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Alert | Capital Markets

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UK Listing Review Recommends Significant Changes to UK Listing Rules, Including for SPACs, Dual Class Share Structures and Free Float Thresholds

Background

The UK's capital markets are among some of the most liquid capital markets in the world and have proved their resilience and importance in the last 12 months with substantial levels of capital raised by existing listed companies. That said, with Brexit having now occurred, the UK government has taken the opportunity to review the UK's listing regime and determine whether changes are needed to maintain London's competitive position as a leading financial centre and home to some of the world's pre-eminent capital markets. In November 2020 HM Treasury commissioned Lord Hill (a former European Commissioner for Financial Stability, Financial Services and Capital Markets Union) to undertake a wide-ranging review into the state of the UK's capital markets, considering among other questions:

- whether the current rules around free float requirements, dual class share structures, and company track record requirements achieve the right balance between maintaining high standards of corporate governance and market integrity on the one hand, and the requirements of companies seeking to list on the other;

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- whether the rules determining when a prospectus must be prepared (retained from the harmonised EU standards as part of UK law following Brexit) are appropriate for the UK markets, including whether companies that are already listed should be able to more easily raise new capital, and whether other triggers and documentation required for offers to the public and admission to trading venues are optimal for the UK markets;
- whether there are non-legislative actions which the government could take to improve the UK as a destination for IPOs and optimise the capital raising process for large and small companies on UK markets; and
- other issues, including whether there is a case to introduce differentiated entry requirements for the UK's Premium listing segment in respect of companies which already have a primary equity listing on markets in other countries that are assessed to have high standards of corporate governance.

On 3 March 2021 the government published Lord Hill's report on the results of a wide-ranging review into the UK's capital markets and listing rules (the **Listing Review**). Many of the recommendations proposed in the Listing Review have a common objective: making the UK's capital markets more attractive to encourage more successful companies (from both the UK and abroad) to list in London, and to list earlier in their growth cycle. To achieve this, the Listing Review suggests that in many instances, the UK's regulator will need to exercise its post-Brexit power to move away from a number of the rules which were implemented while the UK was subject to the EU's harmonised capital markets regulatory regime. This GT Alert focuses on certain of the recommendations, and the Listing Review can be viewed in full here.

Overhauling the Prospectus Regime

The Listing Review identifies wide appetite for change to how the prospectus regime is framed in the UK. This is particularly so in the case of prospectuses which are published by companies in connection with secondary (post-IPO) capital markets transactions. In practice, the ever-increasing drive for more disclosure, and the potentially stringent liability assumed by companies and their directors, have resulted in prospectuses becoming longer, more detailed and arguably less relevant for their end users. Taking this into consideration, the Listing Review calls for the UK's prospectus regime to resemble more closely the regulatory approach that was taken prior to the implementation of the EU Prospectus Directive (2003). This would benefit both companies – by simplifying the prospectus process and tailoring the content requirements more closely to the type of capital raising – and investors, by streamlining and reducing the presentation of prospectus content and highlighting key information.

The Listing Review calls on HM Treasury to conduct a fundamental review of the prospectus regime, to better align it with the breadth and maturity of the UK's capital markets and to encourage participation by retail investors in the UK's capital markets. For example, the Listing Review recommends that consideration should be given to:

- recalibrating the prospectus exemption thresholds, such that prospectuses are only required where the nature of the transaction requires detailed prospectus disclosure;
- the use of alternative disclosure documentation where appropriate, including where existing listed companies – who are already subject to robust ongoing disclosure requirements under the Listing Rules and market abuse laws – are seeking to raise further capital; and
- allowing companies to provide forward-looking financial information in prospectuses and providing a specific statutory defence to such forward-looking financial information, with the aim of ensuring that investors are better informed about the business' future direction.

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Overhauling the prospectus regime is an ambitious but necessary task and is unlikely to be achieved in a short timeframe, but the Listing Review's recommendations in this regard will be welcome news to many companies and investors alike.

Dual Class Share Structures

Throughout the Listing Review there is mention of the need to ensure that companies – whether UK businesses or otherwise – consider the UK's capital markets as viable and attractive listing venues. Many companies, particularly those in the technology sector led by founders with a significant ongoing ownership stake in, and continuing vision for, the business, have dual share class structures that typically give founders preferential voting rights or other control rights over the company which are not necessarily proportionate to their actual shareholding. While debate about the pros and cons of dual class share structures is likely to continue, many founders see dual class share structures as a necessary precaution against the destabilizing effects of the short-term investor thinking that can plague public companies. Founder shares or similar instruments are also seen as a legitimate protection mechanism against opportunistic takeover bids which could undermine the founders' vision and, ultimately, erode long-term shareholder value.

