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UK Listing Review Recommendations for Reform of the LSE Listing Rules

On 3 March 2021, the UK Listing Review, chaired by the Rt Hon. Lord Jonathon Hill, published its recommendations for reform of the Listing Rules of the London Stock Exchange[1] (the **LSE**) (the **UK Listing Rules**). The reforms are aimed at increasing the attractiveness of the UK as a listing venue, particularly for new economy companies, while also maintaining high standards of investor protection.

The key proposals include:

i) allowing companies with a dual class share structure to list on the premium segment of the LSE;

ii) reducing the free float requirements and allowing companies to use other measures to demonstrate liquidity;

iii) relaxing the rules in relation to special purpose acquisition companies (**SPACs**);

iv) rebranding and remarketing the standard listing segment of the LSE; and

v) reviewing the prospectus regime.

The recommendations further propose a review of the recently introduced conduct of business rules in the Financial Conduct Authority Handbook (the **FCA Handbook**) and various recommendations are aimed at better monitoring and delivering results with respect to enhancing the UK's attractiveness, improving investor experiences and meeting investor needs.

1 https://www.gov.uk/government/publications/uk-listings-review

1. Overview of the London Stock Exchange (LSE)

The LSE offers a choice of markets for listings of UK and international companies, including the Premium Segment, Standard Segment, High Growth Segment and AIM.

A standard and premium listing differ mainly in that companies seeking a listing on the premium segment must appoint a sponsor, meet enhanced eligibility criteria and comply with stringent continuing obligations. Premium listed companies are also potentially eligible for the FTSE UK Index Series. Companies with standard listings are not eligible for inclusion. The High Growth Segment is also a segment of the LSE's Main Market and is designed for mid-sized European and UK companies. It was launched in 2013 with the aim of attracting mid-sized tech companies to list in the UK.

As at February 2021, there were 1,124 companies (911 UK companies and 213 international companies) listed on the Main Market of the LSE.[2] Around 22% of companies listed on the LSE's Main Market have a market value of between GBP 0 – 25 billion while 15% have a market value of between GBP 1 – 2 billion.[3]

AIM is London's market for smaller, growing companies. It is open to companies from all sectors and from all over the world. The key differences between AIM and the LSE's Main Market is that there is no minimum public float and no minimum market capitalisation. The main requirement is that the company must

2 https://www.londonstockexchange.com/reports?tab=new-issues-and-ipos

3 https://www.londonstockexchange.com/reports?tab=main-market

be “appropriate” for the market, a judgment which is made by the company’s nominated adviser (nomad).

As at February 2021, there were 817 companies (705 UK companies and 112 international companies) listed on AIM.[4] Just under half (46%) of AIM-listed companies have a market value in excess of GBP 50 million, around 37% have a market value of less than GBP 25 million and around 17% have a market value of less than GBP 50 million.[5]

Overall, the LSE saw 60 IPOs in 2020 (34 Main Market IPOs and 14 AIM listings),[6] with 25% of all capital raised in 2020 from the technology sector.[7] Six of the 10 largest IPOs on the LSE were international companies.[8]

2. UK Listing Review Recommendations

a. Monitoring and Delivering Results

The Review recommends that an annual report is prepared and delivered to Parliament on the state of the City and its competitive position. In particular, the Review recommends that the Chancellor of the Exchequer outline the steps that have been taken / are to be taken to promote the attractiveness of the UK as a listing venue. The Review recommends that the first edition be published in early 2022.

The Review further recommends that the FCA should be charged with a duty of expressly taking into account the UK’s overall attractiveness as a place to do business. This is in line with other financial regulators around the world that have competitiveness or growth as a regulatory objective. For example, in Hong Kong, the Securities and Futures Commission (the **SFC**) is charged with the regulatory objective of maintaining and promoting the competiveness of the securities and futures industry under the Securities and Futures Ordinance (the **SFO**). Currently, the FCA has no similar objective.

b. Improving the Environment for Companies to Go Public in London

The Review sets out the following recommendations aimed at encouraging companies to list in London at an earlier stage of their growth cycle and generally enhancing the attractiveness of the UK as a listing venue.

