SLAUGHTER AND MAY/

CLIENT BRIEFING

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ATTRACTING MORE IPOS TO LONDON: FCA AND GOVERNMENT PUBLISH PROPOSALS

This month the FCA and HM Treasury proposed some of the most significant changes to the UK listing and prospectus regimes for many years. Many of the proposals reflect recommendations made by Lord Hill in his March 2021 report on the UK listing regime and by Ron Kalifa in his February 2021 review of UK fintech, and are designed primarily to attract more companies to list in London. This briefing highlights the key proposals.

SUMMARY

- Companies should be able to list on the premium segment with a dual class share structure.
- For both the premium and standard listing segments, the free float requirement should be reduced from 25% to 10%.
- In the medium-term, the FCA may introduce more fundamental changes to the listing segments and their rules.
- Changes should be made to the liability regime to encourage companies to include more forward-looking information in their IPO prospectuses.
- Changes to the Listing Rules are expected soon that are designed to encourage more SPACs to list in London.

FCA CONSULTATION ON PROPOSED CHANGES TO THE LISTING REGIME

On 5 July the FCA published a consultation on proposed changes to the listing regime (CP 21/21). The proposals take forward most of the IPO-related recommendations made in Lord Hill's report. (The recommendations most relevant to already-listed companies were covered in our April briefing.)

Dual class share structures (DCSS) to be permitted on the premium segment

A DCSS typically involves a company having two classes of shares that are identical in all respects other than voting rights. One class of shares (the ordinary shares) carry one vote per share, and the other class (which are often unlisted) carry multiple votes per share, typically 10 or 20 votes per share. The high vote shares are typically held by the founder (and sometimes some or all other pre-IPO shareholders), while the ordinary shares are held by third party investors from admission. In the last few years, a number of high-profile companies have listed in the US with a DCSS, including Airbnb, DoorDash, Peloton, Slack, Lyft and Pinterest. Older examples include Facebook and Google-parent Alphabet.

In the UK, a company with a DCSS can join the standard segment (as the Hut Group, Deliveroo and Wise have recently done), but not the premium segment. This has deterred some companies - especially fintech and "new economy" companies controlled by one or more founders concerned about losing control - from listing in London.

To address this, the FCA intends to allow companies to join the premium segment with a DCSS where:

- The high vote shares are unlisted and held only by directors of the company or beneficiaries of such a director's estate.
- The DCSS lasts for no more than five years after the company first joins the premium segment.
- The unlisted shares have weighted voting rights (up to 20 votes per ordinary share) in only two situations:
  - (i) On a resolution to remove the holder as a director, whenever this is proposed. This is designed to "entrench" the director for an initial period after IPO.
  - (ii) On any shareholder resolution (whether or not required by the Listing Rules), but only after a change of control has occurred. This is designed to deter a takeover during that initial period.

The unlisted high vote shares will be able to vote alongside holders of ordinary shares, on a one vote per share basis, on all other matters requiring shareholder approval - such as major and related party transactions, cancellation of listing and transfer between listing categories.

Like other companies applying to join the premium segment, a company with such a DCSS would have to demonstrate it is capable of carrying on an independent business; and, if it has a controlling shareholder, it would have to put in place a relationship agreement and the other protections for non-controlling shareholders mandated by the Listing Rules.

Standard segment companies with a DCSS will be able to transfer to the premium segment provided their DCSS already complies, or is brought into line with, the new requirements.

Indices

A main attraction of listing on the premium segment, rather than the standard segment, is eligibility for inclusion in the FTSE 350 and other key indices. (At present, standard segment companies are not eligible.) For this change to the Listing Rules to have its desired effect of attracting more companies to the premium segment, it will therefore be important that companies with a DCSS are eligible for such indices. Currently FTSE Russell requires a company that is assigned a developed market nationality to have greater than 5% of its voting rights (aggregated across all of its equity securities, including, where identifiable, those that are not listed or trading) in the hands of unrestricted shareholders.

