Cooley

UK Listings Review: Lord Hill's Recommendations on the UK Listing Regime

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On 3 March 2021, as the Chancellor of the Exchequer prepared to unveil his budget to take Britain out of lockdown and reawaken the UK economy, Lord Hill of Oareford published a long-awaited review of the UK listing regime with the aim of reawakening London's capital markets.

The UK Listing Review (the Review), led by Lord Hill, was launched by Chancellor Rishi Sunak in November last year to further enhance the UK's position as an international destination for equity listings. The Review examined how companies raise equity capital on UK public markets and makes a series of recommendations to improve the listing process and encourage fast-growing, ambitious companies (particularly in the technology sector) to select London as a listing venue.

High-level summary

In summary, the Review recommends the following:

- Instituting the presentation of an annual report by the Chancellor to Parliament on the 'State of the City'
- The Treasury should consider whether the Financial Conduct Authority (FCA) should be charged with the duty of taking expressly into account the UK's overall attractiveness as a place to do business
- Companies with dual class share structures should be permitted to list on the premium segment of the Official List, subject to certain conditions
- The standard listing segment of the Official List should be re-branded and promoted as a venue for companies of all types to list in London
- The existing rules on free float should be reassessed, including reducing the required percentage from 25% to 15% as well as allowing companies of different market capitalisations to use alternative measures to an absolute percentage threshold to demonstrate that there will be sufficient liquidity in their shares following listing
- The existing rules around SPACs should be relaxed, in particular the removal of the presumption of suspension of listing of a SPAC's shares when it announces an intended acquisition
- A fundamental review and refocus of the prospectus requirements in the UK
- Exploring whether dual-listed companies could rely on the prospectus they had produced for their home market, rather than having to produce a new one
- Facilitating the provision of forward-looking information to investors in the IPO process by amending the liability regime for issuers and their directors
- Reviewing the revenue-earning requirements for scientific research-based companies to broaden their application to other high-growth, innovative companies
- Amending the requirement for premium listings that the historical financial information in the prospectus must cover 75% of the issuer's business for the full three-year track record period so that it is only applicable to the most recent financial period within the three-year track record period
- Considering how technology can be used to improve retail investor involvement
- Considering how to improve the efficiency of further capital raisings by listed companies, in particular through a reconstitution of the Rights Issue Review Group and considering its outstanding recommendations
- Reviewing the rules relating to the inclusion of unconnected research analysts in the IPO process to establish whether it is having its intended effect

We consider each of these proposals in more detail below.

‘State of the City’ annual report

The Review suggests that the Chancellor should present an annual report to Parliament on the ‘State of the City’, setting out the steps that have been taken or are to be taken to promote the attractiveness of the UK as a well-regulated global financial centre, with dynamic capital markets and a strong ecosystem that attracts the growth companies of the future to list and grow here.

FCA objectives

The Review asks the Treasury to consider whether the current statutory objectives of the FCA provide it with sufficient scope to play its part in building a welcoming, supportive and dynamic environment for companies looking to list. Financial regulators in Australia, Singapore, Hong Kong and Japan each have competitiveness or growth as a regulatory objective. The European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority are required to take due account of the impact of their activities “on the Union’s global competitiveness”. The Review suggests that the FCA should similarly be charged with the duty of taking expressly into account the UK’s overall attractiveness as a place to do business.

Dual class share structures

Currently, dual class share structures are not possible for a premium listing in London, whereas they are available on other major stock exchanges. This has meant that London has risked missing out on attracting high-growth, innovative companies (especially those in the often founder-led technology sector for whom the structure is particularly attractive) when such companies are deciding on an IPO venue.