Allow companies with dual class share structures to list in the premium segment of the LSE

The Review recommends that the FCA create new rules-based provisions within the Listing Rules for dual class share structures and stipulate a transition period, with conditions that apply during that time, for issuers that have dual class share structures to be eligible for a premium listing. At the end of the transition period, companies would either become subject to all the rules of the premium listing segment or could move segment and maintain or expand the scope of their share structure, subject to a shareholder vote.

The Review proposes the following restrictions:

i) a maximum duration of five years;

ii) a maximum weighted voting ratio of 20:1;

iii) limitations on transfer – the shares must convert on transfer, subject to certain exceptions;

iv) limitations on who is able to hold the voting class shares (i.e. to directors of the company); and

v) limiting the matters that could be subject to weighted voting for the duration of the dual class share structure.

The recommendation to allow dual class share structures is aimed at addressing the concerns of founder–led companies, for whom the dual class share structure is particularly attractive.

Under London’s existing Listing Rules, premium listed companies are essentially prohibited from employing dual class share structures by certain requirements under the FCA’s Premium Listing Principles, which require:

i) all equity shares in a class that has been admitted to premium listing to carry an equal number of votes in any shareholder vote; and

ii) where a listed company has more than one class of securities admitted to premium listing, the aggregate voting rights of the securities in each class should be broadly proportionate to the relative interest of those classes in the equity of the listed company.

4 https://www.londonstockexchange.com/reports?tab=aim
5 https://www.londonstockexchange.com/reports?tab=aim
6 https://www.londonstockexchange.com/reports?lang=en&tab=aim
7 https://www.londonstockexchange.com/discover/news-and-insights/2020-year-resilience?lang=en
8 https://www.londonstockexchange.com/discover/news-and-insights/2020-year-resilience?lang=en

Shareholder voting is required on a number of key matters and a 75% majority is required for:

i) class 1 transactions (transactions where any percentage ratio is or exceeds 25%);

ii) related party transactions;

iii) transfer outside of the premium listing category;

iv) employee share schemes and long-term incentive schemes; and

v) cancellation of listing.

As for the standard segment, there are no requirements for shareholder votes and a number of listed companies (e.g. THG Holdings) have employed structures similar to dual class share structures, where one "special share" is held by the founder.

Comparatively, in the US, dual class share structures on public markets are not prohibited by the Security and Exchange Commission (**SEC**) rules and US exchanges have also not introduced rules prohibiting dual class share structures. There is however a constraint on dual class share structures in the US in the form of the inclusion criteria set by the indices in the US. For example, the S&P 500 has excluded new dual class share structures since 2017.

Hong Kong and Singapore both introduced dual class share structure regimes in 2018, along with enhanced safeguards. In Hong Kong, the HKEX Listing Rules now allow high growth and innovative companies with weighted voting rights (**WVR**) structures to list on the HKEX, subject to meeting various suitability and other requirements. In Singapore, new economy companies with dual class share structures are eligible to list on the SGX, subject to meeting eligibility and suitability criteria.

Rebrand and remarket the standard listing segment of the LSE

The Review recommends that the standard segment of the LSE be rebranded (including a name change to the "Main Segment") and remarketed as a venue for companies of all types to list, with an emphasis on flexibility, while also maintaining minimum standards of eligibility.

The Review outlines concerns that the standard listing segment is currently seen as "unattractive" owing to a lack of index inclusion. Issuers listing on the premium segment are eligible for inclusion in the FTSE All-Share Indices and AIM issuers are eligible for inclusion in the FTSE AIM Index.