We expect FTSE Russell and other index providers to review their inclusion criteria in light of the proposed changes to the Listing Rules, although it is not yet clear if and when a consultation on any changes to the inclusion criteria would occur.

Minimum market capitalisation: threshold to become £50 million

For both premium and standard segments, the FCA proposes to increase to £50 million the current £700,000 threshold (which has remained unchanged since 1984) - i.e. on admission, the expected aggregate market value of all securities, excluding treasury shares, would have to be at least £50 million. The change would not apply to investment companies or to companies that are already listed.

Understandably, the FCA believes that companies with a sub-£50 million market capitalisation are better suited for admission to other markets such as AIM or AQSE Growth Market. In practice companies with such a low market capitalisation are unlikely in any event to want to join the Main Market.

Minimum free float to become 10%

Currently, both premium and standard segment companies must have a free float of at least 25% on admission and on a continuing basis, although in some circumstances the FCA can accept a lower percentage if there is still adequate liquidity.

Shares are considered to be in public hands only if they are held by shareholders who have less than 5% of the total number of shares in a company. (Shareholders with holdings of 5% or more are assumed to have strategic holdings that do not provide liquidity.) Others who do not count for free float purposes include directors and their connected persons; shareholders who have the right to nominate directors; trustees of company employee share schemes and pension funds; and shareholders whose shares are subject to a lock-up for more than 180 days.

The free float requirement usually means that at the time of IPO key shareholders need to sell some of their shares, which can lead to under-pricing and loss of control, and/or the company needs to issue new shares, which dilutes existing shareholders. Some companies and founders concerned about these issues and the associated execution risks have therefore chosen to list on other markets, where free float requirements tend to be less onerous. (The NYSE and NASDAQ also impose free float requirements, but do not specify an absolute percentage of issued share capital.)

To make London more competitive, the FCA therefore proposes to reduce the absolute requirement for both the premium and standard listing segments to 10%. As now, the requirement would apply both on admission and on a continuing basis. The FCA would no longer have discretion to accept a free float lower than 10%. If a listed company's free float falls below 10%, it would need to present the FCA with a plan to address the problem as soon as possible. No changes are proposed to the rules on which shares count as being in public hands.

Due to the proposed increase in minimum market cap, the free float shares would need to be worth at least £5 million on IPO. This is on a par with Euronext, and will help ensure adequate liquidity.

Going forward, the FCA is considering requiring issuers to disclose on a regular basis what percentage of their shares qualifies as free float for Listing Rule purposes, although no specific proposals have been made at this stage.

Indices

At present, FTSE Russell generally requires a company to have a free float of at least 25% in order to be eligible for the UK index series (although it has slightly different rules for determining which shares count towards the free float). A key issue is therefore whether FTSE Russell

and other index providers will amend their criteria to permit companies with a free float of 10% to 25% to be included in key indices.

Timing and impact

The proposed changes relating to DCSS, free float and minimum market capitalisation, and certain unrelated technical changes to the Listing Rules, Disclosure Guidance and Transparency Rules and Prospectus Regulation Rules, are expected to come into effect by late 2021. Assuming that the changes are introduced broadly as proposed, effectively from next year a company will be able to list on the premium segment with a DCSS, and to list on the premium or standard segment with a free float of only 10%.

Comment

According to Lord Hill's report, the number of listed companies in the UK has fallen by about 40% from a recent peak in 2008. Between 2015 and 2020, the UK accounted for only 5% of IPOs globally. The FCA's proposals to permit companies with a DCSS to join the premium segment, and to permit companies to join both the premium and standard segment with a free float of only 10%, will go some way towards putting London on a par with other listing venues in Europe and the US. However, to make London more competitive, and hence increase significantly the number of companies choosing to list here, the criteria for FTSE index inclusion will need to be amended and, in the longer term, analyst coverage will need to broaden and institutional investors in UK markets will need to become more comfortable backing companies with high growth prospects but only a modest track record of generating profits.

