UK Secondary Capital Raising Review

July 2022

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1. LETTER TO THE CHANCELLOR

Dear Chancellor

Since Lord Hill published the UK Listing Review in March last year, the progress made in modernising the UK listing regime has been impressive. Reviews and consultations including the Future Regulatory Framework Review, HMT's Prospectus Regime Review conclusions and the FCA's Primary Markets Effectiveness Review work have moved the rules and, at least as importantly, the conversation and the mindset in the UK capital markets, forwards meaningfully.

There is a sense of a coalescing recognition of what the issues are, what needs to be done and a desire to seize this once-in-a-generation opportunity for meaningful reform.

The UK capital markets have for many years been world-leading. All stakeholders want them to continue to be so in the future. To ensure that happens in the context of a fast-changing and ever more competitive global environment, we as a market need to be bold and brave in our thinking. We need to look at our existing rules and practices with a fresh set of eyes and a blank sheet of paper, and ask ourselves with a bottom-up rather than top-down approach – what is the right regime for us as a market for the next decade and beyond? – and in asking that question not to be limited by thinking that all we can do is change or tinker with what we already have. But rather to challenge ourselves as to whether we need what we currently have at all and, if so, why. What do future-proofed, globally competitive UK capital markets that are fit for purpose for the next 15 or 20 years look like?

That requires bold thinking and potentially addressing vested interests that have organically (and understandably) grown up in the past couple of decades due to how the system currently operates – and that may have made our capital markets fit for purpose in the past couple of decades but will not necessarily make it fit for purpose in the coming two decades. The threshold question should be – does the existing framework impede or undermine the UK's ability to support UK companies, investors, individuals and the wider UK economy? And, from an international perspective, does the existing framework put UK firms and international firms based in or who want to come to the UK at a disadvantage to firms using other capital markets around the world? There is absolutely no point in having a theoretically perfect regulatory regime if it is unattractive compared to global competitors and so does not attract domestic and global issuers and investors.

The UK has always thrived on innovation and flexibility and applying our natural aptitude in these areas will ensure that we successfully navigate this next stage of adaptation for the UK capital markets and London as a financial centre more generally. Even after the admirable modernisation of the regulatory regime in the coming months has been implemented, there are other points that need to be addressed in order to keep the UK capital markets fully fit for purpose and competitive in the modern world. These include discussions around investor attitudes in the UK capital markets, UK remuneration policies as well as attitudes more widely to the UK remuneration regime, the approach of proxy advisers, tax policies, pension fund investment and investment research amongst others. Now is the time to move those conversations forwards meaningfully as well.

There is also a wider discussion to be had around how we join up our UK capital markets and build a comprehensive, effective and world-leading ecosystem that enables and encourages companies to start here, grow here, scale here – and stay here. As well as world-leading public capital markets in the UK, we have thriving private capital markets and fast-developing crossover or quasi-public capital markets – and all three need to be connected effectively. This will amongst other things involve a drive to digitisation and the use of developing technologies to transform how the capital markets operate – we in the UK can lead that if we are bold and brave.

That is the broader picture. Bringing the focus back to this particular Review, efficient capital raising is essential in order to allow companies on the UK public capital markets to raise the capital they need to grow and develop as quickly and as cheaply as possible and so attract new companies to list here, help existing companies to develop and generally to drive the UK economy and, in turn, productivity, jobs and wages. It is also important in keeping the UK capital markets competitive on the global stage.

Secondary capital raising is an area that has attracted much debate in the UK over the years. There are many – sometimes competing and overlapping – structures, views and guidelines that create a complex architecture. Practice has built up over many years. It is, for want of a better phrase, an area that is very 'whack-a-mole' in nature, in that when one issue is addressed, it often causes another that needs to be addressed to pop out elsewhere – usually for a different set of stakeholders.

As such, you will find that the subject matter of this Report is broad. It is an area that can only be meaningfully reformed and enhanced if it is looked at holistically.

The Review has had multiple wide-ranging discussions in the past weeks and months. These have been through trade bodies and industry groups as well as countless conversations bilaterally and with stakeholders of all sizes and in all areas across the UK capital markets. As mentioned earlier, modernisation and maintaining the attractiveness of the UK capital markets takes place in an increasingly competitive global environment – and so I have in particular been careful to take into account the views of global stakeholders as well, including on the investor side, in formulating the recommendations.

As such, the Report is intended to be comprehensive and also to give assurance that its conclusions have broad market support – that it arrives with you as 'received wisdom' in the market. In framing where the Review has come out, it is worth reiterating the broad principles that it has been guided by:

- *Pre-emption rights*

The maintenance of the principle of pre-emption[1] rights for existing shareholders was not in question. It is a valued feature of the UK capital markets that should not be disturbed. This feeds into the basic principle that companies should only be able to issue new shares in accordance with the wishes of their existing shareholders. It is shareholders, in regular and effective dialogue with management, who should decide how individual companies use the reformed regime as set out in this Report.

- *Cost & efficiency*

The fundraising structures available to issuers should be as efficient as possible in terms of time and cost while ensuring that appropriate standards of investor protection are preserved – with technology employed as appropriate to facilitate this.

- *Choice*

The choice of structures available to companies on the UK capital markets who want to raise capital should be as broad as possible. Different structures may be more relevant to particular situations, but the UK markets and its issuers and investors are best served by having as much optionality as possible.

- *Enabling retail investors*

As much of a company's existing shareholder register as possible – including, importantly, retail investors – should be able to participate in any capital raising in a timely way, whatever its structure. Again, technology and digitisation have a key role to play here.

In terms of the broad themes that emerged from the many conversations and submissions, everyone agreed that there is a need to reform and update the secondary capital raising regime and that it can be made materially cheaper, more inclusive and more efficient and there is general agreement also with the principles set out above. These principles inform the recommendations that are set out in this Report.

As well as wanting to ensure that the recommendations have broad market support, I also wanted to make sure that they are implementable. That of course does not mean that they are all very near-term actions; in thinking about this area, as with the UK Listing Review, it is also necessary to think longer-term and there are inevitably some recommendations that will take longer than others to realise. There is also an order in which the various reforms will need to flow through. However, it is important to note that the recommendations are intended to be implemented as a holistic package, so that progress in one area is not undermined by a lack of movement in another. A key

[1] Namely that, in a fundraising, existing shareholders should have the right for new shares to be offered to them pro rata to their shareholding before new shareholders are approached.

measure of success for the Review will be the timely taking of co-ordinated steps by a wide range of stakeholders to achieve the aims that the Review sets out.

I have summarised where I have come out below. This letter is followed by section of the Report that contains an overview of each of the recommendations. There then follows a more detailed and contextualised explanation of the background to each recommendation as well as, where relevant, potential solutions and next steps.

Maintaining and enhancing pre-emption

Coming back to the key question of pre-emption, we are fortunate in the UK to have well-thought through and comprehensive principles that guide the market. They have been carefully considered over the years, including by the Myners report on pre-emption in 2005, following which the Pre-Emption Group (PEG) was revived. The principles also have the important feature of not being codified either in law or the regulatory rulebook and so of being flexible and being able to be reactive – and I believe that should continue.

Given the importance of pre-emption in the UK capital markets, the Pre-Emption Group should be put on a more formal footing than it is currently and brought front and centre as a key stakeholder in the UK capital markets. This should involve:

- a more formal and transparent governance structure, including revised terms of reference
- a dedicated and easily accessible website
- a review of the group's membership to ensure it is fully representative of today's UK capital markets as well as a transparent and objective appointment process for group members

PEG should also publish an annual report on the operation of the market in relation to pre-emption and feed its findings into the annual State of the City report that Lord Hill advocated in the UK Listing Review (Recommendation 1).

Increasing the ability to raise smaller amounts of funds quickly

The ability of companies on the UK capital markets to raise funds quickly and efficiently via placings when the Covid-19 pandemic struck in March 2020 was due in large part to the foresight and pragmatism of the Pre-Emption Group and its rapid relaxation of its Statement of Principles on pre-emption. It recommended that, due to the pandemic, investors should support share issues by companies of up to 20% of their existing issued share capital rather than the usual limit of up to 10%.

Recognising how effective this was and how responsibly it was used by companies, this position should be made permanent. So companies would be able to go to their shareholders at each AGM to seek authority for a pre-emption right disapplication authority of up to 20% – with up to 10% available for use for any purpose and up to a further 10% for use in connection with an acquisition or a specified capital investment. This approach has the benefit of having been tried and tested during the pandemic and means that issuers will be able on an ongoing basis to raise up to 20%

of their issued share capital quickly and cheaply each year provided that shareholders have given their prior approval at the annual general meeting (Recommendation 2).

Moving to this new threshold should be accompanied by appropriate rigour being put around the use of the regime. Companies should report to the market on how the placing was conducted. This should be done against objective parameters, including confirming that as far as possible the principle of soft pre-emption was applied (and detailing any specific points in that respect that the company considers relevant), confirming that appropriate prior consultation of key shareholders was carried out, the basis on which allocations were made (including the role that management played), how the interests of retail investors were considered as well as details of the offer structure for them that was used, the use of proceeds, the discount to market price at which the shares were issued and disclosure of the gross and net proceeds raised.

This should all be done using a short, template form that PEG would publish on its website and which, when filled out, should be published by the company in the week after the placing. The form should also be filed with PEG, which should maintain a public, searchable database of the forms that investors and other market stakeholders can access, similarly to the Investment Association's Public Register. The details contained in the form should also be included in company's next annual report, meaning that shareholders will have the information to hand when making a decision as to whether it is appropriate to renew any request for a new disapplication authority at the next annual general meeting (Recommendation 3).

Allowing additional flexibility for capital hungry companies

This Review is not overtly about making the UK capital markets an attractive listing venue for high growth companies. However it is relevant to them, as such companies are often particularly capital hungry as they expand and want to know how easy it is to raise capital in the UK if they decide to list here rather than elsewhere. As such, while the principle of pre-emption should be maintained and enhanced, it is also important to recognise that companies in these sectors – such as tech and life sciences – may well need to raise larger sums of capital more frequently. The same could equally apply to companies who are not 'high growth' but which are in a particularly capital hungry period due to their current strategy.

It may be appropriate for such companies to be able to raise more than 20% of their existing share capital non-pre-emptively each year and it should be open to them to seek approval to do this – and not frowned upon if they do. A limit of 75% is recommended, in line with the recommendation that the admission to trading threshold for a prospectus be raised from 20% to 75%. For companies coming to market in an IPO, the possibility of this approach should be noted in their offer documentation and for all companies it would be subject, as with the usual 20% threshold, to prior approval by shareholders at the annual general meeting each year. It will be up to the company in each case to make an appropriately compelling argument for approval of the enhanced authority to its shareholders (Recommendation 5).

This would give capital hungry companies the support and flexibility to be able to seek higher disapplication authorities to meet specific capital needs.

Involving retail investors more fully in capital raisings

It is also important that retail investors are involved as fully as possible in all types of secondary fundraisings, including placings.

Due consideration should therefore be given by a company conducting a fundraise as to how it will involve retail investors, on the same terms and conditions. And the default assumption should be that they will be included. It should be open to a company to decide how best to do that, depending on the fundraise circumstances and the nature of its shareholder register. It could use one of the various market solutions and technology platforms that have already been and continue to be developed or, for example, by having a separate retail offer that follows on from a placing. As mentioned above, companies should then have to report to the market on what approach they took to retail investors and how their interests were looked after.

Separately, while on the topic of retail investors, their inclusion in IPOs should also be encouraged through the FCA shortening the six day period for which an IPO prospectus must currently be made available to retail investors – and reducing this to three days (Recommendation 7).

Reducing regulatory involvement in fundraisings

One of the principles that has guided the Review is to ensure that, while the once-in-a-generation opportunity for bold and brave reform is seized, appropriate standards of investor protection are preserved. This does not however mean that the regulatory footprint has to stay as it currently is. It should not and it should be removed in relation to secondary fundraisings.

Companies on the UK public capital markets are already subject to ongoing disclosure and other market obligations. And they are raising money in these processes from shareholders, both institutional and retail, who have already made an investment decision in relation to the relevant company. The vast majority of the disclosure that is currently required in a prospectus prepared in connection with a fundraise is duplicative of information that is already in the public domain. The requirement to reproduce it should be removed. Instead, the focus of the fundraise disclosure should be on new information about the company and the capital raise that is relevant for shareholders in deciding whether to invest more money in the company. As a result this should focus on the background to and reasons for the fundraise, the amount and use of proceeds and, as relevant, how the transaction will affect the company's strategy, financial viability and forward-looking guidance.

As such there should be no, or at most very little, regulatory oversight of the secondary capital raising process by the FCA. The current long and expensive lead time to launching a fully pre-emptive offer in the UK will be helped materially by not always having to produce a full prospectus. But the regulatory workstream also needs to be addressed. In addition to FCA review of a prospectus, the other key factor in the current long lead time is the diligence that an investment bank, acting as sponsor, has to do in order to give the current required confirmations to the FCA. This includes in relation to the working capital exercise, where the formally required levels of diligence are overly costly and time consuming, as well as being out of line with what is required in other jurisdictions.

In line with its laudable objective of moving to an outcomes and more principles-based regulatory model and one that is based around disclosure rather than being overly 'rules-based', a sponsor firm should only need to be appointed and required to give confirmations to the FCA in relation to a secondary fundraise that is connected to an acquisition that is otherwise caught by any significant transactions rules contained in the FCA's listing regime – which itself is the subject of reform discussions by the FCA at the moment. Similarly, a prospectus should only be required on a fundraise to be produced by a company in relation to admission to trading where the offer size is at least 75% of the existing share capital (Recommendations 8 and 9).

Making existing pre-emptive fundraising structures quicker and cheaper

It has been received wisdom for many years that documented fundraisings such as rights issues and open offers take too long and are too expensive for companies on the UK public capital markets and there remains market agreement on this.

Reduced regulatory involvement is important as, together with no longer requiring companies to prepare a duplicative offer document, it will mean that pre-emptive fundraising structures become much quicker and cheaper for companies to prepare for and launch.

The time and cost of the structures after they have been launched should also be addressed. In today's digital age, there is common agreement that offers should not need to be open for ten business days and that the period can and should be shortened. Before we move to a system of digitised shareholdings and while some shareholders still hold in paper only form, there is a structural limitation on how short the period can be made. Consideration also needs to be given to how the intermediated shareholding system currently works and how quickly instructions can be obtained from underlying beneficial owners / decision makers, as well as the time that existing shareholders need to consider the merits of the offer, potentially free up cash to participate and, in some cases, engage with management. Taking these factors into account, offer periods should be reduced from ten business days to seven business days for both rights issues and open offers (Recommendation 12).

In a similar vein, to allow the offer timetable to be further condensed when the current structural limitations are not as pronounced, the Secretary of State should be delegated authority in statute to reduce the minimum notice period for shareholder meetings that that are not annual general meetings from 14 clear days to seven clear days at the appropriate time (Recommendation 13).

Increasing the range of choice of available fundraising structures for companies

As well as making existing fundraising structures quicker and cheaper, it is clearly a sound principle that companies should also be given as much choice of structure as possible. In that regard, we can learn from best practice in other jurisdictions and in particular there are aspects of the Australian accelerated fundraising structures that are attractive.

When implemented, the reforms mentioned in the recommendations above in relation to streamlining existing offer structures and involving retail investors in all fundraises will go a long way to achieving many of the benefits that the Australian structures have.

Accelerated fundraising structures such as AREOs, ANREOs, PAITREOs and SAREOs that are used in Australia cannot in any event simply be lifted and dropped into the UK capital markets due to the wider regimes in the two jurisdictions differing in various areas.

There are nevertheless features of the Australian models that can usefully be adopted in the UK in the near term (Recommendations 18, 19 and 20). These include the cleansing notice approach, the use of shorter offer documents that do not duplicate existing market disclosure, the ability to split the shareholder register more accurately and so identify institutional and non-institutional investors more readily, the involvement of both institutional and retail investors, the lack of regulatory involvement and the use of market standard terms and conditions with institutional investors.

Raise the priority of an ambitious 'drive to digitisation' to facilitate innovation, stewardship and improved market infrastructure, which is actioned by a Digitisation Task Force with an independent chair and a clear set of principles to be followed

Finally, we come to the question of digitisation of shareholdings. Much work has already been done in this area by the Government, the Law Commission, the registrar and custodian communities and various technology platforms, amongst others.

The recommendations in this Review to make fundraising structures quicker and cheaper will be realised even more effectively – with for example even shorter offer periods and more efficient involvement of all investors, including retail – if an ambitious digitised shareholding system is developed.

A drive to digitisation should start with the eradication of paper share certificates. However, the ambition of digitisation should only start and not stop there – it should seek to ensure that rights attaching to shares flow to end investors quickly and clearly and that investors are able to exercise those rights efficiently. This will not be an overnight project and it will almost inevitably have to be done piecemeal and through experimentation with new technology and imaginative thinking rather than in one big bang. But as a project it should be made more of a priority. It can be a key part of the UK positioning itself as a pro-innovation jurisdiction. It should be seen as a key component of the effective implementation of the Government's and the FCA's commendable innovation and ESG agendas.

It should be coordinated and driven by a new Digitisation Task Force, with an independent, respected chair to head it and a technically experienced second-in-command – who both have no 'skin in the game' – similarly to how the Bank of England Settlement Task Force headed by Pen Kent and Iain Saville was set up to drive the adoption of CREST. The terms of reference of the Task Force should be clearly set out at the point of its establishment.

Now is the perfect time to start this ambitious drive to digitisation and to position the UK as the leading jurisdiction of innovation in this area, as is already happening with listing regime reform and in relation to crypto and financial market infrastructure more generally.

What happens next?

While some of the recommendations in this Review will inevitably be able to be implemented more quickly than others – and, importantly, some immediately – I believe that as a holistic package they will result in a much quicker, more inclusive and more efficient secondary capital raising regime in the UK. And when set alongside the reforms that have already been implemented by the FCA on the back of the UK Listing Review as well as the HMT Prospectus Regime Review and the further changes to the listing regime that the FCA is currently discussing with the market, I believe that we will in the near future have a listing regime in the UK that is modernised and fit for purpose, including when compared to any other global listing venue.

As I mentioned at the start, this is by no means the end of the story in terms of us collectively keeping the UK at the forefront of the international capital markets, but it will be a significant step forward, and it will be an enormous credit to the visionary and reactive teams at the FCA, HM Treasury and BEIS as well as to market stakeholders in the UK that are embracing the opportunity for bold and brave once-in-a-generation reform.

Before I conclude I would like to say thank you to the secretariat that has tirelessly helped me with the work on this Review – namely Jenny McCarthy, Tom Simmons and Charles Downes – as well as to Finsbury for helping with the communications side of things. Thank you also to all those who took the time to respond to the Call for Evidence and the hundreds of people, including all the companies, investors, industry groups and trade bodies as well as other stakeholders, with whom I and the team have spoken at length in the past few months. I am hugely grateful to them all both for the time that they gave as well as for the can-do, positive spirit with which they engaged.

I hope you will find this Review helpful. The process of regulatory reform that Chancellor Sunak started the UK capital markets on is necessary, ambitious and exciting and I hope the Review helps you continue to move it meaningfully forwards. The market is right behind you.

Mark Austin
Chair, UK Secondary Capital Raising Review
July 2022

2. RECOMMENDATIONS OVERVIEW

Maintain and enhance the pre-emption regime

1. The principle of pre-emption is an important shareholder protection in the UK capital markets and it should be preserved and enhanced. To reflect this, the Pre-Emption Group should be put on a more formal and transparent footing than it is currently and, as part of this move, its secretariat at the FRC and, in due course, ARGA, should be appropriately resourced. It should be a central stakeholder in the UK capital markets. This should include:

   (a) a more formal and transparent governance structure, including revised terms of reference

   (b) a dedicated website with a searchable database of pre-emption regime information

   (c) a transparent, formal and objective appointment process for members

   (d) an objective review of the membership of the group to ensure it is fully representative of today's ownership of the UK capital markets

   (e) publication of an annual report on the operation of the pre-emption regime

   (f) contribution each year to the Chancellor's State of the City report

Implementation: FRC / PEG

Timetable: Immediately

Increase the ability of companies to raise smaller amounts of funds quickly and cheaply

2. The ability for companies to issue up to 20% of their issued share capital that was introduced when the Covid-19 pandemic first hit in 2020 – and which worked well – should be made permanent and the Pre-Emption Group's Statement of Principles updated accordingly. Conditions similar to those in 2020 should apply, namely:

   (a) an explanation of the background to and reasons for the fundraising and the proposed use of proceeds

   (b) to the extent reasonably practicable and permitted by law, consultation with a representative sample of the company's key shareholders should be undertaken

   (c) as far as possible, the issue should be made on a soft pre-emptive basis

   (d) company management should be involved in the allocation process

   In addition:

(i) due consideration should be given in all placings to the involvement of retail investors and other existing investors

(ii) up to 10% should be available for use for any purpose with up to a further 10% only being used for an acquisition or a specified capital investment, using the existing Pre-Emption Group definitions, with the acquisition or specified capital investment announced contemporaneously with the issue or which has taken place in the preceding 12-month period.

As is the case now, prior shareholder approval should be obtained at a company's annual general meeting each year for the up to 10% + 10% authorities. Ahead of a company's next annual general meeting at which it can seek shareholder approval for this authority, a transitional regime should be put in place by the Pre-Emption Group to allow companies to use the revised regime in the meantime.

3. In light of the increased threshold, companies should report publicly after a placing on how it was carried out. This should be done using a short, template form – which would be downloadable from the Pre-Emption Group's website – that is filled out by the company and made available publicly by it via an RIS in the week after the placing and which:

(a) confirms that, as far as possible, the principle of soft pre-emption was applied, detailing any specific points in this respect that the issuer considers relevant

(b) confirms that appropriate consultation of key shareholders was carried out before launch

(c) sets out the basis on which allocations were made in the placing, including the role that management played in the allocation process

(d) sets out how the interests of retail investors not allocated shares as part of the soft pre-emptive process, as well as other existing investors, were given due consideration

(e) sets out the use of proceeds, including details of any acquisition or specified capital investment

(f) confirms the discount to market price at which the shares were issued

(g) discloses the gross proceeds raised in connection with the placing, as well as the net proceeds (i.e. net of all fees)

The form should also be filed with the Pre-Emption Group and be available going forward in a publicly searchable database maintained by it as well as a summary of the details being included in the company's next annual report. This will allow shareholders to make an informed decision as to whether it is appropriate to grant any request for a further disapplication authority at the next annual general meeting.

4. Cash box structures legally involve an issue of new shares for non-cash consideration and so, as a technical matter, avoid the application of pre-emption rights given that such rights apply on issues of shares and other equity securities for cash. In connection with undocumented placings, such structures should only be used for up to the amount of the pre-emption disapplication authority that has been granted by shareholders at the company's most recent annual general meeting, as a mechanic to increase the company's distributable reserves. This should also be reflected in the Pre-Emption Group's updated Statement of Principles.

Implementation: FRC / PEG

Timetable: Immediately

Support additional flexibility for capital hungry companies

5. Companies that need to raise larger amounts of capital more frequently should be supported by shareholders, if appropriate in the circumstances, if they request a disapplication of pre-emption rights of more than 20% in any one year or a disapplication over a longer period. This approach should be reflected in the updated Pre-Emption Group Statement of Principles. Any disapplication should be subject to prior shareholder approval and it will be up to the company in question to make an appropriately compelling argument for the enhanced authority to its shareholders such that they are willing to approve it. For newly listed companies, the putting in place, as well as the size and duration, of an enhanced authority at IPO and any intention to seek further authorities on the same or similar terms in the future should be fully disclosed in their IPO offer documentation.

Implementation: FRC / PEG

Timetable: Immediately

Involve retail investors in all capital raisings

6. On all capital raisings, including undocumented placings of up to 20% of issued share capital, companies should give due consideration to the interests of retail shareholders, as well as other existing shareholders, and how to involve them in the offer as fully as possible.

   Companies should consider the most appropriate method by which to do this, taking into account both the company's and the market circumstances at the time of the placing as well as the constitution of their shareholder register. It may for example be most appropriate to use one of the many technology-driven market providers and solutions that now exist and are being developed or, if a company wished to, it could include a follow-on offer that would take place after the institutional offer had closed. If this route was chosen, companies should ensure that any follow-on offer is limited to no more than 20% of the size of the placing, with a monetary cap of £30,000 per investor. This amount would fall outside and be in addition to the up to 20% disapplication authority. The follow-on offer should otherwise be made on the same terms and conditions as the institutional placing and be open for five business days. The offer document should be short and contain the offer structure, the timetable, a chair's letter (which includes the background to and reasons for the fundraise), the terms and conditions and the use of proceeds.

Implementation: FRC / PEG

Timetable: Immediately

7. As a separate but related point, further to HMT's Prospectus Regime Review outcomes paper, on an IPO that involves a retail offer a prospectus should not continue to have to be made available to the public at least six working days before the end of the offer. This period should be shortened materially and should be a maximum of three working days.

Implementation: FCA

Timetable: Near term

Reduce regulatory involvement in larger fundraisings

8. Given that secondary capital raisings involve the issue by existing listed companies, who already have disclosure and other continuing market obligations to comply with, of new shares to existing shareholders who have already made an investment decision in relation to the company, regulatory scrutiny of and involvement in larger fundraisings should be removed as a default.

   HM Treasury's reforms to the prospectus regime will mean that prospectuses do not, as a default, need to be prepared and published when a company is making a public offer of securities to its existing shareholders, which will in many cases materially shorten the pre-launch preparation time and cost involved for companies. Separately, the threshold at which a prospectus should be required for an admission of shares to trading should be raised materially from the current 20% threshold, meaning that prospectuses that are inherently duplicative of a company's existing market disclosure should not be needed on most fundraisings. It is recommended that the threshold should be linked to where an issue of shares of at least 75% of the existing share capital is involved.

9. In addition, a sponsor firm should not need to be appointed by a company in relation to a secondary fundraising. Formal declarations by a sponsor in relation to the position of the company should not need to be made to the FCA, although sponsor declarations on a circular will continue, under the current regime, to be required for certain secondary offers that are linked to a material acquisition for example. Separately, the working capital diligence approach followed on placings consists of a working capital warranty being given to the underwriting banks and an exercise undertaken to stress test and sensitise the company's financial model, with the involvement by the company as it wishes of accounting advisers and financial advisers. This approach should be able to be followed on all secondary fundraises. Current market

practice is supported by industry guidance on the scope of the working capital exercise – and the related issues of quantum of and use of proceeds – expected for statements in public documents, and this will continue to provide a framework to which companies should work in the absence of a sponsor declaration requirement.

10. The FCA's approach to working capital statements, when and if required in the future, whereby clean statements cannot be accompanied by disclosure of assumptions made by the company in making its confirmation, should be reconsidered and revised to allow greater flexibility of approach and a disclosure-based approach – as the FCA has already raised as a potential approach to working capital on IPO in its recent Primary Markets Effectiveness Review discussion paper.

    Additionally, the FCA's approach to the formulation of language emphasising how important the shareholder vote is on fundraises that constitute a reconstruction or refinancing, if retained as a concept (known as 'importance of vote' language) should be revised. The key disclosure should be around the rationale for the quantum of funds being raised and the use of proceeds. The current approach to the inclusion of 'importance of vote' language can result in unnecessarily hypothetical outcomes having to be outlined by a company. This is often artificial and can give rise to real risks for the fundraising and the continued viability of the company.

11. The current overlap between working capital diligence exercises and the work that issuers are required to undertake to give going concern statements and viability statements – and in due course resilience statements – should be addressed, noting that the upcoming BEIS audit reforms will incorporate the going concern and viability requirements within the resilience statement. The working group that has already been set up by the FCA and the FRC to look at this area should progress its work as soon as possible.

Implementation: FCA / FRC

Timetable: Near term

Make existing fundraising structures quicker and cheaper

12. The offer period for rights issues and open offers should be shortened so that an offer is open for acceptance for seven business days rather than ten business days. At present the Companies Act 2006 and the FCA Handbook use different methods of calculating minimum offer periods and these should be aligned to clarify the obligations for listed companies.

Implementation: BEIS / FCA

Timetable: Near term

13. Statute should be amended to give the Secretary of State the flexibility, without further primary legislative change, to reduce the notice period for shareholder meetings other than annual general meetings to seven clear days at the appropriate time.

Implementation: BEIS

Timetable: Medium term

14. Companies should continue to be able to seek annual allotment and pre-emption rights disapplication authorities from their shareholders of up to two thirds of their issued share capital, but with the authority extending not just to rights issues as is currently the case but to all forms of fully pre-emptive offers made on the basis of the updated pre-emption provisions set out in Recommendation 15 below, and any follow-on offer as described in Recommendation 6.

Implementation: Investment Association

Timetable: Near term

15. The pre-emption provisions in the Companies Act should be amended to align them to the process that is usually followed on a rights issue or open offer when a disapplication resolution has been used to modify statutory pre-emption rights. This should include the ability to exclude shareholders in overseas jurisdictions where the cost and burden of extending the offer to them would be disproportionate, flexibility to deal with fractional entitlements through aggregating and selling them, as well as permitting the new shares to be offered to securities holders with a contractual right to them – such as convertible bondholders, warrantholders and preference shareholders – as if they were holders of ordinary shares.

Implementation: BEIS

Timetable: Near / medium term

16. The listing regime should be amended to cater for the ability to have excess application mechanics attached to rights issues – where existing shareholders can apply to take up shares that are not taken up by other shareholders, at the offer price.

Implementation: FCA

Timetable: Near term

17. The current structure of rights issues in the UK and the proportion of UK share registers that are held by US shareholders or EEA shareholders mean that often shares or rights to shares that are not taken up by existing shareholders in a rights issue need, in practice, to be capable of being sold by the banks to institutional shareholders in the US and other non-UK jurisdictions. Interpretation of US securities laws mean that this involves the provision of appropriate legal and accounting comfort to the investment banks that are involved. This in turn currently leads to the need for issuers to publish a full prospectus in order for that comfort to be given. Without this area being addressed, the ability for companies to undertake pre-emptive offers more quickly and cheaply – and in particular using a non-duplicative offer document

– will be undermined where marketing and offering of shares or rights to shares outside the UK is required. As a result, two actions should be taken:

(a) Companies should be able to 'opt in' to an enhanced continuous disclosure regime – including by way of more detailed disclosure in their annual report in certain areas, such as risk factors, business overview and the operating and financial review, as well as potentially through ongoing periodic updates and website disclosure – that would bolster their disclosure in certain areas that are particularly relevant to a fundraising, and that could be relied on in a fundraise in the following year. The intention would be for this package of disclosure to be materially less onerous and duplicative but nevertheless to equate to current prospectus standards and, under this approach, a shorter, non-duplicative offer document, together with the enhanced disclosure package and an efficient diligence process, would be sufficient for the necessary legal comfort to be given by law firms to the underwriting banks on an offering made outside the UK. An alternative would be for all the supplemental offer disclosure to be published in an extended press release at the time of the offer.

(b) To facilitate the move to shorter, non-duplicative offer documents instead of long, duplicative prospectuses, the usual director liability regime for market disclosure should apply to the document and any other documents and information published by a company in connection with a secondary fundraising that does not require a prospectus. Consideration should also be given to clarifying further that investment banks and financial advisers, acting in any capacity, are not liable for the offer documentation of an issuer, or any information incorporated by reference into it.

Implementation: HMT

Timetable: Near / medium term

Increase the range of choice of fundraising structures for companies

18. With the recommendations outlined above, retail investors will be much more fully involved in all capital raisings in the future. In addition, the reforms to pre-emptive offer processes contained in Recommendations 12 to 15 above, when combined with HM Treasury's prospectus regime reforms, will materially reduce the time and cost currently involved in larger fundraisings. These two measures combined will do much to improve the efficiency of secondary capital raisings and the inclusion of offers to retail investors in the UK. Nevertheless there should also be greater choice of structure available to UK issuers to use if the circumstances are relevant.

Accelerated fundraising structures such as AREOs, ANREOs, PAITREOs and SAREOs that are used in Australia cannot be readily implemented in precisely the same way in the UK due to the wider regimes in the two jurisdictions differing in various areas. However the principles that they follow – including their speed and their observance of pre-emption rights – are sound and there are various features of the Australian models that could be adopted in the UK capital markets in the near to medium term.

The Australian concept of a ‘cleansing notice’ is one that should be adopted in the UK where a secondary issue involving a public offer does not require a prospectus. In a cleansing notice a company at the time of a fundraising confirms publicly that it is in full compliance with its market disclosure obligations and that it is not delaying the disclosure of any inside information – i.e. level-setting the market in terms of its existing market disclosure and confirming that it is accurate and up-to-date. Such a statement, alongside publication of the company’s investor presentation and any supplementary offer document and in conjunction with other Recommendations made in this Review, including around potentially clarifying the bank liability regime, will help streamline disclosure where offers are made without the current full prospectus.

Implementation: FCA

Timetable: Near / medium term

19. Ahead of a move to full digitisation of shareholdings, section 793 of the Companies Act should be amended so that, in addition to the information about its shareholders that is already provided to a company when it does a section 793 ‘sweep’, the identity of the ultimate investment decision maker or beneficial owner in relation to a share is also disclosed. This will assist in identifying institutional and non-institutional shareholders in the context of fundraisings as well as being of benefit more generally in terms of a company having greater visibility over its shareholder register.

