20 June 2023

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

Via email: cp23-10@fca.org.uk

Dear Sir/Madam,

Consultation: Primary Markets Effectiveness Review Feedback to DP 22/2

The UK Corporate Reporting Users' Forum (CRUF) welcomes the opportunity to provide the FCA with our comments on this review which could, in theory, have some potential to improve the effectiveness of the UK equity market's smooth functioning and make the UK a more attractive destination for issuers to list shares.

The CRUF was established in 2005 and we have been holding regular meetings since. CRUF UK has prepared this comment letter based on discussions in CRUF meetings and through the circulation of this response. As always, we do not seek to reach a consensus within the CRUF but to reflect a broad spectrum of users' views. We have highlighted any contrasting views, which arose during the drafting process, in our response. Our comments are based on our professional experience as users of corporate reporting and participants in the UK capital markets.

We support the desire of Government and Regulators to seek ways to make the UK a successful destination for companies to list and, more broadly, to deepen capital markets, creating a vibrant ecosystem which leverages the huge expertise in the City of London. We concur that the UK has more stringent listing standards than some other markets which may well deter a small number of issuers who see these as overly burdensome, but there are many more issues that are linked to this topic which we have broken down into four key areas:

1. Importance of other factors

   In our view changes to the listing rules in themselves will not make much difference relative to a range of other factors which are either peculiar to the UK or have been trends for some time, many of which are interconnected. These include:

   i. Valuation of UK Listed Equities relative to Global competitors
   ii. Stamp duty impact on UK Equity Risk Premium
   iii. Lower liquidity in the UK market
   iv. Loss of ACT allowances (many years ago)
   v. Low allocation of UK pension fund and other savings to UK equities (i-iv all relevant)
   vi. Attitude of the UK Press to executive pay and company profits (e.g., Oil currently)

   In our experience, higher valuations and greater liquidity in other markets are overwhelmingly the key reason why companies choose to list outside the UK and without addressing the first three factors above it is hard to see why anyone would list in the UK simply because changes

are made to reduce disclosure, increase founder rights and relax other safeguards for shareholders.

Several CRUF members believe that the single biggest improvement which could be made by Government is removing the burden of stamp duty in the UK, although they accept that this is unlikely at the current time given fiscal constraints. These members believe that this tax significantly increases transaction costs, reducing velocity of trading and allocation of risk capital by equity market participants. This directly hampers liquidity and raises the equity risk premium (ERP), fundamentally impairing valuations of UK listed equities compared to other markets where such a transaction cost does not exist. They argue that the greatest supporting evidence for this is a comparison between the trend in average holding periods for the S&P500 vs FTSE100 and valuations. The trends are very clear and stable - shorter holding periods (= greater liquidity) are strongly correlated with increasing relative valuations (liquidity is an increasingly important part of an ERP assessment). It is important to emphasise that longer holding periods (low liquidity) are not a sign of a strong market or better shareholder behaviour but evidence of a malfunctioning market in which “price discovery” is impaired.

2. *Caveat Emptor* trends and loss of minority protections

In many respects these proposed changes continue a trend towards an attitude of *caveat emptor* when it comes to equity markets. As a group of mainly professional analysts and investors, CRUF, as a body, has no significant problem with this, however we are mindful that retail investors may suffer more from this trend as safeguards are reduced and many asset management firms, charged with safeguarding client interests, will justifiably seek greater protection than we may feel we need.

The aspects of the proposals which protect minorities and which we think are especially important are those to do with Related Party Transactions (RPT), Significant Transactions (ST) and Dual Class Share Structures (DCS) and we are concerned that your proposals go too far. We believe that there must be thresholds for votes on STs and RPTs. Indeed if shareholders are being asked to take more risk and engage more with businesses, they need the tools to do so, which must include exercising our votes on issues like this. We also note that you have proposed a weakening of DCSS rules as well as a 10-year sunset clause, despite the fact that a 5-year sunset clause for DCSS was already being implemented after a significant consultation on the topic. We cannot understand why there is a need to alter it so swiftly when the impact on businesses seeking to IPO is unclear.

As minorities lose protections through the listing rules, we would hope to have seen some proposals which seek to strengthen other aspects of the UK system to compensate for this. Shareholder engagement is not the answer as we note in the next section.