Market segments and their rules: fundamental review

At the same time, the FCA seeks views on some fundamental questions relating to the listing segments and their rules. It suggests that the existing segments could be reorganised along the lines of one of the following models:

- **Model 1**: Replace the premium and standard segments with a single segment and set the minimum possible requirements for eligibility for listing (i.e. rules broadly based on those for the current standard segment). Trading venues would have more freedom to specify their own admission criteria and continuing obligations for particular markets or segments; and index providers would continue to be able to specify criteria for inclusion in an index.
- **Model 2**: Replace the premium and standard segments with a single segment based on the current premium segment rules (subject to the proposed changes referred to above). Companies that could not meet these requirements, or that choose not to, could opt to be admitted to markets for securities that are not admitted to the Official List ("unlisted markets"). Investors would have a clear demarcation between what to expect from a listed company compared to a company admitted to an unlisted market. The FCA could maintain an oversight role over unlisted markets.
- **Model 3**: Maintain two broad segments, but make some targeted improvements. In particular, to avoid the problem of the "alternative" segment being seen as inferior, what is currently the standard segment could be branded as primarily aimed at companies with particular strategies, such as those that are acquisitive and therefore likely to find the requirement to obtain shareholder approval of significant transactions difficult to operate; and/or start-ups that may want to use particular share structures that deter takeovers in the early years of the company's development. The FCA would continue to set the eligibility criteria and continuing obligations for each segment.
- **Model 4**: Maintain two segments but allow the market, instead of the FCA, to set minimum standards for the "alternative" segment. The FCA's role would be limited to verifying basic eligibility information for securities, approving prospectuses and setting certain ongoing disclosures (such as those concerning inside information and financial reporting) to ensure market integrity is maintained, and to secure an appropriate degree of protection for retail investors in particular. Elements such as the level of free float would either need to be agreed with potential investors or set by the relevant trading venue.

Timing and impact

In relation to the fundamental review of market segments and their rules, the FCA will provide feedback and, if appropriate, consult further on any proposed changes. No timing for this is specified.

HM TREASURY CONSULTATION ON PROPOSED CHANGES TO THE PROSPECTUS REGIME

On 1 July 2021 HM Treasury (HMT) published a consultation on the UK prospectus regime. The consultation is designed to take forward the prospectus-related recommendations made by Lord Hill.

Role of FCA

Generally, it is proposed that the FCA should become responsible for making and amending prospectus rules. In particular, it should have power to set rules on whether or not a prospectus is required when securities are admitted to trading on UK regulated markets, including relevant exemptions, and to make detailed rules on prospectus content. The UK is free to make such changes now it is no longer part of the EU; but the pros and cons of diverging away from the EU prospectus regime will need to be carefully considered.

When a prospectus should be required

Among other things, the Government suggests that:

- Where a company does a rights issue or other pre-emptive offer to existing shareholders, no prospectus should be required simply by virtue of this fact (although a prospectus may be required if the company is listed on a regulated market).
- Private companies wishing to raise money via crowdfunding should continue to be able to avoid having to produce a prospectus by limiting their offer to EUR 8 million. However, the Government seeks views on whether, for private companies, the prospectus regime should be replaced by rules that are more proportionate and effective - e.g. by requiring the offer to be made via an authorised investment firm (and perhaps imposing new rules on firms that mediate such offers).
- No material changes should be made to the exemptions for offers to 150 people or fewer, offers to qualified investors or offers to employees and directors.

Forward-looking information in prospectuses

Usually IPO prospectuses contain very little forward-looking information. A major reason for this is concern about liability. Instead, companies often provide connected research analysts with some forward-looking guidance and review the analysts' models for factual accuracy before the research is published.

However, Lord Hill reported that IPO investors are clamouring to be given more forward-looking information and that companies are keen to give it to them. To address this, Lord Hill recommended that the Government should review the standard of liability that applies to forward-looking information in prospectuses. In response, the Government says it is minded to apply to forward-looking information in prospectuses the same "recklessness standard" for liability as applies in relation to misleading statements and omissions that are made outside a prospectus under section 463 of the Companies Act 2006 and Schedule 10A(3) of the Financial Services and Markets Act 2000 (FSMA). That standard is that a person "knew the statement to be untrue or misleading or was reckless as to whether it was untrue or misleading" (and, in respect of omissions, that the person "knew the omission to be a dishonest concealment of a material fact").