Proposed changes to free float requirements

The Review recommends that:

i) the definition of shares in public hands be reviewed and updated, in particular it is recommended that the definition should be:

- widened to increase the threshold above which investment managers and other institutional shareholders are excluded from contributing towards the free float calculation from 5% to 10%, and refined to take account of where holdings are diversified across fund managers within the same investment house who are making independent decisions;
- extended to include non "inside" shareholders;
- refined to exclude shareholders who are subject to lock up agreements of any duration that mean those shares are not realistically accessible as part of the regular liquidity pool;

ii) the required percentage of shares in public hands should be reduced from 25% to 15% for companies in both listing segments and companies of different market capitalisations should be allowed to use alternative measures to the absolute percentage of 15% to demonstrate that there will be sufficient liquidity in their shares following listing. The measures used should be objectively assessable by potential issuers and their advisers and the FCA would still need to confirm that it agrees with the analysis. The FCA's approval should however be "confirmatory" in nature, as far as possible. In particular, the Review recommends that:

- companies with larger market capitalisations should, as an alternative, be able to demonstrate that they have a minimum number of shareholders, a minimum number of publicly held shares, a minimum market value of publicly held shares and a minimum share price to support a liquid market; and
- smaller companies should, as an alternative, be able to use the same method that is used on AIM. This would require them to have in place an agreement with an FCA authorised broker to use its best endeavours to

find matching business if there is no registered market maker on the relevant market.

Under the current UK Listing Rules, the free float level is set at 25%, although the FCA can waive this requirement down to a minimum of 20% on a case-by-case basis, with the FCA generally more freely granting waivers in the standard listing segment. AIM does not have a minimum free float level. The High Growth Segment (which has only been used by two companies since 2013) has a 10% free float level.

By comparison, the NYSE and NASDAQ have no required free float level, however there are minimum values of publicly held shares that must be met and various other requirements. Hong Kong has a 25% free float level, which can be reduced to 15% if market capitalisation exceeds HK$10 billion. Singapore has various free float levels applicable to different market capitalisations ranging from 12% to 25%. In Australia, the free float level is 20%, which increased from 10% in 2016.

Additionally, according to data from the London Stock Exchange Group (the **LSEG**), there is no positive correlation between the free float generated at IPO and increased liquidity in the secondary trading market and there is, according to the data analysed by the LSEG, no significant reduction in liquidity at free floats lower than 25% on other international markets.

*Liberalise the rules for special purpose acquisition companies (**SPACs**)*

Under the current rules, SPACs are unable to meet the conditions for premium listing involving independence of business and track record requirements and are typically listed in the standard listing segment. Further, in the case of a shell company and where a reverse takeover is announced or leaked, shares are typically suspended due to a presumption that there will be insufficient publicly available information in the market.

The Review recommends that the FCA remove the rebuttable presumption which can require trading to be suspended in the shares of SPACs on the announcement of a potential acquisition.

The Review further suggests that the FCA consider developing rules and guidance on:

i) the information SPACs must disclose to the market upon the announcement of a transaction in relation to a target company;

ii) the rights investors in SPACs must have to vote on acquisitions prior to their completion;

iii) the rights investors in SPACs must have to redeem their initial investment prior to the competition of the transaction; and

iv) if necessary, the size of SPAC below which the suspension presumption may continue to apply.

The rule was previously reviewed by the FCA in 2018 and the FCA removed the rebuttable presumption of suspension for commercial companies but retained it for SPACs. The FCA's reasons for retaining the requirement for SPACs included a significant increase in the number of SPACs with very small market capitalisations and the likelihood that these SPACs would experience high levels of volatility around the time of a proposed transaction.

The SPAC market is largely dormant in the UK, with only four SPACs listing in the UK in 2020, raising an aggregate total of GBP 0.03 billion, compared to 248 SPACs that were listed in the US in 2020, raising GBP 63.5 billion. SPACs have failed to gain popularity in the UK owing to the regulatory environment, which, according to the Review, is deterring SPACs of all sizes. The Review recommends liberalising the rules based on the fact that SPACs are rapidly gaining popularity in the US and Amsterdam owing to the benefits they offer, including an alternative and quicker form of financing and the possibility of higher valuations for niche businesses. The advantages have been recognised in particular by a number of tech-focused companies and so the recommendation aims to stop the UK missing out on "homegrown and strategically significant" companies.

c. Re-designing the Prospectus Regime

Fundamental review of the on-shored prospectus regime

The UK's current prospectus regime, which is rooted in the EU Prospectus Regulation (on-shored into the UK law at the end of 2020), sets out the relevant requirements which apply on:

i) making an offer of securities to the public; or

ii) making a request for the admission of securities to trading on a regulated market.