Implementation: BEIS

Timetable: Near / medium term

20. Standard form terms and conditions with institutional investors for use on secondary fundraises should be agreed by the market and made available publicly, as is the case with the Master ECM Terms in Australia. This will remove the need to agree any bespoke terms with investors at the time of a transaction, reducing cost and increasing speed.

Implementation: Appropriate industry group(s)

Timetable: Near term

Raise the priority of an ambitious ‘drive to digitisation’ to facilitate innovation, stewardship and improved market infrastructure, which is actioned by a Digitisation Task Force with an independent chair and a clear set of principles to be followed

21. Moving to a system where all shareholders – both institutional and retail – hold their shares in fully digitised form will be of huge benefit to the UK capital markets if done effectively. An appropriate legal and regulatory framework could significantly improve the effectiveness of existing listing

regime protections, contribute to better stewardship outcomes and lead to better engagement between issuers and their investors. It would also allow the full benefits of many of the recommendations in this Review to be realised and, in some cases, the fundraising structures made even more efficient.

However, despite the significant amount of time that has been spent in recent years considering what digitisation should mean and how to implement it, a combination of factors have contributed to a lack of progress.

Despite the vast majority of publicly traded shares being held in dematerialised form, the need to accommodate manual, paper-based processes for the residual certificated shareholder base leads to inefficiencies and increased cost for issuers and investors. And whilst the intermediated shareholding system that the UK capital markets currently has brings advantages in the form of efficiencies and economies of scale and can make trading quicker, cheaper and more convenient, cost and efficiency have arguably been prioritised over corporate governance and transparency, particularly in relation to retail investors. This should be addressed as all beneficial holders of shares, whether institutional or retail, should be able to exercise their shareholder rights effectively and efficiently.

The practice of investors holding certificates can and should be eradicated, in a way which preserves their rights to vote, receive information and participate in corporate actions. Similarly the current intermediated securities chain from central securities depository to end retail investor has, if approached with ambition and commitment, significant potential for reform and improvement. However, it is clear that a voluntary framework is unlikely to be effective and progress is more likely to be secured through imposing formal obligations on intermediaries to notify and provide underlying beneficial owners with the option to attend meetings, vote, receive information and participate in fundraisings, for example.

Going further, the implementation of the Shareholder Rights Directive II could be revisited so that the provisions facilitating the identification of shareholders, transmission of information and the exercising of shareholder rights could be applied to the underlying beneficial owner of a share as well as to the legal owner whose name is included on the company's shareholder register.

While both of the above could form steps in a digitisation process, digitisation should ultimately involve creating a system to provide near real-time transparency on investment decision makers and share owners. It may involve substantial changes being made to the current structure, including clarifications and revisions from a legal perspective that have already been identified. The use of innovative technologies, such as distributed ledger technology, should be explored alongside tried and tested technologies which could create more efficient shareholder engagement, such as online presentations, app-based platforms and online and automated telephone-based payments.

In any event, the move to an ambitious digitised shareholding system should be made more of a priority. It is a key part of the UK positioning itself as a pro-innovation jurisdiction. It can and should be seen as a key component of the effective implementation of the Government's and the FCA's commendable innovation and ESG agendas. In particular, it could be brought together with the Bank of England and FCA's Financial Market Infrastructure Sandbox that was announced last year – for example, the criteria for MTFs applying to test in the FMI Sandbox could include how the MTF's DLT settlement arrangements could facilitate beneficial owners exercising their shareholder rights.

To put it bluntly, the recommendations in this Review to make fundraising structures quicker and cheaper and to involve all shareholders, including retail, meaningfully in every fundraise will only be fully realised if the UK securities holding model is updated to ensure it does not prevent issuers from understanding the detailed make-up of their investor base and all end investors from being able to exercise their shareholder rights in an effective and efficient way.

The drive to an ambitious digitised shareholding structure should be coordinated and driven by a newly established Digitisation Task Force, with an independent chair to head it and a technically experienced second-in-command – who have no 'skin in the game' – similar to the Bank of England Settlement Task Force headed by Pen Kent and Iain Saville that was established to drive the adoption of CREST. The principles and terms of reference that the Digitisation Task Force is to follow should be agreed and clearly set out at the point of its establishment. The exercise will require strong commitment across both regulatory and governmental authorities as well as across the market.

The arrangements between issuers, registrars, clearing systems and banks for the holding and settlement of securities is often referred to as the 'plumbing' that underpins the effective and efficient functioning of the UK capital markets. The pipes between these entities that enable, in particular, retail investors to exercise their shareholder rights need to be updated and modernised where necessary to create a shareholding system in the UK that works equally well for all shareholders as well as issuers.

Now is the perfect time to turbo charge this ambitious drive to digitisation – which is likely to have to happen piecemeal rather than in one big bang given the complexity involved – and to position the UK markets as the innovation leader in this area, as is already happening with listing regime reform and in relation to crypto and financial market infrastructure more generally.

Implementation: HMT / BEIS

Timetable: Near term

3. INTRODUCTION (OVERVIEW)

Capital raising by listed companies in the UK

3.1 Publicly traded companies in the UK have a number of options when looking to raise secondary capital. Exact terminology varies depending on the legal structure employed, however fundraising structures can be broadly categorised as follows:

(a) Placings

A placing of shares involves an issuance of shares to a specific pool of investors, who may be new or existing shareholders in the company. As such, a placing will be dilutive to some existing shareholders who do not participate in the offer as their share of the company becomes smaller. A placing is therefore described as non-pre-emptive.

Placings are most frequently conducted by way of an ‘accelerated bookbuild’ (ABB). This involves an underwriting bank rapidly procuring orders from investors over the course of a matter of hours (i.e. building a book). The price of the offer will be formed during this book building period, meaning the offer price can move depending on demand. Such offers may be ‘undocumented’, referring to the fact that a prospectus is not produced when offering investors the chance to purchase shares.

(b) Open offers

In an open offer, the company initially directs an offer to subscribe for new shares to existing shareholders in the company in proportion to their existing stake. This provides an existing shareholder with an ‘entitlement’ that they can exercise, allowing them to avoid dilution. For this reason an open offer is described as a pre-emptive offer, as it gives existing investors first refusal. However, if a shareholder does not take up this entitlement, they will suffer dilution in a similar fashion to a placing. The price and terms of the offer are set out at the time of its launch. A compensatory open offer is a variation of open offer where any non-participating shareholders are compensated by way of a bookbuild of their entitlements. However, compensatory open offers have not proven popular in the UK, with only two documented examples since their introduction.

(c) Rights issues

In a ‘rights issue’ the company initially directs an offer to subscribe for new shares to existing shareholders in the company in proportion to their existing stake, similar to an open offer. However, shareholders have a greater number of options than in an open offer as rights issue entitlements are tradeable for cash. Additionally, ‘lazy’ shareholders may be compensated if they do not respond to the offer – their entitlements will be subject to a ‘rump’ placing where new investors purchase the entitlements from the lazy shareholders who have not taken them up.

3.2 Placings are by far the most dominant type of offer in the UK. Of the 1,880 deals that have taken place on London Stock Exchange's Main Market since 2010, non-pre-emptive placings have constituted between 74% and 91% of offers each year.

	Year												
Type of offer	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**Total**
Non-pre-emptive placing/accelerated bookbuild	74%	76%	79%	80%	76%	82%	83%	88%	83%	91%	88%	86%	84%
Offer includes pre-emptive component	26%	24%	21%	20%	24%	18%	17%	12%	17%	9%	12%	14%	16%

Source: SCRR analysis, Dealogic

3.3 Offers including a pre-emptive component include rights issues and open offers (in the minority of fundraising types) but also fundraisings where there may be a combination of a non-pre-emptive and pre-emptive component, such as a placing and open offer.

3.4 The reasons for the overwhelming popularity of non-pre-emptive placings become clear when the application of the regulatory framework and associated transaction timetables are considered.

The regulatory framework and transaction timetables

3.5 When choosing a type of fundraising structure a company must take into account a range of legislative and regulatory requirements, market guidance and market practice.

3.6 The UK offers a selection of markets for companies with varying eligibility criteria and continuing obligations[2]. Although companies are colloquially described as having 'listed' irrespective of which market their securities are traded on, at a technical level a listing refers solely to companies who have sought admission to the FCA's Official List (i.e. the premium or standard segments) and therefore comply with the FCA's Listing Rules, requiring a concurrent admission to trading on an associated regulated trading venue such as the London Stock Exchange's (LSE) Main Market or AQSE's Main Market. An admission to AIM, for example, does not involve an admission to the Official List, meaning that companies on AIM must comply with the AIM

2 As of 24 June 2022, there were 438 companies with securities listed on the segment for premium equity commercial companies, 89 on the segment for standard GDRs, and 231 on the segment for standard shares (FCA Official List, 'Live securities'). Suspended securities not included. As at 31 May 2022 there were 840 companies admitted to trading on AIM (LSE: link). As of 26 June 2022, there were 101 securities admitted to trading on AQSE's AXS & APX markets.

Rules for Companies rather than the FCA's Listing Rules. Differences in these respective rulebooks – as well as the way in which supporting legislative and regulatory requirements apply to and reference the different regulated status of these venues – mean that companies may have considerably more or less flexibility when seeking to raise capital after listing depending on the circumstances and the application of the rules of the market they are traded on. This review focuses on companies admitted to the Official List.

3.7 Broadly speaking for premium-listed companies, key considerations will include: whether a requirement for a prospectus is triggered; whether directors have authority to disapply pre-emption and to allot securities; the requirement for a Class 1 circular and any requirement to convene a general meeting linked to the above. Each of these factors can have a significant impact on a transaction timetable, whether in the pre-launch phase of an offer where a company, and its advisers, prepares the relevant documentation, or post launch of an offer where investors get to decide how they wish to proceed and notice periods may need to be observed.

3.8 A schematic showing the interaction of the considerations highlighted above is shown in Figure 1[3]. The route travelled by a company will be for the company to determine with the help of its advisers, factoring in issues such as the immediacy of the fundraising requirement, the cost of undertaking the offer in comparison to the funding need, and the needs of the shareholder base as a whole.

3.9 The attractiveness of undocumented placings becomes apparent on the basis that such offerings can easily be structured so that they:

(a) are exempt from the requirement to prepare a prospectus (under both the public offer and admission to trading triggers);

(b) do not require a general meeting to disapply pre-emption authorities, if structured so that they operate within the 5%+5% limits voted on at annual general meeting (AGM) in line with guidance from the Pre-Emption Group (PEG, see Part 2 of Annex C);

(c) do not require a general meeting for allotment authorities, falling in line with the Investment Association (IA) share capital management guidelines (see Part 2 of Annex F);

(d) do not require a Class 1 circular or sponsor declarations to the FCA.

3.10 The resulting path for an issuer is shown in the schematic in Figure 2.

3.11 However, undocumented placings are generally only targeted towards institutions. Whilst there is evidence that issuers and their advisers are

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3 Schematic reflects the current position at the time of publication and does not reflect HMT's updated prospectus regime proposals to be implemented in the near term (UK Prospectus Regime Review: Outcome (March 2022).

beginning to use retail platforms to include retail when conducting a placing[4], the retail component of the offer has historically been restricted to under €8m to ensure it falls within an exemption from the requirement to produce a prospectus. Such a structure will not protect against the dilutive effects of the overall fundraise.

3.12 Where companies wish to raise a significant amount of capital, or extend their offer to the public, this typically has significant implications on the offer timetable. It may also require a general meeting, adding an additional dependency to the success of a transaction in the form of the need for relevant shareholder votes to be passed. The implications for a rights issue are shown in Figure 3.

3.13 As can be seen from the above, a rights issue will involve the production of a prospectus, a circular to convene a general meeting and associated sponsor declarations to the FCA. Open offers will trigger similar considerations. Such pre-emptive offers cannot typically be structured within the confines of resolutions set out at AGM in advance of the transaction regarding disapplication of pre-emption authorities and allotment authorities, meaning the company must seek additional shareholder authorities.

3.14 The current regulatory regime therefore presents issuers with a stark choice in terms of whether to choose a non-pre-emptive placing or a pre-emptive rights issue or open offer. A placing can be agreed in a matter of hours post public launch, whereas at its extreme a rights issue could take two to three months of preparation in the pre-launch period and three weeks to five months in the post launch period[5].

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4 See for example Ocado Group Plc's recent placing, retail offer and financing (RNS, 20 June 2022)

5 easyJet plc's rights issue was completed within 19 days of its first announcement (no GM required), whereas TP ICAP plc's rights issue in 2020 took 131 days, launched in October and finishing in February 2021. *Source: Practical Law What's Market*

FIGURE 1: INTERACTION OF ISSUER REGULATORY CONSIDERATIONS AND IMPACT ON TRANSACTION TIMETABLE

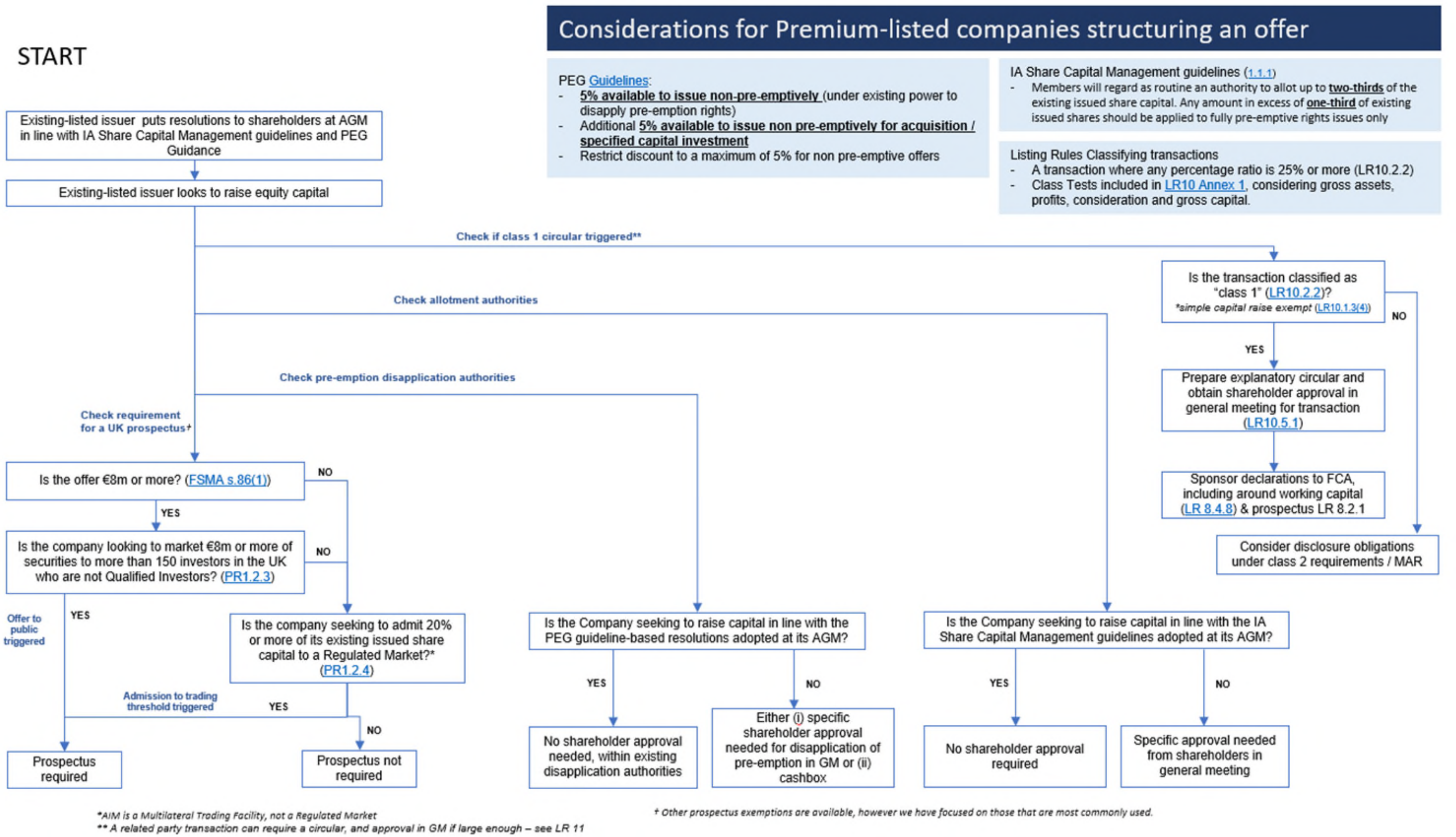


FIGURE 2: INTERACTION OF KEY REGULATORY CONSIDERATIONS FOR AN UNDOCUMENTED PLACING AND IMPACT ON TRANSACTION TIMETABLE

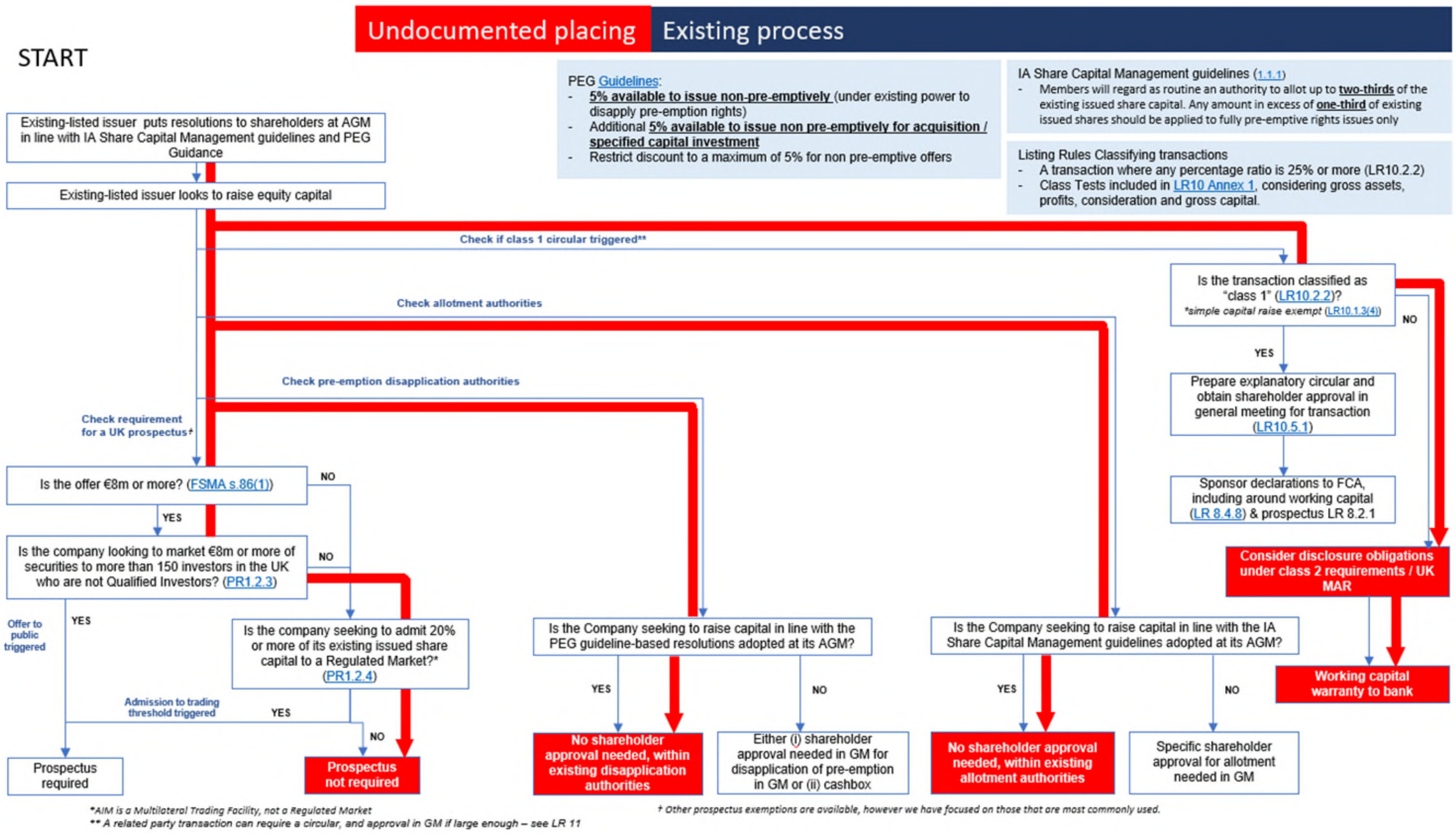
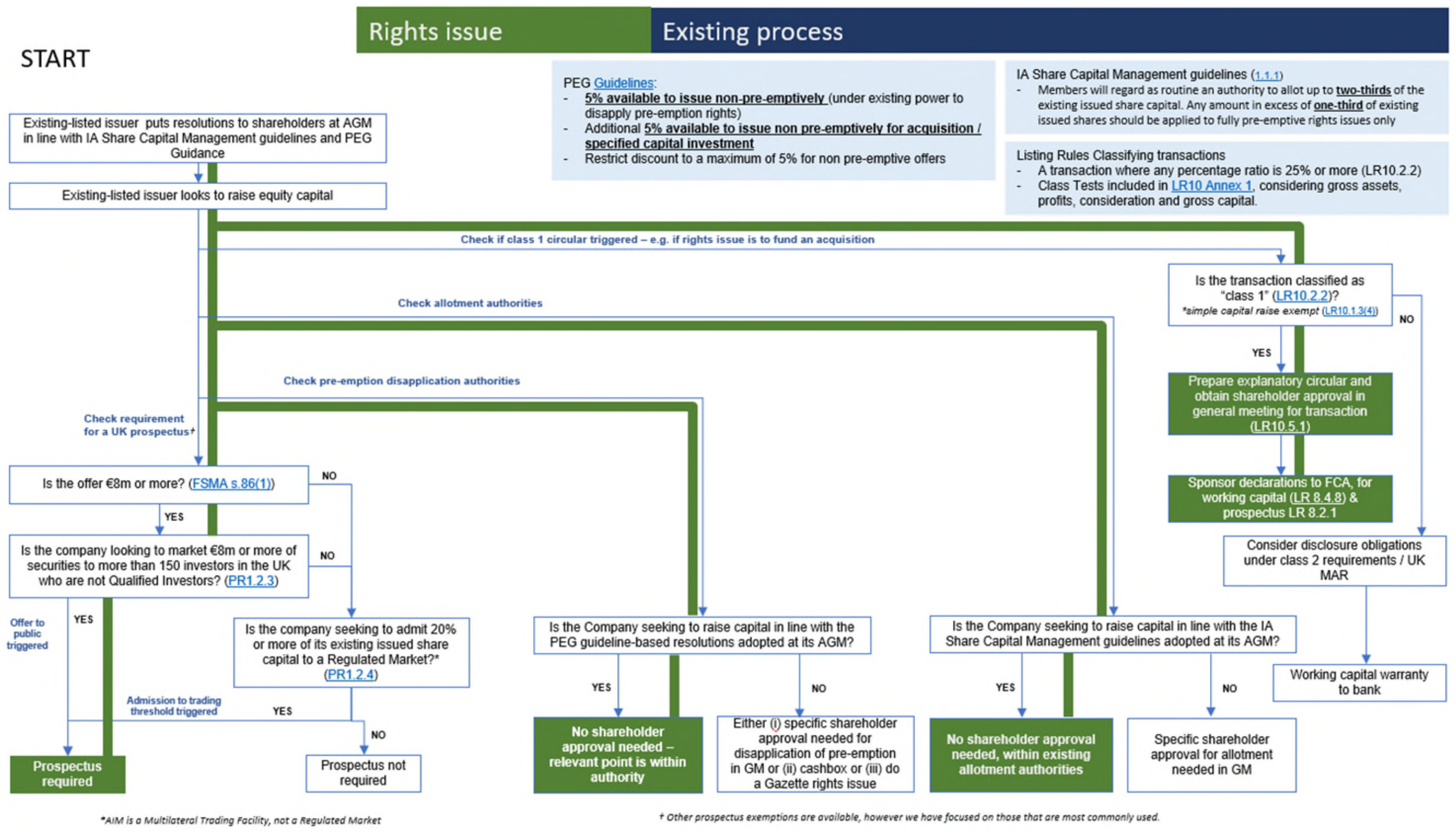


FIGURE 3: INTERACTION OF KEY REGULATORY CONSIDERATIONS FOR A RIGHTS ISSUE AND IMPACT ON TRANSACTION TIMETABLE



Ownership of UK quoted companies and participation in fundraisings

3.15 Whilst soft pre-emption is frequently observed when conducting placings[6] and shareholders provide companies with authority to issue up to a specified amount of shares on a non-pre-emptive basis, soft pre-emption does not cater to minority shareholders who are less likely to be included in the placing, such as retail investors. This is important, as share issuances in the UK are most commonly issued at a discount to the current share price, with 79% of capital raises in the last two decades taking place at a discount and the average discount being 15%[7]. This presents a number of dilution issues for investors who cannot participate in such offers: their stake in the company will represent a reduced percentage ownership interest by virtue of the increased number of shares in issue; and their existing holding may be worth less should the market price fall to the value of the discounted shares.

Full pre-emption versus soft pre-emption

As opposed to full pre-emption where an issuer must offer new securities to its existing shareholders in proportion to their existing holdings, soft pre-emption usually takes the form of a company working with its book-runners to ensure that they give due regard to protecting the interests of existing investors on a company's register. This will mean that full pre-emption will not be observed – e.g. to avoid the time and expense associated with triggering a public offer – if this would prevent the company from taking an action which is in the best interests of the company as a whole, but the offer will be structured in a way which observes the principle of pre-emption in so far as is practical. (Additional background on the concept of soft pre-emption in Part 5 of Annex C.)

3.16 The popularity of placings therefore presents an issue for retail investors. Such investors would generally be excluded in the exercise of soft pre-emption in an accelerated bookbuild, given the issues in co-ordinating an offer to a significant number of investors in such a short period of time and the unknown nature of their capacity to fund an investment at short notice, as well as regulatory obstacles. Although retail investors are able to immediately purchase securities in the secondary market after a placing has been concluded, the price at which they can do so may not be as competitive as the price offered to institutions in the placing.

3.17 Identifying the impact of this aspect of market practice on retail investors is not an exact science. As we detail in Section 10, retail investors can hold their shares in a number of different ways. Whilst ONS statistics identify that individual investors beneficially own around 8.4% of FTSE 100 issuers, and

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6 In the PEG's relaxation of the PEG guidelines during Covid-19, observing soft pre-emption was specifically encouraged when acting within the PEG limits (April 2020).

7 The good, the bad, and the ugly of secondary public equity offerings in the UK (Schroders, Nov 2020)

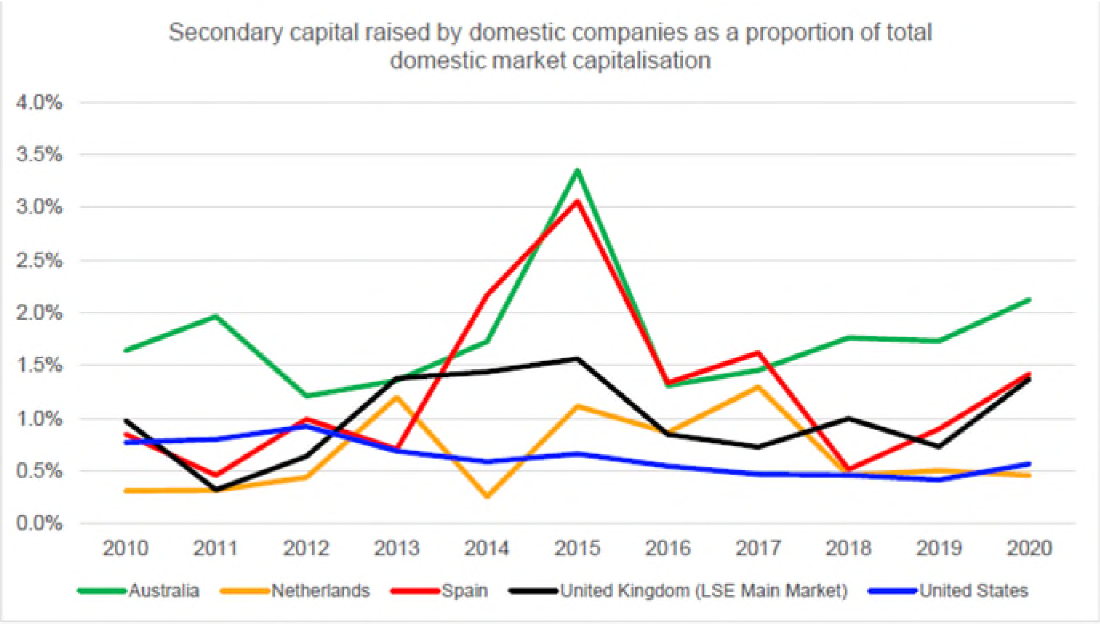
24% of AIM companies,[8] having beneficial ownership does not mean that all of these investors have the ability, or indeed inclination, to participate in placings. However, it does show that this is an important enough constituency to try to improve the status quo.

Capital raising by companies listed on overseas markets

3.18 Data collated over the past decade for select mature capital markets highlights that – when adjusted for the relative sizes of the domestic markets in question – the UK market is competitive in terms of the depth of capital available to issuers.

3.19 Per the data in Figure 4, Australia consistently outperforms most international markets in terms of the proportion of capital raised against the market capitalisation of the market. The 2008 Rights Issue Review Group[9] highlighted the use of the RAPIDs model (Renounceable Accelerated Pro-Rata Issue with Dual-bookbuild Structure – now known as an AREO – see Section 9). Although this is still used in Australia, additional transaction structures have been developed utilising similar features to the RAPIDs model. The Call for Evidence for this Review specifically asked for respondents' views on Australian ANREO, AREO, SAREO and PAITREO structures, with conclusions drawn out in Section 9 of this report.

Figure 4: Secondary capital raised by domestic companies as a proportion of total domestic market capitalisation



8 Ownership of UK quoted shares – Office for National Statistics (ons.gov.uk) (release date 3 March 2022)

9 *http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/pbr08_rightsissue_3050.pdf*

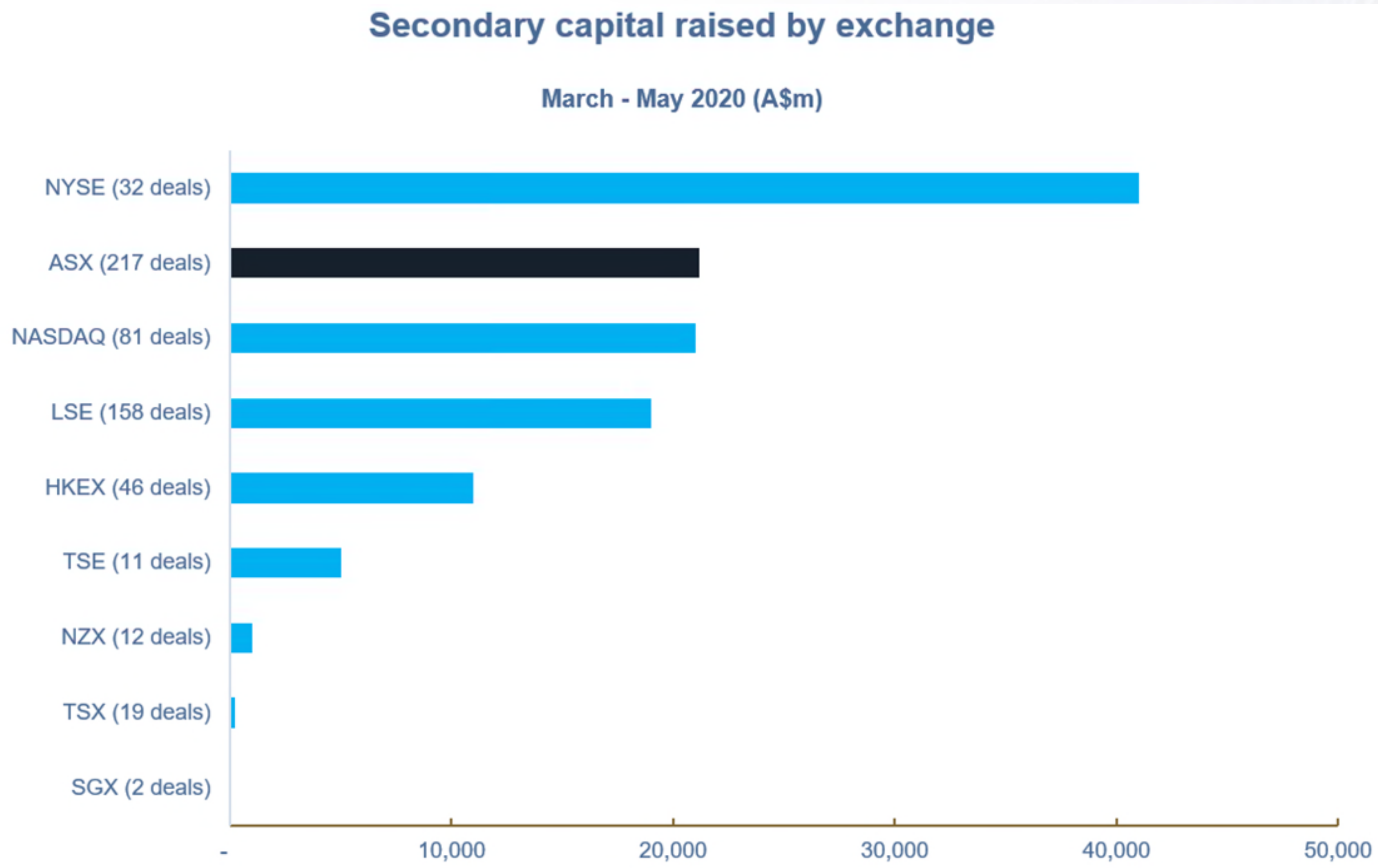
3.20 The data above is consistent with data released by ASX, which highlighted that during the initial reaction to Covid-19, the market was ranked second globally for follow-on offerings (by dollar capital raised) and had more deals than any other developed market. Figure 5 shows a breakdown of secondary capital raised by exchange during the Covid-19 pandemic period, March-May 2020.