The Review recognises that 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 sensible way forward. The Review recommends that companies with dual class share structures should be permitted to list on the premium listing segment of the Official List whilst maintaining high corporate governance standards by applying certain conditions. These would include:

- A maximum duration of five years for the dual class structure to be in place
- A maximum weighted voting ratio of 20:1 – to ensure that holders of weighted voting rights need to have a minimum economic interest in the company
- Requiring holders of the B class (i.e., high vote) shares to be a director of the company
- Voting matters being limited to ensuring the holder(s) are able to continue as a director and able to block a change of control of the company while the dual class structure is in force
- Limitations on transfer of the B class shares – the shares must convert on transfer, subject to limited exceptions including for transfers for estate planning and charitable purposes

This is a highly welcome recommendation and one which Cooley has been advocating for some time.

Re-brand and re-market the standard listing segment

The Review suggests that the standard listing segment of the Official List should be re-branded and promoted as a venue for companies of all types to list in London and that the driving force behind the segment should be the companies and investors who use and benefit from it. The Review also pushes for index inclusion to be permitted on the standard segment, with the current lack thereof being a key reason why issuers see the current standard listing segment as unattractive. The Review encourages investor groups to develop guidelines on areas they see as particularly important to allow for companies on the rebooted segment to be index-eligible (for example, dual class share structures and key corporate governance protections). The goal is that, longer term, the flexibility of the standard segment would hopefully serve to attract an increasingly large cluster of like-minded companies that would generate its own momentum and also attract others to join.

Reassess free float requirements

According to the Review, existing FCA rules on free float levels (i.e., the number of shares that are in public hands) are seen as one of the strongest deterrents to companies when they consider where to list, particularly for high-growth and private equity-backed companies.

The Review recommends that the definition of shares in public hands should be reviewed and updated to consider whether the shares are in fact contributing to liquidity - for example, increasing the threshold above which investment managers and other institutional shareholders are excluded from contributing towards the free float calculation from 5% to 10%. The Review further recommends that the FCA reduce the required percentage of shares in public hands from 25% to 15% for all companies in both the premium and standard listing segments, as well as allowing companies of different market capitalisations to use alternative measures to an absolute percentage threshold to demonstrate that there will be sufficient liquidity in their shares following listing. Interestingly, the Review still advocates for FCA approval for any such waiver of the percentage threshold, but suggests that any such approval should be confirmatory in nature and should avoid the inherent discretion that currently applies when the FCA has to consider waiving the existing threshold. The Review suggests that companies with larger market capitalisations should, as an alternative to complying with the 15% threshold, be able to demonstrate that they have a minimum number of shareholders, a minimum number of publicly held shares, a minimum market value of publicly held shares and a minimum share price to support a liquid market. Smaller companies should, as an alternative to complying with the 15% threshold, be able to use the same method as that used on AIM, i.e., having in place an agreement with an FCA-authorised broker to use its best endeavours to find matching business if there is no registered market maker on the relevant market.

Relax the Listing Rules around SPACs

SPACs – special purpose acquisition companies – are cash shell companies formed with a view to making an acquisition, with the subsequent acquisition of a target company being referred to as the “de-SPAC” transaction. They have been incredibly popular in the US over the last 18 months and have started to gain increasing popularity in other listing venues in Europe, in particular as an alternative to a traditional IPO for fast-growing technology companies. For example, in the US there were 248 SPACs listed in 2020, raising gross proceeds of approximately $83.3 billion. Incredibly, there have already been 228 SPACs listed in the US in the first two months of 2021 alone, raising just over $73 billion. By stark contrast, only four SPACs were listed in the UK in 2020, raising an aggregate of £0.03 billion. London has been seen as missing out on this SPAC boom in no small part due to FCA rules which can require trading in the SPAC to be suspended when it announces an intended acquisition. This is seen as a key deterrent for potential investors in UK SPACs as there is a risk that they will be “locked into” their investment for an uncertain period after the SPAC identifies an acquisition target, even if they want to exit due to differences of view over the target or for other reasons.

The Review recommends that the FCA remove the rebuttable presumption of suspension and replace it with appropriate rules and guidance to increase investor confidence – similarly to how commercial companies are treated when undertaking an acquisition that is a reverse takeover. The Review suggests providing additional protections for shareholders at the time of the acquisition, such as a shareholder vote and redemption rights.