An investor would not need to demonstrate they acquired, held or disposed of shares "in reliance on the information in question": it would be presumed that investors have relied on the (forward-looking statements in the) prospectus.

To take advantage of the lower standard of liability, an issuer would have to explicitly identify any forward-looking information in the prospectus.

This reduction in liability would apply only in relation to statements in a prospectus which project or predict a future state of affairs. It would not apply to statements of fact - i.e. any statement on the state of affairs at the date of the document or any statement of historic fact; nor would it apply to the working capital statement. These would remain subject to the existing standard under section 90 FSMA.

Offers into the UK by overseas companies and recognition of overseas prospectuses

The Government is also considering introducing a new regime of "regulatory deference", which would replace the (non-functioning) equivalence regime in the Prospectus Regulation. This would allow companies with securities listed or to be listed on a non-UK stock market to extend an offer of those securities to the public in the UK on the basis of offering documents prepared in accordance with the rules of that market's jurisdiction. However, there would be no FCA review of the documents. The regime would extend only to those markets assessed by HMT and the FCA as providing broadly equivalent protection to investors overall.

Timing

The consultation closes on 24 September 2021. Further consultations by HMT and the FCA will follow on key issues - such as to what amendments should be made to the exemptions and to the rules specifying information that must be included in a prospectus - which will necessitate changes to (at least) FSMA and the FCA's Prospectus Regulation Rules. No timing for this is specified, but changes are unlikely to be introduced until at least Q2 of 2022.

OTHER DEVELOPMENTS

SPACs

In CP 21/10, published in April this year, the FCA proposed to amend the Listing Rules to relax the presumption that a SPAC's shares will be suspended when it announces a proposed acquisition. Instead, the FCA will agree, on a case by case basis, not to suspend provided the SPAC satisfies certain conditions designed to protect outside investors. The conditions include:

- Shareholders in the SPAC must be able to redeem their investment before the acquisition is completed, even if they vote in favour of the acquisition.
- Any proposed acquisition must be approved by a simple majority of shareholders.
- Funds invested in the SPAC must be held by an independent third party and used only to fund an acquisition or be returned to shareholders (less any amounts specifically agreed to be used for the SPAC's running costs).
- When the SPAC is first listed, it must have raised at least £200 million from outside investors.
- The SPAC must complete an acquisition within two years of listing but, with the approval of non-sponsor shareholders, this can be extended by 12 months.

If the FCA agrees that a suspension is not necessary, the SPAC would have to announce certain information about the acquisition, its timetable, and how the target was valued as soon as the relevant information is available.

The consultation closed on 28 May 2021. We expect the FCA to introduce the changes broadly as proposed later this month or shortly afterwards. As a result, more SPACs are likely to consider listing in London – e.g. as an alternative to Amsterdam – although we do not expect to see large numbers of SPAC listings.

A forthcoming briefing will discuss the impact of SPACs on M&A.

Follow-on capital raises

In 2020 the markets generally functioned well for follow-on capital-raises; but there are still concerns that it takes too long and is too difficult for companies to do large fundraisings, particularly rights issues. Lord Hill therefore recommended that the Rights Issue Review Group (RIRG) should be reformed "*to reconsider its outstanding recommendations in terms of capital raising models used in other jurisdictions such as Australia, including in light of technological advances, in order to facilitate a quicker and more efficient process of raising capital for existing listed companies and more easily involve retail investors*". We therefore expect the RIRG to be re-formed later this year or perhaps next year. It will need to take into account any changes to the prospectus regime that affect secondary issues - such as a reduction in the amount of information that must be included in a rights issue prospectus.

In relation to non-pre-emptive issues, the Pre-Emption Group is known to be considering whether to change its guidelines to permit companies to issue up to, say, 20% of their share capital for cash on a non-pre-emptive basis provided certain conditions are met. So far, though, it has not made any announcement about this.

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