There are exemptions available (for example, in the case of offers to qualified investors only or offers to less than 150 persons) however some exemptions apply to both circumstances and

others apply to only one. Offers below EUR 1 million are exempt entirely.

The Review recommends a fundamental review of the prospectus regime be carried out in order to tailor the required content to the type of capital raise and consider how retail participation in primary issuances can be increased. In particular, it is recommended that the FCA consider:

i) treating admission to a regulated market and offers to the public separately;

ii) amending the prospectus exemption thresholds so as to require documentation only where it is appropriate for the type of transaction and the circumstances of the capital issuance. In particular, further issuances by companies that are listed or quoted should either be completely exempt from requiring a prospectus or be subject to slimmed down requirements; and

iii) allowing alternative listing documentation to be used where appropriate and possible.

The recommendations are aimed at tackling concerns that following the introduction of the EU Prospectus Regulation and Directive, prospectuses "ballooned" in size, reducing the usefulness of prospectuses. The imposition of additional requirements for retail investors also led to companies excluding retail investors.

Prospectuses drawn up under other jurisdictions' rules

The Review further recommends that regulatory allowances should be made for foreign issuers' home prospectuses in order to promote dual and secondary listings in the UK. Accordingly, a "prospectus equivalence" regime would have to be developed.

Under the UK's current prospectus regime, the UK Government has a mandate to recognise overseas prospectuses, however this is thought to have limited effect in practice. However, London remains a pre-eminent listing destination, with over 200 dual listings on the LSE's Main Market as at February 2021.

d. Tailoring Information to Meet Investors' Needs Better

Proposed changes to the liability regime for issuers and their directors

Under the UK's current liability regime for prospectuses (section 90 of the Financial Services and Markets Act (**FSMA**)), persons responsible for the prospectus are liable to pay compensation to any person who has acquired any of the company's shares and suffered loss in respect of them as a result of an untrue or misleading statement in, or an omission from, the prospectus. A breach of section 90 is a criminal offence and the FCA has the power to prosecute these offences.

The Review recommends that the HM Treasury launch a review of the liability regime for prospectuses, listing particulars and other published information in FSMA as it relates to forward-looking information. In particular, the Review suggests that directors could have a defence to liability provided that they can demonstrate that they exercised due care, skill and diligence in putting the forward-looking information together and that they honestly believed it to be true at the time it was published.

This recommendation is based on investor demand for more forward-looking information in prospectuses. Currently, companies must provide three years of backward-looking financial information in their prospectuses and, comparatively, very little forward-looking information. This stems from the fact that the level of liability associated with past and future information is the same under the current prospectus regime and companies do not, generally, have the same level of certainty as they do over past events.

Review the provisions for scientific research-based companies

The UK Listing Rules currently contain special provisions in recognition of the difficulties that scientific research-based companies may have in complying with the standard revenue earning requirements in the premium listing segment. The Review recommends that the provisions be broadened to also apply to other types of high growth, innovative companies from a variety of sectors who are also sufficiently mature in ways other than through having positive revenue earnings. Further, the Review recommends that the provisions should be reassessed to ensure that they are fit for purpose, particularly with regards to biotech companies.

Amend the historical financial information requirement

Through the Call for Evidence, the Review found that a number of businesses have ruled out listing in the premium segment owing to concerns that complying with the requirement for historical financial information covering at least 75% of an issuer's business for premium listings (the **75% Test**) was too onerous. There is an exemption (which is subject to certain

qualifications) for scientific research-based companies that allows them to demonstrate their ability to attract funds from sophisticated investors if they are unable to fulfil the minimum period for financial information or the revenue earning track record.