The specific factors to highlight from reduced protections are:

i. Greater risk should increase the ERP and reduce valuations - directly contrary to the stated objective, although we are unable to quantify the impact by analysing the ERP in different markets with different levels of minority protection.

ii. Laxer rules on IPOs in the US, for example, are offset by an interventionist regulator in the form of the SEC as well as a greater exposure to litigation if problems arise later.
iii. Weaker listing rules run the risk of negative selection bias in which “bad actors” will seek to exploit access to capital in the UK.
iv. Passive funds, which have seen the greatest growth in the UK and are particularly prevalent in the pension market, will, arguably, be worse hit as they have to buy shares that list. Caveat emptor normally requires an assumption that the buyer will do due diligence before investing but this cannot happen for an index fund as they must track the index.

3. Shareholder engagement

These changes also call for greater shareholder engagement, potentially intended as a mechanism to increase minority protection by consulting with some shareholders ahead of a transaction. We see a number of problems with this:

i. The proposed engagement with shareholders during a deal process is very problematic due to Market Abuse Regulations / Insider Trading Rules. We cannot see any mechanism that could “cleanse” recipients after the event, even in the event of no transaction taking place.
ii. Large active shareholders often engage and many have dedicated teams behind a Chinese Wall to facilitate this, but we have to acknowledge that many will divest shares when they do not like what they see and will lose the ability to make the case for change.
iii. Whilst many passive funds also seek to engage, it has to be acknowledged that they have little economic incentive to engage to change outcomes. Indeed, with low fees being the main driver of market share, there is increasingly less income to invest in engagement.
iv. Retail investors usually have little ability to engage except through exercising their rights to vote shares. In circumstances where there are highly contentious matters, such as significant transactions and related party transactions, we think it is important that mechanisms are found to ensure that shareholders are well informed before voting their shares, as we suggest in our responses regarding shareholder voting advisory firms.

The shortcomings of relying on shareholder engagement, without a vote, mean that UK governance regimes place a significant burden on the Non Executive Directors (NEDs) and Audit Committees working with the external auditors and advisors. This should be considered carefully when thinking about changes to the Sponsor regime. Many CRUF members are inherently suspicious of Sponsor motivations as they will typically see their client as the entity they serve, rather than the shareholders, and within the company, the Independent NEDs.

4. Accessing early-stage companies

Linked to allowing companies to list with less historical trading evidence, a number of CRUF members made the point that for funds that invest some of their portfolio in private companies, there is a significant burden in pricing the private securities and therefore the overall fund. If earlier-stage businesses can list, there will be better access to comparable valuations of publicly listed early-stage companies, which will reduce the burden of calculating a fair value. In addition, it will make an IPO easier for companies held in these funds, creating more liquidity. This is

likely to increase the valuations of these companies and is aligned with the stated objective of the proposed reforms.

In conclusion we believe that these proposals do nothing to address the lower valuations in the UK market, which is a pre-requisite if more companies are to list here. As a result, some CRUF members believe there is an argument for not changing anything in the listing rules to make the UK equity market more attractive by reducing safeguards. As a recent FT article concluded, "next time a UK float runs into trouble, it's probably best viewed as a vote of confidence on the company rather than its host market"[1].

Responses to the consultation questions that relate to issues that concern investors are set out below. We have excluded questions where we feel we have nothing to add to the debate.

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.

Some CRUF participants accept this removal of disclosure. They believe that the prospectus contains sufficient disclosures for investors to make an informed decision.

However, a minority disagree as (in the context of our answer to Q51) they believe there is an appropriate time in the life-cycle of a commercial company for it to come to the public market for equity capital. If these companies do not have a reasonable track record to show their business is commercial, or do not have the prospect of sufficient working capital to show potential viability in the medium term, then this is evidence that these companies are not yet ready for public money. Therefore, some members suggest the premium segment requirements are retained for the proposed new single segment.

Q2: Do you agree with a proposal to explore a modified approach to the independence of business and control of business provisions for a single ECSS category, with a view to enhancing flexibility, alongside ensuring clear categories for funds and other investment vehicles?

We share the concerns highlighted in 4.17 but recognise that this is a material constraint for listing of some businesses which would otherwise be attractive investment opportunities.

Q3: Do you have views on what rule or guidance changes may be helpful, and whether certain disclosures could also be enhanced to support investors and market integrity, or any alternative approaches we should consider?

When considering potential guidance changes, we would highlight a problem with current IFRS GAAP which applies the equity method of consolidation to associates and joint ventures. This is very opaque and severely limits the ability for investors to value enterprises. We would encourage

[1] FT Alphaville Ten Years of UK IPOs in nine ugly charts by Bryce Elder 12 June 2023 - https://on.ft.com/45VZLw7

some level of enhanced disclosure in the prospectus for businesses which act as strategic investors as detailed in 4.10 c.

