UKSIF
UK Sustainable Investment and Finance Association

Primary Markets Policy Team
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

UKSIF
73 Watling Street
London
EC4M 9BJ
info@uksif.org

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Dear FCA Primary Markets Policy Team,

We are pleased to respond to the FCA's consultation, CP 23/10 – Primary Markets Effectiveness Review: Feedback to DP22/2 and proposed equity listing rule reforms. We believe the consultation marks a very important moment in the UK's efforts to cement its status as a competitive and thriving financial services centre and attractive destination for international investment.[1]

About UKSIF

The UK Sustainable Investment and Finance Association (UKSIF) is the UK's leading membership organisation for sustainable finance, committed to promoting a financial system that works for the benefit of the environment, society, and us all.

UKSIF represents a diverse range of financial services institutions committed to these aims, and our more than 300 members-representing over £19trn of global assets under management (AUM)-include investment managers, pension funds, banks, financial advisers, ESG data and research providers, NGOs, among others.

UKSIF and our membership have played a prominent role to help better embed sustainability in the UK's policymaking and regulatory framework, and across the financial system, over recent years and find ways to overcome barriers to the growth of sustainability in the UK. For example, UKSIF is a representative on a number of advisory groups to policymakers providing guidance on delivery of a number of sustainable finance initiatives, including the UK's 'green taxonomy,' the Sustainability Disclosure Requirements (SDRs), voting disclosures, and the integration of social issues in the pensions sector.[2]

Our response

A critical component supporting the UK's current enviable position as a world-leading financial services and investment centre has been its reputation and regime for good governance and stewardship. This has helped to attract pools of capital and investment opportunities to the UK's markets, in the process promoting economic growth and prosperity across the country.

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[1] UKSIF's response is informed by our membership, though this does not necessarily reflect the views and perspectives of our entire membership, either individually or collectively.
[2] For more information, please visit www.uksif.org.

We firmly believe that the existing high bar in the UK for strong corporate governance and shareholder rights should be reflected as a core priority in the FCA's upcoming changes to the UK's listings regime.

In recent years, we have recommended that high-quality sustainability and climate-related disclosure standards remain in place for those companies seeking to list in the UK's markets, in particular for companies on the premium listing segment. We have argued that this would further improve the attractiveness of the UK's capital markets while providing increased confidence to all investors and retail savers invested in companies here at home.[3]

In terms of attitudes from foreign investors, strong governance standards and disclosures, including in relation to sustainability, have been an integral part of the London market's success in recent years, and have been viewed by global investors as carrying lower risks and an ability to raise capital at a lower cost than competitors in other markets seen to have lower standards.

UKSIF now represents more than 300 financial institutions and investors managing over £19trn of global assets under management (AUM). **Alongside our members, we hugely value the high-quality standards that have been in place to date for the UK's listings regime**.

We welcome the FCA's direct recognition of this in the consultation, and we would strongly recommend that the regulator retains as a core principle the importance of high standards of disclosure and transparency to guide its upcoming work. **We very much share the regulator's ambition for the UK to continue to be regarded as 'one of the leading global markets of choice'** for investors, issuers, and others in comparison to other markets around the world.

In our response to the consultation, we outline a number of our and our members' broad reflections on the direction of travel of several of the FCA's proposals, including in regards to dual class share structures, shareholder votes on certain significant company transactions, among other areas of the consultation. We would reiterate the vital importance, above all, of strong governance standards and investor safeguards to remain in place to further enhance the effectiveness of the UK's listings rules and effective functioning of financial markets in the coming years.

Q1: Do you agree with the proposal to remove specific financial information eligibility requirements for a single ESCC category? If not, please explain why and any alternative preferred approach.

Although open to the proposal to establish a new single listings category in the UK's upcoming regime, **we would not be supportive of efforts to remove specific financial information eligibility requirements for a single ESCC category**, which would carry greater financial risks we believe for our members and the clients and savers they serve.

We do not believe that this action would outweigh the possible benefits afforded by wider investment opportunities for investors. Therefore, we would recommend that the new single listings category maintains the existing financial eligibility rules and required financial disclosures, such as clean working capital statements and three-year revenue track record requirements, of the current premium listings segment. In relation to the clean working capital statement specifically, it would be disappointing to see the removal of this requirement which provides decision-useful financial

[3] Further details can be found in UKSIF's 'Policy Vision' thought leadership report published in April 2021, which outlined a roadmap for enhancing the UK's global leadership on sustainable finance.

information for investors, and our expectation is that early-stage companies could still seek to raise sufficient capital to cover near-term requirements.

