a private investor are becoming more blurred, as large investors are sometimes both. This has complicated what for a long time was an adequate process for assessing a company's free float. The Panel views there to be a need to consider a more suitable set of guidance to bring greater visibility to the free float test. However, the regulator should retain optionality to provide one-off waivers as this flexibility can be useful. Definitional thoughts for shares that are in public hands that could be considered include:

- Underlying funds: testing the underlying management of the funds. While an investor might own 5%, it might be diversified across different fund managers that can make independent decisions

- Fund nature: testing whether the investor is a recurrent holder of listed securities

- Locked up shares: making some determination around the amount of shares that are locked up and those that are not

- Type of investors: labelling shareholders as public, private or crossover

- Number of shares that are free to trade: producing a separate notion of the amount of shares that are effectively free to trade

- Non 'inside' shareholders being treated as free float: e.g. without a board seat or sovereign wealth fund shareholders that are acting in a purely investment capacity not being treated as being in concert with governments or greater flexibility for investors that hold through different underlying funds, further the first bullet above

Reform options

The question of what the criteria should be in relation to free float tends to zero in on whether free float is more to do with liquidity, which we also know has long been the FCA's view, or alternatively governance and, in particular, the continuing control that a majority shareholder may be able to exercise over a company following listing, potentially to the detriment of the interests of minority shareholders.

It seems to the Panel that there are three broad options available in terms of reform, namely:

- Keeping a set percentage of shares that must be in public hands, as at present – either at the current percentage level, with the ability for the FCA to waive this down, or at a lower level

- Keeping a set percentage but changing the basis on which free float is calculated – for example, allowing shares that are locked up to be included, as well as potentially making an assessment of the types of investor that hold the shares for example

- Replacing the requirement for a set percentage of shares to be in public hands with another measure or measures of liquidity – for example, the absolute value of the shares in public hands and/or the number of shareholders, as is the case in the US (noting that requiring a large number of shareholders may be likely to compromise the ability of smaller companies to list). It is also noted that some major index providers, such as MSCI, use liquidity tests for index inclusion. It is also understood that over 35% of MSCI is either controlled by an outright majority of shareholders or is effectively so controlled

It would seem to the Panel that there is a case for a debate over whether a set percentage of shares should be replaced with other measures of liquidity – for example, as mentioned above, in the US both NYSE and NASDAQ have criteria involving minimum numbers of shareholders, minimum numbers of publicly held shares, minimum market values of publicly held shares and minimum share prices. These measures of liquidity would seem particularly relevant to larger companies coming to market, where for example 25% of shares held in public hands for a company with a market capitalisation in the hundreds of millions or billions is arguably an unnecessarily large level of liquidity to have to attain.

The diversity of companies on public markets should be taken account of - for some a 25% threshold is appropriate and achievable, for others it is a barrier to public markets, for example it might represent a greater proportion of the company to be sold at IPO than is desirable for existing holders, whilst at the same time does not necessarily lead to desired liquidity outcomes. It therefore may be the case that several liquidity measures should be applied.

In relation to whether free float is rightly more about governance and control, there is a debate to be had as to whether it is the right way to control the actions of a majority shareholder The FCA already has a controlling shareholder regime for companies listed on premium listing segment, which seeks to regulate majority shareholders – with a requirement for a relationship agreement to be put in place between the controlling shareholder and the issuer in order to regulate the actions of the former. Perhaps seeking to amend this regime as necessary to ensure control cannot be abused – for example, additional protections for minority shareholders in such companies - would be more appropriate than seeking to regulate such shareholders through the free float requirements.

Failures of corporate governance involving major shareholders have not tended to happen in companies where there has been a lower than 25% free float but rather where either the controlling shareholder regime was not yet in force or was not applicable or not fully observed. For example, it is difficult to see the causality between poor governance and free float when ENRC listed in 2007 with 18% free float as the outcome would have been the same with a 25% free float.

