ICAEW
REPRESENTATION 64/22

PRIMARY MARKET EFFECTIVENESS REVIEW: FEEDBACK AND FURTHER DISCUSSION

Issued 1 August 2022

ICAEW welcomes the opportunity to comment on the discussion paper DP22/2 Primary Market Effectiveness Review: Feedback and Further Discussion, published by the Financial Conduct Authority on 26 May 2022, a copy of which is available from this link.

For questions on this response, please contact our Corporate Finance Faculty at CFF@icaew.com quoting REP 64/22.

This response of 1 August 2022 has been prepared by the Corporate Finance Faculty, ICAEW's centre of professional expertise in corporate finance. The response reflects consultation with capital markets teams in professional services firms, brokers and advisers including sponsors.

The faculty contributes to policy development and responds to consultations by international organisations, governments, regulators and other professional bodies. It provides a wide range of services, information, guidance, events and media to its members, including its highly regarded magazine Corporate Financier and its popular series of best-practice guidelines. The faculty's international network includes member organisations and individuals from major professional services groups, specialist advisory firms, companies, banks and alternative lenders, private equity, venture capital, law firms, brokers, consultants, policy-makers and academic experts. More than 40 per cent of the faculty's membership are from beyond ICAEW.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 161,000 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
icaew.com

The Institute of Chartered Accountants in England and Wales (ICAEW) incorporated by Royal Charter (RC000246)
Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

KEY POINTS

1. The proposals risk unintended negative consequences for market access and investor protection and engagement. Further thinking is needed if regime change is to meet the outcomes described by the FCA. For example:
    - for some sponsors, serving IPOs with no or limited post-admission services may not be economically viable or conducive to making their declaration under Listing Rule (LR) 8.6.7. A reduction in this pool of professionals would jeopardise what the FCA considers is a fundamental part of a well-functioning market and helps to safeguard investor protection;
    - certain eligibility criteria create barriers for smaller companies to access the UK's Main Market, adding to the impact of the recently introduced market capitalisation threshold of £30 million;
    - the proposed single segment is not a genuinely distinct regime and the decision of FTSE Russell on issuers' eligibility for index inclusion may render the supplementary disclosure regime redundant or lead to the supplementary disclosure regime being considered similarly to the premium segment.
2. Revised proposals should ideally be considered together with other legal and regulatory reforms recommended in the Hill Review and the Secondary Capital Raising Review, and the proposals expected from HMT's prospectus review. It is less than optimal for example to fully evaluate these proposals for potentially substantive changes to the disclosure regime, when there are other moving parts such as the disclosures under the prospectus regime. Market participants cannot genuinely evaluate these proposals amid a move towards a more disclosure-based regime without knowing what the disclosure regime will be.
3. We believe that the proposals should be revised, nonetheless we have set out thoughts in response to the FCA's specific questions.

ANSWERS TO SPECIFIC QUESTIONS

CHAPTER 3: THE STRUCTURE OF THE LISTING REGIME

Q1: Do you think that a single segment regime would meet the outcomes we have described? Are there any changes or enhancements that could be included to enhance the effectiveness of a future regime?

4. We set out comments and suggestions about the proposals while being mindful of the desired outcomes set out in paragraph 3.15 of the discussion paper and shown below in bold.

    - **Ensure that the value of being listed is simpler to understand by removing complexity that isn't serving a genuine and defined purpose**

    - **Promote broader access to listing for a wider range of companies, by continuing to set clear, simple and robust minimum ongoing standards for listed companies, providing greater investment opportunities for investors on UK markets**

5. The proposed single listing segment in which issuers can move between two sets of continuing obligations subject to a shareholder vote and FCA assessment may be perceived as analogous to moving between the current listing segments without constituting a genuine regime change. For potential applicants and future investors, it does not really alter complexity or better explain the value of being listed, and could add rather than remove confusion.