Q4: 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.

Some members agree that this is an area where some flexibility can be allowed but are unclear why recent changes, which received extensive consultation, need to be adjusted so quickly. The current regime adopted a 5-year rule and we see little reason to adjust that.

It is fair to say that all CRUF members are uncomfortable with dual class share structures. Some members go further and believe that shareholder democracy is a fundamental rule which should not be adjusted for pragmatic reasons and that a single class of shares, with equal votes, is the only answer. They believe DCSS lead towards unfettered powers of decision-making resting with one individual or a small group of shareholders. This in turn weakens the scope for legitimate challenge to decision-making by other shareholders. Systems of dual class shares also lack transparency in that it is unclear what value is really being placed on the relative values of the investment contributions of different shareholders. These members would prefer to see a single class of share with one vote each. Those individuals considered to have made a greater contribution to the founding and development of the business would receive a greater number of shares.

Q5: Do you agree with our proposed approach to the controlling shareholder regime for a single ESCC category? Do you have any views on the suitability of alternative approaches to the one proposed? AND

Q6: Do you agree that our proposals as regards controlling shareholders align with our need to act, as far as is reasonably possible, in a way which is compatible with our strategic objective of ensuring markets work well and advances our market integrity and consumer protection objectives? If you don't agree, how do you believe these should be balanced differently?

These are some of the more contentious changes in our view. Minority shareholders can be very exposed in these control situations, and it is important to ensure that safeguards are in place. We do not think that simply relying on independent board members and disclosure is adequate. We note that the current rules were brought into existence to protect minority investors when there had been specific examples of value loss. We would seek a more robust framework than the one proposed, with votes on material matters. Your proposals mean we need to rely on independent directors even more and they also assume that minority shareholders are vigilant. To an extent the entities that provide advice for shareholder voting can and do act as a protector in these circumstances, and so it is important that all shareholders have access to this in a cheap manner. We would encourage you to introduce a requirement for companies with such controlling shareholders to disclose recommendations from these groups when they issue their voting notifications to shareholders.

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.

We are not aware that potential shareholder votes on significant transactions have been a factor dissuading companies from listing in the UK or indeed delisting, although we do recognise that it

may dissuade companies from entering into value creating transactions and err on the side of caution more generally. We also understand that many other geographies, including the USA, do have requirements for shareholders to approve some transactions. Whether the current UK regime is optimal (Class 1 and Class 2), we will not comment except to say that some limitation must be sensible which would trigger a shareholder vote.

Q8: Do you consider that additional disclosure could be considered to further support transparency to shareholders on significant transactions and, if so, what (e.g., considering current circulars)?

Most companies will make disclosures about the track record of the target and provide pro forma information out of choice, but we think that there should be more mandatory disclosure. The IASB is currently reviewing disclosure requirements in relation to acquisitions and we would mandate companies to provide as much of this information as possible when they announce the transaction, rather than waiting until the next annual report. We believe it should be possible to provide much of the information for consolidation at the time the transaction is closed and do not think this is overly burdensome. This should be made available to all shareholders at the same time and certainly not to a sub-set of shareholders in an engagement process before announcement.

Q9: Should we consider further mechanisms prior to a significant transaction being formally completed (for example, a mandatory period of delay between exchange and completion) to support shareholder engagement with listed commercial company equity issuers in place of shareholder approval? What should those mechanisms be and why?

We believe that the checks and balances which exist through a listed company board structure should, in an ideal world, be sufficient to safeguard shareholders. Having said that, we think there is a significant risk that moving from the current regime will weaken the vital ecosystem of advisors, which provides input to boards and enables non-executive directors (NEDs) to become comfortable with a transaction. It is hard to see how such engagement with shareholders during a deal process, as proposed, can take place without breaching inside information rules. Even if the company were to pull out of the transaction based on negative shareholder feedback, this would still be material information in the hands of those shareholders who had been consulted. This could not be cleansed without sharing the information that a transaction was contemplated which would damage the reputation of the management team and clearly impact the share price.

Q10: Should the sponsor's advisory role in assessing whether a potentially significant transaction meets the proposed disclosure threshold be mandatory or optional, and what are your reasons? Do you agree with our proposal that sponsors have more discretion to modify the class tests, including substituting the tests with alternative measures, without seeking formal FCA agreement to the modifications? If you disagree, please provide your reasons and alternative proposals.

Some participants consider that the proposals may go too far. Paragraph 5.10 eliminates the requirement for a shareholder vote or a detailed shareholder circular in all cases apart from a reverse takeover. This could be acceptable for smaller transactions, given the cost of circulars and the delay involved in a shareholder vote, but only if there are appropriate safeguards introduced.

