MARKET EFFECTIVENESS: PROPOSED CHANGES TO THE UK LISTING AND PROSPECTUS REGIMES

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In early July 2021, HM Treasury published a UK prospectus regime review consultation and the Financial Conduct Authority (FCA) published a primary markets effectiveness review consultation (CP21/21). The consultations propose significant changes to the interlinked prospectus and listing regimes in the UK.

The consultations, together with the FCA's consultation on special purpose acquisition companies (SPACs)[1], have been launched in response to the recommendations of the UK Listing Review chaired by Lord Hill and published in March 2021[2], and the Independent Strategic Review of UK fintech chaired by Ron Kalifa OBE and published in February 2021. Those Reviews are part of the Government's wider plan to reform the UK financial services sector after Brexit and specifically to encourage more companies to list on UK markets.

This briefing summarises the key elements of the consultations and considers their potential impact.

PROPOSED CHANGES TO THE LISTING REGIME

DUAL CLASS SHARE STRUCTURES

As part of its aim to encourage innovative, founder-led growth companies to list on UK markets, the FCA proposes to introduce a five-year exception to the "one share, one vote" premium listing principle that effectively prevents companies with dual class share structures from listing on the premium segment of the London Stock Exchange (LSE) Main Market[3]. A dual class share structure typically involves two classes of shares which are identical in all respects except for voting rights, where the "high vote" shares allow the holders to retain voting control over a company that is disproportionate to their economic interest in the company; and the "low vote" shares are held by outside investors on listing and conform with premium listing principles. These proposals would bring the UK regime closer to that of United States, where dual or multi-class voting is generally permitted on NYSE and Nasdaq exchanges, and is particularly common among founder-led technology companies.

Under the proposals, issuers applying for a premium listing would be permitted to list with a specific kind of dual class share structure, which would enable holders of unlisted high-voting shares to carry additional voting rights subject to certain conditions, including that:

- they are held by one of the directors of the issuer at the time of the IPO (or a beneficiary of his or her estate following death); and
- *before* a change of control[4], they provide additional voting rights (no greater than 20:1 relative to the low-vote shares) *only* on a vote to remove the holder as a director (and not, therefore, a vote on any other matter); but *after* a change of control such additional voting rights may be cast on any vote (the intention being to enable the holder of the high-vote shares to deter a takeover).

The FCA says this exception would be available only to issuers seeking admission to the premium listing segment for the first time.

As noted above, the FCA's proposal would not enable the holder of the high-vote shares to retain absolute control before a change of control. For example, the additional votes could not be cast on proposals to appoint or remove other directors, or on other matters requiring a shareholder vote, whether under company law or the Listing Rules (such as authorising on the board to allot shares and disapplying pre-emption rights that would otherwise apply on the allotment of shares; the triennial vote required to approve the company's directors' remuneration policy; significant acquisitions and disposals (i.e. Class 1 transactions), and related party transactions). In the US and some other markets (such as Amsterdam), by contrast, the additional votes may be cast on these matters (if a shareholder vote is required at all).

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[1]Link to Weil's May 2021 client briefing on the SPACs consultation, https://www.weil.com/-/media/files/pdfs/2021/spacs-come-to-the-uk-3-may-2021.pdf

[2]Link to Weil's March 2021 client briefing on the Hill Review, https://www.weil.com/~/media/weil-london-thought-leadership/pema/hill_review_key_recommendations_reform_uk_listing_regime.pdf

[3]Please refer to the paragraph entitled "Listing segments" below for background on the premium and standard listing segments of the LSE Main Market.

[4]The FCA is proposing a new definition of change of control in this context which would cover, broadly, the acquisition of more than 50% of the votes able to be cast on all or substantially all matters at general meetings of the company.