6. Having two sets of obligations also undermines the concept of a single segment.
7. Investors and issuers must be helped to appreciate how the constituents of a new FTSE Russell Index Series will differ from current ones. This is necessary to prevent the perception that they will be equivalent.
8. The proposals extend the requirement for shareholder approval of material related party transactions to all listed commercial companies. We note that the related party transaction requirements in Chapter 11 of the LRs parallel the requirements set out in Chapter 7.3 of the Disclosure Guidance and Transparency Rules (DGTRs) that implement the provisions of the Shareholder Rights Directive. In line with its de-duplication objective the FCA could consider removing LR Chapter 11 and inserting the shareholder approval requirement into DGTR Chapter 7.3. This would also have the benefit of eliminating the confusion arising from the divergent definitions of related parties in the current regime.

- **Empower investors to conduct their own decision-making over the suitability of listed companies to meet their investment needs through clear, high-quality disclosures**

9. For some investors, the existence of two sets of continuing obligations in a single segment will be no easier to understand than the existence of primary and standard segments is now. This would include those new to investing on UK markets as well as ones that do not understand the implications of lower shareholder involvement.
10. A transparent and informative labelling system or kitemark that indicates which set of obligations issuers have adopted will help investors ensure ongoing alignment with their strategy, and to protect an investor base with more diverse risk profiles. We point out however that, while we consider it necessary, labelling will also denote different constituencies within the new listing segment, thus undermining the concept of a single segment. See also our answer to Q9.
11. There is potential for a disclosure-based regime to provide relevant information that meets the quality standard required by investors. However, it is not possible to properly evaluate the potential of the FCA's proposals to be realised without knowledge of the nature of disclosures under the prospectus regime. A disclosure-based regime must also enable an issuer's performance measures to be appropriately benchmarked.

- **Allow issuers and investors flexibility to agree where additional shareholder engagement, overseen by the FCA, is appropriate**

12. Companies and investors will need to consider and decide which set of continuing obligations will be most appropriate and acceptable, either going forward or on listing. Investors need to be able to have a real say in whether their company should comply with the supplementary disclosures, perhaps by giving shareholders an annual vote on the matter. What is also not clear from the proposals is the extent and method of engagement with minority shareholders.
13. Whether or not the proposals really do provide issuers and investors with the flexibility to agree where additional shareholder engagement is appropriate will likely depend on the approach FTSE Russell adopts.

Q2: Do you agree that revenue track record, historical financial information, and the requirement for a 'clean' working capital statement can be replaced by disclosure in listing documentation such as prospectuses?

14. That depends on what the disclosure requirements of the prospectus rules will be; ie, how the FCA implements the legal requirement for prospectuses to include 'the necessary information which is material to an investor for making an informed assessment' (Prospectus

Regulation Rules (PRR) 2.1), the 'necessary information' requirement within Art 6 of the Prospectus Regulation being a subjective test.

15. Disclosure requirements in a prospectus could potentially replace the Listing Rules (admission to Premium Segment) additional requirements relating to historical financial information (HFI) and a 'clean' working capital statement.

16. Lord Hill recommended maintaining the three-year track record requirement for the premium listing segment. We acknowledge that a revenue track record is not the only way in which a company can demonstrate its maturity and quality, and it is currently an obstacle to the listing of young, innovative, high growth companies. We also note that the FCA considers that it is not best-placed to set alternative requirements to revenue stream that would be universally appropriate. However, there could be some high level indicators that a business has operated for a period of time, even if not generating revenue throughout. Some general principles and, potentially, certain industry-specific ones would enable these to be explained. The revenue earning record could be replaced with an 'operational existence requirement'.

17. Regarding complex financial history requirements, the current guidance inherited from the EU is not particularly clear or well written and can lead to inconsistent outcomes. If the historical financial information (HFI) requirements of the LRs (admission to premium segment) are removed, and once the FCA assumes responsibility for the prospectus regime, it should review the complex financial history requirements and the extent to which a more qualitative approach compared to HFI could effectively reconcile information discussed in the prospectus. A technical note with guidance on the approach adopted would be useful.

Q3: Under a disclosure-based regime, are there any elements of the listing regime that should be incorporated into future changes to the prospectus regime to ensure that investors receive appropriate information upon which to base their investment decisions?

18. Disclosure requirements for Class1 and Class 2 transaction will be needed if these will not be maintained in the Listing Rules.

19. Please also refer our response to Q2 on a suggested alternative to the HFI requirements in the event these are removed from the LRs (admission to premium segment).