Perhaps the point should simply be more emphasis being put on appropriate disclosure of the nature of the shareholder base of a majority-controlled company so that investors are able to make a fully informed decision as to whether to invest in such entities or not. In any event, it may be that free float should properly be more about liquidity than control.

The Panel also notes that any discussion of free float amendments should seek to ensure engagement with FTSE as well, from an index inclusion point of view.

Dual class share structures (DCSS)

The Panel notes that DCSS are already permissible in any form in London on the main market so far as the FCA is concerned, provided that a standard listing is sought by the relevant issuer. It also notes that, as well as a DCSS needing to be acceptable to the FCA, the structure in any individual case would also need to be approved by both the Takeover Panel – in particular in relation to the structure's inter-relation with Rule 9 of the Takeover Code, frustrating action and concert parties - and probably by HMRC as well, in order to assess the stamp duty, capital gains and employment tax implications of implementing the structure.

The Panel also notes that there are already three premium listing categories – namely for commercial companies, closed ended investment funds and open-ended investment companies – reflecting the different nature of issuers that are currently able to list on the premium listing segment. There are also several concessionary routes to a premium listing – namely for mineral companies and scientific research-based companies as well as potentially property companies, plus there are others that have existed in the past, for example – perhaps ironically - in relation to innovative high growth companies (the old Chapter 25 of the Listing Rules).

The various categories and concessionary routes reflect the different types of issuer that are able to list in London and the flexible and thoughtful nature of the regime. At a high level, the present discussion around the potential application of DCSS can be seen as a continuation of the development process of the London markets, aimed at ensuring that they continue to provide a primary market environment that caters for as wide a range of issuers as possible, alongside of course appropriate regulatory safeguards.

At present, in order to list in London, founder-led companies need to be considered as fully-fledged commercial companies at the point of listing. Given the nature of such companies, it must be unlikely that they will always be able to - or perhaps should be expected to - make that transition fully prior to that point and also before they know for certain that the listing will proceed. The move to a public listing almost always necessarily entails a shift, often material, in the culture of a founder-led company that has only previously existed in the private sphere and that, more often than not, has been in scale up mode. And it is precisely that culture – and the 'vision' of the founder – that has led the company to its level of scale and success and it is precisely that vision and culture that investors are now seeking access to.

If that premise is assumed to be correct and it is combined with the presumption that London, as a diverse, mature and leading listing venue, should be able to offer founder-led companies an attractive listing option in comparison to other jurisdictions - including the ability to list and still, for a period, maintain the necessary control to promulgate the founder's vision for the company - then the ability for the premium listing segment to accommodate DCSS should be debated.

When founders bring their companies to market they often seem to be concerned mostly about the promulgation of their vision not being derailed by being removed as a director/CEO. However, the Panel has discussed that perhaps the bigger risk to founders as they come to market is that their vision is not able to come to fruition because the company, once listed, is able to be subject to an opportunistic takeover bid by relatively new investors in the company at a conventional bid premium to the market price. There are many examples of technology companies coming to market and having had this happen – for example, ARM, Sophos and Worldpay.

If that is right then providing founders with a transition period during which they are able to ensure that control is retained – on the basis of their vision and control rights having been fully disclosed to prospective investors at the time of listing – would seem to be a potentially sensible move from the point of view of developing London's listing regime. The Panel also notes that preventing DCSS from being used on a premium listing drives an issuer to a standard listing, where more actions can be taken by a founder without shareholder approval, making the governance framework weaker – which in itself is not an effective method of protecting investors.

It goes hand in hand with the idea that companies with DCSS are in a transition period that such rights should only be permitted for a finite period. The Panel is aware of academic research that supports this as well – as it seems to be the case that as time passes the potential costs of DCSS tend to increase and the potential benefits tend to erode. It is also apparent from academic research that, at the time of IPO, companies with DCSS tend to have higher valuations than issuers with a single class of shares, with the valuation premium dissipating over time and turning to a discount about six years after IPO.

