Bright ideas?

Lord Hill's recent review of the UK Listings Regime proposed several major changes that might increase the attractiveness of a London listing. Nicholas Neveling asked expert Corporate Finance Faculty members about the potential new rules

In November 2020, Chancellor Rishi Sunak announced a number of measures to help the UK remain a major global centre for financial services. He commissioned Lord Hill, Conservative politician and former European Commissioner, to review the Listings Rules. Recommendations published in March aimed to secure the long-term status of the London Stock Exchange (LSE) as a top-tier venue for the world's best companies.

According to Cboe Europe, Amsterdam overtook London as Europe's largest share-trading hub in January. It might be a blip, but it might not. The drop in trading volumes has been linked to the post-Brexit transition, but even before the EU referendum in 2016, London markets were facing headwinds.

According to economics consultancy Oxera, the number of companies on the LSE fell by 21% between 2010 and 2018, as company founders and management teams favoured private market capital or other exchanges offering higher potential valuations, such as Nasdaq in the US for technology company listings.

Rick Thompson, investment banking managing director at N+1 Singer and member of the Corporate Finance Faculty's technical committee, observes that Hill's review couldn't have come at a better time, both to set out a post-Brexit pathway and to reassess how the UK listings regime can evolve more generally to enhance London's competitiveness.

'Some UK tech companies look to Nasdaq because dual-share structures are permitted'

Chris Searle
corporate finance partner, BDO

"The Hill review has been a breath of fresh air," he says. "London has a well-deserved reputation for its gold-standard regulation, but the number of listed companies has been falling, and it is important to have the conversation about how regulation and listings rules can adapt to make the market more attractive. There's little point in a club sticking dogmatically to entry standards when its membership is in decline."

Refresh, reboot

Four recommendations from Lord Hill's 88-page review have emerged as holding the greatest transformational potential for London's stock market: dual-class share structures; smaller free float requirements; a more flexible cash shell framework; and an overhaul of the prospectus regime.

Allowing dual-class share structures for premium London listings is viewed as one way to attract fast-growing technology companies, when founders typically want to retain voting control over company strategy. These share structures are standard practice on Nasdaq and have also been introduced on the Singapore and Hong Kong markets in recent years.

Chris Searle, a corporate finance partner in BDO's London transaction services team (and member of the faculty's board), specialises in advising on IPOs. He says: "We have seen some successful UK tech companies look to Nasdaq rather than London on occasion because they obtain a higher valuation there, and also because dual-share structures are permitted.

"In the UK at present, companies such as The Hut Group, which achieved a £4.5bn valuation on IPO last year, have listed on the standard segment of the main market, rather than the premium segment, so they can use dual-share structures. This didn't seem to put investors off, so why not expand it to the premium segment and let investors decide? More recently, Deliveroo had a dual-share structure. But I suspect its post-IPO performance was more down to a too-aggressive valuation. Companies will consider a variety of factors when deciding where to list, but dual-share structures are a measure that could enhance London's attractiveness."

Lord Hill has suggested certain limitations on dual-class structures, including a maximum duration of five years, a maximum weighted voting ratio of 20:1 and restrictions on transfers of B class shares.

David Coffman, head of corporate finance at Novum Securities, says: "I am not the biggest fan of the dual-class shares idea, but it seems that companies want it, and Lord Hill has made recommendations to ensure high governance standards. If a dual structure reduces the risk of losing companies to other exchanges, then it's worth looking at."

Increased liquidity

The review's reassessment of free-float requirements has also been broadly welcomed by the market. Lord Hill has called for companies to be given more discretion when it comes to setting the value of their free float, so that it suits their size and is based on liquidity measures rather than being restricted to an absolute free float percentage. "Absolute percentages for free floats can oblige companies to raise more capital than they want or need, diluting owners. More flexibility is to be welcomed," explains Coffman.

For Thompson, Lord Hill's recommendations on changing the rules for 'blank-cheque' companies listed in London, known in the US as special-purpose acquisition companies (SPACs), are another positive development. In the US, SPACs – companies that raise capital on stock markets so they can then make an acquisition – have boomed over the past year. According to Refinitiv figures, SPACs raised an all-time high of US$79.3bn globally in 2020, almost all in the US.

Less than four months into 2021, the record SPAC haul secured last year had already been

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KATERINA JOANNOU
ICAEW capital markets manager

"The Corporate Finance Faculty hosted two round-table events to examine Lord Hill's review. The first was to get the views of reporting accountants, and the second for investors, advisors, non-executives and lawyers. We submitted the formal response on behalf of the ICAEW in January. There are considerably different opinions on the recommendations. We are ensuring that those different views and the reasons for them are presented clearly to Lord Hill."