Q.4: Do you agree with our proposed approach to dual class share structures for the single ESCC category and the proposed parameters? If you disagree, please explain why and provide any alternative proposals.

Alongside a number of our members, we have some reservations with the proposed approach outlined in the consultation to dual class share structures (DCSS), which would go some way to restrict shareholders' existing rights.

We would question the evidence base that more permissive use of DCSS for listed companies would lead to a real step-change in the competitiveness of the UK's listings regime, and with it higher flows of capital into UK-based companies.

There is some evidence we see showing a limited impact in practice of DCSS in the United States and other jurisdictions, with any benefits for companies likely to be relatively short-term in the aftermath of a listing.[4] In the context of the UK, evidence also appears relatively limited currently in terms of the positive impacts that DCSS may have had in relation to companies on the existing premium listed segment. One reason is that it has only been around 18 months since FCA first permitted the use of DCSS for companies on the premium listed segment, and we think that more time will be required to assess any potential tangible benefits for UK-based companies.

More globally, **there is some evidence pointing to the benefits of mandatory sunset provisions in place for DCSS companies.** For example, a CFA Institute paper has considered this issue across various jurisdictions, including the Asia-Pacific region (APAC), North America, Europe, and elsewhere. It highlighted a study from the U.S Securities and Exchange Commission (SEC) comparing the relative valuation of DCSS companies with sunset provisions against those companies with perpetual dual-class structures, and the study examined the valuation of these two groups of companies over time.

The SEC's study concluded that from the third year onwards of the IPO, those companies with sunset clauses started to trade at a valuation premium compared to those with a perpetual DCSS structure. This would indicate that initial advantages enjoyed by the latter group of companies post-IPO begins to decline over time. Also, those companies that gave up their DCSS share structures experienced a considerable rise in company valuations, according to this study.[5]

For these reasons, **we would recommend that the FCA, at a minimum, maintains the current five-year mandatory sunset clause in place for the expiration of enhanced voting rights.** Ahead of any further changes, we would ask the regulator to consider more fully- in the coming months- the impact of recent changes in this area. The five-year sunset clause, we believe, would be sufficient for newly-listed companies in UK markets, including to deliver on their business strategy and fund future growth while allowing founders to retain influence, and an extension at this point by the regulator may appear relatively premature.

Separately, **there is some evidence indicating an increase in the voluntary use of time-limited sunset clauses among U.S-based dual-class IPO companies**, including technology companies.

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[4]A study from Harvard Law School has indicated that benefits of multi-class share structures can decline over time. Lucian A. Bebchuk and Kobi Kastiel, 'The Untenable Case for Perpetual Dual-Class Stock,' (June 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2954630.
[5]CFA Institute, Dual-Class Shares, The Good, The Bad, and the Ugly, A Review of the Debate Surrounding Dual-Class Shares and Their Emergence in Asia Pacific, August 2018.

Further guidance from the FCA in this area may be most appropriate as an initial step to better guide discussions between investee companies and their investors on the proportionate approach to sunset clauses.[6]

Separately, we have a number of concerns over proposals in the consultation that enhanced voting rights could be exercised in a number of scenarios, specifically beyond simply preventing a change of control in a company or safeguarding a founder's position as a company director. Finally, **there are questions over whether a more permissive approach to DCSS, and other proposals outlined in the consultation, would complement related initiatives in the UK aimed at enhancing the voting rights and influence exercised by investors.**

We see a conflict between the FCA's ongoing, welcome efforts to support more active stewardship and engagement from investors, and the potential dilution of existing rights and mechanisms that investors can exercise to hold investee companies accountable.

One example we identify is the work of the independent Vote Reporting Group (VRG), overseen by the FCA and the FRC, which is seeking to facilitate consistent, decision-useful voting disclosures from UK investment managers to clients, and there will be other upcoming initiatives to consider that may not be consistent with the signals provided by the proposed changes to listings.