It is noted that careful consideration would need to be given to who constitutes a 'founder' for these purposes and so which companies should be eligible for any permissible DCSS regime. For example, many private equity-backed companies come to market with majority shareholders who are instrumental in guiding the company in question and there is a debate to be had as to what extent DCSS should be available to them and other issuers. Or should it be a question of the concession being open to all but then being down to whether investors are willing to accept it in relation to the company in question during PDIE and the wider marketing process, for example. Or should a set of qualifying criteria be put in place – as is the approach taken in Hong Kong and Singapore. And as was also the case for innovative high growth companies under Chapter 25 of the old Listing Rules in London. The Panel comes back to this area later on in this response. However, areas that the Panel considers should be thought about in the context of DCSS include:

- Applicability: should a DCSS regime only apply to founders or to all pre-IPO shareholders?

- Transferability: once the shares are sold or transferred do they become ordinary common shares?

- Extent of control: the weighted voting control that the B shares confer – 49%, 75% or 100% / other

- Sunset clause: what is the right length of time? As mentioned above, academic literature seems to suggest that valuation premium of DCSS erodes after a period of 5-7 years

- Carve-outs: should the weighted voting rights be limited to certain permissible areas?

- Service clause: Should the shares cease to infer enhanced voting if the founder ceases to be executive of the company?

- Legal status: what should be the legal structure as well as liquidation preference, dividend entitlements, etc?

- International application: how is it ensured that the structure benefits international investors? The Loi Florange in France that accords double voting rights to shares held over a certain period of time is only implemented in certain French custody accounts and thereby much harder for international investors to avail themselves of the same benefit that accrues to similar French funds / government entities

Track record requirements

The Panel has discussed at various times in the past whether the balance between backward-looking information and forward-looking information is currently appropriate in relation to new issuers coming to market on the premium listing segment. It is considered that the value of a company at listing is determined as much, if not more, by its future prospects than by its past performance. Past performance is clearly important and some track record needs to be disclosed but its purpose, arguably, is actually to validate the forward-looking commentary in relation to the relevant issuer – which is, though, also a reason why three years is a sensible period to have to be included, as it is less easily able to be manipulated than if, for example, only one or two years of information was needed.

It is noted that there are already exemptions to the three-year track record requirement for premium listed scientific research, mining and property companies and that an issuer seeking a standard listing can present a shorter period if it has not been in existence for three years.

At present, absent fitting within any of the existing exemptions, issuers on the premium listing segment come to market with three years of historical financial information contained in the registration document and prospectus. There is also, as there should be, a full description of the operations of the company in the business section. However, forward-looking information is limited to what is often half a page or less of narrative disclosure in the 'Current trading and prospects' section of the document. There is outside this an involved process by which analyst and investor models, via relevant pieces of information being included in the analyst presentation and the prospectus, are able to be tuned to the views of management.

This balance would seem to be wrong. It is clear that when companies raise capital prior to listing, whether in funding rounds or otherwise, prospective investors are more than anything keen to understand a forward-looking assessment of prospects for the company. This is often achieved by business plans being provided. Yet when it comes to what is invariably the biggest liquidity event / funding round of that company's development, similar forward-looking information cannot be provided without triggering the profit forecast regime and the attendant potentially unattractive liability consequences for the company and its directors.

The Panel considers that it would be worth exploring whether the forward-looking information regime should be reformed to make it more usual for increased forward-looking information to be provided. This would, amongst other things, probably involve legislative changes to amend the liability regime for directors. For example, perhaps directors should be able to disclose the company's financial model should they wish, with a defence to liability similar to the FSMA due diligence approach being adopted – i.e. that no liability would accrue if the model turned out not to be how things developed, provided the directors honestly believed the model to be true at the date it was published and that it was prepared with appropriate care, skill and diligence.