However, the requirements regarding a sponsor that you introduce in paragraph 5.13 first bullet are far too limited. It should be a mandatory requirement for the sponsor to assess whether the

transaction threshold is met and report this to the FCA and shareholders. Experienced third party perspectives are essential when assessing whether a transaction meets class tests, especially when there are any modifications. Simply relying on the company to "mark its own homework" is no more appropriate in the context of major transactions than would be permitting companies to publish annual results without audit, by relying upon the directors' legal obligations with regard to the approval of accounts.

Q11: Should we consider expanding the sponsor's role further on any aspects of significant transactions?

We have indicated our concern about the loss of an ecosystem to support the NEDs. Therefore, depending on the final form of the regime, it is quite likely that some expansion of the sponsor's role may be a good idea, notwithstanding our earlier comment that the sponsors also have conflicts.

Q12: Do you agree with the proposed approach to RPTs for a single ESCC category, which is based on a mandatory announcement at and above the 5% threshold, supported by the 'fair and reasonable' assurance model which includes the sponsor's confirmation as described above? If not, please explain why and any alternative proposals in the context of a single ESCC category.

We would be minded to maintain a requirement for shareholder approval.

Q13: Do you consider that additional disclosure requirements could be considered to further support transparency to shareholders on RPTs, and should we consider requiring certain mechanisms prior to a deal being completed (for example, a mandatory period of delay between exchange and completion) to support shareholder engagement with listed companies to replace the requirement for independent shareholder approval?

As noted above we would seek to maintain approval rights which necessitate disclosure. Notwithstanding this, in answer to your question regarding shareholder engagement, we reiterate our view that prior engagement is problematic given the materiality of the information.

Q14: Should it be mandatory for a listed company in the single ESCC category to obtain guidance from a sponsor on the application of the LR, DTR and MAR whenever it is proposing to enter into a related party transaction (irrespective of the size of the transaction), or should it be at the company's discretion?

We believe that this should be a mandatory requirement.

Q15: Should it be mandatory for the sponsor to consult with the FCA and agree any modifications to the class tests and classification of a proposed RPT, or should the sponsor have more discretion? Please explain your reasons.

Consultation with the FCA should be mandatory as RPTs are the riskiest class of transaction for minority shareholders.

Q16: Are there any broader, alternative mechanisms that existing shareholders or prospective investors would want to see in place of, or made use of, in order to strengthen shareholder protection in relation to RPTs in the event that these changes are made to our LR? If so, would these be matters for inclusion in our LR or are they found, for example, in legislation or market practice?

The most useful additional mechanism would be for audit committee (AC) reports to specifically discuss all RPTs that have taken place together with an explanation of the assessment that the AC undertook. This would be an important piece of disclosure when considering voting for the reappointment of the Chair of the AC.

Q17: Do you agree with the proposed approach to cancellation of listing for the single ESCC category, and do you have any views on other possible changes to the existing cancellation process?

We concur that a shareholder vote is essential when a company seeks to cancel its listing.

Q 18: Do you think that the notice period proposed for the single ESCC category for de-listing should be extended (taking the approach of other jurisdictions) and if so to what? What would the benefits be?

The current notice period is adequate in our view. We think the US requirement to publish further financial information even after delisting is a helpful protection as this creates a check and balance, opening up the opportunity for shareholders to litigate if it becomes clear that there was material new information after delisting which would likely have been known at the time.

Q19: Do you consider the policy for cancellation of listing by the FCA after a long suspension should be revisited? If so, how?

We have no strong views relating to this except to note that a 6-month suspension is a very long time. If the process is "overly cumbersome" there may be merit in administrative change.

Q20: Do you agree with retaining shareholder approval provisions on discounted share issuance and on share buy-backs, as currently required by the premium LR, as part of a single ESCC category, or would these be problematic for certain issuers?

Yes, for the reasons you highlight in 5.50.

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?

Yes

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?

We are not aware of any matters that require disclosure which would be overly burdensome or cause issuers to choose an alternative listing venue.

Q23: Do you agree with our proposed changes to the LR principles? If not, please explain why and provide details of any alternative suggested approach.

Yes, subject to earlier comments about DCSS and we concur with you regarding the importance of clarifying the role that directors play in relation to compliance.

Q24: We are considering applying the principles as eligibility criteria, to clarify expected standards and reflect the fact that in practice these requirements need to be complied with at the point of listing. Please provide details if you foresee any issues with this approach.