DUAL CLASS SHARE STRUCTURE EXAMPLES

Also in early July 2021, London-based money transfer fintech company Wise announced its direct listing to the standard segment of the Main Market. It is the first significant direct listing in London by a technology company[5] and is significant in the context of the listing and prospectus consultations because Wise features a dual class share structure and opted for a standard listing. On admission, Wise had two classes of shares, Class A shares and Class B shares. The Class A shares will trade on the Main Market, whilst the Class B shares, which carry nine votes per share, will not be admitted to listing or trading on any stock exchange and are non-transferable. The Class B shares carry no economic interest or right to dividends. In September 2020, THG Holdings plc listed on the standard segment of the Main Market with a dual class share structure to enable its founder to hold a "special share" enabling him to deter an unwelcome takeover. Deliveroo plc also listed in London with a dual class share structure, in March 2021, but with weighted voting rights structure designed to empower, and ensure that majority control resides with the founder (or his permitted transferees) for so long as he holds the shares and is a director. These listings have generated significant attention in the UK and shone a spotlight on the premium listing restrictions, which will have influenced these companies' listing segment decisions. Lord Hill and the FCA see their challenge as needing to strike the balance between investor protection and sentiment – flexing the one share, one vote principle to encourage high profile premium listings in London but ensuring investor protection and avoiding long term founder entrenchment.

From a US perspective, the change to allow dual class share structures to list on the premium segment is particularly necessary if London wants to compete in attracting offerings by founder-led or "unicorn" companies, which overwhelmingly favour dual-class or multi-class voting structures. In 2020, dual-class companies constituted approximately 60% of the market capitalisation of US IPOs despite making up only 15% of the total number of IPOs[6]. This trend is particularly true for high profile technology companies as evidenced by recent debut offerings by Airbnb, Lyft, Pinterest and Slack – all of which had dual-or multi-class stock and listed on either NYSE or Nasdaq.

LOWER FREE FLOAT REQUIREMENT

The FCA proposes to reduce the free float requirement, which applies to premium and standard listings, from 25% to 10% to remove a potential barrier to companies choosing to list in London. This requirement would apply at the point of listing and as a continuing obligation.

Noting that shareholdings by individual shareholders of 5% or more are not treated as "public" under the Listing Rules (because they are assumed to be strategic holdings that do not provide liquidity), a 10% free float requirement would mean that a company must have at least three public shareholders at the point of listing.

HIGHER MINIMUM MARKET CAPITALISATION

The FCA proposes to increase the minimum market capitalisation required for new listings on the premium and standard listing segments from £700,000 to £50 million because it considers that companies with a low market capitalisation are better suited for admission to junior or growth markets such as the LSE Alternative Investment Market (AIM) or the AQSE Growth Market[7], and that the £700,000 minimum is out of date given market growth since its introduction in 1984.

The FCA believes that raising the minimum market cap to £50 million will also work alongside its proposal to reduce required free float to 10% (as above), to set a minimum free float for IPOs and direct listings of £5 million. This will provide an additional safeguard to liquidity at IPO or, in the case of a direct listing, the point of introduction to the market.

While the increased minimum market cap will apply only to new issuers, smaller listed SPACs would need to consider the rule in relation to their re-admission following a de-SPAC acquisition.

LISTING SEGMENTS

The FCA is also consulting on the structure of the premium and standard listing segments of the LSE Main Market in order to understand what issuers and investors most value in the current regime. Broadly, premium listings are subject to the highest standards of regulation and a premium listing is a prerequisite for inclusion in the FTSE UK Index Series; whilst standard listings are subject to EU-derived minimum standards. Outside Main Markets, which are classified as "regulated markets" under relevant legislation, the UK also hosts a number of "growth markets" which are a sub-category of multi-lateral trading facilities (MTFs), as opposed to regulated markets. MTFs are principally regulated by the exchanges on which they operate, rather than

[5]A direct listing allows a company to be admitted to trading without the traditional route of an offering of shares and raising immediate capital. Existing shareholders are free to sell shares on the stock exchange at market-based prices and since there is no underwritten offering, a direct listing does not require the participation of investment banks acting as underwriters.

[6]Dual Class IPO Snap Shot 2017-2020 Statistics, Council of Institutional Investors, https://www.cii.org/files/2020%20IPO%20Update%20Graphs%20.pdf. Note that the quoted figures exclude SPACs and real estate investment trusts (REITs).