The Panel also notes that in Chapter 25 of the FCA's old Listing Rules, which related to innovative high growth companies, amongst other things there was a requirement for "*an explanation of capital expenditure plans and financial commitments together with an estimate of funding requirements of the business for a period of two years following the listing and a statement explaining how these requirements will be met, under current estimates, with reference to existing resources and the proceeds of any issue of securities made at the time of listing*". This is mentioned just to note that similar forward-looking information ideas have been used in the past. While the above past formulation may not necessarily be precisely fit for purpose today, the broad concept may be worth reconsidering.

Separately, and noting its comments about the downsides of shortening the three-year period set out above, the Panel considers that there is a case for at least examining whether the current three-year track record requirements are fit for purpose in terms of their duration and/or exemptions made available for certain additional types of issuers. This may in particular be relevant for certain types of issuers such as technology or biotech companies.

It is also worth examining how the 75% requirement is applied and whether it is fit for purpose. It can sometimes result in perhaps not overly useful pre-acquisition information being presented for acquisitions and it could be that a more nuanced method of establishing a three year track record could be used.

Prospectuses

As noted above, the Panel considers that there is a case for considering permitting the inclusion of more extensive forward-looking information in prospectuses, both on IPO and when published as part of a secondary capital raise. There is also a case for a recasting of the prospectus regime to separate out admission to trading from public offers.

Separately, the Panel considers that there is merit in reconsidering the monetary and investor public offer thresholds in relation to a prospectus – which are currently set at EUR 8m and 150 investors respectively – and whether each of these should be raised. Conversations in the past, including the UK's response to the EC's consultation on the Prospectus Regulation, have considered whether the thresholds should be £20m and up to 500 investors respectively and the Panel thinks this discussion should be continued. It notes in this context that the threshold in investor terms in the US is 10,000. The trend towards the involvement of (at least certain) retail investors in undocumented capital raises since the start of the pandemic has become marked and there is at least a case for considering whether the current restrictions should be loosened, bearing in mind at all times the continuing need for appropriate protection for such investors.

The Panel considers that the 20% new share issue threshold for a prospectus is appropriate and does not need to be altered. However, it is of the view that serious consideration should be given as to whether the permitted pre-emption rights disapplication threshold should be aligned with it – i.e. at 20% rather than 5% plus 5% as is currently the case. The response discusses this further below in the 'Pre-emption rights' section.

Premium and standard listings

The Panel considers that it is worth discussing whether the current distinction between the premium and standard listing segments continues to be appropriate.

The rationale for the additional requirements imposed on issuers by the premium listing regime has generally been considered to be an assurance of enhanced governance standards on listing and also potentially an enhanced valuation, partly due to the higher eligibility and governance standards to which the company has been judged and partly due to only premium-listed companies being eligible for inclusion in the FTSE indices.

In recent years, London has been facing increasingly fierce competition for listings from other jurisdictions. It is becoming more common for an IPO process to dual track a London listing with a listing in another, often continental European, jurisdiction but also with the US. The feedback from those processes has often been that both venues will attract largely the same (global) investors and that valuations will be more or less similar, with any downside delta to London not being pronounced. If that is true, the rationale for a premium listing becomes more heavily predicated on the governance imprimatur that it affords. Yet there is also evidence that the fairly heavily prescribed requirements of a premium listing – including on an ongoing basis, for example such as the related party regime and significant transactions regime – can cause putative issuers and their shareholders, when weighing London against other listing venues on a global basis, to consider other venues potentially more attractive.

The Panel is fully in favour of London maintaining its high governance standards. But in this context, it may nevertheless be worth having a debate about what purpose a standard listing now serves (noting also that the standard listing segment reflects the EU minimum standard and so in any event is no longer mandated now that the UK is outside the EU). Unlike with the main market and AIM, there are not understood to be different investor bases as between premium and standard listings. On that basis, perhaps there is merit in the two listing segments being elided into one, perhaps with the overall eligibility and continuing obligation requirements being pitched somewhere in the middle of the two as they currently stand. The regime would be no weaker in terms of governance standards than it is now but the rulebook could be less prescriptive or 'black letter' and perhaps applied more holistically on the basis of an outcomes-based regime.