A fundamental review of the prospectus regime

The Review notes that a drive towards disclosure and transparency coupled with the liability profile attached to prospectuses has led to a ballooning in their size and a reduction in their usefulness. Furthermore, as additional requirements were tied to the inclusion of retail investors, the easiest way for companies to raise capital has often been to simply exclude them. The Review recommends a fundamental review and refocus of the prospectus requirements in the UK. The consequence of a fundamental review should be that further issuances by companies that are listed or quoted should either be completely exempt from requiring a prospectus or be subject to much slimmed down requirements, for example, confirmation of no significant change. The existing corporate reporting requirements and market abuse rules mean companies are required to ensure information is disclosed to investors on an ongoing basis and in many cases a prospectus adds very little for an investor.

The Review suggests that consideration should be given, as a minimum, to the following areas:

- Changing prospectus requirements so that in future admission to a regulated market and offers to the public are treated

separately

- Changing how the prospectus exemption thresholds function so that documentation is only required where it is appropriate for the type of transaction being undertaken and suits the circumstances of capital issuances
- Use of alternative listing documentation where appropriate and possible, e.g., in the event of further issuance by an existing listed issuer on a regulated market.

Maintain the existing approach within the Listing Rules for secondary and dual listings

The Review recognises that London is a pre-eminent listing destination for global companies seeking a listing overseas and that no significant concerns had been raised regarding the regime for secondary listings. However, the Review suggests that the best way in which the government and regulators could help promote dual and secondary listings in the UK is by making regulatory allowances for foreign issuers' home prospectuses. It should be explored whether companies could rely upon the prospectus they had produced for their own market, rather than having to produce a new one, removing a significant burden in the process. This could extend to further issues as well as at IPO.

Facilitate the provision of forward-looking information

Currently, a fast-growing company planning its listing in London must present three years of backward-looking financial information and yet can only give often half a page or so of narrative forward-looking information. The Review states that it is clear that investors are clamouring to be given more forward-looking information by issuers and that issuers are keen to give it to them. The Review comments that it would be strange for an investor to expect the same level of certainty over forward-looking information as there is over past events, and highlights that the current equal level of liability associated with both backwards-looking and forwards-looking information should be addressed. The Review suggests to facilitate the provision of forward-looking information by issuers in prospectuses, by amending the liability regime for issuers and their directors. The Review notes that this could be achieved, for example, by directors having a defence to liability provided that they could demonstrate that they had exercised due care, skill and diligence in putting the information together and that they honestly believed it to be true at the time at which it was published.

Review certain provisions for scientific research-based companies to broaden their application to other high-growth, innovative companies

The Listing Rules contain bespoke provisions which recognise the difficulties that scientific research-based companies have in complying with the standard revenue-earning requirements in the premium listing segment. The Review suggests that these provisions should be broadened to include other high-growth innovative companies from other sectors who are also able to show that they are sufficiently mature in ways other than through having positive revenue earnings. In broadening these provisions, more should be done to ensure that the existing provisions for scientific research-based companies are fit for purpose, particularly with regards to biotech companies, and they should be revised as appropriate.

Amend the requirement for historical financial information covering at least 75% of an issuer's business for premium listings

The premium listing segment contains a requirement that historical financial information must cover 75% of an issuer's business for the three-year track record period, which the Review identifies as a key reason why a number of businesses had ruled out a premium listing in London. Accordingly, the Review recommends that the 75% test is only applicable to the most recent financial period within the three-year track record requirement.

Due to the general requirements to disclose comparatives to meet International Financial Reporting Standards, this is expected effectively to reduce the period of disclosure from three years to two for acquisitions made in the last financial period.