Q4: Do you agree with extending the Premium Listing Principles to all issuers of equity shares in commercial companies under a single segment regime? Would any specific changes to the principles be necessary to do so?

20. We agree and are not aware of any changes needed.

Q5: Do you agree that we should consider allowing dual class share structures in the single segment? Do you agree that the only form of dual class share structure that should be permitted within a single segment regime should be the regime recently introduced in PS21/22?

21. Yes, DCSS should be permitted in the single segment but only in the form introduced in PS 21/22.We note that this means limiting all DCSS to a 20:1 weighting - whereas the current standard segment does not have a limit – which could reduce access rather than encourage more issuers

Q6: Do you think the eligibility requirements for the single segment regime described will broaden access to listing to a wider range of companies?

22. Access may be broadened but not for smaller companies. The cost to companies of the proposed requirement for a sponsor for all initial listings will mean that some smaller companies will not be able to access the Main Market.

Q7: Does the suggested division between the mandatory and supplementary continuing obligations provide enough flexibility for issuers, alongside appropriate investor protection? Please provide any evidence and examples where possible.

23. Unless FTSE Russell mandate that only companies who opt for the supplementary obligations would be eligible for inclusion in these indices, there will be very little incentive for companies to opt into the supplementary regime risking the regime becoming redundant. Conversely, if FTSE Russell was to mandate the supplementary regime, the motivations to choose between mandatory/ supplementary regimes under the proposed model would then be similar to that of the current standard/premium segments, albeit with higher baseline requirements
24. We see more merit in the FCA revisiting the listing model options it presented in consultation paper CP21/21. We see Model 3, if adapted with revisions to the eligibility criteria so that companies that have historically used standard segment as a stepping-stone would have greater flexibility to directly join a premium-equivalent segment, as being more likely to achieve the desired outcomes.
25. We are not persuaded that a supplementary obligation for shareholder approvals for major transactions is consistent with ensuring that shareholders have an enhanced role in the decision-making of the business. We would like to see more explanation of the FCA's thinking behind making supplementary the independent business and controlling shareholder obligations, as well as its proposals for related disclosure in the annual report and a prospectus.

Q8: Should more be done to ensure there is a genuine choice for issuers to decide whether the supplementary continuing obligations are suited to their business model and strategy?

26. It is unlikely that the proposed single segment regime can ensure more choice. The relative importance of index inclusion will influence the issuer's decision on which continuing obligations to adopt. If index inclusion is important to its investors and FTSE Russell decides that all companies listed on the Main Market (under either the mandatory or supplementary regime) will qualify for admission to the UK Index Series, issuers are unlikely to adopt supplementary continuing obligations. In contrast if FTSE Russell decides that only companies listed under the supplementary regime will qualify for admission to the UK Index Series, issuers may treat the mandatory regime in the same way they do the standard segment.

Q9: What sort of labelling would be most helpful to ensure investors are aware of whether an issuer is opted into the supplementary continuing obligations? e.g. Annual reports, noted on the Official List, or made clear by the trading venue.

27. We support a transparent and informative labelling system or kitemark that indicates which set of obligations issuers have adopted will help investors ensure ongoing alignment with their strategy and will protect an investor base with more diverse risk profiles. We acknowledge, however, that labelling will result in segmentation within the single segment. leading to more confusion that currently, where at least it is known there are two distinct segments.

Q10: What factors should we take into account when considering the level of the threshold for Class 1 transactions within the significant transactions regime? What threshold would be appropriate?

28. Timeliness and adequacy of disclosures are the principal elements of a significant transactions regime. It would be worth considering a lower threshold for disclosure about significant acquired businesses with a higher one applying where shareholder vote is required.

Q11: Do you consider the scope of the single segment to be appropriate? Should any additional instruments be eligible to list there? e.g. Depository Receipts (DRs)

29. Please see our response to Q26 on inconsistency of treatment.

Q12: Do you think the current regime for listing close ended investment funds is fit for purpose?

30. We have no comment.

Q13: Do you agree that 'UK listing' could be used to describe the possible regime described?

31. Yes, coupled with appropriate and prominent labelling that indicates the issuer's choice of continuing obligations.

Q14: Are there any other factors we should take into account when considering the treatment of existing standard listed issuers?