This would of course also mean that discussions should be had with FTSE around index inclusion as it relates to any revised listing segment. And, if no changes are made to the listing segments, it would seem to the Panel that a discussion should be had with FTSE in any event around the eligibility of standard listed issuers for FTSE indices inclusion.

Other

Debt markets

The Panel would refer the review to the ICMA response that has separately been submitted and to which Panel members have contributed. A link to the ICMA submission can be found here: https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/primary-market-topics/initial-disclosure-pd-and-priips/

In particular, the Panel would draw the review's attention to three points:

1. It seems likely that many issuers of wholesale vanilla bonds will wish to continue to access funding on a pan-European basis (i.e. in both the EU and the UK) going forward. It is therefore important that any changes that are made to the UK prospectus regime are made in such a way that preserves the smooth functioning of the pan-European wholesale market for new bond issues. One way to ensure this would be to continue to align the exemptions and thresholds for (lighter) wholesale disclosure ("wholesale thresholds") in the two prospectus regimes. An alternative way would be to ensure that the exemptions from the UK regime and UK wholesale thresholds are not narrower than the exemptions and wholesale thresholds in the EU regime. This would give issuers the choice of issuing debt that is exempt from, or qualifies for wholesale disclosure under, the EU regime (and also exempt from, or qualifies for wholesale disclosure under, the UK regime) or issuing debt that is exempt from, or qualifies for wholesale disclosure under, the UK regime (but which might not necessarily be exempt from, or qualify for wholesale disclosure under, the EU regime).

2. Issuers should be able to incorporate by reference future periodic financial information (as is permitted under the London Stock Exchange's International Securities Market Rulebook and in other jurisdictions such as the US). This would make it cheaper / easier to keep prospectuses updated and mean quicker access to market post-results.

3. ICMA has previously called for two aspects of the EU Prospectus Regulation regime relating to base prospectus supplements to be clarified and the review may want to consider these points now. The two points are:

    - Allowing supplements to be used to include additional, or amend existing, securities note information in a base prospectus (e.g. to add a change of control provision or provisions related to index-linked securities to a base prospectus that did not previously include these provisions). If an issuer is unable to use a supplement to amend its base prospectus to include a new change of control provision or new index-linked securities, for example, its options are either to update the whole base prospectus or to publish a drawdown prospectus. These options are more time-consuming and more costly than the publication of a supplement and may therefore reduce the ability of an issuer to access the markets for funding. From the perspective of an investor, it seems unlikely to matter if the relevant disclosure is contained within a supplement or a drawdown prospectus or an updated base prospectus. ICMA members therefore consider that issuers should be able to use a supplement to include additional, or amend existing, securities note information in a base prospectus.

- Allowing issuers to prepare a supplement to include additional information, voluntarily, which is not "significant" within Article 23 of the UK Prospectus Regulation. This might include information which may, nevertheless, either be deemed to be important for investors (e.g. securities codes, ambiguities in certain terms) or simply be revisions which may not be "significant" or "material" but which an issuer may wish to make."

Pre-emption rights

On 1 April, the Pre-Emption Group published a recommendation that investors, on a case-by-case basis, consider supporting non-pre-emptive placings by companies of up to 20% of their issued share capital over a 12-month period. The forbearance measure was then extended from an end date of 30 September to an end date of 30 November. It was however discontinued from that point.

The Panel considers that there is a case for exploring whether the enhanced flexibility in relation to placings of up to 20% should be introduced on a permanent basis. The additional flexibility was well-received by the market and was not abused, with the conditions attaching to its use being observed, including around appropriate wall-crossing of shareholders in advance, the inclusion of retail shareholders where possible, the application of soft pre-emption rights and the involvement of management in the allocation process.