3.21 Although several improvements to the UK rights issue process were highlighted in the Call for Evidence, many respondents raised that the Review should explore features of other international markets, allowing the UK to examine whether best practice in other jurisdictions could be incorporated into UK capital raisings.

3.22 In this regard, it is notable that placings are considerably more prevalent in the UK than in other European markets:

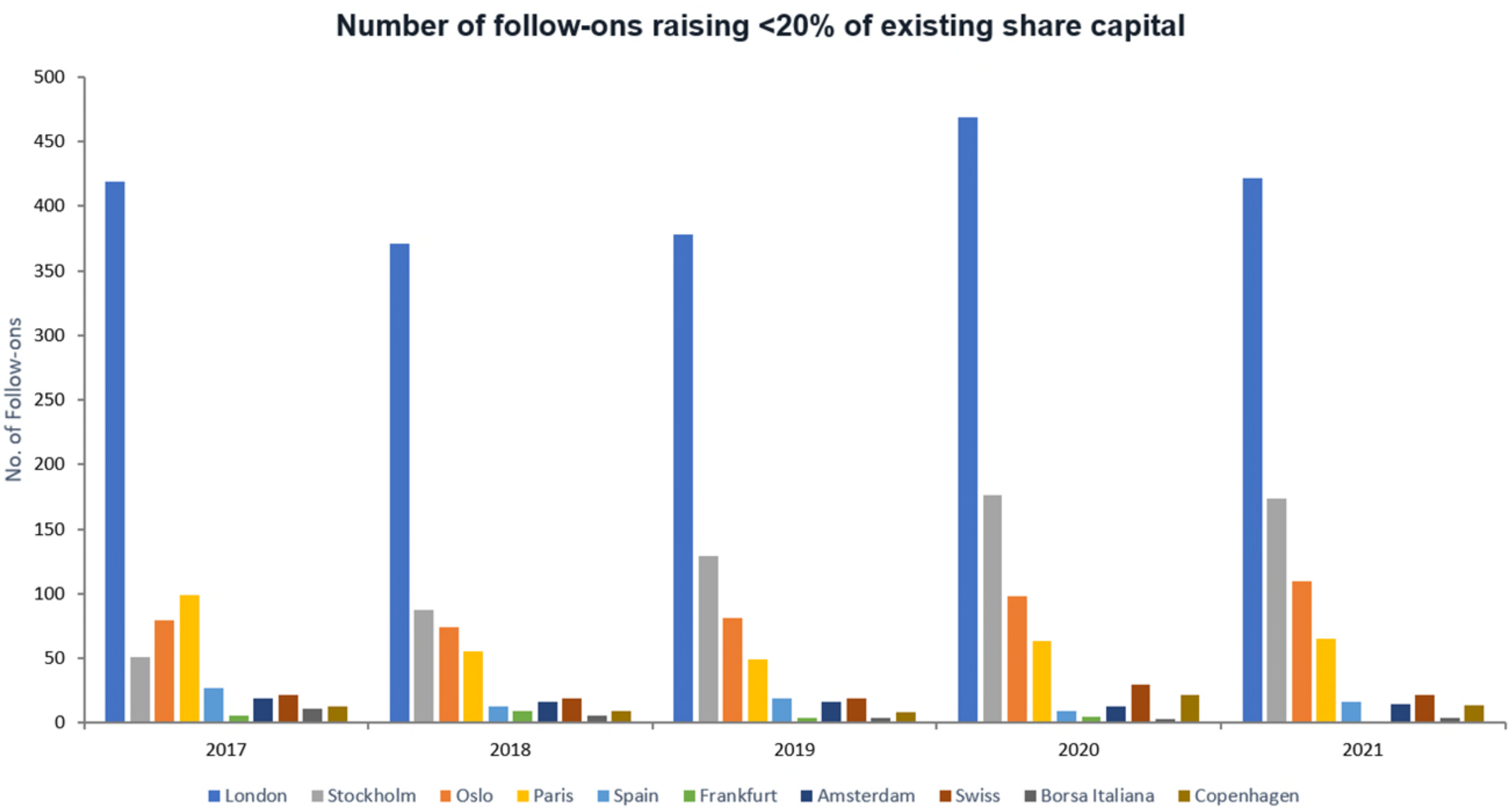
3.23 Figure 6 highlights that in addition to examining more novel structures in other jurisdictions, the importance of accelerated bookbuilds as a constituent part of UK capital raisings should not be underestimated. As such, it is important that due consideration is given as to how to make this structure as efficient as possible.

FIGURE 5: SECONDARY CAPITAL RAISED BY EXCHANGE MARCH-MAY 2020



Source: ASX, Dealogic, 1 March to 22 May 2020; deal value excludes block trades and SPPs; 100% apportioned to primary exchange; ASX-NZX dual listings apportioned 50% to each exchange.

FIGURE 6: FOLLOW-ON OFFERS RAISING LESS THAN 20% OF EXISTING SHARE CAPITAL ACROSS EUROPEAN MARKETS, 2017 TO 2021



Source: London Stock Exchange, Dealogic, Refinitiv. Includes main markets and growth markets.

Disambiguation – rights issues

3.24 When considering overseas secondary capital raising structures, it is important to note that similar terminology can be used to describe capital raising structures with different features. For example, in the UK a 'rights issue' very clearly refers to an entitlement offer where all existing investors are offered entitlements which are tradeable for cash consideration and 'lazy' shareholders will be compensated if no instruction is provided in respect of the entitlements allocated to them. In contrast, certain overseas territories refer to rights issues in a general sense of providing an entitlement to an existing shareholder, without necessarily requiring such rights to be tradable or compensation to be provided (i.e. similar to a UK open offer). It is therefore important to ensure that the features of the entitlement offer are clear when making any cross-jurisdictional comparisons.

Which features could the UK look to implement?

3.25 We have summarised some of the key features of overseas practice identified as part of the Call for Evidence below. We have made reference to the body of the report with consideration given as to how these features could be adopted and implemented in the UK.

Trading halts to limit price volatility

3.26 The UK operates under a concept of continuous trading. Trading halts are not imposed when fundraising during market hours unless a company is incapable of complying with its disclosure obligations. In this regard, the principle obligations in respect of a fundraise are governed by the UK Market Abuse Regulation and its requirement to disclose inside information to the market as soon as possible.

3.27 The Australian and Belgian markets implement trading halts in respect of institutional offers to varying extents. Respondents to the Call for Evidence highlighted that a trading halt during an institutional bookbuild would have the potential to limit volatility during that phase of the offer.

3.28 We examine the merits of Trading Halts in Section 9.

Excess application facilities

3.29 Respondents to the Call for Evidence questioned whether the UK rights issue process, with its compensation for the 'lazy shareholder', unnecessarily complicates the pre-emptive issuance process contributing to an elongated timetable.

3.30 Spain was highlighted as a jurisdiction in which pre-emptive offers include excess application facilities, whereby a shareholder participating pre-emptively can apply for additional entitlements than are allocated to them. Any entitlements which are not taken up by other shareholders are allocated to the shareholders applying for more than their pro-rata amount. The rights issue undertaken in 2020 by International Airlines Group, a company listed in both Spain and the UK, demonstrates how such a feature can be incorporated into a secondary capital raise in the UK. An excess application facility can help to avoid the requirement to place a rump of shares at the end of a rights issue process. The requirement to place a rump of shares into overseas jurisdictions such as the US is a key consideration in the preparation of offering documentation.

3.31 We have considered the merits of such structures in Section 8.

At-market rights issues

3.32 Respondents to the Call for Evidence noted that Germany, Austria and Switzerland have the concept of 'At-market' rights issues, where the subscription price for the shares is determined by the board of directors at the end of the rights issue offer period. The rights are non-renounceable, with no trading or compensatory bookbuild. In this regard it is similar to a UK open offer, albeit with pricing determined at the end of the offer period rather than at the beginning as in the UK.

3.33 One of the key benefits of the structure is that there is less ownership dilution as the offer is at a market price. This means there is no need for a so-called Opération Blanche, where a shareholder sells enough subscription rights so that they can use the proceeds to exercise the subscription rights they still hold (known in the UK as a cashless take-up or tail-swallowing), to protect themselves from dilution.

3.34 A case study of an at-markets rights issue for Swiss Steel is shown in Annex A, showing an underwritten offer. However, underwriting is not always required.

3.35 Noting that Germany operates in a historically similar prospectus framework to the UK, and such an offer could be structured so that it falls within allotment and pre-emption guidelines, this model is something which companies and their advisers may wish to consider in appropriate circumstances.

Over the past 10 years there have been 21 "At Market" rights issues in Switzerland with the average uptake across these issuances being 59% and average discount of around 3.1%, illustrating their relative popularity amongst shareholders and issuers alike. In Germany and Austria, during the same period, similar at market rights issues saw an average take up of 85.7% and discount of 6.6%. *(Source: Credit Suisse)*

Short retail bookbuilds

3.36 In Greece, offers to retail are prevalent alongside institutional offers. A contributory factor may be that institutional investors often hold small percentages in the share capital of Greek corporations,[10] meaning that the retail investor base becomes a more important source of funding outside of shareholder-owners linked to founders or founding families.

3.37 In contrast to the Australian model, public offers to retail in Greece can occur alongside an institutional placement. For example, Alpha Bank (see case study in Annex A), undertook a synthetic rights issue respecting pre-emption to the extent that participating investors could subscribe for amounts up to and including their pre-existing entitlements.

3.38 Conversations with advisers have raised that a significant contributory factor to a higher retail take-up in such a scenario is likely to be a longer period of time between announcement of the transaction and the retail offer opening. Indeed, in the case of Alpha below, the retail offer was preceded by an approximately three month notice period and a general meeting. Nevertheless, the Greek model provides an interesting case study for UK markets, noting that it operates under a historically similar prospectus framework and that the retail offer was opened and closed within three days.

3.39 As with at-market rights issues highlighted above, there do not appear to be substantive regulatory issues in structuring an offer in such a manner in the UK. However, operationally there may be issues in co-ordinating an offer to retail investors in such a limited space of time in the UK. We explore these issues in more detail in Section 10 on digitisation.

Repair offers

3.40 In Norway, where a company undertakes a non-pre-emptive placing there is a practice of following this with a 'repair offering'. Such a structure is designed to be consistent with a principle of equal treatment of retail and institutions. The subsequent repair offering is geared towards existing shareholders who were not invited to participate in the private placement. A case study is included in Annex A, detailing the approach taken by Nordic Nanovector.

Removal of pre-emption rights

3.41 Respondents to the Call for Evidence highlighted that the ability to have unfettered authority to issue new shares can be positive, in particular for growth companies who are capital hungry businesses with identifiable stages in their lifecycle where significant capital will be required, or for issuers with a capital raising requirement which is unlikely to be met by their early shareholder base. These can include, for example, Biotech businesses, whose roadmap to commercialisation would require them to raise amounts in the future far in excess of their current market capitalisation and linked to strict regulatory approval processes.

3.42 In the US, the power to issue new shares is primarily entrusted to the board of directors, within the limitation of the number of shares authorised by the

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articles of incorporation. Practice is to 'provide for a number of authorized shares significantly larger than the number of outstanding shares, so that if new financial resources are needed, directors can easily issue new shares'[11]. The principle of pre-emption is an important shareholder protection in the UK capital markets and it should be preserved and enhanced.   We have make recommendations in respect of capital hungry businesses in Section 5.

Principle areas of reform

3.43 Features of international markets have provided useful input into the Review's consideration of ways to improve the UK secondary capital raising framework. Our resulting recommendations have been distilled into the following key areas which form the ensuing sections in this report:

(a) Maintain and enhance the pre-emption regime

(b) Increase the ability of companies to raise smaller amounts of funds quickly and cheaply

(c) Support additional flexibility for capital hungry companies

(d) Involve retail investors in all capital raisings

(e) Reduce regulatory involvement in larger fundraisings

(f) Make existing fundraising structures quicker and cheaper

(g) Increase the range of pre-emptive offer structures for companies

(h) Raise the priority of an ambitious 'drive to digitisation' to facilitate innovation, stewardship and improved market infrastructure.

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[11] See 'Issuing New Shares and Preemptive Rights: A comparative Analysis', Marco Ventoruzzo, Penn State Law (2013) (link)

4. MAINTAIN AND ENHANCE THE PRE-EMPTION RIGHTS REGIME

Introduction

4.1 The principle of pre-emption is a cornerstone of UK company law. While statutory pre-emption rights for all companies incorporated in England and Wales were introduced only in 1980, the principle is of longstanding application to companies listed on the London Stock Exchange.

4.2 As noted by Myners[12] in his 2005 report on pre-emption rights, the objective of the right of pre-emption is to provide a company's shareholders with protection from wealth transfer and erosion of control. Where a third party is permitted to subscribe for new shares at a discount to the market price of those shares, the discount represents a dilution in the value of the shares held by existing shareholders. The issue of new shares to a third party also gives that new investor voting rights as well as a claim on the earnings and valuation of the company, representing a diminution in the control held by the original pool of investors. Pre-emption rights provide existing shareholders with a mechanism to control this transfer of value to third parties.

4.3 Respondents to the Call for Evidence showed strong support for the retention of the principle of pre-emption as a hallmark of the UK market. It is worth noting here that although pre-emption is a feature of the capital markets of many jurisdictions, including across the European Union, it is by no means universal. A notable exception is the US market, in which shareholders typically do not receive the protection from dilution afforded by pre-emption rights. The US approach clearly has advantages, in particular for companies in capital-hungry sectors, but it has developed over time as part of a fundamentally different system. As such the absence of pre-emption is only one of a number of differences between the US and UK capital markets, and one that the Review does not believe should be adopted in isolation. As such, the Review shares the view of respondents to the Call for Evidence and recommends that the principle be preserved as an important aspect of shareholder protection.

4.4 Given the broad support for retention of pre-emption rights, the Review has focused on whether further improvements can be made to the secondary fundraising regime within the principle of pre-emption. We outline in Part 1 of Annex B the nature of the pre-emption rights that currently apply to London listed companies. In Section 8 of this report we focus on the detail of these rights and make suggestions to improve the way in which pre-emptive offers work in practice.

4.5 In Section 5 we outline our recommendations on the way in which disapplications of pre-emption rights can be used to best effect in the UK market. In this section, we consider the role of the Pre-Emption Group (PEG),

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12 Pre-Emption Rights: Final Report, Paul Myners, February 2005 (nationalarchives.gov.uk)

in shaping market practice on disapplications, and consider how its role should be centralised, formalised and enhanced.

Enhancing the transparency of pre-emption oversight

4.6 As outlined in Part 1 of Annex B, the rules on pre-emption set out in statute and in the FCA's Listing Rules allow shareholders to agree that directors can issue shares without first offering them to existing shareholders. But the rules themselves do not provide any framework for the level of disapplication that a company should seek, or provide a benchmark for investors in determining what is an appropriate degree of latitude to give to management.

4.7 This role has instead been taken on by the Pre-Emption Group, an investor body that publishes a Statement of Principles (summarised in Part 2 of Annex C) to guide the market on the disapplication of pre-emption rights. We set out some further background on the Pre-Emption Group in Part 2 of Annex B.

Constitution of the Pre-Emption Group

4.8 The original PEG was set up in 1987, and has been constituted at intervals since that date. The group in its current form was set up in 2005 following publication of the Myners report, and the first Statement of Principles was published in 2006 (to replace earlier Pre-Emption Guidelines). The principles were updated in 2008 with limited amendments, with a more substantive reissue in 2015.

4.9 Its current members represent listed companies, investors and intermediaries and are set out in Part 3 of Annex B.

4.10 As discussed further in Section 5, the response of the PEG to the funding needs of companies when the Covid-19 pandemic struck in 2020 was timely and widely welcomed by the market. The speed with which the group was able to move to relax its principles shows the significant benefit in retaining investor guidance, rather than imposing regulation, in this area. While formal rules would provide the oversight of a regulator, such codification would lose the more significant benefits of flexibility and adaptability. As such, the Review recommends the Pre-Emption Group should remain central to the pre-emptive regime in the UK capital markets and that its role should be further centralised, formalised and enhanced through taking the steps outlined below.

Enhance transparency

4.11 Given the acknowledged importance of pre-emption to the UK capital markets, the Pre-Emption Group should be more central and visible in its role guiding best practice.

4.12 We note that the Financial Reporting Council (FRC), which has to date acted as the secretariat to the PEG, will relaunch as the Audit, Reporting and Governance Authority (ARGA). Depending on timing this transition could be embraced as an opportunity to re-establish the PEG with sufficient resources to enhance its role within the UK capital markets.

Recommendation: The Pre-Emption Group should be put on a more formal and transparent footing

4.13 We set out below a number of suggestions that would help to promote transparency in the operations of the PEG. Many of the points below could be set out in updated terms of reference for the group.

(a) **Membership:** To maintain its credibility the PEG should be representative of the percentage ownership of UK equities. The PEG currently aims to comprise representatives of listed companies, investment institutions and corporate finance practitioners, to which could be added global institutional investors and the retail investor community.

(b) **Governance:** The group should work to objective principles that are clearly set out and publicised to market participants. The principles should be included in terms of reference made available on the group's website. The terms of reference should outline the group's aims, structure and working practices to ensure the activities of the group are transparent to the market.

(c) **Appointments:** A clear process by which members of the PEG are appointed should be established, alongside details of the duration of service of members. A nomination committee approach should be taken to appointments with full transparency around vacancies; when a position is to be filled details should be posted publicly on the group's website to facilitate applications from a broad pool of relevant stakeholders.

(d) **Independence:** Members should serve in an individual, rather than a corporate, capacity.

(e) **Annual report:** The PEG should publish a report each year on how the pre-emption regime is operating, including (as also suggested by Myners in his 2005 report) publicly available data on requests for pre-emption disapplications (broken down by size and type of company, market segment, size of exemption sought and reasons given, whether the request was made at an AGM or another general meeting and the outcome of the application). It should also provide an analysis of the data made publicly available through post-transaction reporting (see below).

(f) **State of the City report:** The Chancellor has accepted the recommendation of Lord Hill's UK Listing Review to make an annual State of the City report to Parliament. As pre-emption is a key element of the UK secondary capital markets, the PEG should become a formal stakeholder in that process. The PEG, through its annual review, should contribute an analysis of the current state of the pre-emption regime for consideration by the Chancellor as part of the report to Parliament.

(g) **Post-transaction reporting database:** As noted in Section 5, one recommendation of this Review is for improved transparency around the basis of allocation for issues made on a soft pre-emptive basis, alongside other features of a transaction. We recommend that in addition to publication of this information via a regulated information service (RIS), and individual companies including disclosure in their subsequent annual report and accounts, data should be sent to the PEG and made available by it on a publicly searchable database.

(h) **Template reporting form:** To standardise post-transaction disclosures, the group should publish a template reporting form. As noted in Section 5, this should cover (among other matters) brief details of the allocations policy used, the consideration given to the impact of the offer on retail investors and the reasoning behind whether they were able to participate, gross and net proceeds and the discount to the market price at which the shares were offered. A suggested starting point is included at Part 7 of Annex C.

(i) **Continuity and work schedule:** As noted above, the PEG has been intermittent in its operations to date, generally forming at a period of change but with subsequent periods when it is less visible to the market. Monitoring reports were published in the immediate aftermath of the changes to the Statement of Principles published in 2015, but none have been produced since 2017.

While the flexibility to convene and adapt quickly to market developments is valuable, there are benefits also to a degree of predictability and certainty for the market around the operation of a body overseeing such a central pillar of the UK capital markets. The website of the PEG could be used to make public the dates of upcoming meetings at which developments may be considered. Outline minutes of those meetings could also be made available, so that the market generally is aware of proposals made and planned activities.

(j) **Website:** The PEG should ensure it has a dedicated and up-to-date website ensuring that it contains details of the body’s members, publications and governance structure. It should also host the post-transaction reporting database.

(k) **Censure:** The PEG does not express a view on, or otherwise intervene in, individual cases, which are properly a matter for consultation between listed companies and their shareholders. As part of its monitoring role, however, the PEG may wish to consider making public its findings in relation to listed companies or their advisers where they feel that standards of allocation, consultation or disclosure have fallen below those expected of the market.

We believe that these changes would enable the PEG to continue to shape market practice in relation to the pre-emption regime.

5. INCREASE THE FLEXIBILITY FOR COMPANIES TO CARRY OUT SMALLER FUNDRAISINGS QUICKLY AND CHEAPLY

Introduction

5.1 In this section, we outline our recommendations on the way that disapplications of pre-emption rights operate in the UK market.

5.2 As noted in Section 4, the right of pre-emption is an important shareholder protection. Equally important, however, is the need to ensure that this strong investor protection against dilution is correctly calibrated against the need of companies for an efficient capital raising process. Companies need to be able to recapitalise quickly and at the lowest possible cost.

5.3 To balance these two principles, the UK market has developed a system whereby shareholders routinely agree to waive their formal pre-emption rights within market standard limits.

Why do companies seek annual pre-emption disapplications?

5.4 Any disapplication of pre-emption rights requires authorisation by the company's shareholders, typically at their AGM. We set out in Part 1 of Annex C more detail on the way in which this works for shareholders in companies incorporated in England and Wales.

5.5 Companies typically ask shareholders to approve pre-emption disapplications for two broad reasons:

(a) **Modified pre-emption for larger offers:** Companies will seek to modify the way that pre-emption is applied when the company makes a pre-emptive issue (for example a rights issue or open offer). Although technically a 'disapplication' of statutory pre-emption rights, the usual form of resolution seeks permission from shareholders to respect pre-emption but in a more flexible way. We discuss this reason for disapplication resolutions more in Section 8.

(b) **No pre-emption for smaller offers:** A disapplication resolution will also give the directors the flexibility to make smaller issues of shares on a non-pre-emptive basis.

5.6 In this section, we recap the reasons companies might wish to put a disapplication in place to allow smaller offers to be made non-pre-emptively.

Why make a non-pre-emptive issue?

5.7 A non-pre-emptive issue of new shares is typically made by way of a placing (the placing structure can also be used for sales of existing shares by current shareholders, but as pre-emption rights do not apply to such 'block trades' they are not considered further here). While subject to constraints, notably as to size and discount (further detail is set out in Part 1 of Annex D), a non-pre-emptive placing of new shares has a number of advantages for issuers:

(a) **Speed of execution:** The key advantage for companies using a non-pre-emptive placing is speed of execution. A placing can be completed in a matter of hours.

(b) **No disclosure document:** A placing will be structured so that no public offer prospectus or admission to trading prospectus is required. The issue will instead involve only a regulatory announcement of the terms and conditions of the offer and any other disclosure that the listed company thinks is appropriate. This will typically include a trading update, reasons for the offer and details of the use of proceeds.

(c) **Short preparation period:** A placing will not require an extensive pre-launch preparation period. Management due diligence and transaction documentation are commonly completed within a week, allowing an issue to be launched quickly.

(d) **No regulatory involvement:** No aspect of a placing requires formal regulatory review, again supporting a condensed timetable.

(e) **Access to US institutional investors:** Institutional investors located in the US are routinely included in placings. Market practice is comfortable with this approach for smaller deals without a disclosure document. We discuss in Section 8 the documentation requirements of larger offers to US institutions.

5.8 While we consider in Section 8 how pre-emptive structures can be improved to encourage their adoption, the Review believes that non-pre-emptive placings will continue to play an important role in the UK capital markets as the quickest and simplest way for a company to recapitalise.

5.9 It remains important to ensure placings are used in a way that strikes the right balance between company and shareholder interests. Key points are the maximum size of a placing and the maximum discount to market price at which the shares can be offered. The FCA's Listing Rules place a limit on the offer price in a placing, limiting the discount to 10% to the middle market price of the shares at the time of announcement of the offer[13]. There are, however, no statutory or regulatory restrictions on the size of a non-pre-emptive offer, or the level of standing disapplication of pre-emption rights that a company can ask its shareholders to authorise.

5.10 In practice, therefore, companies look to guidance from the Pre-Emption Group (PEG) when deciding the proportion of their share capital that should be the subject of a disapplication resolution, and in setting the size of a proposed issue. The Pre-Emption Group also provides guidance on discount that goes beyond the FCA Listing Rule requirements, as further detailed below.

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[13] LR 9.5.10R - LR 9.5 Transactions - FCA Handbook

PEG guidance on non-pre-emptive offers

5.11 As discussed in Section 4, the PEG is a group comprising representatives of listed companies, investment institutions and corporate finance practitioners. It publishes voluntary guidance in its Statement of Principles[14] on the disapplication of pre-emption rights, and monitors and reports periodically on how this guidance is applied. It has also published template disapplication resolutions[15]. The PEG was originally established in 1987 and has periodically refreshed its investor guidance to the UK market, with the most recent general update in 2015. We discuss the role and constitution of the PEG more in Section 4.

5.12 We set out in Part 2 of Annex C a summary of the PEG's recommendations in its Statement of Principles. In broad terms, the PEG recommends that:

(a) **General corporate purposes:** Non-pre-emptive issues for cash for general corporate purposes are limited to: 5% of existing share capital in any one year, with the cumulative effect not exceeding 7.5% in any three-year rolling period.

(b) **Acquisitions / specified capital investment:** An additional 5% per year is permitted for an issue in connection with an acquisition or specified capital investment (announced contemporaneously with the share issue or occurring in the previous six months).

(c) **Discount:** Discounts should be limited to 5%.

5.13 Listed companies seek authorisation for pre-emption disapplications on a 5%+5% basis, following the format of template resolutions published by the PEG. The PEG format has been widely adopted in the UK market: in 2021, almost 72% of FTSE 100 companies used the 5%+5% formulation, with a further 25% opting for a single disapplication of 5% or less[16].

Updated PEG guidance in the Covid-19 pandemic

5.14 Many companies faced unexpected funding needs as a result of the Covid-19 pandemic when it first hit in 2020. The PEG recognised that companies facing immediate funding shortfalls needed greater flexibility, noting the clear interest of investors in ensuring the companies in which they were invested had access to the capital needed to maintain their solvency.

5.15 On 1 April 2020[17] the PEG issued a temporary recommendation to investors that they consider, on a case-by-case basis, supporting non-pre-emptive

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14 PEG Statement of Principles (2015) (frc.org.uk)

15 PEG-Template-resolution-for-disapplication-of-pre-emption-rights.pdf (frc.org.uk)

16 *Source: Practical Law What's Market, SCRR analysis based on 96 AGM notices published by FTSE 100 companies in relation to 2021 AGMs.*

17 PEG Statement 1 April 2020 (frc.org.uk)

issuances by companies of up to 20% of their issued share capital. This recommendation remained in place until 30 November 2020.

5.16 The PEG set out a number of conditions with which listed companies were expected to comply in return for shareholders' support for larger non-pre-emptive issues. The conditions included:

(a) **Explanation:** The particular circumstances of the company should be fully explained, including how they were supporting their stakeholders;

(b) **Consultation:** Proper consultation with a representative sample of the company's major shareholders should be undertaken;

(c) **Soft pre-emption:** As far as possible, the issue should be made on a soft pre-emptive basis; and

(d) **Allocations:** Company management should be involved in the allocation process.

5.17 The PEG expected companies to report on the consultation undertaken and efforts made to respect pre-emptive rights (given the time available) in their next annual report and accounts. The PEG also set out expectations around the approach to share awards. We set out the requirements in more detail in Part 3 of Annex C, including refinements announced on 4 September 2020.

5.18 We consider below the way in which the market responded to this increased flexibility.

Market activity in the Covid-19 pandemic

5.19 There is general agreement amongst stakeholders that the market responded well to the increased flexibility granted by the PEG temporary disapplication, and that the required conditions – including soft pre-emption – were generally observed. In its 4 September 2020 announcement extending, and refining, its pandemic period guidance, the PEG noted that the additional flexibility had been successful in helping companies raise much needed cash quickly and efficiently; given that success, PEG encouraged a further review of market mechanisms for capital raisings, with a view to possible changes to make the market more effective and competitive in the future.

5.20 During the period of the PEG relaxation to 20%, non-pre-emptive placings (that were not used as part of a pre-emptive structure) represented around 73%[18] of the secondary offers made by companies listed on the LSE's main market (raising around 54%[19] of equity funds in the period).

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[18] *Source: SCRR analysis of Practical Law What's Market data*

[19] Ibid

5.21 Of these placings, just over 14%[20] were for an offer size of 5% or less, i.e. within the unrestricted limit set out in the PEG's usual Statement of Principles. A further 25%[21] had an offer size of between 5% and 10%, a size normally only within the PEG principles if linked expressly to a contemporaneous acquisition or specified capital investment. The remaining 60%[22] took full advantage of the PEG relaxation and had offer sizes ranging between 10% and 20%.

5.22 Although larger offer sizes were seen in this period, the level of capital raised remained bespoke to each company and there was no general move to automatically upsize offers to the new 20% ceiling. Only around 27%[23] of placings overall had an offer size of 19% or more. This experience suggests that even at a time of widespread uncertainty around funding needs and when greater flexibility was permitted, companies still made nuanced and responsible decisions around the level of capital they required.

5.23 Another notable feature is that placings in the pandemic period had tight discounts. Of main market placings in the PEG disapplication relaxation period for which discount information was published, more than half had a discount of 5% or less (or were made at the market price, or at a premium)[24], with only 4 out of 52[25] such placings offering a discount of 9% or more (the Listing Rules sets a maximum discount of 10% for a placing).

5.24 We set out some further detail of market activity in the pandemic period in Part 4 of Annex C.

Non-pre-emptive threshold comparators

5.25 As noted above, while pre-emption is not a feature of all jurisdictions it is part of the EU capital markets that have implemented the EU Second Company Law Directive.

5.26 While it is always difficult to draw direct comparisons between markets with different legal and regulatory requirements, investor guidance and established market practices, we set out below an estimate of the typical level of non-pre-emptive offer in Austria, Belgium, France, Germany, Hong Kong, Spain and the Netherlands.

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20 Ibid

21 Ibid

22 Ibid

23 Ibid

24 Ibid

25 Ibid

Austria	Belgium	France	Germany	Hong Kong	Spain	The Netherlands
Up to 10% (market practice)	10 – 20% (market practice)	20% with priority right for existing shareholders, 10% without (investor guidance)	10% (German corporate law limit)	2% – 20%	5% – 10% depending on the size of the company and its trading volume (investor guidance)	10% (investor guidance)

5.27 None of the jurisdictions discussed base the level at which non-pre-emptive offers are supported on the use of proceeds of the offer. This is in contrast to the current UK position, where guidance limits offers for general purposes to 5% per year (subject to a further 7.5% rolling three-year limit) with an additional 5% available only where this relates to an acquisition or specified capital investment. The Review understands that this limitation in the UK guidance stems from the premise that these uses of proceeds will increase the value of the company, serving to offset dilution.

5.28 Of particular interest is practice in France. French investor guidance recognises a difference between offers that provide a priority right for existing shareholders to participate and those that do not. A threshold of 20% is supported where existing shareholders are given a priority right, with a lower limit of 10% where this feature is not included. Shareholders are typically given between three and five days to exercise priority rights. Extension of priority rights typically requires publication of a public offer prospectus.

5.29 The Review believes that a similar approach is warranted in the UK, and we consider this further in our recommendation on changes to PEG guidance below.

Recommendation: Routine support for disapplication resolutions up to 20%, on a 10%+10% basis

5.30 The Review recommends that the PEG restate its Statement of Principles to provide that shareholders support disapplication resolutions of up to 20% on a permanent basis. The increased flexibility would allow companies to raise capital quickly and would build on the positive experience of the way the market responded to the previous relaxation.

5.31 At present the PEG expects premium listed companies to seek authorisation for pre-emption disapplications on a 5%+5% basis, with the second 5% reserved for an issue connected with an acquisition or specified capital investment announced contemporaneously with the share issue or occurring in the previous six months. The Review recommends that this structure be replaced with guidance that companies should seek authorisation on the following 10%+10% basis:

(a) **First 10%:** The proceeds of an issue using the first 10% should be available for use for any purpose;

(b) **Second 10%:** The proceeds of an issue using the second 10% should be used only for a transaction which the board determines to be either an acquisition or a specified capital investment, as defined by the Statement of Principles, announced contemporaneously with the share issue or occurring in the previous 12-months.

5.32 The Review recommends that any use of this 20% authority, whether the first or second 10% tranche, should be subject to conditions. We discuss these conditions below.

Conditions to use of 20% disapplication authority

5.33 To take advantage of the proposed new flexibility for larger offers, listed companies should be required to comply with various conditions. Building on the work of the PEG in the pandemic period, these conditions should include, for all issues, that:

(a) **Consultation:** Consultation with the company's major shareholders should be undertaken to the extent reasonably practicable and permitted by law;

(b) **Retail investors:** Due consideration should be given to the involvement of retail investors, as well as other existing investors.