These include: the upcoming review of the UK Stewardship Code later this year, the ongoing consultation on the UK's Corporate Governance Code, and the FCA's Sustainability Disclosure Requirements (SDRs), which considers product-level stewardship principles and more specific stewardship requirements for sustainable-labelled funds, in addition to a firm's corporate approach to stewardship.

Another example we identify where policymakers' objectives may not be entirely consistent is the work of Treasury's Asset Management Taskforce on stewardship, including their report published in November 2022 which made a number of welcome recommendations. This included the proactive use of requisitioned resolutions by shareholders to escalate issues and concerns to company management, including in relation to climate change.[7]

With policymakers in the UK rightly seeking to promote investors' stewardship role and use of voting as an effective tool to hold company boards accountable through these initiatives above, a number of the listings proposals- in their current form- would appear to be in contradiction to this core objective.

From our view, the underlying objectives between the FCA's listings consultation and these initiatives appear to be somewhat inconsistent. Policy coherency, and as clear as possible policy signals for our members, remains absolutely crucial to enhance investor confidence, and to encourage the efficient allocation of capital on behalf of clients and savers across the economy. The regulator could more clearly signal how the shift to a more disclosures-based regime for listings in the UK would align with its, and other policymakers, latest expectations for enhanced stewardship activities from investors across the economy.[8]

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[6]Analysis by the U.S.-based Council of Institutional Investors has found that time-based sunset provisions among dual class IPO companies in that country increased from 26% in 2017 to 51% in 2021. The Council is a non-profit association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined AUM of approximately $4 trillion. More details can be found here.
[7]HM Treasury Asset Management Taskforce, Investing with Purpose, Placing stewardship at the heart of sustainable growth, November 2020.
[8]Linked to this, we recommend that government and financial regulators consider an over-arching 'stewardship strategy', which could promote a more joined-up, coherent approach to investor stewardship. A first step would be a joint strategy from the FCA, FRC, and other financial

Finally, retaining effective safeguards in regards to DCSS will be hugely important in promoting investors' stewardship role in the wider economy, which continues to be a critical tool in driving the UK's transition to net-zero emissions and promoting long-term value in our economy.

<u>Q7. Do you agree with the proposed approach to significant transactions for a single ESCC category? If not, please explain why and any alternative proposals.</u>

We largely do not support the proposed approach in the consultation in regards to significant transactions, though we would be open to a simplification of the class test for these transactions. We appreciate the FCA may want to review the thresholds in time for determining 'Class 2' transactions; for example, to consider over time a higher threshold such as to 10% of market cap and revenue with certain conditions in place.

Above all, **it will be critical to ensure that shareholders are able to sufficiently scrutinise all major transactions in their companies**, and the current rules in place on significant party transactions remain a key investor protection, particularly for minority investors in our view. We have some concerns that the proposed approach from FCA could lead to a rise in the frequency of low-quality corporate transactions in the UK, negatively affecting shareholder value in the process.

Similarly to our previous response to Q.4, investors must continue to be able to effectively exercise their votes as part of their regular ongoing engagement with companies, which the proposed changes relating to votes on both related-party and significant transactions may harm. In regards to related-party transactions, we would like to see the current 5% shareholder vote threshold remain in place, as well as existing rules for mandatory shareholder votes being maintained for RPTs.

The proposals in this area in their existing form could increase the barriers for some of our members in effectively fulfilling their fiduciary duty to clients and beneficiaries.

<u>Q21: Do you agree with our proposed approach to reporting against the UK Corporate Governance Code for companies listed in the single ESCC category, and are there any other mechanisms the FCA could consider to promote corporate governance standards?</u>

We agree with the proposed approach in the FCA's consultation to report against the UK Corporate Governance Code for companies listed in the single ESCC category, given the prominent role the Code has played in maintaining the UK's global reputation for good stewardship and governance.

We think that all listed companies should comply with reporting against the Corporate Governance Code on a mandatory basis, helping to ensure that companies listed in the UK are following a good standard and practice in terms of how they are addressing governance issues and behaving in a responsible manner.

<u>Q22: Do you have any views on the proposed application of reporting requirements under LR 9.8 (i.e., premium LR requirements) as the basis for the single ESCC category?</u>

We agree with the proposed application of reporting requirements outlined in the consultation, including reporting against the Task Force on Climate-Related Financial Disclosures (TCFD), as well as reporting requirements on diversity and inclusion alongside the UK Corporate Governance Code.

