ALLEN & OVERY

FCA reforms UK listing regime to attract dual class share structures to London's premium list

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The overhaul of the UK listing regime recommended in Lord Hill's **Review of the Listing Regime** and **Ron Kalifa's Review of UK Fintech** aims to attract the most innovative and successful tech companies to London and create a desirable environment for issuers and investors alike. Change is considered necessary against a backdrop of some UK life sciences and tech companies choosing to list elsewhere than in London. The recommendations aim to make the London market more competitive on the international stage while retaining the high standards of governance and shareholder protection associated with a London premium listing of shares.

The FCA is now giving effect to some more of Lord Hill's recommendations. As it did with the rule changes relating to SPACs over the summer, the FCA is pragmatically adopting certain changes that have an immediate beneficial effect, whilst continuing to consider the broader modernisation of the listing regime. We agree with this approach. It is also reflective of the co-operative manner in which regulators, investors and other market participants are working together to make London more competitive.

This sequencing also allows companies to take advantage of these changes from early 2022, i.e. in time for Q1 IPOs.

Key points changes under FCA's "**Primary Markets Effectiveness Review**" (Policy Statement 21 /22)

Effective immediately, the FCA is:

- permitting dual class share structures on the Premium listing segment, subject to certain conditions reducing the minimum free float requirement to 10%, from the current 25%, in both the Premium and Standard listing segments
- increasing the minimum market capitalisation, to GBP30 million from the current GBP700,000, again in both listing segments.

In addition, effective 10 January 2022, a number of other rules will be simplified and modernised, making them more user friendly.

In the first half of 2022, the FCA will:

- consult further on potentially amending the three-year 75% financial track record requirement for admission to the premium listing segment
- continue to explore the structure of the listing regime, including the need for and interplay between the premium and standard listing segments.

Dual class share structures

Dual class share structures (DCSS) give disproportionate voting rights to shares held by certain shareholders, typically founders. They enable founders to retain control over the strategic direction of a listed company – for example by being able to control certain shareholder decisions or board appointments.

The argument in favour of such structures is that they enable high growth companies to come to public markets at a point in their growth when control over strategic direction is still important to the founder and important to the growth of the business. The risk of losing such control is a reason cited for companies choosing to list on other venues that permit DCSSs, such as in the U.S., or staying private for longer. In turn, this weakens the pool of companies listed in London and results in investors not having the opportunity to benefit from their growth.

In London, the existing rules discourage premium listed companies having DCSSs. Standard listed companies can have DCSSs, and there have been a number of recent examples such as Deliveroo and THG.

What is changing?

The FCA is giving effect to Lord Hill's recommendation and is removing the prohibition on listing dual class share structures on the premium listing segment, subject to conditions which are designed to protect investors and market integrity. The key conditions are:

- a mandatory duration or "sunset" provision of five years from IPO
- a maximum weighting voting ratio of 20:1
- the holding of weighted voting rights only by persons who are directors on IPO
- the matters subject to weighted voting are restricted to: (a) ensuring holders of the shares remain as directors and (b) blocking unwelcome takeover bids
- shares with enhanced rights must be subject to restrictions on transfer.

Certain resolutions are to be exempt from enhanced voting rights: (i) constitutional changes; (ii) class right changes; and (iii) appointment/removal of independent non-executive directors.

A&O's view

A question remains as to whether founders will be happy with the more limited scope of enhanced voting rights, and would want to retain control over a wider range of issues. For example, over pre-emption rights and dividend policy. In addition, founders may prefer to structure these rights through a “golden share” concept. As is noted by the FCA, such founders can list their companies on the standard segment and retain greater control, as a number of DCSS companies have already done. However, the narrower scope of DCSS rights permitted on a premium listing under the new rules could result in such companies choosing to list in other markets.

It is a careful balancing act with a divergent set of views from different market participants, and at this stage represents a welcome element of flexibility for founder-led companies considering a listing in London. The FCA will no doubt monitor practice and may consider further changes in the future if the rule changes don’t have the desired effect. As Lord Hill noted, regulation should be dynamic and evolving to reflect market practice.

Reducing the free float requirement from 25% to 10% for both the premium and standard listing segments

Prior to 3 December 2021, the free float requirement required 25% of shares to be in public hands, both at the time of IPO and as a continuing obligation. Leaving aside questions around whether this was the best manner in which to assess liquidity (a subject of debate in the consultation), having a mandatory free float at this level introduced certain perceived weaknesses into the UK regime, albeit aligned with other EU listing regimes. First, it required sufficient sell down or new issuance at the time of an IPO to achieve the free float. Absent a need to raise new money, this could result in unwilling sellers. Secondly, and linked to the first, it potentially put greater pressure on pricing at the times of IPO. A smaller sell down can reduce price pressure at the time of IPO, increasing the likelihood of a successful deal and supporting better aftermarket conditions.