It may be appropriate to include retail through a retail investor platform, or an issuer may choose to make a 'follow-on' offer on substantially the same terms as that placing. We discuss the ways in which retail could participate in placings in more detail in Section 6;

(c) **Explanation:** An explanation of the background to and reasons for the offer and the proposed use of proceeds, including details of any acquisition or specified capital investment;

(d) **Soft-pre-emption:** As far as practicable, the issue should be made on a soft pre-emptive basis;

This approach reflects that full pre-emption may not be appropriate in all circumstances, for example on smaller offers where there is a defensible strategic objective or rationale for bringing in one or more new investors, including as anchor or cornerstone investors to the placing. We set out some background on the concept of soft pre-emption in Part 5 of Annex C;

(e) **Management involvement:** Company management should be involved in the allocation process; and

(f) **Post-transaction reporting:** After completion of the issue, standardised disclosure should be made in relation to the conduct of the placing and compliance with the PEG conditions.

5.34 These conditions would apply to all placings, regardless of size. The aim of the Review has been to build on the conditions that were observed during the pandemic period without unduly complicating or impugning the integrity and efficacy of the accelerated bookbuilding (ABB) process. It is important that companies continue to benefit from the speed and simplicity of the ABB structure without an overlay of regulation or overly prescriptive guidance. It is also important, however, that investor guidance continues to emphasise consideration of the position of existing shareholders.

Recommendation: Post-transaction reporting

5.35 Post-transaction reporting should occur on all non-pre-emptive offers. Listed companies should make standardised post-transaction disclosure following a template to be published by the PEG.

5.36 Issuers should release the completed form via regulatory information service (RIS) within a week from close of the offer. Disclosure at this time will provide a public record of relevant information without impacting the expedited placing timetable.

5.37 The completed form should also be submitted to the PEG for inclusion in a publicly searchable database to be hosted on that body's website. This database will both assist the PEG as they monitor compliance with their updated market guidance, and provide a public point of comparison for investors and stakeholders more generally. The information should also be published in the listed company's annual report and accounts, so that it is readily available to shareholders when they consider whether or not to agree to any request to disapply pre-emption rights at the next AGM.

5.38 The template should cover basic details of the transaction and:

(a) **Use of proceeds:** Use of proceeds of the offer, including details of any acquisition or specified capital investment;

(b) **Discount:** The discount the issue price represented to the market price. Although this is commonly included in announcements of the results of a placing, its inclusion would allow for a complete picture to be readily available to shareholders in one place. Discount is as a key factor in the dilutive effect and value transfer inherent in a cash placing.

(c) **Allocations:** The basis on which shares were allocated in the placing, including whether the shares were allocated on a soft pre-emptive basis (and details of any allocations made other than on that basis), and confirmation of the role played by management in the allocation process. Transparency around allocation decision-making will increase the focus given by management and their advisers to the expectations of existing shareholders as they consider soft pre-emption.

(d) **Consultation:** Confirmation that appropriate consultation of major shareholders was carried out before launch, to the extent reasonably practicable and permitted by law.

(e) **Retail investors:** Whether and how due consideration was given to the interests of investors not allocated shares as part of the soft pre-emptive process, including retail investors, and an explanation of the approach taken.

(f) **Gross / net proceeds:** The proceeds raised in connection with the placing on a gross basis and net of all fees. This would allow shareholders to gauge the costs of a non-pre-emptive placing as compared to fully pre-emptive alternatives.

5.39 A suggested starting point for a template covering these points is included at Part 7 of Annex C. The Review recommends that the PEG develop the final form, and seeks input from market participants in doing so.

5.40 The Review acknowledges that completion of the post-transaction reporting template will be an additional administrative requirement, but believes it will provide a greater benefit to the market in terms of transparency and trust. It is anticipated the market will quickly develop standard formulations to cover usual market practice.

Status of conditions

5.41 The Review has considered carefully whether these safeguards should be removed from investor guidance and instead be made more formal, for example through being included in the FCA's Handbook. On balance our recommendation is that investor guidance remains the most appropriate format.

5.42 The key advantage of guidance is that it retains flexibility, a key reason why the UK pre-emption regime works well. In a regulatory context precise definitions are required, and with nebulous concepts such as soft pre-emption there is a risk that in attempting to provide clarity the process would lose the adaptability that has made it a success to date. For example, the pandemic soft pre-emption processes were able to take into account the different needs of a wide range of issuers, investors and circumstances.

5.43 It does of course mean that the recourse open to investors – should a listed company fail to adequately consider how best to protect the position of existing investors – becomes voting against any future disapplication resolutions and/or against the election of directors. But both of these should be effective and appropriate deterrents.

5.44 As discussed above, the monitoring role of the PEG will assist investors in identifying companies that comply with their obligations to existing shareholders on secondary offerings appropriately. The aim of the standardised post-transaction disclosure, noted above, is to facilitate comparison of the approach taken by different issuers.

5.45 We would also highlight for premium listed issuers that the FCA retains the ability to take enforcement action for breach of the Listing Principles and Premium Listing Principles set out in Chapter 7 of the Listing Rules. The obligation on premium listed issuers to ensure equal treatment of shareholders in the same position would provide a basis on which the FCA could seek answers from premium listed issuers that fail to publish and submit the expected allocation information to the PEG. A similar provision in DTR 6.1.3 applies to both premium and standard main market issuers.

5.46 These conditions should be applied by all companies (wherever incorporated) with shares admitted to the premium listing segment. In addition, as with previous iterations of PEG guidance, the conditions should also be considered by companies with shares admitted to the standard segment, High Growth segment or to trading on AIM. We note that the FCA is considering possible changes to the current premium and standard listing segments as part of the second phase of its Primary Markets Effectiveness Review.

Capital-hungry companies

5.47 The Review believes that the recommendation above for routine support for companies seeking the disapplication of pre-emption rights for up to 20% of existing issued share capital will provide sufficient flexibility for the majority of listed companies. However, funding needs, including as to size and frequency, vary between sectors and between companies. Respondents to the Call for Evidence raised a number of concerns around the difficulties faced by companies in capital hungry sectors, such as tech and life sciences, that may be exacerbated by the application of pre-emption rights. The Review has therefore considered whether support for additional flexibility is warranted for this type of issuer.

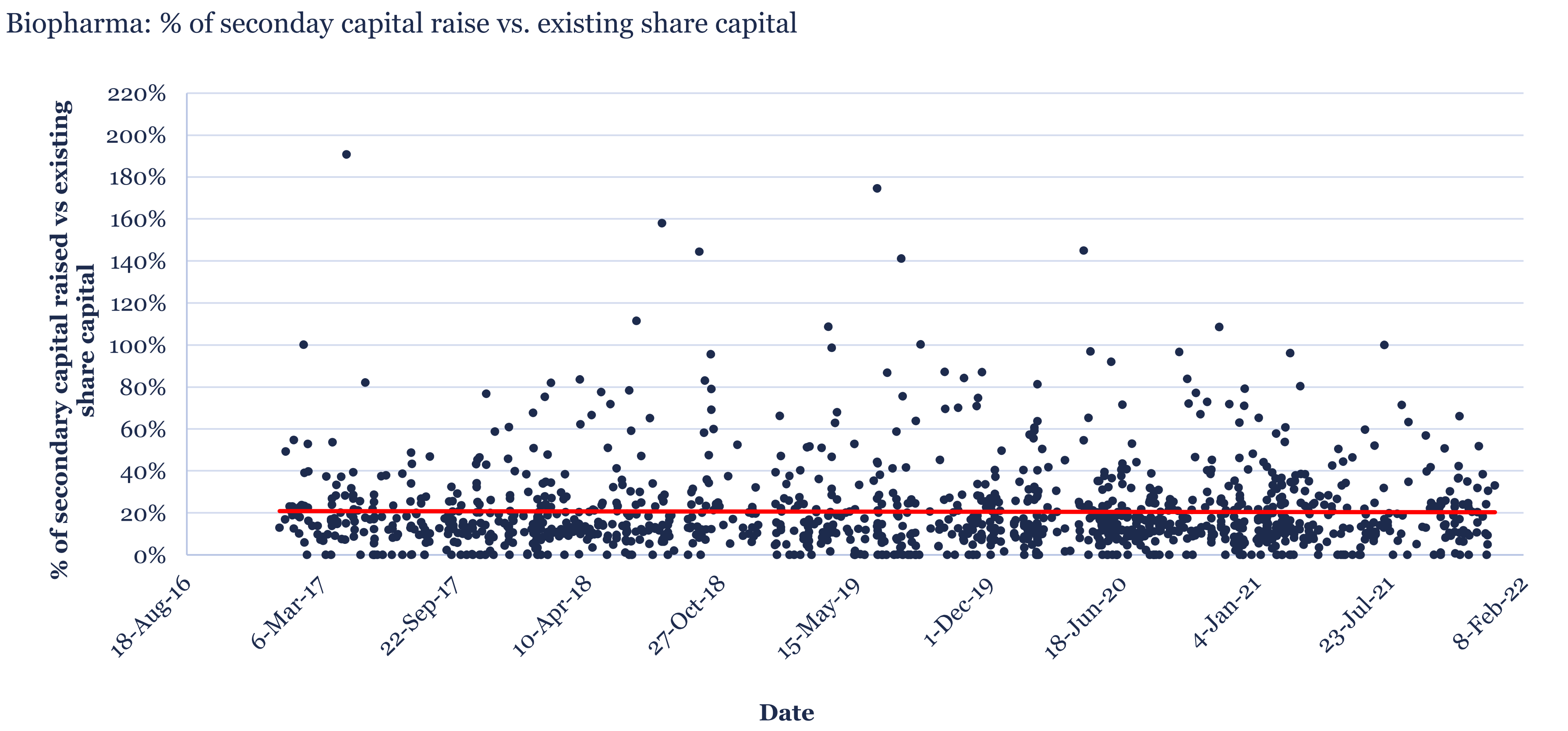
5.48 Lord Hill's UK Listing Review had as one of its objectives the creation of dynamic capital markets in the UK, with a strong ecosystem to attract the growth companies of the future to list and grow. While there are many factors that feed into the attractiveness of the UK as a venue of choice for growth and other capital-hungry companies, including the pool of capital open to pre-revenue investments and its consequent impact on liquidity, it is important to consider the extent to which a one-size-fits-all approach to pre-emption rights represents a regulatory hurdle that does not exist in other, competing, markets such as those in the US.

5.49 We outline below a number of specific concerns for growth and other capital-hungry companies that were identified to the Review:

(a) **Small capitalisations:** Growth companies commonly list at an early stage of their lifecycle, and their market capitalisation at the point of listing is relatively small compared to the size they expect in future. As the market standard disapplication authority is calculated on the basis of existing share capital, this means that companies with expected large funding needs for growth will not be able to accommodate those needs within a 20% resolution. Seeking authorities above this threshold can, however, lead to difficulties in securing support from shareholders who will be used to the market standard 20% authority. As such the 20% limit will represent more of a restriction for a small, growing company, than for an issuer that already has a large capitalisation.

This point is illustrated by the graph in Figure 7 which highlights that between 2017 and 2021 biopharma companies listed across different jurisdictions across the world, including, but not limited to, the United States, United Kingdom, Hong Kong, China, Australia, Canada, France and the Netherlands, raised on average 24% of their existing share capital in a secondary capital raise (*source: BioWorld*).

FIGURE 7: BIOPHARMA: SECONDARY CAPITAL RAISE SIZE AS PERCENTAGE OF EXISTING SHARE CAPITAL (CROSS-JURISDICTION)



Note: This chart excludes three Biotech companies that raised 513%, 390%, 353% of respective issued share capital

(b) **Frequent funding needs:** It is not uncommon for early-stage growth companies to need to raise capital on an annual basis. This may exceed the funding appetite of existing shareholders, requiring input from new investors. The pre-emption regime will, however, require that a right of first refusal be given to existing shareholders each time, imposing administrative costs and limiting the ability of the company to act nimbly and seize opportunities for fresh investment.

(c) **Strategic investors:** Many growth companies expect their investor base to evolve significantly over the early years of their lifecycle. The investors who will support innovative companies once listed may be different to those able to invest prior to or on listing. As such a requirement to offer equity to existing shareholders in priority to new investors can hinder a company that lists early in establishing itself with the type of investor that will be in a position to support it as it grows.

(d) **Annual requests:** It is market practice in the UK to disapply pre-emption rights on an annual basis. Shareholders often look to proxy advisers to determine whether they should support such requests, and proxy advisory services typically do not flex their guidance depending on the stage of growth of the company concerned. As such, shareholders may be encouraged to deny higher disapplication requests even where this would be in the best interests of the individual company. This may be a particular concern for investors in sectors that attract international investors from jurisdictions, such as the US, where pre-emption rights are not typically seen. Investors who are unfamiliar with the concept of pre-emption may be reluctant to go against proxy guidance where they lack understanding of the rights they would be disapplying. The need to re-educate a changing investor base to secure support on an annual basis can take significant management time for UK listed growth companies.

Recommendation: Guidance to support case-by-case consideration of higher disapplication authorities for capital hungry companies

5.50 The Review recommends that the reformulated guidance from the PEG make specific provision for growth companies:

(a) **Informed shareholder approval:** Any such relaxation should be contingent on the individual issuer obtaining shareholder approval and making a cogent, issuer-specific argument for the enhanced authority. Where an issuer is conducting an IPO, or a transfer to the main market from AIM, it should highlight its proposed approach to pre-emption disapplications in its offer document, to ensure that investors are aware of management intentions at the point of making their investment decision.

(b) **Higher threshold:** The guidance should support growth companies seeking authority to disapply pre-emption rights to a threshold above

20%. If our recommendation in Section 7, that the FCA increases the threshold at which an admission to trading prospectus is required to 75%, is taken forward, this is likely to represent the practical upper limit of an annual disapplication request. The entire authority should be available for use for any purpose.

(c) **Longer disapplication periods:** The Companies Act 2006 permits shareholders to disapply pre-emption rights for periods of up to five years where an allotment authority is given for that period. Although annual authorities are standard in the UK market, it may be appropriate for a company with a consistent long-term growth strategy to seek a longer period in certain circumstances, particularly given that an issuer will typically be subject to a contractual lock-up arrangement with its banks for the first year after listing.

Use of the cash box structure

5.51 The UK market has a longstanding practice of using a 'cash box' structure for secondary offers in certain circumstances, including when a company needs to move quickly and would otherwise need to delay a capital raise to get shareholder approval for a further disapplication of pre-emption rights. It was used in this way during the Covid-19 pandemic, when 28 out of 33[26] placings with a size over 10% used the cash box structure.

5.52 Details of the structure are set out in Part 6 of Annex C, but in essence it changes the legal form of an offer so that it is no longer an offer for cash to which statutory pre-emption rights apply.

What limits the size of a cash box?

5.53 As an offer for non-cash consideration, in theory a cash box structure could be used to allow a listed company to issue shares without regard to the pre-emption rights of its existing shareholders up to any amount. The only limit would be the authority to allot given to the directors of the company at the last general meeting which, for non-pre-emptive offers, is typically set at one third of the existing share capital of the company.

5.54 There are two reasons that cash boxes are not used for large placings in this way.

(a) **PEG:** Firstly, the PEG Statement of Principles is expressed to apply to any non-pre-emptive issue that is designed to raise cash for the issuer, and as such it 'looks through' the way a cash box technically changes the legal form of an offer. The PEG guidelines around non-pre-emptive offer size and acceptable levels of discount therefore apply in the same way both to straightforward cash placings and to those structured as 'cash box' placings.

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26 Ibid

(b) **Admission to trading prospectus requirement:** Secondly, and more decisively, the practical maximum size of a cash box placing at present is limited to 19.9% because any issue of shares of 20% or more requires a company to publish a prospectus for the subsequent admission to trading of the new shares. Triggering this obligation would remove the time and cost advantages of a placing and, while the PEG guidelines can be flexed if shareholders agree, this 20% is currently a hard limit in the FCA rulebook. As a result, no placing in the pandemic period went above the 20% threshold[27].

Impact of HMT's UK Prospectus Regime Review on cash box placings

5.55 As a result of HMT's UK Prospectus Regime Review, however, in future the power to decide when an admission to trading prospectus is required will be delegated to the FCA. This Review has recommended that the FCA raise the current 20% threshold to 75%. This is discussed further in Section 7.

5.56 One consequence of this change would be to potentially open the door to larger cash box issues. A company could issue up to one third of its share capital non-pre-emptively with no time or cost implications. This would expose shareholders to a greater risk of dilution than they, in practice, face at present.

5.57 One option to deal with this issue would be to reduce the standing authority to allot given to directors from one third to 20%. But this would unnecessarily limit the headroom of directors to make allotments for any purpose. Another would be to prohibit use of the cash box structure entirely, but this would limit the flexibility of companies that wish to use a cash box structure for other legitimate purposes, commonly the creation of distributable reserves.

Recommendation: PEG guidance to restrict use of the cash box structure to circumvent pre-emption rights

5.58 The alternative preferred by the Review, therefore, is for the PEG to reiterate in its Statement of Principles that a cash box is permitted only for non-pre-emptive issues up to the percentage disapplication authority that was granted at the company's last AGM.

5.59 This approach retains the 'substance over form' approach of the PEG. Where an issue is undertaken with the purpose of raising cash for the listed company the principle of prior shareholder approval should be respected, regardless of its legal form. The prohibition would not apply to a true vendor placing, a structure to allow a listed company to use its listed shares as acquisition currency by facilitating the sale of those consideration shares in the market so that the seller receives cash.

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27 Ibid

Timing

5.60 The Review notes that there are a number of steps that will need to be taken in order for companies to take full advantage of the recommendations above, both for routine support for disapplication resolutions up to 20% on a 10%+10% basis, and case-by-case consideration of higher disapplication authorities for capital hungry companies.

5.61 The Review has been working with the PEG and it expects shortly to publish an updated version of its Statement of Principles, alongside revised template resolutions and various other documents. These will set out expectations of listed companies as they seek disapplication authorities from shareholders going forward. For many companies however, given that the main AGM season for this year has now passed, there could be a significant period before any new disapplication authorities are able to be put in place – for example, companies with a 31 December financial year end will typically not hold their next AGM until spring 2023.

5.62 In addition, until the proposals in HMT's UK Prospectus Regime Review outcome paper[28], as published in March, are implemented and the FCA assumes its anticipated new powers, the current public offer prospectus requirements will continue to apply. As such a retail follow-on offer with a size greater than €8 million would require a public offer prospectus. The aggregate size of a non-pre-emptive placing and any associated follow-on offer will also continue to be subject to the current 20% threshold for an admission to trading prospectus. This threshold will limit the aggregate value of a placing and any follow-on offer, and will also impact as a practical matter the size of non-pre-emptive offers by capital hungry companies.

5.63 The Review has therefore agreed a transitional approach, as set out below, with the PEG, which should be followed by issuers in relation to non-pre-emptive offers in the period between publication of the revised Statement of Principles and their next AGM, and until updates to the prospectus regime are in place. In order to help companies raise equity capital in this interim period on the basis of the revised Statement of Principles, the PEG recommends that investors, on a case-by-case basis, consider supporting issuances by companies of up to 20% of existing share capital provided they otherwise comply with the conditions in the revised Statement of Principles, namely:

(a) **Soft-pre-emption:** As far as possible, the offer should be made on a soft pre-emptive basis;

(b) **Use of proceeds:** The proceeds of an offer using the first 10% should be available for use for any purpose. The proceeds of an offer using the second 10% should be used only for a transaction which the board determines to be either an acquisition or a specified capital investment, as defined in the Statement of Principles, which is announced

28 UK_Prospectus_Regime_Review_Outcome.pdf (publishing.service.gov.uk)

contemporaneously with the issue, or which has taken place in the preceding 12-month period and is disclosed in the announcement of the issue;

(c) **Explanation:** An explanation of the background to and reasons for the offer and the proposed use of proceeds, including details of any acquisition or specified capital investment;

(d) **Consultation:** Consultation with the company's major shareholders should be undertaken to the extent reasonably practicable and permitted by law;

(e) **Management involvement:** Company management should be involved in the allocation process;

(f) **Post-transaction reporting:** After completion of the offer, disclosure via an RIS should be made in relation to the conduct of the placing and compliance with the PEG conditions, as well as being included in the next annual report; and

(g) **Retail investors:** Due consideration should be given to the involvement of retail investors in the offer, as well as any other existing investors who did not receive shares as part of the soft pre-emptive process. It is noted that until the current public offer prospectus rules are amended, it is not expected that a listed company will make an offer to retail investors requiring publication of a prospectus. Similarly the aggregate of any non-pre-emptive placing and associated retail offer is unlikely ever to exceed the current 20% admission to trading prospectus threshold as requiring publication of a prospectus would be unduly burdensome. Companies should however continue to give due consideration to the interests of retail shareholders and calibrate their offer accordingly, including use of the current €8 million exemption where appropriate, and explain their approach and reasoning in their post-transaction report and next annual report.

5.64 We summarise in Figure 8 the way in which the revised PEG Statement of Principles can be applied to allow companies to make use of the revised approach in the period prior to their next AGM, and before all legislative and regulatory steps are in place to update the UK prospectus regime.

FIGURE 8: UPDATED PRE-EMPTION GROUP STATEMENT OF PRINCIPLES – TRANSITIONAL APPROACH

Pre-existing 5%+5% authority in place *(prior to first AGM post-update of Statement of Principles)*	+	**Prospectus required for public offers to retail investors**	+	**20% threshold for admission to trading prospectus**	=	• **Consider supporting issuances by companies of up to 20% provided conditions met** • **Use of proceeds for the first 10% can be for any purpose, second 10% for an acquisition or specified capital investment (within 12 months) only** • **Retail involvement can be limited to <€8 million** • **Aggregate size of placing and retail involvement can be kept below 20%**
Pre-existing 5%+5% authority in place *(prior to first AGM post-update of Statement of Principles)*	+	No prospectus required for public offers to retail investors	+	**20% threshold for admission to trading prospectus**	=	• **Consider supporting issuances by companies of up to 20% provided conditions met** • **Use of proceeds for the first 10% can be for any purpose, second 10% for an acquisition or specified capital investment (within 12 months) only** • Retail involvement as set out in Statement of Principles • **Aggregate size of placing and retail involvement / follow-on offer can be kept below 20%**
Pre-existing 5%+5% authority in place *(prior to first AGM post-update of Statement of Principles)*	+	No prospectus required for public offers to retail investors	+	75% threshold for admission to trading prospectus	=	• **Consider supporting issuances by companies of up to 20% provided conditions met** • **Use of proceeds for the first 10% can be for any purpose, second 10% for an acquisition or specified capital investment (within 12 months) only** • Retail involvement as set out in Statement of Principles • Retail involvement / follow-on offer size up to 20% of placing size
Pre-existing 5%+5% authority in place *(prior to first AGM post-update of Statement of Principles)*	+	**Prospectus required for public offers to retail investors**	+	75% threshold for admission to trading prospectus	=	• **Consider supporting issuances by companies of up to 20% provided conditions met** • **Use of proceeds for the first 10% can be for any purpose, second 10% for an acquisition or specified capital investment (within 12 months) only** • **Retail involvement can be limited to <€8 million** • Retail involvement / follow-on offer size up to 20% of placing size (in practice, will be limited by public offer prospectus requirement)

10%+10% authority in place	+	**Prospectus required for public offers to retail investors**	+	**20% threshold for admission to trading prospectus**	=	• Use of proceeds to follow 10%+10% authority as set out in template resolutions • Cash box structure to be used within 10%+10% authority only • **Retail involvement can be limited to <€8 million** • **Aggregate size of placing and retail involvement can be kept below 20%**
10%+10% authority in place	+	No prospectus required for public offers to retail investors	+	**20% threshold for admission to trading prospectus**	=	• Use of proceeds to follow 10%+10% authority as set out in template resolutions • Cash box structure to be used within 10%+10% authority only • Retail involvement as set out in Statement of Principles • **Aggregate size of placing and retail involvement / follow-on offer can be kept below 20%**
10%+10% authority in place	+	**Prospectus required for public offers to retail investors**	+	75% threshold for admission to trading prospectus	=	• Use of proceeds to follow 10%+10% authority as set out in template resolutions • Cash box structure to be used within 10%+10% authority only • **Retail involvement can be limited to <€8 million** • Retail involvement / follow-on offer size up to 20% of placing size (in practice, will be limited by public offer prospectus requirement)
10%+10% authority in place	+	No prospectus required for public offers to retail investors	+	75% threshold for admission to trading prospectus	=	• Use of proceeds to follow 10%+10% authority as set out in template resolutions • Cash box structure to be used within 10%+10% authority only • Retail involvement as set out in Statement of Principles • Retail involvement / follow-on offer size up to 20% of placing size

6. INVOLVE RETAIL INVESTORS IN ALL CAPITAL RAISINGS

Introduction

6.1 As discussed in Section 8, pre-emptive offers such as rights issues and open offers represent best practice for companies wishing to involve their entire shareholder base in a capital raise. As considered in Section 5, however, there are situations in which listed companies legitimately need the flexibility to issue non-pre-emptively to raise funds quickly and to bring in new investors.

6.2 Traditionally, these accelerated non-pre-emptive issues have been carried out as placings to institutional investors only. The protections for smaller, retail investors in these circumstances have been limited to restrictions on the size of non-pre-emptive offers and on the maximum discount to the market price at which they can be offered. While market practice started to change a little when the Covid-19 pandemic first struck in 2020, retail investors have historically not been offered the opportunity to participate in these offers. Where retail investors are excluded, they face automatic dilution and do not have the opportunity to benefit from the discount at which the placed shares were offered to institutions. Retail shareholders are, however, permitted to purchase shares at the non-discounted market price after a placing has taken place. The aim of reform should be to ensure that, as far as possible, all shareholders, including both institutional and retail investors, should be treated equally.

6.3 In Section 5 we recommend that increased flexibility for non-pre-emptive offers should be accompanied by ensuring that due consideration is given to the inclusion of retail investors. In this section we consider the reasons the traditional non-pre-emptive placing structure has been limited to institutional investors only, and how recent progress on the participation of retail has been enabled. We then consider how issuers can further improve retail investor participation as part of, or on substantially the same terms as, the soft pre-emptive tranche.

What are the difficulties in including retail investors in a placing?

6.4 Placings are the quickest way for a listed company to recapitalise and are the market standard structure for non-pre-emptive offers, but they have traditionally been open only to institutional investors. We set out more detail on the usual institutional investor placing format in Part 1 of Annex D, but the key points to note are that limiting participation to institutions allows the structure to make use of prospectus and financial promotion exemptions. It also limits the perceived scope for investor claims.

6.5 In considering the inclusion of retail, the simplest approach is to allow retail investors to participate in the accelerated bookbuild offer that is open to institutions. But there remain practical challenges to overcome with this approach. A key advantage of the accelerated bookbuild structure is its speed. Placings typically launch either at market open or outside market hours with books often open for only a few hours. While a clear advantage to issuers, this quick timetable has historically brought drawbacks for retail participation:

(a) **Awareness:** The curtailed offer period means that many retail investors may in practice not become aware of the placing in time to participate, even when technically able to do so.

(b) **Bandwidth:** While investment professionals within institutions are able to make an investment decision in a short period of time, it may not always be appropriate to ask retail investors to do the same, particularly when appropriate consumer protection principles are considered. Even those retail investors monitoring market announcements closely enough to be aware of the placing may be unable to devote sufficient time to making an investment decision on the institutional timetable.

(c) **Funding:** Retail investors may also require more time to make arrangements to fund a purchase before they are in a position to make a firm commitment to subscribe.

(d) **Information:** A placing announcement will set out details of the offer and commonly includes information on the issuer and its current trading status. It does not, however, set out the same level of comprehensive information as a prospectus and accordingly investors will need to have regard to other existing market information in reaching an investment decision.

Professional investors can be expected to be sufficiently up-to-date on the latest publicly available information on the listed company. This information is also available to retail investors and, while a similar assumption needs to be able to be made about their level of awareness, additional time to consider the information may be appropriate in some circumstances.

(e) **Investor protections:** Retail investors are afforded additional protections under the financial promotion regime, meaning in practice that the inclusion of retail requires additional diligence and approvals. This can be challenging to arrange in the short preparatory window in advance of launching a placing.

(f) **Increased risk of investor claims:** There is also a general perception that dealing with less sophisticated customers would increase the possibility of claims were an issue to fail to perform well in the aftermarket. Where funding needs can be met from institutional subscribers, this may influence whether retail are included.

Why include retail investors?

6.6 While there are a number of perceived challenges in including retail investors in placings, there are also advantages. In particular:

(a) **Equality of treatment:** At the end of 2020 (the latest point for which data is available), individuals held 12.0%[29] of shares quoted on the London Stock Exchange and openly traded between investors. The current system sees this sizeable constituency often not able to participate either at all or fully in non-pre-emptive fundraisings, meaning their holdings are often diluted and they are unable to capture value that is made available to institutions through discounted accelerated offerings.

(b) **Additional pool of capital:** From the perspective of the company, it would also deepen the potential pool of capital available to it when raising funds.

Retail participation in placings during the Covid-19 pandemic

6.7 Although the basic challenges to the involvement of retail remain, the market has recently taken steps to extend participation in secondary capital raisings. In particular, retail investors were increasingly included in the wave of Covid-19-related recapitalisations by main market companies.

6.8 As noted in Section 5, 73%[30] of secondary capital raisings by main market issuers during the period 1 April 2020 to 30 November 2020, when the Pre-Emption Group relaxed its pre-emption disapplication guidance, took the form of a non-pre-emptive placing.

6.9 Main market companies made 55 non-pre-emptive placings in this period. Of these, 15, or around 27%[31], included a retail component. This trend has continued with 10 of 31 main market placings in 2021, around 32.3%[32], also involving a retail offer. Although not part of the institutional accelerated bookbuild process, the retail offers were run alongside that process and to the same timetable.

6.10 Compared to the size of the institutional placing, however, these retail offerings have been modest, with the proceeds of the retail offers by main market companies in 2021 (for which this detail is available) being responsible for only between less than 1% and less than 5% of total gross proceeds[33]. No retail offer in this period exceeded £6.9 million in aggregate. The small size of these offers is, however, arguably a product of regulatory constraints on

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29 *Source: Ownership of UK quoted shares – Office for National Statistics (ons.gov.uk) (release date 3 March 2022)*

30 *Source: SCRR analysis of Practical Law What's Market data*

31 Ibid

32 Ibid

33 Ibid

retail participation and not reflective of market estimates of retail investor appetite. We discuss these constraints below.

Regulatory constraints on the inclusion of retail investors

6.11 As set out in more detail in Part 1 of Annex D, there are constraints on the level of retail participation at present. In particular, the offer size of a retail component alongside an institutional placing must remain small in order not to trigger an obligation to publish a prospectus. There are also additional investor protections through the financial promotion regime that must be met.

€8 million prospectus exemption

6.12 Retail investors are generally not 'qualified investors' for the purposes of the UK Prospectus Regulation. This means they cannot make use of the same prospectus exemption as investors participating in the institutional tranche of a placing.

6.13 The UK Prospectus Regulation regime does, however, have a separate exemption designed to enable a degree of retail involvement. This exemption is limited to UK investors, who may participate up to a low aggregate cap of €8 million[34]. While this exemption has been useful to retail investors it is not a perfect solution.

6.14 The total value of shares allocated to retail investors as a group under this exemption cannot exceed €8 million in any 12-month period. This remains the case no matter the size of the listed company's existing share capital, the size of the institutional allocation, the proportion of retail shareholders on the company's register or retail demand in the placing. As the cap applies on a rolling 12-month basis, it could also mean the entire retail capacity is absorbed in an initial placing, with none left for any subsequent capital raise within the same year.

6.15 For larger companies, or those with significant retail registers, therefore, the €8 million exemption results in a significant scaling back of retail interests. Individual retail investors may be unable to avoid dilution, placing them at a disadvantage to institutional investors able to participate in the institutional tranche, nor will they benefit to the same degree as institutions from the discount to the market price.

Financial promotion regime

6.16 As set out in more detail in Part 5 of Annex D, the financial promotion regime is designed to provide safeguards to investors by ensuring that promotional material around investments meets certain standards. There are exemptions to the financial promotion requirements, however, and the institutional tranche of

[34] Section 86(1)(e) of the Financial Services and Markets Act 2000 (FSMA)

a placing will typically be able to make use of one or more of these. A placing extended to retail investors, however, will not.

6.17 This impacts the way offers are structured. Although run on the same timetable, as a formal matter the retail offer component of a placing is typically entirely separate from the offer to institutions. This is because any materials published in connection with the retail offer must be approved as a financial promotion by an authorised person. While investment banks will place shares in the institutional placing, they will not be involved with the retail offer and will not provide these financial promotion approvals. On recent placings, therefore, the financial promotion approval has been given by the retail investor platform facilitating the retail element.

6.18 As noted in Part 5 of Annex D, this approval of a financial promotion imposes a regulatory burden on the retail investor platform. Given the speed of the typical institutional placing process, the due diligence required to provide an approval can be challenging in the time available. This is particularly true as typically, to maintain confidentiality around the proposed capital raise, the retail investor platform is brought into the offer process only a short time before launch. This gives little time for the retail investor platform to get comfortable with detailed disclosure. In consequence while retail investors will have access to all information made public by an issuer, the announcement of the retail offer itself is commonly kept very short and limited to the mechanics of applications.

Impact of HMT's UK Prospectus Regime Review

6.19 HMT's UK Prospectus Regime Review is making changes to the way the UK prospectus regime operates. Of particular relevance here, once these reforms are implemented, the FCA will have the flexibility to determine when a listed company will be required to produce a prospectus (as the automatic 'public offer' trigger will be removed). This will mean that the current €8 million constraint on retail offers will no longer automatically apply. This is a welcome development supported by the Review.

