bvca
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Primary Markets Policy Team
Financial Conduct Authority
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By email: cp23-10@fca.org.uk

28 June 2023

Dear Primary Markets Policy Team

Re: BVCA response to Primary Markets Effectiveness Review: Feedback to DP22/2 and proposed equity listing rule reforms

The BVCA is the industry body and public policy advocate for the private equity and venture capital (private capital) industry in the UK. With a membership of over 700 firms, we represent the vast majority of all UK-based private capital firms, as well as their professional advisers and investors. Between 2017 and 2021, BVCA members invested over £57bn into around 3,900 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over two million people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

The BVCA welcomes efforts by the Financial Conduct Authority (the "FCA") and others to promote the UK as a more flexible and attractive place to do business and in particular to make the London Stock Exchange ("LSE") a more accessible listing venue. We believe that, if calibrated correctly and accompanied by other recommendations from the Lord Hill Listing Review as well as wider ecosystem reforms and subject to FTSE Russell's approach on indexation eligibility, the proposals set out in CP23-10 will support the objective to improve the environment for companies to go public and the efficiency of the listing process in the UK and attract a more diverse group of companies to list on the LSE.

This consultation is an important step towards improving the competitiveness of the UK market from a regulatory perspective and should have the dual benefit of making the UK a more attractive listing destination and improving the competitiveness of UK listed companies in international M&A processes. However, we agree that changing the listing rules can only be one part of making the UK's capital markets work better and that there needs to be a sustained commitment to improve aspects such as the depth of liquidity, perceptions on valuation gaps, the extent and quality of research coverage, the approach to executive remuneration and consistency of investor appetite for IPOs in the UK (especially from UK investors). These will also need to be addressed if the UK is to materially improve its competitive position.

As such, we see these reforms as part of a wider discussion about how to unlock and improve the attractiveness of the UK's capital markets. We believe that consolidation of DC pension funds and other approaches must be taken in the medium term to unlock the capital necessary to transform the outlook for the UK's capital markets and the companies that list on them. A key aspect of this is developing the skills and understanding so UK pension funds and other institutional investors have tools to invest in the UK, and in particular private capital funds, which invest in companies across the UK and often use listing as an exit route.

The UK has one of the strongest ecosystems for early-stage investment and companies can be supported by a wide range of investors. Angel investors and tax advantaged schemes such as EIS' and VCTs play a central role in supporting the start-up ecosystem, and the UK has one of the strongest venture capital markets from early stage to Series A. There are areas where the UK can still improve, especially in increasing levels of investment in the regions and nations of the UK, but overall the UK is well served, and companies can receive the majority of their capital from domestic investors. It is at the scale-up stage that the financing of these companies tends to transition to syndicates led by US, Asian and European investment groups. This highlights the gap in UK scale-up investment capital and investment capability. The UK market dysfunction at the Series A stage, identified a decade ago, has been pushed back to the scale-up stage. BVCA analysis of Beauhurst data from 2020-21 reveals

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that over half of 52 Series B growth rounds in UK science and technology companies (ranging from £35m to over £400m) were led by US VCs, while only seven were led by UK investors. Comparable deals in America are 80% led by US investors.

Overseas investment is welcome and validates the quality of UK companies and the investment opportunities being created in the UK knowledge-intensive sector. However, it is a concern that the UK lacks a domestic scale-up investment capability in these knowledge-intensive sectors. To realise the government's Science Superpower vision, the UK needs to become world-class at both creating knowledge-intensive companies, scaling them up and getting them to list on UK venues. Relying on foreign investment to scale up UK companies exposes the UK to geopolitical risk and fluctuations in global capital allocations and often leads to UK companies listing where those foreign investors are located. It also prevents the UK from growing a generation of investment managers experienced in scaling knowledge-intensive businesses.

Turning our focus to the FCA's proposals, we believe that aligning the UK capital markets more closely with other major global markets should go some way to removing a number of the perceived obstacles to making London a global listing venue of choice. The shift to a more disclosure-based regime, with the emphasis on providing investors with the necessary information to support their decision-making and leaving them to make their own risk assessments, combined with an appropriate level of relaxation of the UK prospectus regime and the rules relating to secondary capital raisings should increase the UK's competitiveness while maintaining high standards of governance, transparency and investor protection.

We have set out below our initial high-level comments on the areas most of interest to our members. However, we would add that further detailed analysis will be required to take into account the views of our diverse membership. Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of our comments in more detail (please contact Ciaran Harris).

Yours faithfully,

Victoria Sigeti

Chair, BVCA Legal & Accounting Committee

HIGH-LEVEL BVCA COMMENTS:

Eligibility requirements

1. We believe that removing the specific financial information eligibility requirements for a single listing segment for equity shares in commercial companies ("ESCC") is a positive step. A disclosure-based approach would provide greater accessibility for issuers, especially high-growth companies at an earlier stage of their growth cycle, while still protecting investors as they would be able to decide whether or not to invest based on the disclosures made by an issuer. These changes are likely to be welcomed by issuers, particularly small science and early-stage technology companies, as well as companies that are highly acquisitive, which are typically unable to satisfy the current revenue earning track-record requirements.

In proposing to remove the current track record and clean working capital eligibility criteria the FCA is assuming that requirements for financial information contained in a prospectus, including provisions for issuers with complex financial histories and the requirement for a working capital statement, will remain. However, it refers to potential information gaps in terms of the recency of financial information currently required to be included in a prospectus versus the existing premium listing eligibility requirement relating to the date of the latest balance sheet and comments that this will be considered as part of future work on the proposed new prospectus regime. We would suggest that any information gaps should be adequately covered by the prospectus 'necessary information' test and that proposals to enhance the current historical financial information disclosure requirements should take into account the potential consequences from a global market perspective.