What is changing?

The FCA has reduced the free float requirement from 25% to 10%. The FCA has ceased to use its existing discretion to waive the free float requirements or provide guidance on applying for a modification. This makes the FCA’s position clearer and more definitive.

A&O’s view

The lowering of the free float threshold will not necessarily generally result in companies having lower free floats. Firstly, liquidity is often an important consideration for investors when deciding whether or not to participate in an IPO, given the size of their investments; we may continue to see higher free floats driven by investor requirements. Secondly, FTSE index inclusion is a significant factor for companies seeking admission to the premium listing segment. FTSE Russell is to consult on the free float requirements for its UK Index Series, which will have an influence on the level of free float sought by companies seeking a premium listing.

However, we welcome the change. In appropriate circumstances, it will allow companies to list when they otherwise may not have – for example, where there is not enough sell-side demand to meet the higher free float threshold, or the IPO price does not match a founder’s or financial sponsor’s expectations on valuation. The lower free float also potentially facilitates a greater number of companies seeking a direct listing, as opposed to an IPO.

A minimum market capitalisation of GBP30m is expected on IPO, up from GBP700,000

The minimum market capitalisation is the minimum level of the total market of all securities to be listed.

What is changing?

In a change to the position in its public consultation (FCA CP 21/21), which envisaged an increase in the minimum market capitalisation to GBP50m, the FCA has decided to set the threshold at GBP30m to allow smaller companies to gain access to listing.

A&O's view

The FCA has clearly articulated its reasons for raising the minimum market capitalisation. On its face, GBP700,000 is extremely low for a company traded on the UK's main market and so we welcome a higher level as being appropriate. We don't have a particular view on what the right level is, but the GBP30m figure propose by the FCA appears to be a sensible number based on the feedback received, the data presented by the FCA and the FCA's justification for wanting to increase it.

London's main market for listed securities is one of a number of public markets in the UK available to companies, and companies have the choice to list on one of those other markets, but also to access capital through an increasing number of crowdfunding and other private capital platforms.

Further consultation

Potential adjustment of the three-year 75% revenue-earning financial track record requirement

Premium listing applicants are required to demonstrate a three-year revenue earning financial track record that covers at least 75% of their business.

The FCA was initially of the view that any departures from this eligibility requirement could be dealt with on a case-by-case basis. Following feedback, it recognises that further consultation is necessary. It intends to consult more fully on this in the first half of 2022.

A&O's view

We believe that the rule, as currently applied, has contributed to a number of companies, that otherwise would have been suitable to a London listing, choosing to list elsewhere. It has also increased the burden of listing in London by requiring some companies to spend unnecessary time and incur unnecessary expense in preparing financial information that is of little use to investors. As such, in our view, either the rule, or the implementation of it, needs changing. Any such changes need to be considered alongside the prospectus disclosure requirements to ensure consistency of approach.

The examples we have most commonly encountered are companies that are highly acquisitive, or companies that have undertaken one or more acquisitions, but one to two years prior to the proposed listing. In the former case, acquisitions are part of the company's equity story and DNA, and the company may have acquired a large number of companies. Individual disclosure of financial information in respect of a single or multiple acquisitions may be less helpful than information relating to the company's growth strategy, criteria for acquisitions, performance of past acquisitions, and guidance regarding future performance. Such companies often benefit from synergies, economies of scale and shared platforms as a result of these acquisitions. In addition, the cost structure of the acquired target may therefore be materially different following acquisition, and the future revenue profile of acquired businesses may be very different given opportunities for sharing products, clients and cross selling opportunities.

In the latter case, historical information related to an acquired company relating to the period prior to its acquisition, may be of minor relevance in understanding a group's current financial performance, particularly if the acquisition was early in the historical track record period. If it is of relevance, then the prospectus will need to include all material information, which may include historical pre-acquisition information. In our view, approaching this from a disclosure perspective rather than as a matter of eligibility is more meaningful.

The links to a separate, but related, point – forward-looking information. This is the subject of a separate consultation. For now, we note that shifting focus more towards disclosure of forward-looking financial information and guidance will assist in alleviating the burden of reliance on historical financial information, and support the views we have expressed above.

Potential structural reform of the UK listing regime

The FCA cautions that the changes described above should not be considered as implying any outcome for its broader UK listing regime review. It will continue to consider a range of potential options for structural reform including the possibility of different models for the UK listing regime (such as merging listing segments), rebranding the standard listing segment (so as to position it as a more credible potential alternative to the premium listing segment) or more radical alternatives.

The FCA intends to update the market on its thinking about any broader changes to the UK listing regime in H1 2022. We will consider revisiting this topic once it does so.

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