LORD HILL'S REVIEW: HEADLINE PROPOSALS

Dual-listing rules

Lord Hill recommended that companies with dual-class share structures should be allowed to list in the premium listing segment, subject to certain conditions. These would include: capping the duration of the dual-class structure at five years; allowing a maximum weighted voting ratio of 20:1; obliging B class shareholders to be company directors; limiting the transfer of B shares; and limiting the scope of voting matters while the dual-class structure is in place.

Free-float requirements

The review called for a reassessment of free-float requirements to provide a better measure of liquidity both at and after a listing. Companies could be given more clarity and choice about the free-float requirement at IPO, but lowering the absolute free-float figure so companies of varying sizes can apply different measures of liquidity other than an absolute free-float percentage.

Special-purpose acquisition companies (SPACs)

The shares of SPACs should not be suspended upon the announcement of a potential deal, allowing investors scope to trade out of positions if they desired. The review also recommended the introduction of additional protections for investors at the time of acquisition, including shareholder votes and redemption rights.

The UK's prospectus regime

Lord Hill advised that the Treasury should undertake a fundamental review of the prospectus regime. This should consider changing prospectus requirements so that admission to a regulated market and offers to the public are treated separately. It should also rethink how prospectus exemption thresholds are set and reassess how alternative listing documentation could be used where appropriate and possible.

MARTIN STEINBACH
EMEIA IPO leader, EY

"Exchanges around the world continue to modernise offerings in primary markets in order to attract IPOs and new listings. Providing private companies with efficient access to public markets is critical for economies to fund innovation, growth and create new jobs. This is an important role as the pandemic accelerates trends such as digitisation, with business models – especially in the technology and healthcare sectors – looking for smart money."

SPACs v CASH SHELLS

SPACs have secured record amounts of capital globally this year and last, but the UK's equivalent cash shell structure has attracted a fraction of the interest.

One of the key differences between US SPACs and UK cash shells is the fact that shares in SPACs can be traded after a SPAC has announced an acquisition. This has given investors the flexibility to trade out of SPACs when they haven't liked the look of a deal. US SPACs also allow for redeemable shares, giving investors the option to get their capital back if they don't approve of a deal target.

By contrast, in the UK, cash shell trades are suspended when an acquisition is announced, and investors have to wait until a deal completes and suspension is lifted if they want to exit.

Lord Hill has recommended that trading in cash shell shares should be permitted post-deal announcement, with the added security of redemption rights and shareholder votes on transactions.

The UK might not choose to entirely mimic the US SPAC market, where directors of target companies can set out aggressive earnings projections, which can drive up the price a SPAC has to pay for an asset. This would be tricky in the UK and continental Europe because of the strictures of the Market Abuse Regulation.

surpassed, with US$79.4bn of issuance, overtaking the $79.3bn invested in the vehicles during the whole of last year. By contrast, capital raised by the UK's cash-shell equivalents, says Thompson, totalled "a couple of million at most".

More flexibility

Any SPAC boom could end up being a bubble, warns Searle, because investors have flocked to the vehicles at a time when other investment opportunities have been limited through the pandemic period. Regardless, the SPAC rules in the US have made it a much more attractive option for investors and sponsors with an appetite for SPAC deals.

Thompson explains that, unlike the UK market, where trading in shares is suspended when a cash shell announces a transaction, shares in US SPACs can still be traded after a deal announcement. This offers investors valuable flexibility, with the option to trade out of a SPAC if they don't like the look of a deal that the SPAC has announced.

Lord Hill has recommended similar flexibility for London cash shells, with the inclusion of redemption rights and shareholder votes to enhance investor protection. "We don't have to ape everything the US does," he says. "We have a cash shell framework already in place in London. Making sensible adjustments could make London's blank-cheque companies much more attractive."

Coffman sees the biggest benefits coming with the potential changes to the prospectus regime. "UK-listed companies currently have to produce a full prospectus for secondary fundraising efforts,' he says. "The exercise is time-consuming and costly. Lord Hill has proposed a review of the prospectus regime and when a prospectus is required. Easing the prospectus requirements for secondary capital raisings would be a sensible move, and after Brexit the window is there to diverge from the cumbersome EU prospectus regulations."

'Producing a full prospectus is time-consuming, cumbersome and costly'

David Coffman
head of corporate finance, Novum Securities

Moving on

Now that Lord Hill has published initial recommendations, the next step is for the Financial Conduct Authority (FCA) to review the recommendations and open consultation on what to take forward before regulatory and legislative changes can be made. Thompson says the FCA's clear direction from government is that the matter is a priority and "won't be kicked into the long grass". Searle and Coffman also expect the FCA to move swiftly. A consultation could be opened as early as the second quarter of 2021.

Thompson comments: "Through the pandemic, the liquidity that companies were able to secure via secondary capital raisings in London was materially ahead of Europe, and stock markets were able to outpace private equity investors, who were hamstrung by not being able to conduct due diligence on the ground. Capital markets delivered and new interest in IPOs is at levels not seen in years. Implementation of Lord Hill's recommendations offer the opportunity to build on this momentum."

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