We see no issues.

Q25: Do you agree with our proposed changes to strengthen cooperation and information gathering provisions as outlined in this section? If not, please explain why and any alternative suggested approach to addressing the issue identified.

This seems proportionate.

Q26: In relation to our proposal to ask issuers to provide contact details of their key persons, do you think this should include details of the CEO, CFO and COO? Do you have any other suggestions as to other key roles that we should consider? Also, are there circumstances where it would be appropriate for an issuer to nominate a third party (such as an FCA authorised advisor), as a key person and, if so, why?

We would propose that the Chairman, senior independent director and chair of the Audit Committee should fall within the group that the FCA should have contact details for. Other key roles would be the company General Counsel or Company Secretary and whoever heads up information technology and digital data.

Some participants do not see a need for a third party to be nominated. However, others feel this should include the company's sponsor and the responsible partner at the company's external audit firm.

Q27: Are there specific considerations we need to take into account for different issuer or security types, in relation to our proposals in this section, that we should take into account as we develop our proposals further?

We are not aware of any such considerations.

Q28: Do respondents have any concerns about the availability of sponsor services as a result of the proposed changes to the listing regime and the sponsor role?

The views of the sponsors are key here, but we do believe that it should be possible to have a viable market in sponsor services with appropriate competition between providers to ensure that costs to business are not prohibitive relative to the value the sponsor brings.

Q29 & Q30:

Not relevant for users.

Q31: Do you have any concerns that sponsors will be able to demonstrate continued competence under our proposed approach? What matters should the FCA take into account when assessing sponsor competence?

No as we tend to agree that general capital markets experience and transactional advisory work should be adequate to ensure that sponsors can get the necessary experience to be "competent".

Q32-Q44:

We have no comments.

Q45: Have we identified the areas where our proposals may impose additional costs on investors? If not, please explain the additional costs that we should consider in our CBA.

We do not see any impact on the costs for investors, other than the potential increase to risk that we will bear which may, in theory, increase the equity risk premium (ERP) and lower valuations in the UK. From an operational perspective the level of diligence work which most institutional shareholders undertake is unlikely to change materially and we doubt that retail investors will do more work - which again limits the cost to the potential increase in risk. Clearly there would be higher costs if there is a mandated process of engagement for significant transactions as new teams might be needed across a Chinese Wall to preserve the ability for investment teams to function.

Q46: To assist us to quantify the costs of our proposals, please provide data or additional information to explain the additional costs to or other impacts on investors.

We are unable to suggest a mechanism for looking at the additional operational costs for investors. We also note that there is little evidence that listing regime severity has an impact on the ERP and, therefore, we do not think that these proposals, by increasing risk, will have a detrimental impact on share valuations even if this is theoretically possible.

Q47 & Q48:

We have no comments.

Q49: Do you agree with the benefits of our proposals that we have identified above? If not, please explain why.

This seems to be a fair assessment. We would note that most investors access global markets and so increasing the number of UK listed companies has little impact, assuming the same company would have listed elsewhere.

Q50: Are there any additional benefits that we should consider in our CBA?

None that we are aware of.

Q51: 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.

Valuation and liquidity are fundamental for the private market investors that have backed businesses to build them to the point when they are ready to IPO. These investors will see this as a path to exit after whatever lock-up is required and these two factors are critical. Taxation is important if it affects either of these two factors - and in this case we highlight stamp duty as a UK transactional cost which impacts both. Clearly the depth of the capital market is important too - but this will be a function of the attractiveness of the market to list in the first place. We note that UK equity investors have moved their equity holdings outside the UK and there is potential for this capital to return if the UK becomes a more attractive market. We tend to look at comparable peers

globally and analysts will often look at businesses beyond their domestic market. Therefore, we see these factors as lesser reasons to dissuade issuers from listing in the UK. Regulation comes a long way down the list when considering where to invest as, in developed markets, the reduction in the ERP for higher regulatory protections appears to be too small to justify. However, regulatory factors that are important are whether suitable levels of governance and transparency are required.

Q52:

We have no comment.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers, investors and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations depending on their area of interest or expertise. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. Also, it would not be correct to assume that nonparticipants agree with the initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held in the UK and provided by participants in drafting the response. Differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer or other organisations they are a member of or associated with. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective employer or other organisations. The participants in the CRUF that have specifically endorsed this response are listed below.

Signatures

Jed Wrigley, Private Investor
Jane Fuller, FSIP
Charles Henderson
Jeremy Stuber
Sue Milton, SSM Governance Associates
Peter Parry