6.20 No changes are currently in contemplation for the financial promotions regime in this area. We discuss our recommendations on this constraint further below.

Forms of retail participation

6.21 We consider below some mechanisms for retail participation used in other jurisdictions that have come to our attention during the course of this Review.

Australia – Share purchase plans (SPPs)

6.22 In Australia, issuers can use a 'share purchase plan' (SPP) to raise funds. Although SPPs can be used as a standalone capital raising structure, larger listed companies typically use them in conjunction with a placing to institutional shareholders.

6.23 When used in this way, the SPP is designed to allow retail shareholders to subscribe for shares on substantially the same terms as the placing to institutions, but with a longer timeframe for their investment decision. When an SPP complies with certain conditions, it is exempt from the requirement to prepare a longform disclosure document. Key features of the Australian SPP structure include:

(a) **Size and frequency:** An SPP is subject to a 12-month rolling cap of up to 30% of existing share capital (without further shareholder approval). Only one SPP is permitted in each 12-month period, even if the full 30% is not utilised.

(b) **Offer period:** Australian rules do not mandate the period for which an SPP must be made available. They are commonly left open for extended periods of several weeks.

(c) **Discount:** Rules limit the discount that can be offered on an SPP, with that discount calculated by reference to the market price (VWAP, broadly an average of the daily volume weighted average sale price) for the last five days before either the launch of the SPP or the issue of the shares when the SPP closes. An SPP that follows an institutional placing can provide that the price is to be the institutional offer price or, for example, a 2% discount to the VWAP for the five days prior to closing of the SPP.

(d) **Individual monetary cap and scaleback:** An SPP is limited to a maximum subscription by any one shareholder – or underlying beneficial holder – of A$30,000 in any 12-month period. Australian rules contain requirements for custodians to certify that this requirement is met for underlying holders. An Australian SPP is also permitted to state a maximum monetary size of the offer, and to scaleback applications if that size would otherwise be exceeded.

(e) **Underwriting:** SPPs are typically not underwritten.

(f) **Cleansing announcement / offer documentation:** An SPP requires publication of a cleansing announcement prior to launch of the offer (cleansing announcements are discussed in Section 9). An SPP booklet is generally provided to eligible shareholders. The booklet must contain information on how the issue price is calculated, warnings regarding market price movements and its impact on the value of shares received and details of any scaleback option reserved by the issuer. Market practice has evolved a relatively standard template, including a timetable of key dates in the offer process, details of how to apply to participate, the terms and conditions of the offer and a letter from the chair setting out the reason for the offer and proposed use of proceeds.

(g) **Eligible participants:** In Australia, an SPP is open only to registered holders of the same class of shares. New investors are not able to participate.

Norway – Repair offers

6.24 A further alternative for a follow-on offer is a repair offer, a feature of the Norwegian market. We set out an overview of the Norwegian structure in Part 3 of Annex D.

6.25 A repair offer is made on a pro rata basis but is only open to shareholders who did not participate in an earlier placing. The offer price is the same as that in the initial placing. The practice in Norway is driven by a strong equal treatment requirement and is designed to permit shareholders excluded from the initial placing (for example, where that placing was subject to a minimum application amount or other conditions connected to prospectus exemptions) to repair some of the dilution that they suffered as a result.

6.26 The size of a subsequent repair offer is typically significantly lower than the size of the initial placing (with size assessed on a number of factors, including discount, dilution and the number of shareholders not allocated shares in the initial placing). Recently repair offerings have ranged from 5% to 10% of the initial placing size.

6.27 The right to subscribe for shares in the repair offer is not tradeable, although eligible shareholders may be able to request additional shares over and above their pro rata allocation. Any such excess application is at the discretion of the issuer but as the repair offer will not allow for full repair of the dilutive effect of the private placement, it is rare not to allow eligible shareholders to over subscribe. On some occasions issuers may choose to allow new investors (including therefore those who participated in the initial placing) also to participate in the repair offer.

6.28 In Norway making such an offer requires a prospectus prepared to either national or EEA requirements depending on offer size. An EEA-prospectus has to be approved by the Financial Supervisory Authority of Norway with an approval process taking six to eight weeks, necessitating a significant gap between closing of the institutional placing and launch of the repair offer. As such, share price movements may negate the prejudice to retail shareholders in that period, allowing dilution to be neutralised through market purchases. In these circumstances the issuer may choose to cancel the repair offer to avoid needless expense.

Retail participation in the UK

6.29 As noted in Section 5, it is a key recommendation of the Review that the current market trajectory towards increasing involvement of retail in non-pre-emptive offers continue and be enhanced. While retail involvement may not be proportionate for all smaller non-pre-emptive offers, retail investors should be provided with the opportunity to participate in an offer where this is appropriate. The Review anticipates that there will be a strong market expectation in favour of the inclusion of retail on the majority of transactions.

Recommendation: Issuers should give due consideration to the interests of retail shareholders, as well as other existing shareholders, and how to include them in a non-pre-emptive offer as fully as possible

6.30 The Review believes that there should be no single mandated structure for retail inclusion. Different structures will work best for different issuers, depending on factors such as offer size, the reasons for the initial institutional placing and the number of existing retail shareholders. The market has shown through the innovations brought onto the main market during the Covid-19 pandemic period that it is capable of rising to this challenge, and the Review supports the continuation of this competitive process.

6.31 We consider below two possible approaches to retail inclusion:

(a) **Follow-on offer:** One option is a 'follow-on' offer. In this structure, an institutional-only placing would be followed by a subsequent offer aimed at retail shareholders on substantially the same terms.

(b) **Retail investor platforms:** Recent retail participation in the UK has been largely mediated through the use of retail investor platforms that allow retail investors to participate alongside an institutional placing. The platform aggregates demand from retail investors and is allocated shares in the institutional bookbuild process, on the same timetable as the institutional placing.

6.32 We discuss below how each of these structures could be adapted for use in the UK.

Follow-on offer

6.33 A 'follow-on' open offer, with features similar to the repair offer structure used in Norway, would not be an entirely new departure for the UK. A similar approach is taken by AIM companies, where an open offer can be used to make an offer only to shareholders who did not participate in a previous placing. At present these structures are limited to AIM largely because that market has no admission to trading prospectus obligation. This means that as long as the size of the open offer is kept below €8 million, documentation requirements are minimal.

6.34 As noted elsewhere in this report, however, HMT's UK Prospectus Regime Review will remove the automatic public offer prospectus trigger and will empower the FCA to set the circumstances in which an admission to trading prospectus is required. In Section 7, this Review has recommended that the admission to trading threshold be raised to 75%. If taken forward, these recommendations would place main market companies in a position to take advantage of the same flexible open offer repair approach as an AIM company. As prospectus-exempt offers would no longer be subject to a €8 million size limit, this sort of offer would be a much more practical proposition for larger main market companies.

6.35 As is typical of open offers (see Section 8), a ‘follow-on’ open offer can be structured to allow excess applications by shareholders that can be satisfied at the discretion of the issuer. The offer need not be underwritten, and terms can provide it will proceed whether or not the maximum offer size is achieved (with the offer size expressed as ‘up to’ a specific number of shares).

Practical considerations

6.36 A follow-on open offer has some attractions as a way to extend an offer to retail investors on the same terms as an earlier institutional placing. It is a familiar structure to participants in the UK market, fully pre-emptive (in a follow-on context, it would be fully pre-emptive as between eligible shareholders) and, through the familiar excess application facility, would provide a mechanism for existing shareholders to increase their holdings if the company chose to provide this option.

6.37 One concern with using an open offer structure for a follow-on offer is, however, that it could provide a perverse disincentive to participation in the initial placing. Although the aim of a follow-on offer would be to ensure inclusion of smaller, retail investors, for practical reasons it is likely UK issuers would need to follow current AIM practice and make the offer open to any investor not allocated shares in the original placing.

6.38 As considered in Section 10, the current UK intermediated holding system means that UK issuers are typically not able to distinguish institutional and retail investors on their registers. This is in contrast to practice in Australia where issuers are able to identify institutional investors, facilitating the use of the accelerated dual tranche structures discussed further in Section 9. In the near-term, therefore, any UK follow-on offer targeted at retail investors would also be open to any institutional investor not allocated shares in the soft pre-emptive process in the initial placing.

6.39 A fully pre-emptive process could therefore, in theory at least, encourage institutional investors to wait for the follow-on offer, providing additional time to consider their investment but retaining the benefit of substantially the same terms. This is a concern that could be removed by limiting the participation of eligible shareholders in any follow-on to a level allowing retail shareholders to repair dilution but that would be insufficient for larger institutions to do so, as well as limiting the overall size of the follow-on offer.

Suggested features of any UK follow-on offer

6.40 Where a follow-on offer is used, it should aim to limit the dilution of existing investors not allocated shares in a placing, without undue impact on the initial placing process. While use of a retail investor platform will in many cases be a simpler way to include (both new and existing) retail investors, particularly if as expected technology and systems continue to improve in this area, a follow-on may be appropriate where an issuer wishes to ensure that its existing shareholders have sufficient time to become aware of the offer to make an informed investment decision. This may be the case where an issuer has a significant proportion of smaller shareholders holding in paper form. A follow-on offer could of course be combined with access to the offer being granted to retail investor platforms through the initial bookbuild.

6.41 It is expected that a follow-on offer would be targeted at existing investors, and would not be underwritten. We would anticipate that listed companies would use the initial placing to meet the funding needs for which they require certainty of funds.

6.42 We suggest the following features be included by the PEG in its Statement of Principles as guidance for issuers considering use of a follow-on offer:

(a) **Qualifying shareholders:** The offer should be made to shareholders as at a record date prior to announcement of the placing, and exclude any shareholder allocated shares in that placing. The company should also be permitted to exclude shareholders resident in jurisdictions where onerous requirements would otherwise apply, and to include holders of other equity securities where the directors consider it necessary or appropriate to do so.

This matches the approach the Review recommends in Section 8, to expand the current statutory pre-emption provisions to allow for the inclusion of not only holders of the same class of shares but also holders of other securities with a right to participate. We would expect a follow-on offer to be limited to existing investors.

(b) **Individual monetary cap:** Qualifying shareholders should be entitled to subscribe for shares up to a monetary cap to be determined by the issuer of not more than £30,000 per ultimate beneficial owner. The company should be able to make any arrangements which its directors consider necessary or appropriate to deal with fractional entitlements.

This feature seeks to deal with the concern noted above that a fully pre-emptive follow-on could in certain circumstances reduce support from institutional investors for the initial placing. The Review believes that an individual monetary cap is the best way to ensure the follow-on offer remains primarily a vehicle for the inclusion of retail investors and does not adversely impact the initial placing. As the ability of institutional investors to limit their dilution through the follow-on will be constrained, there will be no disincentive to participation in the initial placing. A cap will also provide a limit to the additional dilution of retail investors who choose not to participate in the follow-on offer, and assist placees in the initial placing in their assessment of the dilution they may face as a result of follow-on take-up.

In addition, as the same monetary cap will apply to each beneficial owner of shares no matter the size of their holding, it will allow smaller investors not only to maintain but also to increase their proportional ownership in the company. A follow-on offer will therefore provide a mechanism through which a listed company can increase the size of its retail register.

(c) **Size:** The number of shares issued in the follow-on offer should not exceed 20% of those issued in the placing. The offer may be made for ‘up to’ a specified number of shares, with fewer shares issued if applications are not received.

The maximum size of a follow-on offer should be 20% of the size of the initial institutional tranche, implying a size of up to 4% of existing share capital before the initial placing (if both limbs of the 10%+10% authorities are used). The PEG template resolutions should provide for a further disapplication linked to the amount issued under each limb of the 10%+10% authorities. This headroom would therefore automatically refresh each year in line with the pre-emption disapplication approved by shareholders. Additional headroom is, we believe, appropriate for a follow-on offer as funds received through this route will be delayed, and are unlikely to be underwritten. Companies should have the full 10%+10% available for an institutional placing, preserving quick access to certain funds up to that level.

Within this maximum the size of a follow-on offer should be left to the discretion of the company, with the aim of limiting the dilution suffered by retail investors without impacting the institutional placing process.

(d) **Price:** The issue price of shares in the follow-on offer should be equal to, or less than, the offer price in the placing.

A company that has indicated it plans to make a follow-on offer after an initial placing should not be required to do so if its directors are satisfied that qualifying shareholders can adequately repair their dilution through market purchases. This may be the case where the offer price in the placing is equal to or higher than the market price of the shares immediately prior to launch of any follow-on offer and this price is expected to be sustained. In those circumstances, an issuer would be expected to make a public announcement clearly stating their reasons for not proceeding.

(e) **Timing:** The company should announce the follow-on offer when, or as soon as reasonably practicable after, it announces the placing. In determining when to launch the follow-on offer the company should ensure that an issue price of equal to or below the offer price in the placing will comply with the discount limit in LR 9.5.10R (LR 9.5.10 requires that the price of an offer for subscription by a premium listed company must not be at a discount of more than 10% to the middle market price of those shares at the time of announcing the terms of the offer).

(f) **Offer period:** The company should ensure the follow-on offer is open for a period sufficient to allow qualifying shareholders to become aware of the offer and to reach an investment decision.

In the opinion of the Review this is likely to mean an offer period of at least five business days. We believe that while five business days is a more challenging timeframe than applies to current pre-emptive offer timeframes, it nonetheless remains workable within current systems. As improvements in electronic communications and the nominee chain continue to be made, it may be possible to reduce this period still further. At present, however, we believe a period of less than five business days would risk disenfranchising certain holders, for example those holding in paper form or through an extended nominee chain. A five business day offer period is shorter than that suggested in Section 8 as the minimum offer period for rights issues and open offers, and would accordingly require confirmation from the FCA that this type of follow-on offer could be distinguished from those structures.

Documentation for any follow-on offer

6.43 HMT's UK Prospectus Regime Review will delegate to the FCA the power to determine when a listed company will need to publish a prospectus in relation to a secondary offer (as the automatic 'public offer' trigger will no longer apply). This Review has recommended in Section 7 that the FCA raise the size threshold at which a secondary issue will require an admission to trading prospectus from 20% to 75% of existing share capital. These changes would allow larger offers to retail investors to be made without a prospectus for the first time since establishment of the current prospectus regime, but leave open the question of the disclosure that should be required instead for this type of offer.

6.44 There was broad support in the Call for Evidence for the proposition that a full prospectus should not be required for an offer to existing shareholders. Existing shareholders have already made an investment decision in relation to the shares, and have based their continuing decision to retain that holding on the information released by the company as part of its continuous disclosure obligations. As noted in HMT's UK Prospectus Regime Review, listed shares are already freely traded in a highly regulated environment[35].

6.45 The Review agrees that a full prospectus should not be required. Nor, however, will it be appropriate for a follow-on offer targeted at retail investors to simply be announced to the market through a regulatory information service, as is market standard on an institutional placing. The disclosure expected of issuers should be calibrated to focus on new disclosures required for an investment decision, rather than the repackaging of information already in the public domain.

6.46 The idea of a reduced disclosure regime is not a new concept, and has been present – in various forms – in both the EU Prospectus Directive and EU Prospectus Regulation, and now as onshored in the UK Prospectus Regulation.

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35 Consultation on the UK prospectus regime (publishing.service.gov.uk)

The original EU Prospectus Directive alleviations were available only to certain pre-emptive offers, but the revised regime in the EU and now UK Prospectus Regulation relates to any issue of the same class of shares by an issuer listed for at least 18 months (and in some cases, to issues of other types of securities).

6.47 In the Covid-19 period, the FCA encouraged[36] issuers to consider using the simplified prospectus, noting that the rationale for the new regime was that: 'investors are already familiar with the company and will be focused on changes that have occurred since the publication of the company's previous annual report, as well as the reason the company is carrying out the secondary issuance'. The Review agrees that this is the right approach to the focus of documentation regarding a secondary offer, and that the UK regime should go further in the alleviations afforded to existing listed issuers.

6.48 The existing simplified prospectus, however, has not entirely met its aims; we discuss the issues that have arisen with using reduced disclosure in connection with offers into the US in Section 8. In particular, it still requires the compilation of information on the issuer that has already been disclosed as part of an issuer's continuous disclosure obligations. As such this Review believes that the existing simplified regime is not sufficiently streamlined for a retail offer to existing shareholders, and that a replacement should focus on offer information.

6.49 The Review believes that a cleansing announcement and offer booklet – similar to the Australian SPP booklet – would provide an appropriate documentation for an offer that is not subject to a prospectus obligation but that includes existing retail investors. We discuss our proposals in relation to the offer booklet below, with a further discussion of liability for all prospectus-exempt offers to retail investors in Section 8.

Cleansing statement and offer booklet

6.50 The Review believes that the key information required to assist an existing shareholder in making a decision about whether to participate in a secondary offer will be met with the following steps.

(a) **Cleansing statement:** Confirmation that the company is in full compliance with its market disclosure obligations and that it is not delaying the disclosure of any inside information. If the issuer has unpublished price sensitive information, it should include that information in the announcement so that it is available at the point the offer is launched. The same announcement will typically be used to announce details of the offer.

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36 Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis | FCA

In practice the management due diligence process undertaken by the banks underwriting the deal will always ensure that this is the case. The cleansing statement would formalise this market practice, and provide a public confirmation to investors that there is no information of which they are unaware.

A similar announcement is made as part of a number of Australian structures discussed in Section 9.

(b) **Offer booklet:** In addition to the public information on the issuer, investors will need information about the secondary offer itself.

Of particular importance to a shareholder's investment decision will be the reasons for the offer, the proposed timetable and the expected use of proceeds. Market practice is to set out this information in a letter from the chair, and the Review would expect this to be included in an offer booklet. Shareholders will also require details of the structure of the offer and the terms and conditions of participation.

An issuer may also wish to make public an investor presentation prepared in connection with the institutional tranche of an offer.

As a document aimed at retail investors, the offer booklet should be drafted in clear language. In the US, long-standing guidance[37] encourages the use of plain English to create clearer and more informative disclosure documents, and we believe this should be a priority in developing offer documentation outside the prospectus regime. The FCA has noted in its recent consultation on the future of the listing regime that one objective of those reforms is 'to empower investors to conduct their own decision-making over the suitability of listed issuers to meet their investment needs through clear, high-quality disclosure'. As market practice develops on the content of an offer booklet (and the offer document discussed in Section 8) on a prospectus-exempt offer to retail investors, we would encourage issuers and their advisers also to focus on presentation and ensure that disclosure remains appropriate for a target audience of retail investors. We would also encourage the FCA to keep this element under review and consider whether guidance in this area would be helpful to the market and to investors.

Offer booklet content

6.51 We do not recommend that detailed content requirements be mandated for the offer booklet, with the exact detail of what is included left to market practice to develop. This will ensure that offer booklets can contain the information relevant to individual transactions, with the aim of avoiding overly long and

[37] A Plain English Handbook How to create clear SEC disclosure document, U.S. Securities and Exchange Commission, August 1998

boilerplate information. Certain existing provisions may apply to their content.

(a) **Circular requirements:** As a document sent to shareholders, an offer booklet may constitute a 'circular' for the purposes of the FCA's Listing Rules.

Routine circulars do not require FCA approval before distribution, but must include the content required by LR 13. This rule sets out overarching requirements that apply to all circulars as well as specific content required in circulars for certain transaction. We set out the detail of those requirements and how they could be applied to an offer booklet in Part 3 of Annex D.

In particular, an offer booklet complying with the circular regime would be required to:

(i) provide a clear and adequate explanation of its subject matter, giving due prominence to its essential characteristics, benefits and risks; and

(ii) if action is required, contain all information necessary to allow shareholders to make a properly informed decision.

The Review believes that should these requirements apply they would form a sound basis to ensure shareholders receive the information they need to decide how they wish to respond to the offer. They are sufficiently flexible to ensure that the listed company can, in conjunction with its advisers, tailor disclosure to the specifics of its particular transaction.

LR 13 also governs the content of circulars for significant transactions (Class 1 under LR 10) and notices of general meetings. Where a combined document is used to both make the rights issue offer and provide other information, therefore, the same regime will apply to all the constituent elements.

(b) **Advertisement regime:** Following implementation of the UK Prospectus Regime Review, the automatic public offer trigger for a prospectus will be removed and the FCA will be empowered to determine when a prospectus is required for an admission to trading.

All exempted offerings will, however, remain subject to an 'equality of information' requirement[38]. This requirement will be derived from provisions in the current UK Prospectus Regulation advertisement regime, which requires that if material information is disclosed by an

38 Paragraph 8, UK_Prospectus_Regime_Review_Outcome.pdf (publishing.service.gov.uk)

issuer to one or more selected investors, then that information must also be disclosed to all other investors to whom the offer is addressed.

This equality of information requirement would apply to information made available in a follow-on offer, including through the cleansing announcement and offer booklet.

Liability and responsibility

6.52 We consider in Section 8 how the introduction of alternative documentation for offers to retail investors without a prospectus should be accompanied by the establishment of a clear liability framework. The approach outlined in that section in relation to an offer document should also apply to an offer booklet prepared in connection with any follow-on offer. Broadly speaking liability should be aligned with that applicable to the continuous disclosure obligations of existing listed companies.

Retail investor platforms

6.53 Recent retail participation in the UK has been largely mediated through the use of retail investor platforms that allow retail investors to participate alongside an institutional placing. Investors that sign-up with the relevant service can elect to receive notifications of placings, and are provided with a way to subscribe for shares electronically. As noted above, at present, this structure typically sees the platform run a separate retail offer using the Financial Services and Markets Act 2000 (FSMA) exemption for domestic offers of up to €8 million. This limitation will fall away on implementation of HMT's UK Prospectus Review reforms as noted above.

6.54 There are advantages to this approach. It is straightforward and a process that is already well-understood by the market. Standard practice has the retail component directly aligned with the institutional timetable, meaning no delay that could impact the institutional placing. This timeline also provides the benefit of speed, getting funds to the issuer in a short period of time.

6.55 There have historically been some drawbacks to the use of retail investor platforms:

(a) **Speed:** As noted above, requiring retail shareholders to participate on an institutional timeline may not encourage participation.

(b) **Not limited to existing shareholders:** Although development in this regard continues, it has not so far been possible for retail investor platforms to restrict take-up to existing shareholders of the issuer, or to apply any form of 'soft pre-emption' to the proportion of shares allocated to each user. It is possible for platforms to require investors to self-certify that they are an existing shareholder, but recent retail offers have been unable to verify this against the company's own records.

(c) **Investor attention:** Participation requires a shareholder to have registered with the relevant retail investor platform in advance, and to be monitoring notifications at the right time. As noted above, this is often out of market hours, with the opportunity to participate available only for a limited window. It is likely therefore that this approach will be most attractive to active investors, and that long-term holders may in practice be excluded.

(d) **Limited pool of platforms:** As noted above, at present in practice the only party able to provide financial promotion approvals for the retail offer alongside an institutional placing is the retail investor platform. This means that the provider of the technology must be an 'authorised person' approved by the FCA. As a result of planned changes to the financial promotion regime, it will in future require the platform to hold a specific authorisation permitting financial promotion approvals[39]. This need to meet regulatory conditions, arguably separate from the platform technology itself, may decrease competition in this area, increasing costs for issuers.

(e) **Limited information:** A further unintended consequence of the financial promotion requirement is that the retail offer announcement may contain less information than does that for the institutional placing. Institutions will also commonly be provided with an investor presentation to assist their decision to participate. Although the announcement of the retail offer will mention the contemporaneous institutional tranche, providing a signpost for retail investors, it may not directly provide information on the proposed use of proceeds or reasons for the offer. Any information directly included in the retail offer will require approval as a financial promotion. Limiting the information to technical matters enables this diligence to be completed in the short preparation window available. It may, however, leave investors with less information than the company itself would have been happy to provide.

(f) **Payment methods:** Retail investor platforms commonly require upfront payment by debit card, requiring a retail investor to have immediately available funds (excluding funds in tax-efficient products such as ISAs and SIPPs).

Future development

6.56 The Review believes that there will continue to be a clear role for retail investor platforms in future placings. Recent market practice has established acceptance of this route to inclusion of retail, and we should seek to build upon this progress. The drawbacks noted above are those that exist at the current stage of development of these platforms, and the Review is aware that this development is continuing. Many of the perceived difficulties of this

[39] Regulatory Framework for Approval of Financial Promotions: Consultation Response, June 2021 (publishing.service.gov.uk)

structure, such as the speed with which an investment decision is required, have in practice not impacted the willingness of retail investors to participate. As familiarity with these processes continues to improve, alongside technological progress, we believe that remaining hurdles will continue to reduce. In Section 10 we consider how digitisation of capital markets could help deliver progress in this area.

6.57 There are a number features that would help further align a retail investor platform with the aims of retail participation as envisaged by the Review, including:

(a) **Soft pre-emption:** The facility to restrict an offer to an issuer's existing investors, or to prioritise their access, will improve the ability of issuers to observe soft-pre-emption in relation to retail investors. Greater communication between retail investor platforms, intermediaries and company registrars may assist in this regard. From our engagement with market participants we understand that this is an area in which progress is being made.

(b) **Streamlined process:** Minimising advance steps, such as pre-registration with a platform provider, will also assist in widening participation beyond the most active investors, particularly given the short window for which placings are typically open. Where possible use should be made of existing channels of communication with retail investors.

(c) **Payment options:** Allowing payment through tax-wrappers such as ISAs and SIPPs may assist retail investors with investable funds held in these products, maximising the funds available to retail investors wishing to participate.

6.58 The Review does not expect all retail investor platforms to offer the same features, and we believe that a competitive market offering different structures to issuers with different register compositions and priorities is the best way to continue improvements in retail engagement. The post-transaction reporting framework outlined in Section 5 will provide issuers with the opportunity to explain the choices they have made in structuring their secondary offers.

Financial promotion regime

6.59 The Review has also considered the impact of the financial promotion regime on the way that listed companies interact with retail shareholders in the context of a secondary offer.

6.60 While our primary focus in this section has been on how to align the treatment of institutional and retail investors when a listed company makes a secondary offer, this is an area in which the position of new retail investors must also be considered. Where new institutional investors will be able to participate in a non-pre-emptive placing, it may be appropriate for a listed company also to widen its retail offer to allow new retail investors to subscribe for shares.

6.61 As noted above, however, at present this requires that any communication made be approved as a financial promotion (further detail on the regime is set out in Part 5 of Annex D). While exemptions from the application of the financial promotion regime are typically available for communications made solely to existing shareholders, this is not the case where new retail investors are also permitted to participate. At present it is common for a retail investor platform to be required to authorise any such communication, a challenging process on the condensed placing timetable and one that may limit the information the issuers are able to make part of the retail offer.

6.62 As noted elsewhere in this Report it can appear anomalous that retail investors are permitted to purchase shares at the market price in the same unrestricted way as institutional investors, but are limited in their access to discounted issues of the same shares. While the protections of the financial promotion regime are necessary in many circumstances, there remains a question as to whether the current formulation is correctly calibrated for further issues by existing listed issuers. We therefore recommend that the announcement of an offering of new shares fungible with those already listed on a UK regulated market be exempt from authorisation as a financial promotion, even where that offer is open to retail investors. This could perhaps be done by providing that an announcement or offer booklet published in relation to such an offer falls within Article 70 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 as a document required or permitted by the Listing Rules, or alternatively within Article 67 as a promotion required or permitted by market rules.

Six-day rule

6.63 Under Article 21 of the UK Prospectus Regulation a public offer prospectus published in connection with an IPO is currently required to be made available to the public at least six working days before the end of the offer. This is commonly referred to as the ‘six-day rule’.

6.64 The six-day rule applies only on a company’s initial public offer (IPO), and only when an IPO is marketed to retail investors. While IPOs are outside the scope of this Review, reform and shortening of the ‘six-day rule’ is long overdue and would, we believe, further assist the wider participation of retail investors in UK listed companies. Our recommendations on the inclusion of retail at the secondary offer stage will be more effective if retail investors are more readily able to form part of a company’s register from the start of its life in public markets.

6.65 The six-day rule seeks to ensure that retail investors have enough time to read the prospectus on which they will form an investment decision, and we agree that this remains an important consideration. In its current, form, however, the six-day rule can act as a disincentive to the inclusion of retail investors in an IPO at all given the speed with which allocation books on an IPO are often built and when they can need to be closed.

6.66 On an institutional-only IPO, the offer of shares can be closed as soon as sufficient demand has been received, minimising exposure to general market volatility. In contrast, when retail investors are permitted to participate, the IPO offer must be kept open for six working days even if it is already significantly oversubscribed and it is in reality often not in the best interests of the company to do so. This artificial extension of the offer period increases deal uncertainty and a risk of the whole IPO failing if markets change quickly around the issuer. As a result, where an issuer is confident of sufficient demand from institutional investors, it can be incentivised to exclude retail altogether from the outset.

Recommendation: Shorten the period a prospectus for an IPO that involves a retail offer has to be made available to the public to a maximum of three working days

6.67 Shortening the six-day period would, in our view, encourage issuers to include a wider pool of investors in the marketing of their IPO, supporting the participation of retail generally in the ownership of listed companies. A period of three working days would strike the right balance, given that prospectus disclosure about the potential investment will have been available publicly for some time by this stage and so providing an appropriate window for review while reducing the disincentive to the inclusion of retail. We therefore recommend that the FCA consider shortening the six-day rule as part of its wider review of the prospectus regime on implementation of the outcome of HMT's UK Prospectus Regime Review.

7. Reduce regulatory involvement in fundraisings

Introduction

7.1 In this section, we consider the ways in which the role of the FCA should evolve in relation to larger secondary capital raisings. This includes both the threshold at which an admission to trading prospectus should be required, and when an existing listed issuer should be required to appoint a sponsor.

7.2 We also consider the working capital statement that issuers are required to include in a prospectus, and the 'importance of vote' language required on secondary capital raisings that constitute a reconstruction or refinancing.

Current regulatory involvement

7.3 The FCA typically has no involvement with smaller fundraisings. As discussed in Section 5, a non-pre-emptive placing will be structured to not require a prospectus, and the FCA's Listing Rules do not impose any other procedural hurdle on this sort of offer.

7.4 The situation is different for larger fundraisings, where regulatory oversight is heightened. We highlight below a number of points flagged to the Review as areas where regulatory involvement on larger offers could be streamlined.

Prospectuses

(a) **Prospectus requirement:** At present, a rights issue or open offer will generally require a prospectus. This is because it will involve both a public offer of securities and the admission to trading of 20% or more of the existing share capital of the issuer.

(b) **FCA review and approval:** The FCA must approve any prospectus before it is published and in order to do so it will undertake a review process. While timescales will vary from case to case, this FCA review commonly takes at least 4-6 weeks from the point at which a near-final draft is first submitted to the regulator.

The upcoming reforms following the recent HMT UK Prospectus Regime Review will remove the need for a public offer prospectus, and will delegate to the FCA the decision of when an admission to trading prospectus will be required. The reforms will also empower the FCA to determine when prospectuses will require its review and approval prior to publication.

We consider the threshold at which an admission to trading prospectus should be required, and whether FCA review and approval of all prospectuses is needed. Where a prospectus is not required, we consider what disclosure should instead be required of issuers.

Sponsors

(c) **Sponsor appointment:** Premium listed issuers must appoint a sponsor when they are required to prepare a prospectus. As noted above, at present this requirement is therefore typically triggered on rights issues and open offers. Some further detail on the sponsor regime is set out in Part 1 of Annex E.

(d) **Sponsor declaration:** Once appointed a sponsor is required to make a declaration to the FCA in a specified form before making an application for admission in relation to a secondary offer. We consider the nature of this declaration, and whether it remains appropriate for all secondary offers.

(e) **Sponsor comfort:** A sponsor owes its regulatory obligations to the FCA, and can be sanctioned by the FCA for any deficiency in connection with its work providing sponsor services. This includes the sponsor declaration. To ensure that the declaration is made properly, therefore, market practice is for the sponsor to require 'back-up' comfort to be provided to it by other parties to the fundraising. This will typically include comfort letters from the listed company, its directors and legal counsel, as well as from the bank's own legal counsel. Notably it will usually involve a working capital exercise culminating in a comfort letter, and associated report, from the listed company's reporting accountants.

In the context of secondary fundraisings being the raising of capital by companies with ongoing disclosure obligations from existing shareholders who have already made an investment decision about the company in question, we consider whether these sponsor requirements remain proportionate. And in particular whether a sponsor should continue to be required for any secondary offers and, if so, which ones. We also consider when a sponsor declaration should be required and the interaction between the sponsor regime and diligence on the working capital position of the issuer.

Specific content requirements

(f) **Working capital statement:** A prospectus is required to include a working capital statement. In broad terms this is a confirmation that the issuer and its group have sufficient funds for the next 12 months. FCA expectations on the format of this statement, and the assumptions that can be stated to underly it, influence the diligence process for the prospectus and to support the sponsor declaration. We consider whether an alternative approach would have benefits for the market.

(g) **Importance of the vote:** Another area of regulatory focus on 'rescue' transactions that are categorised as refinancings or reconstructions[40] under the FCA's Listing Rules is the inclusion of so-called 'importance of the vote' language in the associated prospectus or circular. The expectation of clear disclosure regarding the impact if the transaction does not go ahead can be interpreted to require hypothetical discussions and disclosures that may harm confidence in the listed

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[40] LR 9.5.12R; Primary Market Technical Note: Refinancing and reconstructions (fca.org.uk)

company. We consider whether the requirements in this regard can be amended to reduce unintended consequences for issuers.