[7]Please refer to the paragraph entitled "Listing segments" below for more information on these growth markets.

the FCA. The UK's growth market MTFs include AIM, which is regulated by the LSE; and the AQSE Growth Market (comprised of two segments, Access and Apex) which is regulated by the Aquis Stock Exchange (AQSE)[8].

The consultation seeks views on different models for the structure of the UK listing regime including, at the most extreme end, creating a single segment with standards equivalent to the current standard segment and with additional admission criteria and continuing obligations set by trading venues (and, indirectly, index providers). The FCA is open to exploring the relationship between itself as regulator, the exchanges it operates, and the issuers and investment community it serves; and fundamentally trying to determine a commercial but investor-protective balance between its role and oversight, against that of operators of trading venues.

FINANCIAL TRACK RECORD

The FCA is not proposing to amend the current financial track record requirements for premium listings, which require historical financial information covering at least 75% of an issuer's business for the last three years. The FCA stresses that the requirement is intended to ensure that investors can see the past performance of the business which they are considering investing in over sufficient time and over a sufficient range of business activities. Lord Hill had recommended amending the requirement so that it is only applicable to the most recent financial period within the three-year track record period, but the FCA counters that any perceived benefit would be limited because of similar disclosure requirements under the prospectus regime, which requires companies to produce three years of historic financial information where they have been in existence that long.

However, there are current provisions within the Listing Rules that allow certain specialist companies (mineral companies, scientific-research based companies and property companies) to demonstrate their track record using alternative means to revenue generation or some other proxy for revenue generation and the FCA is seeking views on extending the exemption to other high growth innovative companies. It is asking for feedback on the specific types of high growth company that struggle to meet the standard track record requirement and the nature of the exemption or alternatives that should apply.

Notably, since 2012, the US has allowed "emerging growth companies" (as defined in Exchange Act Rule 12b-2) to take advantage of relaxed disclosure requirements in offering documents, including provision of audited financial statements for the most recently completed two fiscal years (rather than three) and less extensive narrative disclosure.

PROPOSED CHANGES TO THE PROSPECTUS REGIME

OVERVIEW

Under the current regime, inherited from the EU[9] and subject to specific exemptions, public offers and admissions to a regulated market in the UK are separate triggers requiring an FCA-approved prospectus to be published. In line with Lord Hill's recommendations, HM Treasury is proposing to reform the trigger requirements such that that listed companies will not need to publish a prospectus for public offers and the FCA will determine when a prospectus will be required for an admission to trading.

Currently, in order to be approved by the FCA, a UK prospectus must follow prescribed disclosure requirements, also derived from EU legislation, which aim to ensure that it includes all the necessary information which is material to an investor to make an informed investment assessment and decision. Those responsible for drawing up a prospectus are liable should they omit information required to be included or provide untrue or misleading statements in a prospectus.

ADMISSIONS TO TRADING

The Government is proposing to remove the general prohibition on requesting admission to trading on UK regulated markets without first having published an approved prospectus, and to give the FCA discretion to determine whether or not a prospectus is required when securities are admitted to trading, including giving it the flexibility to establish rules and conditions equivalent to those which exist under the current regime, or which go further. The Government suggests that a prospectus may not be needed in all instances where an admission occurs (such as during a secondary issuance of new securities) and that the FCA is the right body to determine if and when a prospectus is required and what it should contain if one is required. The FCA could also use its proposed discretion to recognise prospectuses prepared in accordance with overseas regulation in connection with a secondary listing in the UK.

PUBLIC OFFERS

Regarding the requirement to publish a prospectus on an offer of transferable securities to the public, the Government proposes to narrow the scope of the requirement by introducing a new exemption for companies with, or applying to have, securities admitted to trading on various stock markets (including regulated markets and junior markets like AIM or the AQSE Growth Market).

[8] The Aquis Stock Exchange also hosts a Main Market.

[9] The Prospectus Regulation, which governs the content, approval and publication of prospectuses, is the retained version of the EU Prospectus Regulation EU 2017/1129 and has applied in the UK since 31 December 2020.

Separately the FCA are proposing to change the definition of "the public" (which is also inherited from the EU regime) to ensure that fundraisings to existing shareholders in a company are exempt and are not treated as public offers requiring a prospectus. This aims to remove a disincentive against offering shares to a company's own shareholders which exists under the current regime.