This would also have the benefit of aligning the ability to issue shares non-pre-emptively with the 20% prospectus threshold, which has a logic to it.

In any discussion of the point, the Panel notes that it will also be important to consider the position of retail shareholders carefully and whether it is in their best interests.

IPO process

The current IPO process was introduced by the FCA in 2018 after considerable consultation with the market. The Panel notes that some commentators have made the point that the additional seven-day period that is now required in most cases during the 'public' phase of an IPO process (i.e. if connected and unconnected analysts are not briefed at the same time, which is the usual way the market approaches it) puts the London process at a disadvantage when compared to that in other jurisdictions.

The Panel does not feel strongly on this point but nevertheless considers there may be merit in re-testing the incremental benefits that the formal involvement of unconnected analysts in an IPO process brings.

Direct listings

Direct listings are becoming an increasingly common method for companies to access the public markets in the US. The SEC recently gave approval to a submission by NYSE to allow companies to now also raise new capital alongside a direct listing where the capital raising bookbuild is conducted during the opening auction. The Panel notes increased interest in issuers considering direct listings in

London and, as such, consideration should be given to ensure the UK regime is flexible enough to ensure these routes to market are available to companies in London as well. The introduction route has been used for admission onto London equity markets in the past whilst some of the matters discussed above in relation to free float and other matters might be relevant in the consideration of direct listings.

SPACs

It is well-known that the market for SPACs has been strong in the US in recent months. The differences with the SPAC regime in London are also well-known. The Panel is of the view that regulatory change should not be driven by market trends. It does however remember that the Panel raised the current issues around suspension of SPACs when it engaged with the FCA in 2016 in relation to the then existing rebuttable presumption of suspension for commercial companies on announcement or leak of a reverse takeover – which the FCA had acknowledged could have a 'significant market impact'. The FCA went on to remove the suspension provisions as they apply to operating companies but not to SPACs.

The first acquisition by a SPAC will always be a reverse takeover and the Panel noted at the time that investors buy shares in a SPAC specifically on the basis that it is looking to pursue an acquisition on the basis of a stated strategy. The ability of investors to buy or sell a SPAC's shares on announcement of a transaction is a key feature and attraction of SPACs in the US. The Panel went on to note in its submission to the FCA at the time that suspending the listing of a SPAC's shares on announcement or leak of an acquisition denies investors the right to trade out of their investment in circumstances where holders and potential holders of those shares are in possession of the same level of information and, unlike Chapter 6 operating companies, when initial investors have made their investment in full knowledge that the SPAC intends to make a transformative acquisition.

As such, the Panel continues to think that there is merit in re-examining the suspension rules in relation to SPACs and whether they remain necessary. It may be that certain conditions should be applied in order to avoid suspension perhaps – the Panel is agnostic on this. For example, investors who do not support the acquisition could be provided with a redemption mechanism, investors could be given the right to vote on the acquisition or the acquisition could be carried out in accordance with existing disclosure. There is also a point to be considered as to whether forward-looking information should be able to be given more easily on acquisition – which links in to the point made in relation to forward-looking information more generally above.

Class tests

In the context of any discussion about loosening – or perhaps interpreting more holistically – the current prescribed requirements of the Listing Rules as they apply to a premium listing, the Panel considers that it would be worth discussing whether the current class test thresholds are set at the right level. Or whether, for example, the class 1 threshold should be amended to be either 50% or 33% rather than 25%. Similarly, whether the 5% threshold for related party transactions should be increased. Changes such as this would help to reduce issuer costs without lowering the overall governance standards that apply.

The Panel considers that there is also a discussion worth having around remuneration and, in particular, the proportion of issued share capital that can be used for executive / employee incentive / retention schemes.

We look forward to seeing the outputs of the Review and to continuing the engagement on this important topic as you and the Treasury develop your thinking in more detail.

Yours sincerely

Mark Austin

Chair, FCA Listing Authority Advisory Panel