Admission to trading prospectus requirement

7.5 The publication of a prospectus is a significant undertaking for a company, involving adviser costs and the expenditure of management time. Where a prospectus is required, it can reduce the ability of issuers to move quickly in favourable market windows, indirectly influence the choice of fundraising structure and inhibit the use of equity capital. The Review believes therefore that a prospectus should only be required where there is a clear benefit to investors.

7.6 As noted above, reforms following HMT's UK Prospectus Regime Review will remove the automatic need for a prospectus for a public offer of securities, with the FCA empowered to determine when an admission to trading prospectus is required. At present the threshold set under the UK Prospectus Regulation beyond which a prospectus will be required for the admission to trading of a new issue of shares of a class already admitted to trading is 20%.

7.7 The Review believes there are strong arguments for raising the current threshold. As noted in the initial consultation[41] for the HMT's UK Prospectus Regime Review, there is a well-understood need for a prospectus on IPO to remedy information asymmetries before shares are admitted to trading for the first time. As also noted in that consultation, however, the position is more nuanced when it comes to secondary offers by existing listed issuers. Listed companies are subject to ongoing disclosure obligations under the UK Market Abuse Regulation as well as to continuing obligations under the FCA's Listing Rules and Disclosure Guidance and Transparency Rules. New material information is disclosed in real-time, subject to certain limited exemptions, and the integrity of secondary market trading is based on this disclosure framework. The shares issued as part of a secondary offer are identical to those already subject to trading, and therefore capable of being assessed on the basis of the same information. It was noted by respondents to the Review that the majority of a prospectus serves only to duplicate information that is already publicly available to investors. As a result, there is no proportionate benefit to investors yet there is a disproportionate disadvantage to an issuer in terms of the time and cost involved in preparing the prospectus and having it approved.

7.8 In seeking to identify those situations where an admission to trading prospectus on a secondary offer may add value to investors, it is helpful to distinguish the various functions performed by a prospectus:

(a) **Offer information:** A prospectus, through the securities note component, will provide information about the secondary offer itself.

[41] Consultation on the UK prospectus regime (publishing.service.gov.uk)

This information will always be needed in the context of a secondary fundraise, but need not be provided in the form of a prospectus. Arguably, splitting out offer information into a separate document will make it easier for investors to focus on the key new information.

We discuss in Section 6 our recommendation for a new approach to retail offers that would see investors provided with offer information through an offer booklet and in Section 8 we consider the use of a non-duplicative form of offer document for pre-emptive offers. These documents would include information of importance to a shareholder's investment decision (likely to include the reasons for the offer, the proposed timetable and the expected use of proceeds) alongside of the structure of the offer and the terms and conditions of participation.

The Review believes that an offer booklet or offer document should be provided on all offers that include retail investors where a prospectus is not produced. Listed companies and their advisers will have the flexibility to include in the offer booklet or offer document all information pertinent to the characteristics of a particular capital raise.

(b) **Cleansing:** Another consequence of publication of a prospectus is that it provides a 'reset' for market disclosures, marking a point in time at which an investor can be confident that a listed company is not delaying the disclosure of material information.

The Review believes that investors should continue to get that reassurance on launch of an offer that does not require a prospectus. As discussed in Section 6, this should be through the publication by the issuer of a cleansing statement when it launches the offer. The cleansing statement should confirm that the company is in full compliance with its market obligations and that it is not delaying the disclosure of any inside information. In practice this is what happens on placings, with the launch announcement used to cleanse any previous undisclosed information that could be of interest to investors.

(c) **Consolidated issuer information:** A further advantage of publication of a prospectus is that it consolidates previously published information about the issuer in one place, and it does so in an organised and relatively standardised format. This can provide a useful baseline for investors going forward. Arguably, however, it is not needed when a secondary offer represents a continuation, rather than a material shift of strategy or a business transformation, and is not of a size to materially change the investment proposition of a holding in its shares.

Prospectus review and approval by the FCA

7.9 Where a prospectus is required, a further question considered by the Review is whether it should require prior approval by the FCA.

7.10 At present, all prospectuses are subject to FCA review and approval. Essentially the same process is followed without regard to any particular feature of the issuer or the issue itself. The Review has considered whether this level of regulatory involvement is proportionate for all secondary issues. As noted by HMT's UK Prospectus Regime Review, the current process serves two primary purposes:

(a) **Identification:** Approval by the FCA prior to publication ensures that the market and wider public have the definitive text of the prospectus. This avoids the circulation of alternative versions or drafts, which risks a disorderly market.

(b) **Scrutiny:** At present the FCA is required to scrutinise prospectuses before giving its approval. Formal criteria for the scrutiny of the completeness of the information contained in the prospectus are set out in technical standards forming part of the UK Prospectus Regulation regime, requiring consideration of completeness, consistency and comprehensibility.

7.11 The HMT UK Prospectus Regime Review reforms will, when implemented, give the FCA the flexibility to establish its own policy in this area. This will allow the FCA to set bespoke rules on when a prospectus requires approval and when it must be subject to review.

Concerns with the current process of review and approval

7.12 The primary concern is that the review and approval requirement elongates the pre-launch timetable of an offer, meaning that issuers are limited in their ability to move quickly when needed and face an extended period in which confidentiality must be maintained.

7.13 Drafting a comprehensive prospectus involves an extensive drafting process with the issuer, the banks and their respective legal counsel and other advisers. The version of the prospectus submitted to the FCA to begin the review process must be a near-final draft. This means that the regulatory review and approval period cannot be run concurrently with the drafting process, but instead will serve to extend the period over which the prospectus is finalised.

7.14 The current regime already recognises, to a limited extent, that secondary offers require less scrutiny than those of an initial applicant. Once an initial submission is made the review process works to published turnaround times[42], and for a secondary offer this means FCA comments are returned in five clear working days of the first submission, and in three clear working days for all subsequent submissions. Longer turnaround times apply for IPO candidates, where the equivalent time periods are an initial 10 clear working days with subsequent turns of five clear working days.

7.15 The shorter periods applicable to a further issue reflect that disclosure for an existing listed issuer will build on previous documentation and market disclosures, but there is no further distinction between types of secondary

[42] Submit a prospectus or circular | FCA

offer. This means that a moderately-sized rights issue to fund a consistent long-term strategy is subject to the same level of scrutiny as a very large, emergency rights issue. There are, of course, differences in the detail of the disclosure that would be expected from those two scenarios, two of which we consider below when we look at working capital and importance of the vote. But the overarching requirement for regulatory review and approval is not changed.

7.16 Even with the shorter turnaround times for a secondary offer, the need to draft the prospectus, submit it to the FCA and then wait for and respond to comments can add several weeks to the pre-launch timetable. For an existing listed issuer, this extends the period in which the proposed secondary offer must be kept confidential or, where an offer has already been announced, or leaked, to the market, it extends the period in which the share price of the issuer is vulnerable to volatility ahead of launch. It also further reduces the ability of issuers to move quickly if required and to time issues to favourable market windows.

7.17 Another factor in considering the level of review that is appropriate is FCA resourcing, and how it can best be focused. Reducing regulatory involvement on arguably lower risk issues by seasoned issuers would increase the resources available to scrutinise higher risk transactions, where regulatory oversight will provide the greatest benefit to investors. The Review would suggest that while applicants that are new to the market will always require scrutiny, this will only be proportionate for certain secondary offers.

Approach in other markets

The Review has looked at other jurisdictions that do not require a prospectus for offers meeting certain conditions, or that have a reduced review and comment process. We highlight below some points of interest from the EU, US and Australian systems.

EU – simplified prospectus and Universal Registration Document

7.18 Public offers and admissions to trading in the EU require publication of a prospectus unless exempt. EU regulators are required by the EU Prospectus Regulation regime to scrutinise and approve all prospectuses prior to publication. The current EU regime does, however, acknowledge that reduced requirements may be appropriate for secondary offers through two concepts:

(a) **Simplified prospectus for secondary issues:** Issuers that have been listed for at least 18 months are permitted to prepare a simplified prospectus in certain circumstances, including when making a further offer of the same class of shares. The simplified prospectus, which must be approved in the same way as a full prospectus, allows an issuer to reduce disclosure where this overlaps with continuing disclosures. Notably the regime does not require an operating and financial review, limits the overview of the issuer's business and eliminates certain more technical disclosures A simplified prospectus is, however, required to include a summary of the information disclosed under the EU Market Abuse Regulation over the last 12 months which is relevant as at the date of the document, a requirement that does not apply to a full prospectus.

The simplified prospectus was onshored (in substantially the same form) as part of the UK prospectus regime following the UK's withdrawal from the EU. The simplified prospectus does not eliminate the need to compile issuer information that has already been disclosed as part of an issuer's continuous disclosure obligations. In addition, although the format has been used in the UK, this has not reduced the overall complexity of prospectus disclosure. As we discuss in Section 8, this is largely because offers extended into the US typically re-include substantive elements of disclosure on a 'voluntary' basis, to meet US expectations.

(b) **Universal Registration Document (URD):** An URD is an optional shelf registration mechanism for frequent issuers, containing issuer information. It can also be used as an issuer's annual financial report.

Once an URD has been approved for two consecutive years, subsequent URDs can be filed without prior approval, although the relevant competent authority can choose to do an ex-post review. Filing an URD on an annual basis gives an issuer the status of a frequent issuer, leading to a shorter approval process when the URD is used as part of a prospectus, if certain conditions are met. In particular, the issuer must confirm when filing the URD that to the best of its knowledge it has complied with its disclosure obligations under the Transparency Directive and EU Market Abuse Regulation over the last 18 months.

The URD was onshored (in substantially the same form) as part of the UK prospectus regime following the UK's withdrawal from the EU. Although it remains an option available to issuers, it is not commonly used in the UK as the burden of preparing and maintaining the document is perceived to be disproportionate to the benefits gained.

US – well-known seasoned issuers

7.19 While there are many differences between the US capital markets system and that of the UK, one US concept of note in this context is the 'well-known seasoned issuer' (WKSI). To qualify as a WKSI a company must, broadly speaking, be an existing large cap issuer that meets certain specified conditions, including timely compliance with its ongoing reporting requirements to the SEC. A key benefit of this status is that when a WKSI files a shelf registration statement with the SEC, it is automatically effective, and is not subject to review by the SEC when filed or when it is used in connection with an offer.

7.20 The WKSI concept demonstrates a recognition in the US system that existing issuers are differently placed to new applicants. It is worth noting, however, that although there is no SEC review at the point a WKSI files its automatic shelf registration statement, that document will incorporate by reference disclosure included in other regular SEC filings – broadly similar to a UK annual report and accounts – that can be selected by the SEC for review and comment. As such there is some residual SEC oversight of elements of content.

7.21 For companies incorporated in England and Wales, annual reports are not subject to review by the FCA but are subject to selective monitoring by the FRC. The FRC process is generally viewed as lighter touch than that of the SEC, however, and the number of reviews it undertakes is limited. In 2020/1, for example, the FRC reviewed 246 reports (of which 72% were produced by FTSE 350 companies)[43]. We note that the role of the FRC will soon be transferred to the new Auditing, Reporting and Governance Authority (ARGA), and this may change the approach taken to review of periodic reports. There will remain a fundamental difference however, in that the UK system is based on a distinction between periodic reports for shareholders that speak as of a point in time and are backward rather than forward-looking and disclosure documents prepared in connection with offerings, whereas the US system takes an integrated approach.

Australia – prospectus exempt offers

7.22 In Australia secondary offerings can often be made by an ASX-listed entity on the basis of a cleansing notice, rather than a prospectus, where relevant conditions are met (the low doc regime). As such there is typically no regulatory review of documents produced in connection with an Australian secondary offer.

7.23 The offers that can be made without a prospectus include those made on a pro rata basis through a traditional or non-traditional rights issue (for example those, such as an ANREO or AREO, that involve an accelerated offer to institutional investors). A cleansing notice must be published affirming there is no material information that the issuer is aware of that has not been disclosed to the market under continuous disclosure rules. It will also set out limited details about the offer and verify that the issuer has complied with its continuous disclosure and reporting obligations. It is also common to make public an investor presentation containing further detail of the transaction.

Recommendation: Admission to trading prospectuses should remain subject to prior FCA approval but should be required for secondary offers only where the offer size is at least 75% of existing share capital

7.24 In the opinion of the Review, an admission to trading prospectus should only be required where there has been a material shift in what it means to be invested in an existing listed issuer. In these circumstances an admission

[43] FRC CRR Annual Review_October 2021

prospectus can serve as a single, consolidated source to prevent asymmetries of information that may otherwise arise.

7.25 In determining what constitutes a sufficiently material event in the life of a listed company, it is helpful to look at the way in which other significant events are treated under the FCA's Listing Rules, in particular the significant transaction rules in Chapter 10.

Significant transaction rules

7.26 LR 10 requires premium listed companies to test significant transactions against a series of 'class tests' which serve to compare the size of a proposed transaction against the existing listed company (with transactions with the same counterparty aggregated over 12 months). The steps that must be taken by a listed company are determined by the relative size of the transaction.

7.27 Smaller 'Class 2' transactions (where one class test ratio is 5% or more, but each is less than 25%) require announcement of specified information; larger 'Class 1' transactions (where any ratio is 25% or more) require the premium listed company to seek shareholder consent for the transaction, which will be based on a circular setting out details of the transaction. Only the most significant transactions, however, referred to as 'reverse takeovers', require readmission of the enlarged entity and publication of a prospectus.

7.28 A transaction is a reverse takeover where any class test ratio is 100% or more, or if it in substance results in a fundamental change in the business or in a change in board or voting control of the issuer. In these circumstances all issuers, whether on the premium or standard segment, are required to seek re-admission on completion of the transaction (premium listed issuers must also comply with the Class 1 requirements). In the reverse takeover context this gives the FCA an opportunity to reassess the eligibility of the enlarged group for listing. In addition, the prospectus that must be prepared in connection with that re-admission consolidates information on the enlarged group. This can then act as a baseline for investors against which future disclosures can be marked.

7.29 An issue of securities (that does not involve the acquisition or disposal of a fixed asset) is excluded from the definition of a significant transaction, and so does not fall to be assessed under the class tests.

7.30 In the opinion of the Review, an admission to trading prospectus should be required only at a threshold that represents a fundamental change for the issuer that changes the investment proposition for its shareholders.

7.31 The Review therefore recommends that the threshold for publication of an admission to trading prospectus for a secondary issue of shares should be raised from 20% to 75% of existing share capital. Although arguments can be made for a higher threshold than this, on balance our view is that 75% is an appropriate level at which to require new prospectus disclosure.

7.32 An increase of this size will represent the influx of material proceeds for the company and potentially a material shift in its nature and position. The burden of preparing a prospectus in these circumstances would be proportionate to the benefit to investors in having an updated overview of the issuer and its business. In many cases larger capital raises where proceeds are to be used for a transaction will also need to prepare a circular, in which case these two documents can – as is commonly the case now – be combined. A 75% threshold also means that where a company incorporated in England and Wales has been granted a general authority to allot up to two thirds of its share capital as part of a pre-emptive offer, it will be able to make use of that authority without the delays inherent in preparation of a prospectus.

Retention of FCA review and approval

7.33 We have considered whether there should be a possibility for issuers to file a prospectus without review. The approach taken by HMT's UK Prospectus Regime Review has been to reduce the number of situations in which a public offer prospectus is required, and we agree that this is the right way forward. Our recommendation above therefore follows the same principle, proposing that the FCA reduce the situations requiring an admission to trading prospectus rather than introducing the ability to file prospectuses without a review and approval process. The situations in which we recommend a prospectus requirement be retained are complex, and are areas in which FCA oversight will be of benefit in ensuring maximum investor protection.

7.34 Smaller and more ordinary course offers will be best served by more focused disclosure through a cleansing notice and offer document approach, ideally with the public release of an investor presentation at the discretion of the issuer. No FCA review or approval will be required for these. Identification of the documents produced in connection with this type of offer will be facilitated through an obligation to file a definitive version with the National Storage Mechanism (NSM) and publish a link to it by way of a regulatory information service. For transactions without complicating factors we believe the drafting and diligence process put in place by issuers, who will remain responsible for the content of the documents and announcements, and the appropriate consideration of their responsibilities, obligations and potential liabilities by boards and management teams, together with the appropriate use of advisers, will ensure robust disclosure without the need for a regulatory overlay. We discuss the offer document and liability framework in Section 8.

Sponsor regime

7.35 At present, a sponsor is required on all secondary offers that require publication of a prospectus. Reducing the situations in which a prospectus is required, as recommended above, will therefore also reduce the situations in which a sponsor must be appointed. The Review has considered, however, whether reform should go further, and no longer require a sponsor simply because a prospectus has been prepared.

7.36 Although the concept of a sponsor is not unique to the UK, it is not a role present in all major markets. Even where a sponsor concept exists, there may be no formal requirement to engage a sponsor in connection with a secondary capital raise. We set out further detail of practice in other major markets in Part 2 of Annex E, but it is notable that in some markets the use of a sponsor or equivalent is restricted to alternative growth markets where issuers are less experienced in the capital raising process.

7.37 The future of the sponsor regime is being considered by the FCA as part of the second phase of its Primary Markets Effectiveness Review. The FCA is considering different potential models for the UK listing regime, including changes to the current premium and standard listing segments, which may lead to modification of the sponsor role. Although discussion of the wider sponsor regime is beyond the scope of this Review, we consider below the scope and purpose of the sponsor role in relation to secondary offers, and our recommendation on when a sponsor should be required in that context.

Sponsor role

7.38 A sponsor has a dual role, owing overriding regulatory duties to the FCA as well as acting as an adviser to the listed company. The FCA describes the regime as meeting the needs of multiple stakeholders: the FCA, investors and listed companies[44]. Some further detail on the sponsor regime is set out in Part 1 of Annex E, but we summarise the impact for key stakeholders below:

(a) **Listed companies:** Sponsors provide guidance and advice to companies as well as liaising with the FCA on their behalf. As noted by the FCA, the sponsor regime also has a more indirect benefit for listed companies, through their contribution to the status and reputation of the premium listing segment.

(b) **Investors:** Although sponsors do not owe any direct obligations to investors, investors who are aware of what a sponsor is and the role it undertakes may take comfort from the knowledge that the sponsor has carried out diligence on the company sufficient to enable it to provide confirmations to the FCA.

Feedback to the Review on this aspect of the sponsor regime was mixed, with no consistent view of the value placed upon the additional layer of review represented by the sponsor regime. We consider below when this back-up to individual investor diligence and interaction with management is likely to be of most utility to investors.

(c) **FCA:** The FCA relies on confirmations given to it by sponsors. The sponsor declaration made in connection with the admission to trading of further securities is broadly focused on prospectus requirements. The declaration requires the sponsor to confirm that it has come to a

44 The sponsor regime | FCA

reasonable opinion, after having made due and careful enquiry, that the company has satisfied all applicable requirements set out in the prospectus rules, and that the directors of the applicant have a reasonable basis on which to make the working capital statement in the prospectus.

Given the focus of the declaration on prospectus requirements, there is a strong correlation between the utility of the sponsor confirmations to the FCA and the prospectus requirement.

7.39 A key factor in the sponsor process is the declaration made to the FCA regarding compliance with the prospectus rules and, in particular, there being a reasonable basis for the working capital statement. Respondents to the Review noted that this latter requirement has the greatest impact on increasing the pre-launch timetable. In the view of many respondents, the formalised back-up comfort that is currently required whenever a sponsor declaration is made is disproportionate in many cases.

Impact on working capital diligence

7.40 Although there were mixed views from respondents to the Review, the working capital position of a company making a secondary issue of shares is an important consideration for many investors. It is a required disclosure in any secondary offer prospectus.

Working capital diligence as part of sponsor comfort

7.41 When back-up comfort is required for a sponsor declaration on working capital, the issuer's reporting accountants will be engaged by the sponsor to perform a robust due diligence exercise involving a deep dive into the issuer's historical trading, the assumptions which underpin its projections, the financial position of the company, liquidity or cash requirements and, where the company has debt facilities in place, covenant compliance.

7.42 The output of this process is typically a longform working capital report, which can range in size from 40 pages up to and in excess of 120 pages depending on the circumstances of the transaction and the levels of liquidity or cash headroom in the business over the working capital review period (market practice is to extend the 12-month requirement out by a further six months). The reporting accountants will also provide, either as part of that report or in a separate comfort letter, confirmations aligned to those to be made by the sponsor in its declaration to the FCA. The report is a private document which is not published.

7.43 We set out further detail on how the working capital report is prepared in Part 3 of Annex E, but in summary the directors of the issuer will prepare projections and detailed underlying assumptions. This will include:

(a) **'Base case' scenario:** A base case scenario covering a period of at least 12 months from the date of the prospectus. The base case should represent the directors' reasonable expectation of the likely performance of the business.

(b) **'Reasonable worst case' scenario:** The directors must also consider whether the company can cover a reasonable downside scenario. The appropriate basis for this will be discussed between the issuer, sponsor and reporting accountants prior to preparation by the company of the working capital model.

The reasonable worst case scenario will involve sensitivities being applied to the company, for example reduced trading volumes, increased costs, rises in interest rates rises and one-off cash impacts. If, following the application of sensitivities, singularly and in aggregate, the company does not have sufficient headroom it must consider reasonable mitigating actions it could take to remedy the breach. These may include for example cancelling discretionary items of expenditure such as bonuses, dividends or expansionary capital expenditure.

(c) **Working capital model:** The company will then prepare a financial model of both the 'base' and 'reasonable worst case' scenarios, and if required a 'mitigated' scenario should the 'reasonable worst case' scenario breach liquidity headroom. This will typically include two years of historical trading and the forecast information based on stated assumptions.

7.44 The reporting accountants will then assess the working capital model, reviewing its basis of preparation, method of compilation, timescales and review procedures as well as the underpinning assumptions and applying their view of market conditions. The sponsor will undertake its own review of the materials prepared by the company and have the opportunity to ask questions of both the reporting accountants and the company. FCA guidance makes clear that a sponsor must review and challenge the work done by the issuer and reporting accountant and, through its own knowledge and experience of the issuer and its operating environment, ensure that the conclusion reached on the issuer's working capital position is the right one under the circumstances[45]. The reporting accountants will then finalise their working capital report and associated sponsor comfort.

Working capital diligence on an undocumented placing

7.45 Working capital is of course a consideration on any fundraise, even if no prospectus is required, and it is perhaps helpful to look at the process that is carried out on this sort of offer. An undocumented placing does not involve

[45] UKLA Technical Note The sponsor's role on working capital confirmations: tn-704-3.pdf (fca.org.uk)

the publication of a prospectus, and therefore does not require appointment of a sponsor or the submission to the FCA of a sponsor declaration.

7.46 A key feature of the placing process is flexibility, allowing the issuer and its advisers to undertake the process that best fits the individual circumstances of the capital raise. It is standard, however, for the placing agreement between the issuer and the banks placing the shares to contain a working capital warranty in the same terms as would be required in a prospectus, i.e. that the issuer group will have sufficient working capital for its present requirements (at least 12 months from the closing date).

7.47 In order to give that warranty, the issuer will carry out a diligence exercise tailored to the specific features of the issue. It will commonly include the preparation of a working capital memorandum for consideration by the board, describing the stress tests that have been applied to the company's financial model.

7.48 Crucially, the company can choose whether or not to involve its accounting advisers in that process, and can determine the scope of their input as required. The process is led by the issuer as the entity giving the warranty, with the scope informed by experience of its business and funding needs. The placing banks will be heavily involved in the process and will want to ensure that they are comfortable that the warranty can be given cleanly. Similarly, the directors of the company will want to ensure that they have done enough diligence to ensure the warranty can be given, including for liability management and reputational reasons. It is a more streamlined and focused process than on a documented offering but one which produces a similar diligence result.

7.49 There is a strong argument that this more focused and practical approach to working capital diligence gives all parties to a secondary offer (whether a placing, open offer or rights issue), including investors, the necessary assurance that the company has thought about its working capital position appropriately in the context of the fundraising, and yet is materially more efficient in terms of time and cost than the more formal working capital exercise that is undertaken when a sponsor declaration is required to be given.

Recommendation: A secondary offer should not trigger the need to appoint a sponsor

7.50 We recommend that a listed company should not be required to appoint a sponsor in relation to a secondary offer prospectus. Large secondary offers that require an admission to trading prospectus because they have a size of 75% or more of existing share capital will not require a sponsor in relation to that prospectus.

Impact on listed companies, investors and the FCA

7.51 Although the advice and guidance of a sponsor has undoubted value to companies, in the opinion of the Review this aspect of the role does not provide a basis for a mandatory appointment requirement.

7.52 Unlike a new applicant for listing, which can be assumed to be unfamiliar with the FCA's rulebook, an existing listed company will have experience in complying with its ongoing obligations as a listed company. This means it will also be aware when it enters into a process outside its immediate experience where it needs additional advice. It is common for listed companies to appoint an independent financial advisory firm for support in undertaking transactions where additional expertise is required. As the advisory needs of individual companies will naturally vary and be bespoke to their specific activities, we believe the decision of when to seek expert advice on the listing regime should be left to the board and management team of a listed company, as is the case with other areas in which companies seek accounting, legal or other expert advice.

7.53 The sponsor role is not a feature of secondary offers in many European or international jurisdictions, underlining that it is not a necessary feature of a well ordered market. In Germany, the Netherlands, France and Switzerland, for example, the underwriting banks take the lead on due diligence and reporting to the regulator. Where jurisdictions do have a sponsor concept, for example, in Spain and Italy, the role is commonly more involved on growth markets, with similarities to the Nomad role on AIM.

7.54 There are also disadvantages to listed companies in the current system. The sponsor declaration, and the associated regulatory obligations owed by the sponsor to the FCA, imposes formality on key elements of the due diligence process. As noted above on a secondary offer unconnected with a significant transaction this is most acutely felt in relation to the working capital statement, where the appointment of a sponsor in practice leads to the requirement by the sponsor bank for a working capital report to be prepared by external accountants whether or not the features of the transaction would otherwise necessitate this step. This increases costs and reduces flexibility in the pre-launch timetable. As such we believe on balance the decision of whether to seek expert advice on listing rule compliance and other matters should be left to the discretion of listed issuers on secondary offerings.

7.55 Although there may not be universal awareness in the market of the role and work carried out by sponsors, the Review considers that the indirect benefit to investors remains a key consideration. This benefit must, however, be proportionate to the additional burdens placed on issuers, both in terms of time and cost. We believe that the right balance is struck by removing the need for a sponsor on a secondary offer but retaining it for new candidates for initial listing and for specified major transactions through the life of a listed company (such as related party and significant transactions).

7.56 We have also considered the position of the FCA, which relies on the confirmations given to it by sponsors as part of the admission to listing process. The regulatory benefit of a sponsor is clearly associated with the publication of a prospectus. While this recommendation will mean that fundraisings of 75%+ will require a prospectus but no sponsor, the issuer and its directors will continue to take prospectus responsibility in those circumstances. This will include prospectus responsibility for the working capital statement. As at present listed companies will carry out a verification and board approval process for a prospectus, and this will continue to provide assurance to investors. FCA review and approval will also be needed, providing an additional layer of oversight.

Impact on working capital diligence

7.57 We have considered the impact of our recommendation on the working capital diligence process. In particular, one factor raised by respondents to the Review is that there may be situations where a transaction is initially considered to be ordinary course, but the sponsor-led working capital exercise reveals vulnerabilities that means its status changes and it becomes apparent that it is reconstruction or refinancing as more diligence is undertaken.

7.58 We have considered this point, but feel that a blanket requirement for the formal diligence process and increased oversight represented by a sponsor declaration and associated comfort process is not warranted in all cases to guard against this issue. As on an undocumented placing, it is standard for an issuer to be required to warrant its working capital position to the banks marketing a secondary offer, and for diligence work to be carried out in support of that warranty. Where a capital raising has the potential to be a reconstruction or refinancing, we would expect the listed company and its advisers to work together to identify what, if any, extra diligence – by the company or independent accounting firm – is merited.

7.59 We have also considered concerns that removing the oversight of a sponsor from the process of working capital due diligence will leave listed companies uncertain of the level of diligence that is expected as part of a well-run secondary capital raising process. In this regard it is helpful that industry guidance is already in place. Part III of the ICAEW's guidance for preparers of prospective financial information[46] has specific guidance in connection with statements of sufficiency of working capital in capital markets transactions. This guidance typically forms the standard scope of a working capital exercise across transaction types, with minor variations for acquisitions, disposals and straightforward capital raises. We would expect that the market would continue to use this as a basis for working capital diligence going forward, without the need for the FCA to indicate an expectation in formal guidance. FCA guidance to consider these procedures is an option, however, if concerns remain that market standards need improved consistency. We also note that other European regimes with similar rules on working capital disclosure but without a sponsor regime have flexible working capital diligence processes that work well. We set out further detail of our survey of working capital diligence in other jurisdictions in Part 4 of Annex E.

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46 tech-0420-prospective-financial-information.ashx (icaew.com)

7.60 There will remain situations in which a heightened working capital process may be appropriate for an existing listed issuer, where the issuer is undertaking an acquisition or other transaction that constitutes a Class 1 or reverse takeover transaction. In those circumstances a sponsor will require appointment in connection with the approval of the circular itself, whether or not there is an additional obligation in connection with publication of a prospectus, and the sponsor will be required to make a declaration in relation to the circular that covers working capital, as well as other matters relevant to that type of transaction such as a consideration of financial prospects, policies and procedures (commonly referred to as FPPP). As such we believe that these situations do not merit a separate sponsor appointment requirement in relation to the prospectus.

Working capital disclosure

7.61 As noted above, working capital disclosure is currently required in all prospectuses, under both the full and simplified regimes. In this section we discuss the nature of that disclosure and some concerns raised by respondents to the Review. Points raised focused on the constraints currently placed on the way in which an issuer is permitted to describe its working capital position.

Working capital statement

7.62 When a UK listed company engages in a transaction which triggers the requirement to publish a prospectus, the directors are currently required to include a ‘working capital statement’. This confirms the issuer’s ability to access cash and other available liquid resources in order to meet its liabilities as they fall due for the next 12 months. A similar statement is also required by the FCA in certain shareholder circulars.

7.63 A working capital statement can only currently be either ‘clean’ or ‘qualified’. Where an issuer is unable to confirm whether or not it has sufficient working capital, it must make a qualified statement. Current UK guidance in this area has been onshored based on ESMA guidance formulated prior to the UK’s withdrawal from the European Union, and is prescriptive with regard to the disclosures that can be made in relation to each type of statement.

(a) **Clean working capital statement:** In a clean working capital statement the issuer states that, in its opinion, its working capital is sufficient for present requirements. This means at least the next 12 months, being the maximum period of validity of a prospectus.

An issuer cannot disclose any assumptions, sensitivities, risk factors or caveats in relation to a clean working capital statement – it has to be an absolute statement. Issuers may only disclose the basis on which a working capital statement is made, for example ‘taking in account existing bank facilities’. Similarly where proceeds are fully underwritten, issuers should indicate whether the statement is made 'taking into account the proceeds of the issue'[47].

The limit on additional disclosure around an issuer's working capital position also impacts the separate risk factor section in a prospectus. FCA guidance notes particularly close attention will be paid to risk factors that suggest the issuer will or may run out of working capital in the next 12 months – and which therefore cut across or act as a mitigant to a clean working capital statement. Disclosure of risks of this nature is likely to mean a qualified working capital statement is required unless, for example, they are risks with a high impact but very low probability in the FCA's eyes.

(b) **Qualified working capital statement:** In a qualified statement, the issuer states that in its opinion it does not have sufficient working capital. Additional disclosure is required when a qualified statement is made, to ensure that investors are fully informed as to the issuer's actual working capital position. This should include when the issuer expects to run out of working capital, how much additional funding the issuer needs and how the issuer plans to rectify the current shortfall (including disclosure of specific proposed actions, including timing and how confident the issuer is that these will be successful). It should also include the implications of any proposed actions being unsuccessful, for example if the issuer is likely to enter into administration proceedings and when this could occur.

Qualified working capital statements are not common in the UK market: in the period 2017-2019, prior to the Covid-19 pandemic, only three of 34[48] rights issues and open offers by main market issuers included a qualified working capital statement.

7.64 The approach to disclosure of the evidence underpinning a clean working capital statement stands in sharp contrast to the requirements of the FCA's Listing Rules and the UK Corporate Governance Code in relation to similar disclosures in a listed company's annual financial report.

Annual report disclosures

7.65 The working capital statement is required in relation to specific events in the life of a listed company. But shareholders need information of this nature on a routine basis as well, as part of the continuous disclosure obligations of a listed company to allow informed secondary trading in its shares. This is typically done through a company's annual financial report and accounts, in

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47 Guidelines on disclosure requirements under the Prospectus Regulation and Guidance on specialist issuers – Primary Market/TN/619.1; Working capital statements – basis of preparation – Primary Market/TN/320.2

48 *Source: SCRR analysis of Practical Law What's Market data*

the form of a going concern statement, viability statement or – in due course – resilience statement. In May 2022 BEIS published a response[49] to its March 2021 consultation paper[50], including updated plans for the resilience statement. When implemented these changes will incorporate and expand upon the current going concern and viability requirements. We briefly outline what each statement requires below.

(a) **Going concern statement:** The FCA's Listing Rules require premium listed companies incorporated in the UK to include in their annual financial report a statement from the directors on the appropriateness of adopting the going concern basis of accounting. The directors should also identify any material uncertainties to the company's ability to do so over a period of at least 12 months from the date the financial statements are approved. The going concern statement must contain specified information as set out in the UK Corporate Governance Code, and be prepared in accordance with FRC Risk Guidance[51].