32. In addition to the treatment of existing standard listed issuers, the FCA should consider and propose how treat situations for which normal transition arrangements will not be appropriate. An example, while rare, is a listed company that, through a transaction or event, can no longer meet the eligibility criterion of control of business that is included in mandatory continuing obligations. This could arise if an issuer loses control of the majority of their business either through divestiture or occasionally through a 'quirk' of accounting.

Q15: What transition arrangements should we put in place for premium listed companies in order to optimise the benefits of a single segment regime?

33. It will be important for investors in a premium listed company to continue to enjoy current protections until they have been given the opportunity to vote on the issuer's choice of continuing obligations.

CHAPTER 4: THE SPONSOR REGIME - FORWARD LOOKING APPROACH

34. Our discussions with members focused principally on the role of sponsors, their services and fees and we have responded to relevant questions in the discussion paper.

Q21: Would more transparency of how sponsor fees are calculated help issuers and investors to better understand sponsor services and the role of a sponsor?

Q22: Would it also help to be able to differentiate more clearly between the sponsor services and non-sponsor services that may be provided by the same provider? How might this clearer differentiation be achieved?

35. Yes, disclosure and transparency will afford investors a view of the value of the role. This approach is consistent with those applying to other advisers, such as advisers to the parties to an offer under the Takeover Code.

36. While we don't advocate disclosure of the quantum of sponsor fees, disclosure of the basis of fees that also explains when differential or contingent fees are applied, and to which sponsor and, if applicable, non-sponsor elements, will help to achieve transparency. Non-sponsor elements could be categorised by type of advisory service charged for and paid for.

37. Sponsors are required to identify how performing multiple roles could create conflicts of interest and to manage this. Other advisers, eg reporting accountants, face restrictions from carrying out certain roles for the same client where there may be or perceived to be a threat to independence. While current rules do not prevent sponsors from performing multiple roles, clarification of the sponsor role would likely be enhanced by more formal independence guidelines.

Q23: What more could be done to better align a sponsor's incentives with the long-term interests of an issuer, and the interests of investors, to seek to maximise the benefits to be gained from the sponsor regime? Is there more information regarding the performance of a sponsor and of the performance of an issuer, at IPO and thereafter, that could be used to demonstrate this?

Q24: Are there any specific modifications to the role of the sponsor that you think would be needed, if the sponsor regime were applied to all issuers of equity shares in commercial companies under a single segment regime? For example, are there risks that may arise from longer periods of time between sponsor engagement with a company and the provision of assurances to the FCA and, if so, how might they be mitigated?

38. The periods of time between sponsor engagement with a company and, depending on the significant transactions regime, the possible reduction in a sponsor's involvement with a company, could in fact reduce alignment of the sponsor's incentives with the long-term interests of an issuer.
39. With a potentially reduced role post-IPO, firms which currently provide sponsor services but who do not see serving IPOs as being economically viable, may withdraw from the market (or from the small-mid cap end of the market), reducing competition between providers and reducing choice of service provider for applicants.
40. Moreover, compared to the premium segment, the proposed involvement of the sponsor represents a significant reduction in the role following an issuer's admission. This could lead to some sponsors not being able to meet current requirements for a sponsor's declaration (LR 8.6.7).
41. We have previously argued that investor protection that comes with the due diligence undertaken to support the sponsor regime should be retained as, in our members' experience, it has the effect of both enhancing disclosure to shareholders and reducing fundraising and transaction risks. Further to the feedback to CP21/21 indicating that the sponsor regime is a cornerstone underpinning the quality of the operation of the listing regime, there is a case for exploring a recurring sponsor role.

Q25: Are there circumstances where the role of a sponsor after initial listing could be reduced, without materially impacting the benefits gained from the sponsor regime? If so, please provide details and explain how investor protections would or would not be impacted.

42. Please refer to our response to Q24.

Q26: Are there other circumstances in which the sponsor regime should be extended/applied more widely? For example, to any other issuers of securities currently listed in the standard listing segment.

43. The grounds for differential treatment of an overseas issuer of equity securities and an issuer of DRs are not clear. Why would the former be subject to sponsor oversight as part of new single segment, but the latter, as part of the remaining standard segment, would not?