Whilst many international exchanges, including exchanges in the United States, Hong Kong, Singapore and several European countries, allow companies with dual share classes to be listed, the UK has traditionally opposed dual class structures, not least due to concerns raised by the UK's influential investment industry bodies about the weakening of shareholder rights and an erosion of the 'one share, one vote' principle. At present, dual class share structures are possible – albeit rare – on the Standard Segment of the London Stock Exchange (see below regarding reform of the Standard Segment), but the Premium Segment has remained the exclusive domain of single-class companies.

The Listing Review has attempted to find a middle ground to the dual class share structures question, acknowledging – perhaps inevitably – that in order to compete globally the UK should embrace more fully dual class share structures. At the same time, however, limits should be imposed on the duration and parameters of dual class capital structures through a new sub-set of rules within the Listing Rules to accommodate dual class share structures in the Premium Segment of the London Stock Exchange, which would include restrictions such as:

- a maximum duration of five years, after which the company must harmonise its share structure or move off the Premium Segment;
- a maximum weighted voting ratio of 20:1 such that holders of weighted voting rights need to have a minimum economic interest in the company;
- limiting who is able to hold the weighted voting class shares to directors of the company; and
- limiting the matters that could be subject to weighted voting.

Free Float

One of the potentially more significant impediments to companies seeking to list on the Main Market of the London Stock Exchange is the free float requirement, the Listing Rule mandating that 25% of a Main Market-listed issuer's securities must be in the hands of the public (freely tradeable) to ensure sufficient liquidity in the company's shares following listing. For many companies looking to list in London, particularly those backed by private equity sponsors who wish to maintain a significant holding post-IPO or where a small number of cornerstone investors will hold a material portion of the listed company's total

shares following listing, meeting the 25% free float requirement can be challenging. Moreover, it has been acknowledged that the current test of shares in public hands for determining future ongoing liquidity is somewhat of a blunt instrument. The Listing Review cites analysis conducted by the London Stock Exchange which shows that in the United States, where a significant number of companies have a lower free float than currently permitted by the UK Listing Rules, there is no significant decline in secondary market liquidity until below a 10% free float.

In light of the difficulties presented by the current free float requirements, the Listing Review recommends that the Listing Rules be amended to lower – for companies listing on both the Standard and Premium segments of the Main Market – the absolute requirement for free float levels from the current 25% to 15% and allowing more choice for companies of different sizes to use measures of liquidity other than an absolute free float percentage. For larger companies, the Listing Review recommends that, instead of complying with the absolute 15% free float requirement, they could instead 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. Although the FCA does currently have the ability to grant derogations from the free float requirements, this can be a finely-balanced exercise for companies and their advisers and often adds further complexity to the listing process. Subject to seeing the detail of these proposed amendments, many market participants are likely to welcome a greater degree of flexibility in how sufficient after-market liquidity can be achieved.

Rebranding the Standard Listing Segment

The FCA's Official List is currently comprised of companies listed on the Premium Segment – a 'gold standard' of corporate governance – and companies listed on the Standard Segment, originally developed as a listing venue for non-UK companies seeking access to capital in London without needing to comply with the super-equivalent corporate governance rules which apply to the Premium segment. The London Stock Exchange's AIM Market is a well-known and internationally recognized market for growth companies, but the Standard Segment, although subject to the EU Directive level minimum rules (retained following Brexit) has not yet developed such a reputation. Given that its constituent companies are ineligible for inclusion in key indices, the Standard Segment has – perhaps unfairly– been maligned as an outlier of the UK's capital markets, despite many Standard Segment-listed companies voluntarily adopting the UK Corporate Governance Code. The Listing Review recommends that the Standard Segment be rebranded and relaunched as a viable alternative to the Premium Segment, with an FCA-led focus on flexibility of regulation rather than rigid, prescriptive rules. The Listing Review also suggests doing away with a Premium listing being a prerequisite for index eligibility, potentially removing one of the key drawbacks that a Standard Segment listing currently presents. Investor appetite and perception play a significant part in the success or otherwise of any particular listing venue, and while the Listing Review suggests that investors could play a key role in developing standards they expect from companies on the Standard Segment, time will tell whether this recommendation gains traction.