The Review therefore recommends that the 75% test should only be applicable to the most recent financial period within the three-year track record requirement and that the exemptions to the requirement for short stub periods be clarified.

Comparatively, companies seeking a listing on the Main Board of the HKEX must demonstrate a trading record of three years and satisfy one of the three financial eligibility tests (the profit test; market cap/revenue/cashflow test; or market cap/revenue test).

e. Empowering Retail Investors

Employ technology to empower investors

In view of the average age of retail investors decreasing since 2012, and the new generation of investors expecting smoother processes for registering their views as shareholders and being more active in expressing their broader social views through share ownership, the Review recommends that the Department for Business, Energy and Industries Strategy (**BEIS**) consider the most efficient way of employing technology to improve the position of retail investors.

Re-establish the RIRG

The Review further recommends that the Rights Issue Review Group (the **RIRG**) be re-established. The RIRG was established during the 2008 financial crisis to consider the rights issue process and various recommendations were made. The Review suggests that the re-established RIRG should consider which of the outstanding original RIRG report recommendations should be taken forward and whether any additional measures are necessary. In particular, the Review points to a RIRG recommendation of investigation into more accelerated rights issue models.

This recommendation is made in view of the financial situation in 2020 in light of COVID-19, which plagued companies with significant and largely unexpected funding needs. Raising capital quickly was therefore important, however the Review identified "inefficiencies" in the market, namely that only a small amount of capital could be raised without triggering prospectus requirements.

f. Improving the Efficiency of the Listing Process

The Review recommends that the FCA conduct an impact assessment on the recently introduced conduct of business rules in the FCA Handbook regarding unconnected research analysts in the IPO process. The rules require research analysts who are connected to an IPO to withhold publication of their research for seven days following the announcement of the expectation of intention to float and the publication of the issuer's registration document, if unconnected analysts have not been briefed alongside the connected analysts during the private phase of the IPO. There is an exception where unconnected analysts are provided access to the issuer's management team at the same time as connected analysts, however in practice, they are briefed separately.

The Review found from the Call for Evidence that many market participants and advisers consider the rule to be problematic (particularly when comparing London as a listing venue to other jurisdictions) and as having detrimental side effects, such as the extra seven days that are added to the public phase of the IPO process. The Review recommends that if the FCA finds from the impact assessment that the rule has failed to meaningfully promote the production of unconnected analyst research on IPOs, then the FCA should consider abolishing the rule or amending it to address the market's concerns.

g. Wider Financial Ecosystem

Unlocking pension investment

In the Call for Evidence, respondents raised concerns that the assets linked to defined benefit and defined contribution pensions could be better deployed.

In the case of defined benefit pensions, the main concerns related to the treatment of such schemes following transfer to insurance company balance sheets under Solvency II. The Review suggests that amendments to the capital requirements under Solvency II could be amended to increase the quantum of scheme transfer, therefore reducing some of the volatility and risk within the listed company universe and support the investment landscape more broadly.

In the case of defined contribution pensions, it was suggested that capital could be better deployed, with support for more diverse FTSE index inclusion and further transition to potentially less liquid investment strategies. Some respondents also suggested revisiting the regulations, particularly in relation to

the "permitted links" rules and the fee cap in the case of default arrangements for workplace schemes used for auto-enrolment.

Competitive tax environment

A number of respondents pointed out in the Call for Evidence that the UK is becoming less competitive from a tax perspective, when compared to other jurisdictions. Respondents made a variety of suggestions with respect to potential tax reform, including:

i) offset any increase in corporation tax with R&D / investment relief;

ii) develop a new tax-free long-term investment vehicle like municipal bonds in the US;

iii) accompany any changes to capital gains tax with the reintroduction of indexation (commencing after a five to 10-year period);

iv) reassess how ISAs function to better support longer term fund allocation; and

v) consider extending favourable tax treatment for AIM shares to other venues.

SME research

Respondents further raised concerns with respect to the quantity and quality of SME research post-MiFID-II implementation and the Review suggested that repealing some of the MiFID-II rules may improve this situation.

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