The new public offer exemption would mean that all secondary issues including rights issues, placings and open offers would fall outside of the public offer prospectus requirement, with the aim of incentivising companies to issue securities to wider groups of investors and facilitating wider participation in companies, including by retail investors.

The prospectus consultation also proposes amending the requirement that a private company seeking to raise capital from the public (which is relatively uncommon) needs to publish a prospectus. It aims to allow private companies to raise larger amounts of capital via public offers of securities, for example through crowdfunding platforms, and provide investor protection. It proposes three alternative options for feedback including that private companies should be (i) required to make their offer through an "authorised firm" (i.e., one which is subject to FCA conduct of business rules including with respect to financial promotions); ii) required to make their offer through an authorised firm; or (iii) subject to the current rules, which includes an exemption for offers up to €8 million (though this would be converted to GBP).

ANCILLARY PROVISIONS

HM Treasury is also consulting on:

- *The application of public offer prospectus requirements for companies admitted to MTFs*, such as AIM. Currently, a prospectus is not required on initial admission to an MTF unless a public offering above the requisite €8 million threshold occurs; instead an "admission document" determined by the MTF operator's own rules is required. The Treasury consultation includes exploring the possibility of (i) exempting companies listing on MTFs from the offer to the public test, meaning a prospectus would no longer be required for any size of MTF public offer; or (ii) requiring a new "MTF admission prospectus" in order to bring admission documents into scope of the future-reformed prospectus regime, including with respect to the application of liability standards, on which also see below. Notably the proposed changes to the main public offer test to exclude a company's existing shareholders, as outlined above, would apply equally to companies listed on MTFs regardless of this separate question on application
- *Prospectus content*, specifically retaining the overarching EU derived requirement for prospectuses to contain the "necessary information" which is material to an investor making an informed investment decision but giving the FCA discretion to set the rules on detailed disclosure requirements and not having them set out in legislation. The proposals envisage that the FCA will be specify the component parts of the document should it wish to, as well as the detail of individual items of content. Similarly, the FCA would have discretion to determine how base prospectuses (which are used to launch issuance programmes for fixed income securities) should work or to establish the procedure for setting a final price in a price range prospectus.
- *Liability standards*, specifically whether the existing "negligence" standard (contained in section 90 of the Financial Services and Markets Act 2000) which imposes liability on persons responsible for a prospectus for untrue or misleading statements made in, or omissions from, the prospectus should be replaced by a "recklessness" or "dishonesty" standard for forward looking information in prospectuses.

INTERNATIONAL OFFERS

For offerings with a US component, the proposed changes to the prospectus content requirements and additional discretion given to the FCA may not make a significant practical difference, as the US regime generally requires all securities offerings to the general public to be accompanied by an offering document subject to US securities law. In addition, in UK offerings involving a more restricted offer into the US, for example to "qualified institutional buyers" or QIBS in reliance on 144A of the US Securities Act of 1993, legal counsel are expected to deliver requisite US legal opinions and, in most cases, a 10b-5 disclosure letter which provides negative assurance regarding the contents of the prospectus. Regardless, the Treasury's proposed changes to the rules around prospectus content follow the US trend of de-emphasising prescriptive rules in favour of a principles-based approach focused on disclosing information that is material to investors, and this would be a further step towards a more flexible system which might better compete with US markets for listing applicants.

With respect to offers by UK companies which include a European element, passporting of prospectuses is not common and it is usual to rely on the existing exemptions from the requirement for a prospectus in order to offer into Europe. Those exemptions will remain available in European member states (subject to any changes to the EU Prospectus Regulation).

NEXT STEPS

Both consultations close in September 2021. The Treasury consultation is likely to be followed by a FCA review and consultation; and, subject to feedback, the FCA listing rule consultation is likely to result in rule changes by late 2021.

FOR MORE INFORMATION

Our Corporate team is available to discuss any of these issues with you and answer any specific questions you may have. If you would like more information about the topics raised in this briefing, or a copy of our Guide to Premium Listings in London, please speak to your regular contact at Weil or to any of the authors listed below:


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