Special Purpose Acquisition Vehicles

The recent boom in Special Purpose Acquisition Companies (SPACs) – listed cash shells which raise funds with a view to undertaking an acquisition or merger following listing – in the United States has been a ubiquitous topic of discussion in the past year. In 2020, some 248 SPAC vehicles listed on US exchanges, raising the US$ equivalent of £63.5 billion. This trend has continued in 2021 with new SPACs being announced at record pace in the United States and some European exchanges having seen increasing SPAC activity in recent weeks. Although there has been a number of successful SPACs listed on the London Stock Exchange in the past decade, the London market for SPACs has been more muted than the SPAC frenzy in the United States. The Listing Review notes that the UK is at risk of losing out on a

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potentially significant number of listings by successful UK companies who opt to go public via a US-listed SPAC rather than via the traditional London Stock Exchange listing route.

UK SPACs have typically been effected by way of listing on the Standard Segment of the Main Market, one consequence of which is that there is no requirement for shareholder approval of the SPAC's acquisition/merger transaction (which, by contrast, is a typical requirement of the US SPAC, introducing an element of potentially material deal execution uncertainty). Moreover, unlike in the US, the typical UK-listed SPAC does not give SPAC shareholders a right to redeem their investment prior to completion of the SPAC's first acquisition/merger transaction, thereby reducing the risk of significant redemptions prior to such transaction. However, the Listing Rules currently provide that when an LSE-listed SPAC enters into an acquisition or merger transaction, there is a presumption that the FCA will suspend trading in its shares until a prospectus containing full financial and other information regarding the acquisition target is published by the SPAC. Preparing a prospectus and obtaining FCA approval is a time-consuming process, during which period the SPAC shareholders are unable to trade while the SPAC's shares are suspended. The consequence of these rules is a perception – whether right or wrong – that the UK is not an attractive location to list a SPAC. The Listing Rules regarding suspension of trading in shares were reviewed in 2018, at which time the FCA removed the presumption of suspension of trading for commercial companies but retained it for SPACs. The Listing Review has recommended that the FCA now removes the presumption of suspension for SPACs and replaces it with appropriate rules and guidance to increase investor confidence in SPACs, namely guidance regarding:

- the information in relation to a target company which SPACs must disclose to the market upon the announcement of a transaction;
- the rights investors in SPACs must have to vote on acquisitions and to redeem their initial investment prior to the completion of a transaction; and
- if necessary, to safeguard market integrity, the size of SPAC below which the suspension presumption may continue to apply.

Clearly the introduction of mandatory shareholder approval and redemptions could prove to be a handbrake on the current tried and tested UK SPAC model, which is designed to provide permanent capital to the SPAC. Whilst market participants may welcome the proposal regarding suspension of a SPAC's shares, the retention of an element of choice regarding the shareholder vote and redemptions would also be welcome. Overall, these changes will likely be a positive step to help the SPAC achieve greater popularity in the UK and to develop a deeper pool of capital for investment in UK SPACs.

Implementation

Early market reaction to the Listing Review has been positive, with commentators pointing to the government's enthusiastic reception of Lord Hill's report and the sense of urgency which runs through it. With a wide scope of review, the resulting set of recommendations are equally broad, and certain of the recommendations may inevitably take priority over others. In its initial response published on 3 March, the FCA noted that it supports high regulatory standards in the UK whilst ensuring the UK's capital markets are dynamic and effective for companies and investors alike – an acknowledgement on the FCA's part perhaps that the UK listing regime needs some re-alignment.

The FCA has said it aims to publish a consultation paper on potential changes to the listing regime by this summer, with the intention – subject to consultation feedback and FCA approval – to make relevant changes to the Listing Rules by the end of 2021. Any changes to primary legislation will need to be made through the usual legislative process and could take significantly longer to be implemented. In addition to

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the immediate call to change, the Listing Review also proposes that the Chancellor should report to Parliament on an annual basis about the state of the UK's capital markets and the steps which have been taken, and will be taken, to maintain the attractiveness of the UK's capital markets. In this regard, the Listing Review is the start of what is hoped will be an iterative process of continual development and improvement. As always with wide-ranging reviews, the impact on the UK's capital markets will depend on the extent to which and how the recommendations are implemented. Market participants will watch with interest as the FCA now takes centre stage.

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