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regulators comprehensively outlining in a streamlined manner, recent relevant and upcoming stewardship measures for industry and clarifying how initiatives are linked to and complement one another.

Keeping in place other annual reporting requirements under LR 9.8 would be positive, in addition to assessing how the recently published International Sustainability Standards Board (ISSB) S1 and S2 finalised reporting standards can be introduced in future.

Q.51: What do you consider to be the most important factors in deciding where to list (for example, regulation, valuations, depth of capital markets, comparable peers, investor / analyst expertise, taxation, director remuneration requirements, indexation, location of main operations). Please rank your factors in order of importance.

Broadly speaking, **we would challenge the narrative that additional changes to the UK's listings regime will, in practice, deliver the positive changes envisaged by policymakers**, and other groups, in terms of the competitiveness and dynamism of the UK's capital markets. We would welcome the FCA, and government departments, to actively consider commissioning further research on this subject, while also drawing on recent analysis published by UK Finance and EY and other groups.[9]

There are a wide range of factors we think that could make the UK a more attractive listings destination, which have been identified in the recent UK Finance/EY report and the Listings Review chaired by Lord Hill. We are pleased to see the FCA acknowledge in the consultation, as well as publicly, that any changes to listings should not be viewed in isolation and will need to be accompanied by other wider actions.

From our view, these factors include: the role of the wider business and professional services ecosystem in the UK, a consistent policy framework, the broader political environment (drawn into focus in recent years with successive changes in governments), the role of the media and public discourse around listings, the depth and liquidity of markets, tax incentives (particularly for early-stage businesses struggling to scale up), the quality of sell-side research and coverage, governance issues such as board composition and structures, customer base, and the existence of a healthy culture of investing.[10]

We think that the evidence base is steadily increasing in terms of these other factors and issues being highlighted, beyond listings requirements alone, as helping determine where companies are considering to list. While certain changes to the UK's listings regime should be kept under regular review by the FCA, we would highlight the importance of considering these other factors highlighted going forward and whether other mechanisms and policy measures would further strengthen the effectiveness and functioning of the UK's capital markets.

Other considerations

One area that we would like to see given additional consideration by policymakers is improving access to public equity markets for retail investors and other traditionally excluded groups, as well as for SMEs seeking to raise new capital.

Further work is needed to enhance the understanding and capacity of SME business leaders in raising finance in public markets, and broadly boosting awareness of the benefits and utility of capital markets for SMEs. In terms of retail investors, consideration of financial education and literacy campaigns- at the early-years level and beyond this- would be very beneficial and could be aimed at promoting the growth of retail investor capital in the UK.

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[9] UK Finance and EY, UK capital markets: Building on strong foundations, 2023.

[10] In regards to a consistent policy framework, we continue to reiterate the need for the UK to consider a modern industrial strategy and sector-by-sector approach that can drive forward various sectors' decarbonisation pathways and their attractiveness to investors. For tax incentives, further reforms could be considered to the existing EIS and SEIS schemes to better promote growth capital.

In conclusion, **we see a number of the consultation's proposals potentially leading to a dilution in the effectiveness of our members' stewardship role and their ability to regularly hold companies to account on a range of issues, including systemic risks** such as climate change and nature loss.

Above all, the FCA and UK government should prioritise the strengthening of our existing world-leading regime for good governance, which will be essential for the country's transition to net-zero. It is critical that this is reflected in the upcoming changes to the listings regime, with the UK traditionally seen across jurisdictions by global businesses and investors as a leader in this area.

Should policymakers in the UK take additional, substantive actions to dilute listings requirements, this may detract from the quality and depth of the UK's capital markets, potentially reducing pools of institutional and retail capital invested in UK-based companies and increasing financial risks in the process.

These steps could also risk sending mixed signals to other countries pursuing changes to their regulatory regimes and impact the development of governance standards internationally. Globally, we must be attuned to the scenario of a wider decline in standards across different jurisdictions, with high-quality standards for companies seeking to list in the UK's markets a key driver in our ambition to become the world's first net-zero financial centre.

We would be pleased to discuss our response to this consultation paper with you in due course, and would be happy to convene a select group of our members to consider further some of the issues raised in the consultation.

Yours sincerely,

James Alexander
Chief Executive