Consider how technology can be used to improve retail investor involvement

As the average age of a retail investor in the UK decreases, the Review suggests that this new generation of retail investors will expect smoother processes for registering their views as shareholders. They may also be more active in wanting to use Environmental share ownership as a way of expressing their broader social views and the rise in, Social and Governance (ESG) investment products is only set to continue. As the technology they use to buy and sell shares is now accessible in seconds on their smartphones, they will expect the same thing from corporate actions – the Review suggests that this infrastructure is addressed.

Consider how to improve the efficiency of further capital raisings by listed companies

The Review identifies that despite the assistance of the FCA and the Pre-Emption Group in facilitating much-needed emergency capital raising in response to the pandemic, certain inefficiencies became clear when speed was of the essence. In effect, companies could either do a fully pre-emptive offer through a rights issue or open offer (which would require an approved prospectus with all the associated costs and timing implications) or do an undocumented placing, limiting the offer to only institutional investors and a limited number of retail investors (in order to avoid publishing a prospectus) using existing approvals from their shareholders to waive pre-emption rights or using a cashbox structure. The Review notes that these inefficiencies should be considered further, by re-establishing the Rights Issue Review Group that was formed in 2008 during the financial crisis. The Review suggests a reconsideration of the Rights Issue Review Group's outstanding recommendations in terms of capital raising models used in other jurisdictions such as Australia, including in light of technical advances, in order to facilitate a quicker and more efficient process of raising capital for existing listed companies and more easily involve retail investors.

Review the conduct of business rules relating to the inclusion of unconnected research analysts in an IPO process

FCA rules introduced in 2018 require research analysts who are connected to an IPO (i.e., analysts employed by banks which are in the IPO underwriting syndicate) to withhold publication of their research for seven days following an intention to float announcement and the publication of the issuer's registration document, if unconnected analysts have not been briefed alongside the connected analysts during the private phase of the IPO. The rule was intended to promote the availability of unbiased, independent research by giving unconnected analysts time to compete with connected analysts. However, the Review noted that feedback provided was that this rule had not led to any significant increase in research coverage by unconnected analysts yet has had detrimental side effects – including in terms of the increased execution risk that arises from an additional week being added to the public phase of the IPO process, as well as the cost and time implications of the rule for the issuer. The Review recommends that the FCA conduct an impact assessment of the rule to establish whether it is having its intended effect. If the analysis indicates that the rule has failed meaningfully to promote the production of unconnected analyst research on IPOs then the FCA should consider abolishing the rule or amending it in a way that addresses the market's widespread concerns.

Consider and act on industry concerns in relation to the wider financial ecosystem

A number of other elements were cited in the Review that could help foster a stronger UK listing environment,

and ultimately support the wider economy. These key elements include:

- Unlocking pension investment – considering ways to better deploy the assets linked to both defined benefit and defined contribution pensions. This is being explored by a joint working group convened by the Treasury, the Bank of England and the FCA
- Creating a competitive tax environment – the Review noted that they received a number of submissions with regard to potential tax reform, with the main recurring theme being the equalisation of debt and equity funding as a way of harmonising tax treatment for rapidly growing companies
- Market provision of SME research post MiFID-II implementation – the Review noted that the funding of SME research is vital to ensuring enough information on which to base investment decisions is available to investors and that there has been market failure in this area for some time, which has been made worse by MiFID II. The Review notes that this should be considered as a priority by the FCA

What comes next?

The overarching aim for each of these recommendations is to increase the competitiveness of the UK listing regime, with a particular focus on attracting more fast-growing technology companies to list in London. This broad and ambitious package of proposed measures is highly welcome.

Some of the recommendations, in particular in relation to the prospectus regime, would require legislative changes. The Treasury will now examine the Review's recommendations closely and set out next steps. The Chancellor expects to "move quickly" to consult on the recommendations.

Many of the recommendations will require consultation by the FCA on changes to its rules. The FCA has already responded to the Review to confirm that it will carefully consider the recommendations for changes to the Listing Rules, including on free float, dual class share structures, and SPACs. The FCA has stated its aim of publishing a consultation paper by the summer with a view to making the relevant rule changes (if approved) by late 2021.

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