(b) **Viability statement:** The FCA's Listing Rules also require premium listed companies incorporated in the UK to explain in their annual report how they have assessed the prospects of the company, taking into account the company's current position and principal risks. They must also explain the period over which they have done so and why they consider that period to be appropriate. The viability statement must contain specified information as set out in the UK Corporate Governance Code, and be prepared in accordance with FRC Risk Guidance[52].

The disclosure requirements in connection with a viability statement are very different from those that apply to a clean prospectus working capital statement. When the board states whether it has a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of the viability assessment, it is expected to draw attention to any qualifications or assumptions as necessary. FRC Risk Guidance outlines the nature of this disclosure. Broadly, qualifications or assumptions should be specific to the company's circumstances, be relevant to an understanding of the directors' reasons for making the statement and

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49 Restoring trust in audit and corporate governance: government response to consultation on strengthening the UK's audit, corporate reporting and corporate governance systems (publishing.service.gov.uk), BEIS, May 2022

50 Restoring trust in audit and corporate governance (publishing.service.gov.uk), BEIS, March 2021

51 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014

52 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014

include only those matters significant to the company's prospects. They should not include matters that are highly unlikely to occur or impact the company significantly.

FRC Guidance on Board Effectiveness indicates good practice is to clearly explain the underlying analysis that supports the statement, including a proper explanation of how the company has carried out its analysis. In a report on viability reporting[53], the FRC noted that investors wanted detailed information on scenario and sensitivity analyses and not just high level confirmations: 'Simply stating that scenario testing had been done was welcomed but not enough; investors wanted to know what scenarios were tested and the outcome, as well as the underlying assumptions.' Similarly in its recent thematic review[54], the FRC noted that 'Good viability statements should clearly describe each scenario and articulate any assumptions and judgements using both qualitative and quantitative information. It is important that the assumptions factored into the base case and any alterative scenarios are clearly disclosed.'

(c) **Upcoming resilience statement**: BEIS will introduce a statutory requirement to publish an annual resilience statement. The obligation will apply to listed companies (as well as other 'public interest entities'). The resilience statement will set out how directors are assessing the company's prospects and addressing challenges to the business model over the short, medium and long term.

(i) **Short-term:** The short-term section will incorporate companies' existing going concern statement, including disclosure of any material uncertainties considered by management during their going concern assessment that were subsequently determined not to be material after the use of significant judgement and/or the introduction of mitigating action (to the extent the directors consider such disclosure is necessary for shareholders and other users of the statement to understand the current position and prospects of the business).

(ii) **Medium-term:** The medium-term section will incorporate the existing viability statement requirements to provide an assessment of the company's prospects and resilience, and to address matters which may threaten the company's ability to continue in operation and meet its financial liabilities as they fall due. Companies must choose and explain the length of the assessment period. Companies will also need to do more to evidence scenario planning, with the results of at least one

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53 Business model reporting; Risk and viability reporting: Where are we now?, FRC, 8 October 2018,

54 FRC Thematic Review – Viability and Going Concern September 2021

reverse stress test summarised in the statement alongside any mitigating action put in place by management as a result.

Companies should also report on matters that they consider a material challenge to resilience over the short and medium term, together with an explanation of how they have judged that materiality. In doing so they must have regard to certain specified factors.

(iii) **Long-term:** The long-term section will set out what the directors consider to be the main long-term challenges to the company and its business model, and how these are being addressed.

Although the specific wording of the proposed statutory requirements and detailed guidance on the nature of disclosure around the resilience statement is yet to be determined, the direction of travel in relation to annual reports is clearly towards greater disclosure. Investors expect to see not only confirmations from management, but also evidence of how the board arrived at its conclusions.

7.66 The prospectus working capital process covers similar ground to annual report disclosures, and is ultimately prepared for the benefit of the same investor audience. As yet, however, the benefit of additional disclosure in addition to board confirmation has not been fully explored in this context. The FCA did, however, adopt limited alleviations for companies preparing working capital statements during the Covid-19 pandemic.

Covid-19 period temporary changes to working capital statements

7.67 On 8 April 2020 the FCA published a technical supplement[55] outlining a change in its approach to working capital statements in prospectuses and circulars. The amended approach applied for documents approved up to 28 June 2022[56].

7.68 During Covid-19, the uncertainties inherent in the pandemic meant that many companies found it challenging – or impossible – to construct the 'reasonable worst-case scenario' required for the preparation of a working capital statement. In consequence, these companies faced, as a technical matter, having to include a qualified working capital statement in a prospectus even where they had no overall working capital concerns. The FCA recognised that if qualified statements were to become routine, this would make it difficult for potential investors to identify companies that had genuine working capital problems that went beyond Covid-19 uncertainty. To deal with this problem,

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55 Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis | FCATechnical Supplement – working capital statements in prospectuses and circulars during the coronavirus epidemic (fca.org.uk)

56 Primary Market Bulletin 39 | FCA

therefore, the FCA modified its approach on a temporary basis to allow key modelling assumptions underpinning the reasonable worst-case scenario to be disclosed in an otherwise clean working capital statement. The assumptions were permitted only to relate to the pandemic.

7.69 This alleviation has been used for the last two years. 19 of 35 main market rights issues and open offers with a prospectus in that period supplemented a clean working capital statement with a summary of Covid-19-specific assumptions underpinning the assessment of the directors[57]. This contrasts with five that provided qualified working capital statements[58].

Recommendation: The FCA's approach to working capital statements, whereby clean statements cannot be accompanied by disclosure of assumptions made by the company in making its confirmation, should be reconsidered and revised to allow greater flexibility

7.70 The prospectus working capital statement and annual report going concern, viability (and, in due course, resilience) statements each provide a forward-looking assessment of the company. Each is also targeted at that company's existing or potential investor base. At present however, disclosure that represents best practice in the context of an annual report is not permitted where a clean working capital statement is made in a prospectus. We think that the approach taken to prospectus working capital disclosure should be updated to better reflect the expectations of investors accustomed to annual report-style information – and to give a fuller picture of a company's financial position that can then be discussed by investors with management as they see fit.

7.71 In its research on annual report viability reporting, the FRC has noted demand from investors for more information on the analysis and assumptions used by management to support their forward-looking confirmations. At present this can only be done in a prospectus context if a qualified working capital statement is included. This is not a practical option for issuers wishing to provide greater context, as the UK market rightly expects a clean statement where there are no significant working capital concerns, and deviation from this market standard is likely to impact support for a secondary offer. The current approach would therefore result in a technical requirement for a qualified working capital statement when actually the relevant issuer's financial position is fundamentally sound. Qualified working capital statements should only be triggered when there is a clear and genuine working capital concern and issues with a company's financial position.

7.72 As such, we recommend that the rules around clean working capital statements be recast to allow issuers to provide further information to investors on the assumptions used to arrive at their working capital confirmation. A change to

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57 *Source: SCRR analysis of Practical Law What's Market data*

58 Ibid

current guidance would avoid working capital disclosure limitations acting as a potential disincentive to issuers considering use of the capital markets to meet their funding needs. We believe it would also benefit investors who would receive similar detail at the point of a capital raising as is included in a company's periodic reports. The additional disclosures included during the pandemic period did not lead to disruption in the markets. This approach would not decrease the disclosure required of issuers – it would actually increase it – but would provide additional flexibility and explanation where management felt this was appropriate. It is fully in line with the sound 'caveat emptor' or buyer beware principle, that in the capital markets issuers should make requisite disclosure and then investors should be able to decide whether or not they wish to invest in the company having considered it.

7.73 It is important to note that the aim of our suggested approach is not to diminish the importance of the working capital statement itself, which will remain a key confirmation from management when it is required to be given. In its consultation[59] on the UK Prospectus Regime Review, HMT indicated it was minded to retain the higher, negligence standard of responsibility for working capital statements rather than the recklessness standard proposed for other forward-looking information, reflecting the importance of the working capital confirmation as a key point of reference for investors. We note that on implementation of the outcome of that review, authority to decide the liability standard that will apply will be delegated to the FCA. Whatever standard of liability is felt to be appropriate, prospectus responsibility will continue to apply and the statement will remain as a clear confirmation on which investors can rely. We believe the utility of the confirmation to investors should be further enhanced by the inclusion of detail of the assumptions underpinning the analysis undertaken by the issuer. We note that the proposed approach has similarities to that used at present in relation to profit forecasts.

Recommendation: Current overlap between working capital diligence exercises and annual report disclosures should be addressed

7.74 The overlap between work required for a prospectus working capital statement and an annual report going concern statement is already being discussed by an FCA and FRC working group. Work should be progressed in this area as soon as possible.

Importance of vote

7.75 Another area of disclosure that respondents to the Review felt would benefit from reconsideration is so-called 'importance of the vote' language. This is required where a premium listed company carries out a refinancing or reconstruction and prepares a circular, or a combined prospectus and circular, in connection with that transaction.

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59 Consultation on the UK prospectus regime (publishing.service.gov.uk)

7.76 The FCA's Listing Rules require a circular prepared in connection with a refinancing or reconstruction to contain specified content[60], including a working capital statement. In the context of this type of 'rescue' transaction this statement will typically be qualified.

7.77 As noted above, currently additional disclosure is required around a qualified working capital statement to ensure investors are fully informed with regard to the issuer's working capital position. This should include:

(a) **Relative timing:** details of when the issuer expects to run out of working capital;

(b) **Shortfall:** the approximate quantum of any working capital shortfall;

(c) **Action plan:** the action plan the issuer proposes to rectify that shortfall, including specific proposed actions, for example, refinancing, renegotiation of existing credit terms or facilities or the entry into new such arrangements, decreases in discretionary capital expenditure, potential cancelling of discretionary dividends, revisions to the issuer's strategy or acquisition plans or asset sales. The guidance also emphasises that it is important that the issuer explains how confident or otherwise they are that these actions will be successful and the timing of the proposed actions; and

(d) **Implications:** where relevant, the implications of any of the proposed actions being unsuccessful, for example, whether an issuer is likely to enter into administration or receivership and if so, when.

7.78 A reconstruction or refinancing circular requires approval by the FCA[61] and must comply with the content requirements of LR 13. This includes the requirement, where voting or other action is required, that it contain all information necessary to allow shareholders to make a properly informed decision. FCA guidance[62] emphasises that this includes clear disclosure regarding the impact on the company if the transaction does not go ahead.

Recommendation: Approach to importance of vote language should be revised with a focus on the rationale for the quantum of fundraising and use of proceeds

7.79 We agree that shareholders should be fully informed when asked to support a reconstruction or refinancing. However, the current approach can require issuers to include disclosure on highly hypothetical outcomes, giving undue prominence to a chain of events based on the least positive result at each step – which multiplies uncertainties. Investors may assume that disclosure represents a sequence that management believe is likely to occur, even when this is not the case. In such circumstances issuers may, ironically, fail to gain

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60 LR9.5.12R(1)

61 LR 13.2.1R(4)

62 Primary Market Technical Note: Refinancing and reconstructions (fca.org.uk)

the support necessary to remain viable as they are not permitted to give a representative view of the company's position to shareholders through the disclosure.

7.80 The Review believes that disclosure to meet the requirements of LR 13 should focus on key elements of importance to shareholders. These are likely to be the rationale for quantum of funds being raised, and details of how those proceeds will be used. The inclusion of artificial hypothetical scenarios is not helpful to investors and where confusion arises it can endanger the continued viability of an issuer. We recommend that the FCA reconsider the way in which it interprets current guidance, and that should be reformulated to ensure issuers have greater latitude to determine the necessary information to give to their shareholders in the context of a reconstruction or refinancing.

8. MAKE EXISTING FUNDRAISING STRUCTURES QUICKER AND CHEAPER

Introduction

8.1 As outlined in Section 3, a pre-emptive offer is a way for a company to raise equity funds and respect the right of its existing shareholders to maintain their proportional ownership. It does this by giving them a ‘right of first refusal’ to subscribe for their pro rata share of a new issue of shares, before they can be offered to any new investor.

8.2 This right of existing shareholders is set out in both the Companies Act 2006, for companies incorporated in England and Wales, and in the FCA’s Listing Rules, for all companies (wherever incorporated) that have shares admitted to the premium listing segment of the Official List. While these requirements set out the principle of pre-emption that must be respected, and set out some basic requirements that must be met in relation any pre-emptive offer, they leave companies the flexibility to choose the pre-emptive offer structure that best suits their circumstances.

8.3 In this section we consider the different types of pre-emptive offer currently available to UK listed companies. We then consider whether changes are needed to make these processes work better, both for UK listed companies and for investors, and discuss areas of potential improvement highlighted in the course of the Review. We also consider the form of documentation that should be required for an offer not involving a prospectus.

Pre-emptive offer structures

8.4 A company wishing to make a pre-emptive offer to its shareholders can structure it as a rights issue or as an open offer. We set out more detail on the similarities and differences of these two structures in Part 1 of Annex F, but in summary:

(a) **Rights issue:** A rights issue is seen as the ‘gold standard’ of investor protection as it has two key features: it provides shareholders with a ‘tradeable’ right to subscribe for shares that they can either use or sell, and it provides the possibility of monetary compensation for the dilution suffered by shareholders that take no part in the offer.

(b) **Open offer:** A traditional open offer allows each investor to ‘follow their money’ in proportion to their existing holding, but does not make provision for investors who would rather receive cash than their pro rata shares. Shareholders cannot sell their right to subscribe for shares in an open offer, and if they do not participate they do not receive any compensation (although an infrequently used variation on the traditional open offer structure, called a compensatory open offer, does add-on the possibility of monetary compensation for non-participating shareholders).

8.5 Open offers by companies on the main market are generally accompanied by a non-pre-emptive placing to a small number of new or existing investors with some or all of these placing shares subject to 'clawback' into the open offer. This means that if shareholders entitled to participate in the open offer choose to take up their entitlements, the company can reduce the number of shares that will be issued to the placees to satisfy that demand. If open offer entitlements are not taken up, however, this structure means that they are automatically taken by placees, providing certainty to the company that it will raise the funds it requires.

Why make changes to the current pre-emptive offer processes?

8.6 It is generally accepted that pre-emptive offers strike the best balance between the need of a listed company to raise equity funding and protection of the right of existing shareholders to avoid unwanted dilution.

8.7 And yet in the period that the PEG disapplication relaxation was in force, 1 April 2020 to 30 November 2020, there were 75[63] secondary offers by companies listed on the main market, of which only 20[64] included a fully pre-emptive offer element. These were 12[65] open offers and eight[66] rights issues. These pre-emptive offers represented in aggregate just over 45%[67] of value raised in the period, but they were not the first choice of the majority of companies seeking fresh funds.

8.8 Boards need to consider the relative costs of each fundraising structure, the time management would need to divert to the process, the speed at which funds would be made available to the company and the share price volatility that may arise during an extended process. Premium listed companies typically only use a rights issue or open offer when seeking to raise a significant amount of capital. Although smaller issues could be structured in this way, the additional requirements involved in a fully pre-emptive offer can act as a deterrent.

8.9 The aim of the Review, therefore, has been to identify areas within the current pre-emptive offer structures that can be streamlined and improved. A reduction in the time and cost involved in rights issues and open offers may enable boards to conclude that a pre-emptive offer along those lines is a more viable alternative to a placing than at present.

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63 *Source: SCRR analysis of Practical Law What's Market data*

64 Ibid

65 Ibid

66 Ibid

67 Ibid

Areas of concern with current pre-emptive offer structures

8.10 A common criticism of both the rights issue and open offer structures is that their timetables are too long. The difference in timeline between these structures and a non-pre-emptive placing as discussed in Section 5 is marked.

8.11 A placing using an accelerated bookbuild (ABB) structure can be prepared in a few days, with the offer itself usually open for only a few hours. Funds can be in the hands of the company in days not weeks. In contrast, at present, both a rights issue and an open offer require a prospectus, with associated sponsor appointment, comfort process and regulatory review. It typically takes a minimum of six weeks, and often longer, to prepare and obtain FCA approval for a prospectus. Where a deal is required to be announced early, as will be the case if the deal leaks to the market during this preparatory phase or the company otherwise has to announce its financial condition, the company's share price will be vulnerable to market movements throughout.

8.12 This pre-launch preparation period is of course already the subject of the proposed reforms set out in HMT's UK Prospectus Regime Review. When implemented, these changes will remove the automatic need for a prospectus on public offers by listed companies of shares already admitted to trading on a UK regulated market, instead leaving it solely for the FCA to decide when a prospectus will be required in connection with the application for admission to trading. If a pre-emptive offer can proceed without a prospectus the preparation phase will be significantly reduced, making pre-emptive offers more attractive as fundraising options.

8.13 The Review strongly welcomes the HMT UK Prospectus Regime Review reforms as a key step towards streamlining pre-emptive processes. We discuss some further proposals for improvements to other elements of this pre-launch period in Section 7, including the Review's recommendations on when an admission to trading prospectus should be required, and a revised approach to the regulatory and associated comfort processes.

8.14 In this section, we focus on the post-launch timetable constraints on pre-emptive offers: minimum offer period, the reasons that companies need to call a general meeting in relation to a pre-emptive offer and the notice period where one is required.

Minimum offer period

8.15 At the moment, premium listed companies that want to make a fully pre-emptive offer to their shareholders have to give their shareholders at least 10 business days to decide if and how they want to participate. Companies incorporated in England and Wales have an overlapping requirement to keep the offer open for 14 calendar days. In practice these two periods are generally aligned, although there can be discrepancies where an offer runs over a period with extended public holidays.

8.16 This minimum offer period has been in place since 2009, when it was shortened following the report of the Rights Issue Review Group (RIRG)[68]. Although the RIRG recommended a 14 day period, it did so only because it was constrained by two factors.

(a) **EU law:** Firstly, EU law required the UK to have a minimum period no shorter than 14 days (EU Second Company Law Directive), so their proposal reflected the shortest offer possible under prevailing law.

(b) **Structural challenges:** Secondly, there were structural challenges with a shorter time limit in 2009, when electronic dissemination of information and the associated technology to enable it was less pronounced than is the case today.

8.17 Had these factors not been in play, the RIRG was of the view that one week might be the ideal period for a rights issue. The reasons for that view remain valid today. A one week offer period would meaningfully reduce the delay in the issuer receiving the proceeds of the offer. A quicker process would be attractive to issuers, reducing the disincentive to use a fully pre-emptive offer. It would also minimise concerns about market risk and price volatility in an extended offer period, limiting the scope of any short selling strategies.

Price volatility

8.18 The extended period in which a pre-emptive offer must remain open to investors can expose an issuer to the risks of price volatility. While particular concerns arise where a deal is leaked early in the process, allowing short sellers to target the shares prior to announcement of a priced deal in the expectation of covering shorts at a lower price by taking part in the upcoming offer, similar pressures can be felt on deals that are not required to announce early. The current length of offer period required of a rights issue or open offer can leave issuers exposed to activities that may depress the share price for longer than is desirable and to a point that can make a proposed deal no longer viable. This can reduce the confidence of issuers in the capital markets as a source of funding, and may raise the cost of capital for companies seeking funding elsewhere.

8.19 The Call for Evidence specifically sought views on whether the greater transparency around short selling that was introduced after the financial crisis remains fit for purpose. Although not a point covered by many responses to the Review, the general view of those considering this topic was that the transparency brought in by the UK Short Selling Regulation had been effective, particularly since the lower 0.1% threshold was introduced in the UK in February 2021. Respondents to the Review recognised that short selling could contribute usefully to liquidity and price discovery in normal market conditions, although there was perhaps less certainty that this was always true in the context of an offer. While an outright ban on short selling

68 A Report to the Chancellor of the Exchequer: by the Rights Issue Review Group, November 2008

during an offer period would not be appropriate, a limited number of respondents acknowledged there could be arguments for widening the range of circumstances in which the FCA is able to introduce restrictions or temporary bans on short selling. Currently the FCA can only take this step where there is a serious threat to financial stability or market confidence. Reform in this area may be a matter the FCA wishes to consider in the context of any future review of the operation of the UK Short Selling Regulation.

8.20 The key theme of respondents who commented on this area, however, was that shortening the length of the offer period would bring significant benefits to listed companies. Reducing timescales would compress liquidity and reduce the scope for short selling activities. In this Report, therefore, we have focused on the clear benefit that shortening the minimum offer period would have in terms of minimising the potentially adverse impact of short selling on companies in the process of conducting an offer.

Belgian synthetic rights issues

8.21 We have considered the minimum offer periods that apply in a number of other jurisdictions. Of particular note is that, although EU law mandates a pan-EU minimum of 14 days, Belgium has taken unilateral steps to streamline its processes.

8.22 EU rules[69] require all member states to keep a pre-emptive offer to shareholders open for a minimum of 14 days from the date of publication of the offer or from the date of dispatch of letters to shareholders. In Belgium, however, companies commonly use a ‘synthetic rights issue’ structure to shorten this timetable.

8.23 Under the Belgian statutory procedure, preferential subscription rights can be exercised during a period of at least 15 days. In addition, the capital increase and offer period has to be announced in the Belgian Official Gazette (*Moniteur belge*/*Belgisch Staatsblad*), in the financial press and on the company’s website at least eight days prior to the start of the offer period.

8.24 The synthetic rights issue structure is designed to be a nimbler procedure. Statutory preferential subscription rights are cancelled, by the company in general meeting or by the board, and replaced by ‘synthetic’ (‘extra-statutory’ or ‘extra-legal’) subscription rights which confer the same rights on all existing shareholders. These synthetic rights can be given a shorter exercise period, generally one week. There is no need to pre-announce the rights issue in the Belgian Official Gazette. No recent Belgian rights issues have used the statutory procedure.

69 Article 72, Directive (EU) 2017/1132

Recommendation: Reduce minimum offer period for rights issues and open offers to seven business days

8.25 It is the recommendation of the Review that a seven business day offer period be adopted for pre-emptive offers complying with s561 Companies Act 2006. Although shorter periods were suggested to the Review, there are a number of considerations that suggest that a seven business day period is most appropriate.

(a) **Electronic communications:** We discuss in Section 10 our view that electronic communications should be the default way in which listed companies communicate with their investors. It remains the case, however, that until such time as full dematerialisation occurs, some shareholders will inevitably continue to hold in paper form, outside the intermediated securities chain.

While timetables should ideally not be driven by shareholders that rely on physical forms of delivery to receive information from the company and return their instructions, their involvement should not be made practically impossible and this would in any event run counter to various other considerations, including those of appropriate consumer protection. Any change to a solely electronic model should be clearly signposted to shareholders well in advance, ideally at a market level, so that individuals have the opportunity to make alternative arrangements for participation in advance of an offering.

From our discussions with participants involved in the administration of share offerings, a minimum offer period of seven business days would represent a workable compromise between the desire of the listed company to complete an offer without unnecessary delay and ensuring that all investors, however they hold their shares, have the opportunity to participate.

(b) **Investment decision:** Professional investors are accustomed to making quick investment decisions. This is the lynchpin of the placing structure and it is one that works well for this category of offering. It is not unreasonable to expect an investment professional to be sufficiently up-to-speed on the public information made available by a listed company in which they are invested and to have quick visibility on their desire and ability to fund the take-up of new shares. It is less clear, however, that it is reasonable to have similar expectations of the average retail investor.

In this regard the Review has considered experiences with retail offers during the Covid-19 pandemic (as further discussed in Section 5). During this period retail investor platforms allowed individual investors to participate in a retail offer alongside an institutional placing, requiring an investment decision from those participants on the same compressed timeline as institutions. Although that process showed that this offer format worked well for a subset of retail investors, the Review notes that this experience relates only to active investors registered with the relevant platform and even then only those who were actively monitoring notifications of secondary offers at the correct time. It was also not possible at the time to accurately identify which platform users were existing shareholders and which were new investors except through a self-certification process. A pre-emptive offer is open to all shareholders, some of whom may be longer term holders rather than active traders. A longer period of time for shareholders to not only receive information, but also to absorb and reflect on that information in light of their own circumstances, would seem to be appropriate.

It is our view that a period of one week provides enough time for this decision-making process across a diverse shareholder base. It will also provide a period in which shareholders can make arrangements to fund their take-up of shares. As pre-emptive offers are typically larger than placings, with a greater discount to the market price, shareholders face potentially larger dilution than would be the case on a placing if they do not participate.

(c) **Access to management:** Not all institutional investors are wall-crossed, and those investors not part of that process will want time to test the proposed offer, in particular its quantum and use of proceeds, with management. Although many of the arguments in favour of a minimum offer period relate mostly to retail shareholders, this factor is likely also to be relevant to institutions with smaller holdings. These holdings may well be sizeable stakes for the relevant institution, which may therefore need time to diligence further investment. On an open offer, the offer period will be the entire time available to investors to make these assessments, whether or not a general meeting is required. This will also be the case on a rights issue where no general meeting is required.

8.26 The example of Belgian practice would suggest that the market could be left to determine minimum standards rather than regulation mandating a minimum offer period. The Review has considered this option. As the UK market has long had a minimum, however, the Review believes it would be helpful to retain the certainty of a market standard minimum offer period. The Review would support keeping this minimum period under review, however, as it may be that future technological changes, including where dematerialisation may lead, as well as developments in investor behaviour mean that an even shorter period becomes possible. A shorter minimum offer period may also be appropriate if market practice develops to make routine additional ways for existing shareholders to participate, for example by telephone or through an online acceptance and payment route.

8.27 The same minimum offer period should apply under statute, in the FCA’s Listing Rules and other relevant requirements such as the admission and disclosure standards of the regulated market operators such as London Stock

Exchange. As far as practicable the time period required under legislation and each rulebook should use the same terminology and reference points, to mark the start and end of the period, to simplify compliance for listed companies.

Need for a general meeting

8.28 But it is not enough just to shorten the offer period. Another significant factor to the extended post-launch timetable of a rights issue or open offer can be the need to hold a general meeting.

8.29 There are two main reasons that may require a listed company to hold a general meeting in connection with the launch of a fundraise: to increase the directors' authority to allot shares, and to increase their authority to do so without compliance with statutory pre-emption rights. While there may of course be other reasons that a listed company needs to hold a general meeting in connection with a transaction that involves a secondary offer, for example to approve an associated acquisition where required under the significant transaction rules in Chapter 10 of the FCA's Listing Rules, these two requirements are the focus of this Review as they will be considerations on any large secondary capital raising.

Authority to allot

8.30 Authority to allot shares is given to the directors of a company by shareholders, typically on an annual basis at its annual shareholder meeting (AGM). We set out more detail on the usual form of this authority in Part 2 of Annex F, but the level approved for non-pre-emptive offers is typically one third of the company's existing share capital with a further one third approved for fully pre-emptive rights issues only.

8.31 The standing authority to allot for non-pre-emptive offers is generally sufficient for a company wishing to carry out a placing. The size constraint on these offers tends to come from the level of disapplication of pre-emption rights or (where a cash box is used) from the current 20% admission to trading prospectus threshold.

8.32 An open offer is not a 'fully pre-emptive rights issue' so it is required to fall within the same authority to allot bracket as a placing. As main market companies typically only undertake an open offer for offers larger than an ABB, this limit is often too low for an open offer to proceed without returning to shareholders for further authority. As noted above on an open offer the general meeting and open offer periods can run concurrently, but the process still adds unnecessary administrative steps and introduces uncertainty to a pre-emptive offer.

8.33 Fully pre-emptive rights issues benefit from a higher two-thirds authority to allot. However, this is still often too low for larger deals, which is where rights issues are typically most used.

8.34 In the five year period from 2017 to 2021, 36[70] rights issues were undertaken by main market listed companies. Of these, just over 61%[71] were for 66% of existing share capital of less. The remaining 39%[72] were for higher amounts, requiring (for companies incorporated in England and Wales) a general meeting to be called to increase the directors' authority to allot.

8.35 In the same period, 35[73] open offers were undertaken by main market listed companies. Of these, around 26%[74] were for 33% of existing share capital or less. The remaining 74%[75] were for higher amounts, requiring a general meeting to be called to increase the directors' authority to allot.

Size of standard authorities to allot

8.36 One solution to minimise the need for a general meeting to be called in relation to a secondary offer would be to increase the threshold percentage allotment authority that companies could seek each year from shareholders. This was raised in submissions to the Review, with proposals for no limit or a higher limit of 100%.

8.37 Authority to allot resolutions on the current basis are well supported by shareholders and the market guidance from the Investment Association is long-standing and broadly accepted by the market. In the five-year period 2017 to 2021 for companies in the UK FTSE All Share index, there were 13, 21, 21, 13 and 17 significant votes (20% or more) against authorities to allot[76]. Only five[77] resolutions were not passed (an authority to allot resolution requires a simple majority – 50%+ of those present and voting – to pass).

8.38 2017-2021 main market data shows that the larger rights issues were for amounts considerably greater than the standing authority to allot. The largest offer size was 2400%[78] of existing share capital. In that period, increasing the standing allotment authority to 100% would have impacted only four rights issues.

8.39 On this basis the Review has decided against recommending any change to the typical standing allotment authority threshold for a rights issue. We discuss

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[70] *Source: SCRR analysis of Practical Law What's Market data*

[71] Ibid

[72] Ibid

[73] Ibid

[74] Ibid

[75] Ibid

[76] The Public Register / The Investment Association (theia.org)

[77] Ibid

[78] *Source: SCRR analysis of Practical Law What's Market data*

below, however, our recommendation to facilitate open offers – and other forms of pre-emptive offer that may be developed as discussed in Section 9 – by broadening the scope of the two-thirds allotment authority that is currently limited to fully pre-emptive rights issues.

Recommendation: Changing scope of the two-thirds authority to allot

8.40 At present, as noted above, investor guidance suggests the full two-thirds authority to allot be available only for use on a fully pre-emptive rights issue. All other offers, from a completely non-pre-emptive ABB to an open offer made in compliance with the statutory and Listing Rule pre-emption provisions, are restricted to one-third only.

8.41 The term fully pre-emptive rights issue is not defined in investor guidance, but the FCA's Listing Rules use the term rights issue to mean a pre-emptive offer including both tradeable rights and compensation for non-participating shareholders. The key elements originally highlighted by the Investment Association as informing its recommendation, however, are the protections afforded by pre-emption rights and the significant transaction rules set out in Chapter 10 of the FCA's Listing Rules. Both of these elements apply to an open offer (and to other forms of pre-emptive offer that may be adopted, such as the follow-on offers discussed in Section 6).

8.42 The Review believes it is important to incentivise the use of pre-emptive offers, and that widening the scope of the two-thirds authority would help companies to take the route of an open offer, or follow-on offer. An expansion in the scope of offers that came within the two thirds authority to include any pre-emptive structure, not just rights issues, would reduce the need for a general meeting in relation to a larger proportion of open offers. In the years 2017-2021 general meetings would not have been required on an additional 20%[79] of open offers by main market companies if authority to allot for that type of issue had been available on a standing basis up to 66%.

8.43 As noted above, HMT's UK Prospectus Regime Review will remove the need for a public offer prospectus and empower the FCA to determine when an admission to trading prospectus is required. This Review has recommended in Section 7 that the admission to trading prospectus threshold be raised to 75%. This presents an opportunity to move market practice towards more routine use of open offers or other pre-emptive offers alongside ABBs. We discuss this in the context of follow-on offers in Section 6. On AIM, where retail offers can be structured to avoid a prospectus as the admission to trading trigger does not apply, of 81 open offers made since the introduction of the €8 million public offer prospectus exemption, only three have required a prospectus[80].

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[79] Ibid

[80] *Source: SCRR analysis of Practical Law What's Market data (period 21 July 2018 to 13 June 2022)*

8.44 The Review therefore recommends that the flexibility to issue up to two-thirds of existing share capital be extended beyond fully pre-emptive rights issues to include any pre-emptive offer. This should include any form of rights issue or open offer.

Notice period

8.45 At present, London listed companies are typically required to give shareholders 14 days' notice of a general meeting[81].

8.46 As with the minimum offer period, this is a requirement driven by time limits based on physical delivery of documents. As such, it is appropriate to revisit its application and test its relevance given the availability of electronic communications. We discuss in Section 10 our recommendation that electronic communications should be the default form used by companies to communicate with their investors.

Recommendation: Flexibility to reduce the notice period where a general meeting is required

8.47 As the Review has decided not to seek to eliminate the need for a general meeting on secondary offers, our recommendation instead is to streamline the process for obtaining shareholder authority where this is required.

8.48 There was a general view from respondents to the Review that a 14 day notice period is unnecessarily long, and imposes unwarranted delays on the capital raising process. A reduction to this period would, however, represent a challenging timetable for investors that hold through an intermediated shareholding chain, as they would need to receive information from intermediaries more quickly and have a shorter turnaround to return voting instructions. For these reasons we are not recommending an immediate change to the notice period for general meetings, although we believe that this should be the aim of reform as soon as the necessary operational systems are in place.

8.49 To make it easier for the statutory period to be adjusted when conditions permit, we recommend instead that the Companies Act 2006 be amended to delegate to the Secretary of State the authority to reduce the notice period for shareholder meetings to seven clear days. This change will mean that no further primary legislative amendment would be required to effect this change in future.

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[81] Although section 307A(1)(b) Companies Act 2006 specifies a minimum notice period of 21 clear days' notice, listed companies typically take steps to meet the conditions necessary to shorten this to 14.

Inefficiencies in statutory pre-emption provisions

8.50 As discussed in Section 5, the primary reason that companies seek a general disapplication of pre-emption rights is to give the directors a degree of flexibility on smaller issues of shares.