2. Although we agree with the proposal for a more flexible controlling shareholder regime we would expect many issuers, including, in particular, those with an existing premium listing, to prefer to continue with the practice of a written relationship agreement with a controlling shareholder. It is not unusual for such relationship agreements entered into at the time of IPO to include additional provisions beyond those mandated by LR 6.5.4 that can be beneficial to both parties.

   We note the FCA proposal to introduce a new requirement for a market notification if the relationship agreement is amended. We would welcome clarification on whether this notification requirement would be triggered only by the termination of the relationship agreement or amendment to what are currently the LR 6.5.4 undertakings or whether the FCA is proposing that any amendment of the relationship agreement would require a market notification under the revised controlling shareholder provisions. Clearly an issuer would already need to take into account its continuing disclosure obligations, for example under the UK Market Abuse Regulation.

Dual Class Share Structures ("DCSS")

3. A more permissive dual class share structure regime is a welcome proposal following the introduction of the extremely restrictive form of DCSS in December 2021 which continued to leave the UK as an outlier in this area. However, it is important to point out that the December 2021 proposals have not had extended time to bed in. This should be taken into consideration when bringing forward any new proposal.

Significant transactions and related party transactions ("RPT")

4. The proposed removal of the requirement for shareholder approval for significant transactions would eliminate a competitive disadvantage and potential transactional delays for companies, particularly in transactions involving an auction process. Views are likely to be more divided on the proposed removal of shareholder approval for RPTs. This is viewed by many, including some of our membership, as an important shareholder protection mechanism. However, as the FCA notes, the shareholder approval requirement is not a widespread practice in other key jurisdictions.

5. The requirement to obtain shareholder approval for a significant transaction can introduce an element of conditionality and therefore transaction risk into an M&A transaction putting a premium listed company at a competitive disadvantage, particularly in the context of a competitive auction process. In addition, the preparation of an FCA-approved circular can be a time-consuming and costly exercise. The removal of the requirements for an FCA-approved circular and shareholder approval is consistent with the creation of a more agile environment for listed companies. We also support the proposed removal of the profits test for the reasons explained by the FCA. The removal of the shareholder approval requirement will mean that

shareholders will be more reliant on the decision-making power and discretion of the board. This could result in increased scrutiny of the composition of the board as investors seek to get comfortable that the board has the appropriate collective experience and skills to make these decisions and potentially a question as to whether the board composition requirements in the UK Corporate Governance Code are sufficiently flexible in this respect.

6. We would question the value of further mechanisms prior to a significant transaction being formally completed, such as a mandatory period of delay, from a shareholder perspective where terms have already been agreed.

7. The current RPT regime provides a valuable investor protection mechanism, but it can be perceived as overly complicated and often difficult to apply. We believe that further discussion of the options is required, including raising the 5% threshold for shareholder approval to the extent that the shareholder approval requirement is retained.

FCA/FTSE Russell engagement

8. From a listing regime perspective the approach of FTSE Russell to indexation eligibility in the context of a single ESCC listing segment will be a key factor and this should be addressed before draft rules are published by the FCA in the Autumn to allow market participants to provide meaningful feedback on the detailed proposals. As such, we would urge the FCA to engage with FTSE Russell to encourage it to reconsider its indexation eligibility rules. To be in a position to provide meaningful feedback on the FCA's proposals it will be critical for the market to understand how FTSE Russell would intend to amend its ground rules governing UK index inclusion in the event of a shift to a single ESCC listing segment. For example, would indexation attach to the new ESCC listing segment or would FTSE Russell propose to impose an additional layer of eligibility criteria, for example, no dual class share structures or a written agreement with a controlling shareholder, as a condition to UK index inclusion? Retaining a two-tier structure for indexation eligibility would significantly compromise the benefits of a single ESCC listing segment.

AIM Market

9. Whilst the proposals do not address the LSE's AIM Market directly, it is possible that prospective AIM Market issuers would consider a listing on the new ESCC listing segment instead, as a result of the increased flexibility of the proposed ESCC listing segment. For example, the shift from mandatory relationship agreements to a comply or explain and disclosure-based approach. Such flexibility aligns more closely with the approach in the AIM Market, where the need for a relationship agreement is determined by the issuer's nominated adviser based on suitability for listing.

10. In certain aspects, the new ESCC listing segment may actually be less restrictive for issuers than the AIM Market. Currently, issuers listed on the premium segment are required under the Listing Rules to make an announcement for any transactions where the result of any class test is 5% or more, and to obtain shareholder approval with an FCA-approved circular published in advance for any transactions where the result of any class test is 25% or more. On the new ESCC listing segment, any transactions where the result of any class test is 25% or more will require only an announcement; prior shareholder approval will only be required where the result of any class test exceeds 100%, i.e. a reverse takeover. In contrast to this, the current rules applicable to AIM-listed issuers require prior shareholder approval for any transaction where the result of any class test exceeds 75%, which means that the AIM rules would be more restrictive than the proposed ESCC rules. The proposed removal of shareholder approval in cases other than a reverse takeover

could be especially attractive for small and medium size growth companies that are seeking to grow through acquisitions and which would otherwise have considered listing on the AIM Market.

11. The proposals could mean that, if adopted, the £30 million minimum market capitalization requirement of the ESCC could become an important deciding-factor for issuers considering where to list. For potential issuers with a market capitalization of at least £30 million, the ESCC may prove to be a more attractive listing venue.