8.51 A further reason, however, is to modify the way that pre-emption is applied when a listed company makes a pre-emptive offer (for example, a rights issue or open offer). Although technically a 'disapplication' of statutory pre-emption rights, this aspect of the usual resolution seeks permission from shareholders to respect pre-emption but in a more flexible way than the law of England and Wales currently allows.

8.52 In this section we consider the detail of the right of pre-emption as it applies under the law of England and Wales, in the FCA's Listing Rules and as typically applied by listed companies that have put in a place a 'modification' disapplication authority. We then consider whether pre-emptive offers could be made more efficient by making market-level changes to the way the right of pre-emption is applied.

Advantages of 'modifying' pre-emption rights

8.53 Shareholders in premium listed companies incorporated in England and Wales have pre-emption rights under both law and regulation. We set out in Part 3 of Annex F details of the pre-emption rights applied by the Companies Act 2006 (to companies incorporated in England and Wales), by the FCA's Listing Rules (to all companies admitted to the premium listing segment) and those that are typically adopted by companies that put in place a 'modification' disapplication resolution.

8.54 The table in Part 4 of Annex F summarises the key differences between the way pre-emption rights work under Companies Act 2006, the FCA's Listing Rules and the typical provisions applied by companies that use a pre-emption disapplication resolution to allow a modified form of pre-emption on a rights issue or open offer. There are three main advantages to disapplying pre-emption rights:

(a) **Overseas shareholders:** The shareholders of a London listed company can be located in many global jurisdictions. On-market trading means that those shareholders can include retail investors. While on a non-pre-emptive offer investors can be included from many jurisdictions without undue cost, this is because they can generally be selected to participate in compliance with exemptions from local public offer rules. Usually this means including only institutional investors in a placing. On a pre-emptive offer, however, where all shareholders on a register have to be included, that is unlikely to be possible. As such, if a listed company were to send offer documents to all its shareholders as required by pre-emption, it would have to comply with potentially onerous local public offer requirements in multiple jurisdictions, which is likely to be cost prohibitive and lengthy in terms of time.

The statutory regime does have a procedure in place that can deal with this difficulty, allowing an offer to be made by publishing a notice in the Gazette (one of the official newspapers of the Crown – companies incorporated in England and Wales will use the London Gazette) instead of sending documents into foreign jurisdictions. This is known as the 'Gazette route'. Although the Gazette route makes offers to foreign shareholders possible, it still requires that the offer be made to those shareholders.

Where statutory pre-emption rights are disapplied, a company can decide not to offer rights to certain overseas shareholders (typically the US, Australia, Japan and other jurisdictions with onerous local offer requirements), and instead arrange for the rights otherwise attributable to those persons to be sold, nil paid, as soon as dealings commence with the profits paid to those shareholders.

(b) **Fractions:** Where pre-emption rights have been disapplied, fractional entitlements can be aggregated and sold in the market for the benefit of the issuer. Where section 561 applies, shareholder entitlements will be rounded down to a whole number with fractions disregarded. This often means that a prospectus has to be issued in relation to an 'up to' offer size, as the number of fractions cannot be calculated until later in the process.

(c) **Convertible securities:** Where a company has convertible securities in issue, it may not be possible for it to comply with section 561. Section 561(1)(a) requires that the rights issue offer is made to each person who holds 'ordinary shares', which does not include convertible bonds. As such if the terms and conditions of the convertible bond require that an offer be made to them too, the company will not be able to comply with section 561 and will need to pass a disapplication resolution. Similar problems arise where a company has in issue a class of convertible preference shares.

Recommendation: Update of pre-emption provisions in the Companies Act 2006

8.55 The market has accepted that a rights issue or open offer that complies with the modified form of pre-emption put in place after a shareholder resolution has been passed that disapplies statutory pre-emption rights is pre-emptive in substance. The Investment Association does not specify that a fully pre-emptive rights issue for the purposes of its authority to allot guidance must comply with the statutory pre-emption regime; similarly, the Pre-Emption Group does not include guidance on the precise method by which pre-emption should be respected in its Statement of Principles.

8.56 In practice, therefore, it is relatively rare for a listed company to make an offer that complies with statutory pre-emption rights. In the five year period from 2017 to 2021, main market companies incorporated in England and Wales only made seven statutory rights issues (compared to 21 where statutory pre-emption rights were disapplied) and three statutory open offers (compared to 24 where statutory pre-emption rights were disapplied)[82].

8.57 It is the recommendation of the Review that the pre-emption provisions in the Companies Act should be updated to align them with the process that is followed when statutory pre-emption rights are modified. This will allow listed companies to exclude shareholders in cost prohibitive jurisdictions, allow greater flexibility on how to deal with fractional entitlements and allow the inclusion in the offer of holders of other securities that have a contractual right to be included.

Minimising the size of the rump of shares not taken up

8.58 As discussed further below, when we consider the documentation required for a pre-emptive offer that does not need a prospectus, a key factor driving long form disclosure is any ‘rump’ of shares not taken up. While existing shareholders in overseas jurisdictions are normally excluded in pre-emptive offers, save for certain institutional investors, where a process may leave the underwriting banks with a significant number of shares to place into the market as they have not been taken up by existing shareholders there is often a desire to be able to seek buyers in overseas jurisdictions. This typically includes the US, where the need to provide banks with a defence against potential investor claims often supports an enhanced diligence process pre-launch and long form disclosure.

8.59 In this section, therefore, we consider ways in which any rump of shares not taken up could be minimised in size.

Excess applications

8.60 In the UK, as discussed above, there are two different pre-emptive offer structures: rights issues, and open offers. It is also possible to add a compensatory element to an open offer, although this option is not commonly used. The table below summarises the features distinguishing traditional rights issues and traditional and compensatory open offers.

[82] *Source: SCRR analysis of Practical Law What’s Market data*

Feature	Traditional rights issue	Compensatory open offer	Traditional open offer
Fully pre-emptive	Yes	Yes	Yes
Tradeable rights	Yes		
Cashless take-up	Yes		
Compensation for non-participants	Yes	Yes	
Excess application facility		Yes	Yes

8.61 One feature that is common on an open offer is an excess application facility. Shareholders are invited to apply for any number of shares, with a guaranteed ‘minimum entitlement’ representing an amount in proportion to their existing holding. If any shareholder declines their minimal entitlement, those shares are allocated to shareholders that applied for shares in excess of their minimum entitlement. If excess applications made by shareholders cannot be met in full as there are more than the number of shares not taken up, applications made by each shareholder are scaled down (the basis for scaling may be left to the discretion of the board, or be set out in the terms and conditions of the offer, for example, pro rata to applications made).

8.62 A key advantage of this sort of facility is that it reduces the number of shares left untaken at the end of the pre-emptive offer process. Shareholders seeking to increase their shareholding can do so at the offer price. Where this excess demand from existing shareholders exceeds the number of shares not taken up, no shares are left to be taken by underwriters. A combination of excess applications and the use of conditional placings mean it is uncommon for a traditional open offer to require a rump placing of shares.

8.63 At present, it is not possible for a premium listed company undertaking a rights issue to have an excess application facility without obtaining a waiver from the FCA’s Listing Rules. These require that a rights issue – defined as a pre-emptive secondary offer that provides existing shareholders with a tradeable entitlement – must have a rump placing if existing shareholders do not take up their rights to subscribe. This is to provide compensation for non-participating shareholders, who take any premium to the offer price if the shares they did not take are sold by the underwriting banks on their behalf for more than the original subscription price (subject to a de minimis threshold of £5, and after expenses are deducted).

8.64 The September 2020 rights issue by International Airlines Group (IAG) provides an example of how the traditional UK rights issue could be adapted to provide an excess application facility. The IAG process followed Spanish market practice and a waiver of the rump placing requirement was obtained from the FCA. Existing shareholders of IAG were given tradeable rights to subscribe for shares, as on a traditional UK rights issue. Shareholders – or third parties who had acquired rights sold by shareholders – taking up those rights were able in addition to express an interest in subscribing for additional shares, if any were not taken up by existing shareholders under their initial entitlement. At the end of the preferential subscription period, any rights not exercised lapsed without compensation to the original shareholder. Shares not taken up were then allocated to those who had made an excess application.

8.65 To facilitate comparison, the table below shows how a rights issue with an excess application facility compares to the three existing UK options:

Feature	Traditional rights issue	Proposed – Rights issue with excess application facility	Compensatory open offer	Traditional open offer
Fully pre-emptive	Yes	Yes	Yes	Yes
Tradeable rights	Yes	Yes		
Cashless take-up	Yes	Yes		
Compensation for non-participants	Yes		Yes	
Excess application facility		Yes	Yes	Yes

Recommendation: Ability to have excess application mechanics attached to rights issues

8.66 The Review believes that this structure strikes an effective balance between the advantages of a rights issue and an open offer.

(a) **Cash in lieu of shares:** While non-participating shareholders would lose their right to automatic compensation through the rump placing, they would retain their right to sell their tradeable right to subscribe.

The ability to sell rights means shareholders could still opt to receive cash compensation in return for reducing their proportional interest in the company, an option not available on a traditional open offer. This would require some action on the part of investors, with a greater penalty for non-participating shareholders than in the current traditional rights issue structure. However, this should be set against the benefit to the company of reducing the underwriting risks of an offer and, potentially at least, removing the need to prepare documents suitable for an overseas offering.

We discuss below the possibility of changing the default option for shareholders in a rights issue process.

(b) **Cashless take-up:** The inclusion of tradeable rights would permit shareholders wishing to limit their dilution to sell a proportion of their rights to fund take-up of the rest. On a traditional open offer, new money is required for any take-up of shares.

We discuss the advantages of cashless take-up further below.

(c) **Enhancing the rights of existing retail investors:** At present, while all investors are offered their proportional share in a rights issue, in practice only institutions are able to increase their holding. This is because the bookbuilt rump placing is not extended to retail investors. A further advantage of the excess application facility, therefore, would be to allow retail investors the opportunity to acquire additional discounted shares rather than being excluded to the benefit of new institutional investors.

8.67 Use of this structure in the UK would require an amendment to the FCA's Listing Rules, permitting companies to choose to allow existing shareholders to apply for additional shares that would be allocated before any rump placing to new investors. The process to be used would be clearly disclosed in the offer documents so that shareholders were aware of the consequences of failing to take-up or sell their rights. The Review recommends that this additional flexibility and choice be made available to London listed companies.

Default cashless take-up

8.68 At present, a non-participating shareholder is, in effect, cashed out. They do not subscribe for new shares and their holding is diluted accordingly.

8.69 While this is a longstanding default position for shareholders, it is less certain that this is actually the preferred outcome for those shareholders who do not engage with an offer. There may be many reasons that a shareholder does not respond including, as noted in Section 10, inefficiencies in the intermediated shareholding structure, or lack of time on the part of retail investors to devote to active trading. The assumption that a shareholder who does not take active steps to participate would prefer cash over maintaining, as far as possible, their proportional stake in the company is one that should be tested. Arguably a cashless take-up, whereby rights to subscribe are sold in the market to fund the take-up of part of the shareholder's entitlement, would be more attractive to many long -term holders. This process limits dilution as far as is possible without requiring new funds from the investor.

8.70 Investors would retain the ability to 'opt out' of the default, meaning they could still either take up their rights in full or sell their entire entitlement in the market. A cashless take-up is also unlikely to be possible for those overseas shareholders where it would conflict with local securities regulation, and these investors would still need to be cashed out as under the current system. The change may, however, serve to minimise the size of the rump of shares not taken up that will be placed into the market, and so improve deal certainty.

8.71 We recommend that the FCA consult on amendments to its Handbook that would allow listed companies to elect to make a cashless take-up the default outcome on a rights issue. While listed companies wishing to take this option would need to ensure systems were in place to deal with the administration required, the first step should be to make the necessary regulatory alleviations to increase flexibility for issuers. An FCA consultation would be the best forum in which to confirm the level of support such a change would command among shareholders and other market participants.

Pre-placing of rights

8.72 As noted above, another feature of a traditional open offer that is not replicated in the current rights issue structure is the conditional placing of shares subject to 'clawback'.

8.73 Open offers by companies on the main market typically involve a non-pre-emptive placing to a small number of new or existing investors with some or all of those shares subject to clawback into the open offer. If shareholders choose to take up their entitlements in the open offer, the company can reduce the number of shares that will be issued to the conditional placees to satisfy that demand.

8.74 The advantage of this structure for the listed company is clear. If open offer entitlements are not taken up, they are automatically taken by placees. Depending on the size of the placing subject to clawback it could be the case that, if the open offer and conditional placing are viewed together, there are in effect no shares not taken up, and no need for a rump placing. In this scenario, underwriters take settlement risk only, reducing cost and uncertainty. In addition listed companies would not need to consider whether their offer documentation was suitable for overseas markets, as there would be clarity from the outset on whether a rump placing would be needed.

8.75 Clawback does have disadvantages. For a new investor, the conditional placing does not provide any certainty of the level of holding they will secure at the end of the offer process. For this reason it is common for there to be an additional firm placing, of shares not subject to clawback into the offer, to give relevant placees some guarantee that they will receive shares. Open offers are restricted to a 10% discount, while a deeper discount is often available on rights issues. There is therefore a greater expectation that shares will be available for the conditional placees.

8.76 The FCA's Listing Rules contain longstanding provisions on the subject of the pre-placement of rights[83], although the absence of this feature in recent transactions may suggest these rules are no longer aligned with current market practice. It may be of value to seek, in any future FCA consultation on the topic of secondary offers, feedback on whether the ability to pre-place rights

83 LR 9.5.1R and LR 9.5.2G.

remains useful and, if so, whether the current provisions governing the process should be updated to encourage its use where relevant.

Documentation for pre-emptive issues

8.77 In the first part of this section we have considered changes to the post-launch pre-emption process, and to the way in which pre-emption is applied. In the remainder of this section we consider the documentation that should be required for this sort of offer.

8.78 As discussed in Section 7, it is the recommendation of the Review that no prospectus be required for a secondary offer unless the offer size is at least 75% of existing share capital. We set out below our suggestions for the format of the alternative documentation that we recommend replace a prospectus for such offers.

Background

8.79 A rights issue is a pre-emptive offer to existing shareholders but, in practice, it typically has two distinct stages. The first is the pre-emptive offer to shareholders, but the second – for deals where not all shareholders choose to take up their rights to shares – is a non-pre-emptive placing of rights or the 'rump' of shares to institutional investors.

8.80 Although the two steps are part of the same offer process, they typically involve different audiences, and each has its own information requirements that must be met by the disclosure provided. From the perspective of an issuer, however, it is also vital that the requirements of both steps can be aligned, to minimise costs and streamline the process.

8.81 At the moment, issuers do not need to consider the needs of these two distinct audiences. This is because a rights issue generally requires the publication of a prospectus, as a public offer and a non-exempt admission to trading, meaning long form disclosure is available for both aspects of the offer. Issuers must at present produce either a full prospectus or, as permitted by the UK Prospectus Regulation for issuers with shares admitted to trading for at least 18 months, at least one following a theoretically simplified disclosure regime. HMT's UK Prospectus Regime Review is, however, taking forward reforms that will remove the automatic public offer prospectus trigger for listed companies and delegate to the FCA the decision of when an admission to trading prospectus will be required. As discussed in Section 7, this Review would recommend that the FCA use that power to raise the threshold for an admission to trading prospectus for an issue of shares of a class already listed to at least 75% of existing share capital.

8.82 These changes taken together would mean that in future only the largest pre-emptive offers would need to produce a prospectus. Looking at the period from 2017 to 2021, only 13 of 36 rights issues by main market listed companies would have needed a prospectus[84]. In this section, therefore, we consider what disclosure a listed company should be required to produce to launch a rights issue or open offer when no prospectus is required.

Stages of a pre-emptive offer

Pre-emptive offer to existing shareholders

8.83 The first step of any rights issue is fully pre-emptive. For a widely-held listed company, therefore, this means an offer to both retail and institutional investors. This first step is typically primarily a domestic UK offer: as discussed in the first part of this section, it is common to exclude from the pre-emptive offer any shareholders located in overseas jurisdictions that would otherwise require compliance with onerous local securities law requirements.

8.84 While premium listed companies are required to treat all shareholders in the same position equally, the FCA recognises the need for flexibility where the costs of qualifying the offer under local requirements are so prohibitive as to outweigh the benefits. Issuers may of course include non-UK shareholders in certain circumstances, including where local compliance costs are minimal: for example, prior to the withdrawal of the UK from the European Union, it was expected that issuers would 'passport' their FCA-approved prospectus to other EU jurisdictions to enable EU-based shareholders to participate in offers (although in practice this was rarely used as other exemptions were typically available). Issuers may also choose to include overseas shareholders where those located in a particular jurisdiction represent a sizeable proportion of the register, such that the costs of local compliance are felt to be proportionate.

8.85 In many situations, however, overseas investors will not be able to take up shares in the initial pre-emptive offer. This typically includes retail investors located in the US, where compliance costs for a public offer are significant. In many transactions, US institutional investors may certify their status as 'qualified institutional buyers' under US law (known as QIBs) by means of a separate investor letter and participate in the pre-emptive offer, although only rarely when the rump placement is not also being extended to US institutional investors (in such circumstances, US investor participation would be structured on an exceptional basis as a private placement directly between the company and the relevant US investor(s)).

8.86 The disclosure required for the initial stage, therefore, will not typically need to cater for regulation outside the UK. It will need to be suitable for UK retail investors, but as it is targeted solely at existing shareholders it can assume a degree of familiarity with the company.

Placing of the shares not taken up

8.87 This second stage of the offer commonly involves placing of rights or shares with global institutions, including QIBs in the US. The US is a significant

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[84] *Source: SCRR analysis of Practical Law What's Market data*

source of demand and the location of a significant proportion[85] of the shareholders of large UK listed companies. As such the ability to include US institutional investors in a fundraising is often viewed as an important factor to ensure a successful outcome.

8.88 The rump placing will, generally, include new investors. As such, familiarity with the company cannot be assumed as with the initial pre-emptive stage. As it is addressed solely to investment professionals, however, it is not unreasonable to expect these institutions to be in a position to readily digest and distil the information the issuer has already made public. The expedited timetable of the rump placing is standard practice for institutions and analogous to the expedited timetable seen in standalone non-pre-emptive placings. The preceding pre-emptive offer period will also have provided additional advance notice that a placing may arise.

International considerations

8.89 Larger offers will typically include global institutions in the placing of the rump. This will include those located in jurisdictions that were excluded from the initial pre-emptive offer to avoid compliance with onerous local regulation of 'public' offers. However, limiting participation in this way does not avoid all local requirements.

8.90 A particular focus for UK companies is the US, where institutional investors are often included in equity offerings (including rights issues, open offers, placings and IPOs) as part of what is referred to as a Rule 144A offering. It is common for underwriting banks to wish to keep open the possibility of placing rights and shares not taken up with US institutions to ensure sufficient demand is available to ensure the placing is a success. This is a decision that will need to be taken by the issuer and the banks prior to launch of the offer, at a time when the level of take-up by existing shareholders is not known. As the pre-emptive offer must be kept open for a defined period, uncertainty will also remain at this initial stage about how the discounted offer price of the shares will relate to the market price at the point any rump will need to be placed. On larger offerings, ensuring that a Rule 144A offering of the rump is possible will be a key risk mitigation for the underwriting banks.

Documentation requirements of Rule 144A offerings into the US

8.91 Offers to institutional investors in the US fall broadly into two brackets:

(a) **Smaller placings:** Smaller institutional placings of up to 20% of existing share capital are routinely offered internationally, including to a limited number of US QIBs under Rule 144A without any formal

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[85] The proportion of UK-domiciled companies' quoted shares by value owned by investors outside the UK stood at 56.3% by the end of 2020. When broken down geographically, 46.0% of those rest of world shares (the largest proportion) were held in North America. *Source: Ownership of UK quoted shares – Office for National Statistics (ons.gov.uk) (release date 3 March 2022)*

offer document. As noted in Section 5, this type of offer is made with a short regulatory announcement, with institutions expected to do their own diligence from public sources before making their investment decision and to expressly disclaim recourse to the underwriting banks in what is colloquially known as a ‘big boy’ investor letter.

(b) **Larger deals:** For larger deals, however, this approach is not acceptable to the market. Instead the expectation is that a full prospectus will be made available, meeting US disclosure expectations, to provide the banks involved in the placing with a defence to potential US liabilities.

8.92 We set out some background on the U.S. securities law liabilities that may arise when shares are placed into the US, and the way banks can use disclosure and associated comfort from lawyers and accountants to manage their risk, in Part 5 of Annex F.

8.93 There are no formal prescriptive content requirements that apply to offer documentation for use on an exempted offer to US institutions structured to be exempt from US registration. A clear market practice has, however, established the nature of required disclosure, largely by reference to SEC requirements for offerings registered with the SEC by non-US companies. These expectations typically overlap with the content requirements of a full UK prospectus, but not the simplified prospectus regime as discussed below.

Simplified prospectus regime

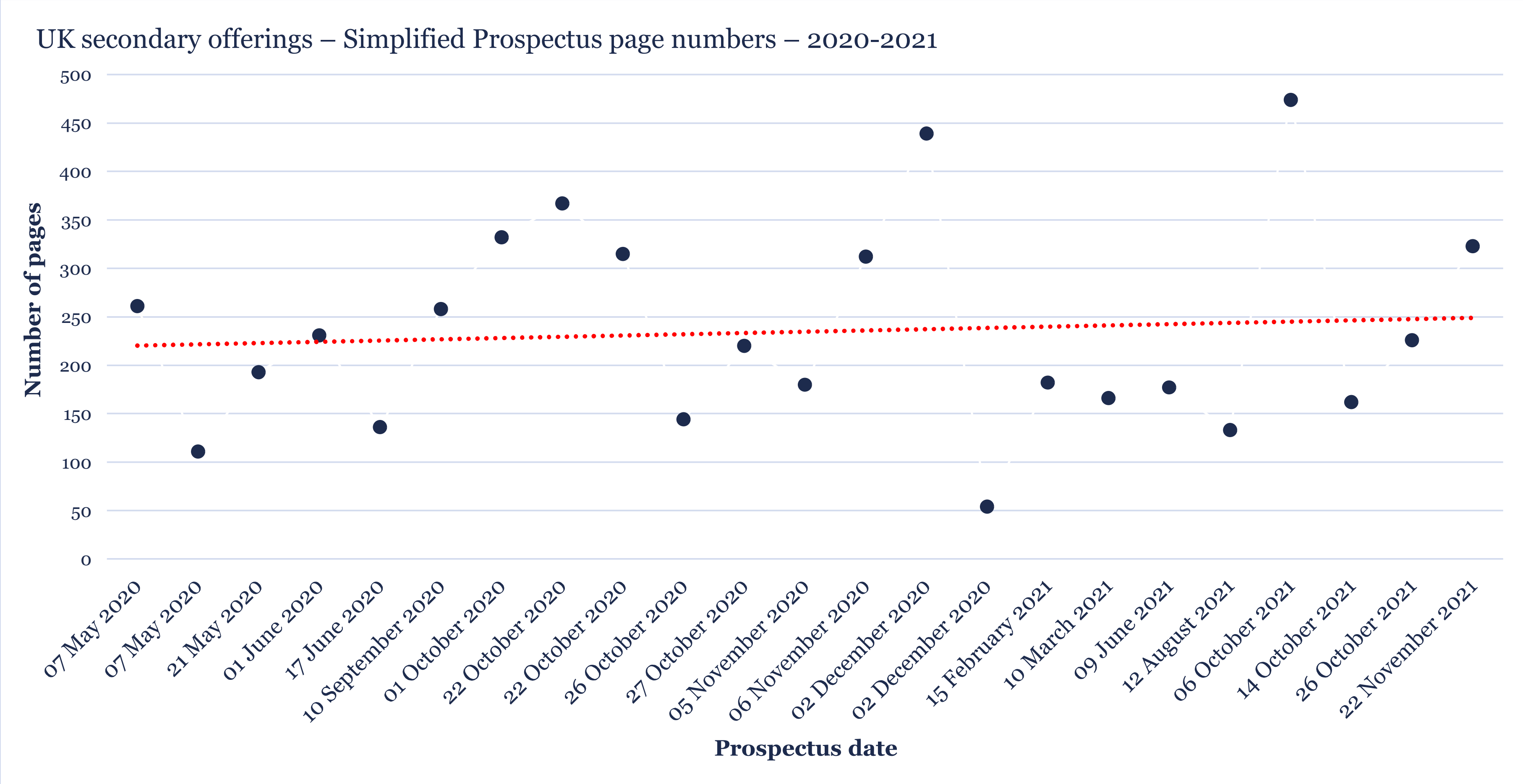
8.94 The impact of US expectations on UK market practice can perhaps best be seen in the way the simplified prospectus has been used since its introduction in 2019. As noted above, issuers that have been listed for at least 18 months are permitted to prepare a simplified prospectus when making a secondary offer of the same class of shares.

8.95 Of the 38 rights issues and open offers by main market listed issuers since the introduction of the simplified prospectus, 22 have used a simplified document[86]. On these deals, use of the simplified format changed the make up of disclosure and the FCA checklists used rather than reducing its length. While some technical disclosure requirements were omitted as intended, much of the substantive disclosure – including in particular a discussion and analysis of the issuer’s financial statements – was added back in on a voluntary basis to meet US expectations. As illustrated on the graph in Figure 9, the average length of a simplified prospectus from introduction to the end of 2021 was over 230 pages[87] with the average length increasing over the period.

[86] *Source: SCRR analysis of Practical Law What’s Market data*

[87] Ibid

FIGURE 9: LENGTH OF UK SIMPLIFIED PROSPECTUSES, 2020 TO 2021



Source: SCRR analysis of Practical Law What's Market data

8.96 This experience shows that, in order for a larger deal to access the US without a prospectus, it must be possible to use the alternative documentation as part of a 'disclosure package' that meets US market expectations. Under US law, the liability of the issuer, its directors and the banks marketing the offer for misstatements or omissions in securities offerings attaches on the basis of information conveyed to prospective investors up to the 'time of sale' (customarily defined as the point at which allocations are confirmed to investors). Market participants will designate a corpus of disclosure (including materials incorporated by reference) as the 'disclosure package' for purposes of assessing the information so conveyed.

8.97 While the market has accepted a UK prospectus as the basis on which the US comfort package may be given, the Review has sought to identify which elements of existing disclosure are in fact needed for these purposes. Not all items currently included in a prospectus are necessary to support an investment decision, with many representing what could be described as background or 'boilerplate' information. The aim of the approach outlined below is to both eliminate the need for unnecessary information and avoid duplication of existing disclosure.

Flexible offer documentation

8.98 The Review believes that a full prospectus is not necessary for a pre-emptive offer to existing shareholders or to support a domestic or international placing of rights and shares not taken up. The current requirements duplicate information already available as part of an issuer's continuous public disclosures, increasing costs for the issuer, extending the length of the offer document and arguably making it more difficult for shareholders and new investors to focus on the important new information about the offer.

8.99 The Review believes that there are strong arguments that the public information available to the market that is sufficient for secondary market trading, in conjunction with details of the proposed offer, should be sufficient for an offer of the same shares at a discount to the market price to both existing shareholders and new institutional investors.

8.100 As such the Review recommends issuers should prepare only a non-duplicative offer document for a pre-emptive offer, including rights issues, open offers and other offer structures that may be developed in the market in the future. It is likely also to be appropriate for the company to make a cleansing statement to the market at the launch of the offer, or to incorporate that confirmation into the offer document. We discuss the content of this sort of document further below.

Offer document

8.101 In the opinion of the Review an issuer launching a pre-emptive offer should prepare an offer document to which no specific content requirements should apply and which should not be subject to a regulatory review or approval process. We believe the content of the offer document should be driven by market practice, allowing it to evolve over time and to reflect individual circumstances. This approach will enable an issuer to deal with the impact of overseas securities regulation to the extent relevant for that issue, without imposing inflexible requirements on all issuers.

8.102 We anticipate that an offer document will typically consolidate the following elements:

(a) **Offer-specific information:** Offer-specific information, as expected to be included in the offer booklet described in Section 6. While the exact offer-specific information included should, in our view, be left to listed companies and the development of market practice, core elements are likely to include the reasons for the offer, the proposed timetable and expected use of proceeds (commonly set out in a letter from the chair), details of the structure of the offer and the terms and conditions of participation;

(b) **Cleansing statement**: Providing confirmation to the market at the launch of an offer that the listed company is in compliance with its existing continuing obligations and that it is not delaying the disclosure of inside information;

(c) **Incorporation by reference of existing disclosures:** The incorporation by reference of those elements of the issuer's existing public disclosures that are relevant for an investment decision in relation to the offer. We anticipate this will be most useful for issuers that have chosen to enhance the disclosures made in their annual report and accounts, as discussed below, but the option should be available to all issuers; and

(d) **Additional disclosure:** Where additional disclosure is required to provide potential investors with the information required to make their investment decision, and to enable the provision of customary comfort to the listed company, its directors and the banks marketing the issue, it should be set out in the offer document.

8.103 The length of an offer document will vary depending on the circumstances of the issuer, the reasons for and nature of the proposed secondary offer and the expected use of proceeds, and the jurisdictions into which it is intended the offer will be marketed. For issuers carrying out a straightforward pre-emptive offer with a domestic focus, the offer document may in practice be similar in length to the offer booklet discussed in Section 6 for use in relation to a 'follow-on' offer after a non-pre-emptive placing. Where circumstances are more complex, or a broader international distribution is anticipated, the document may contain significantly more disclosure.

8.104 We believe that this flexibility will provide a benefit to issuers over the current prospectus regime, encouraging the use of pre-emptive structures. At present, issuers are in practice strongly incentivised to raise capital non-pre-emptively in order to avoid a documented process. While our proposals do not eliminate documentary disclosures, and an offer document will still be expected for pre-emptive offers, our aim is to ensure that disclosure requirements remain proportionate and that issuers are not unduly penalised for seeking to respect the pre-emptive rights of their shareholders in full. Issuers should be able to tailor the disclosure required for pre-emptive offers, with no need to repeat existing public disclosures or to include information that is not material to potential participants in the offer. This should make it quicker for issuers to come to market, in particular where issuers have enhanced their annual report disclosures as discussed below.

8.105 Where an issuer prepares an offer document, we anticipate it would typically send that document to its existing shareholders (subject to local law requirements) as well as using it to facilitate the placing of the rump to institutional investors. The issuer may, however, choose to send only an abbreviated version, equivalent to the 'follow-on' offer booklet discussed in Section 6, to existing shareholders, with the additional information referred to at subparagraphs 8.102(b)(c) and (d) above contained in an offer announcement published via a regulatory information service. In these circumstances we would expect the document sent to shareholders to clearly incorporate by reference the content of that offer announcement, to ensure equality of information as between existing shareholders and potential institutional investors in the offer. The outcome of the UK Prospectus Regime Review indicates that equality of information provisions, derived from those currently found in Article 22 of the UK Prospectus Regulation, will be retained going forward.

Liability for the offer document

8.106 A key distinction between the initial pre-emptive offer and the subsequent placing of the rump is that this second stage involves active marketing by the banks assisting the listed company with the offer.

8.107 Market practice is to ensure that any materials used to market the offer in this way represent essentially a subset of information in the prospectus, with no additional material information. Use of such an offer document for these purposes will require the investment banks involved in placing the rights and shares to be comfortable that they have an appropriate defence to any investor seeking compensation for disclosure in, or omissions from, the offer document. A flexible disclosure framework as set out above must meet the needs of all market participants if it is to be widely used, and bring the improvements that we hope will accrue to issuers.

8.108 We outline below the ways in which listed companies are held responsible for their continuous disclosures, and how in our view that should apply to the flexible offer document.

Existing liability framework

8.109 There are a variety of ways companies are held responsible for any statements made in the course of their continuous disclosure obligations that are untrue or misleading, including both civil and criminal liability. In particular:

(a) **Published information:** As an announcement made via a regulatory information service an offer announcement would fall within the liability regime that applies to information published by listed companies in section 90A of and Schedule 10A to the Financial Services and Markets Act, as amended (FSMA).

We set out more detail on the nature of that liability in Part 4 of Annex D, but broadly the listed company will be liable for loss if it falls below a 'recklessness' standard. This is the standard that applies to all information made public by a listed company under its continuous disclosure obligations.

If disseminated via a regulatory information service, or if the availability of an offer document were to be announced via a regulatory information service, the same liability regime would apply to the offer document.

(b) **Financial promotions:** The financial promotion regime applies to communications that invite or induce a person to engage in an investment activity, such as buying or selling shares. We set out some background on the financial promotion regime in Part 5 of Annex D.

Communications by a listed company to its existing shareholders about the issue of its own shares are exempt from approval requirements, and we would expect this to include an offer document. An alternative, and one that would be necessary should new investors be invited to participate, would be to expand the existing exemption for prospectuses to expressly include this new type of offer document.

(c) **Regulatory sanctions:** Where an offer document constitutes a 'circular' (broadly, for the purposes of the FCA's Listing Rules, a document sent to shareholders, although this is subject to a number of exceptions), the FCA can impose regulatory sanctions for breach of the circular content requirements of the Listing Rules, including on any director knowingly concerned in a breach by the company itself. The Listing Rules also require an issuer to take reasonable care to ensure that any information it notifies to an RIS is not misleading, false or deceptive and does not omit anything likely to affect the import of the information; breach of this requirement could also expose an issuer to regulatory sanction.

Liability standard

8.110 The Review has considered the standard to which issuers should be held responsible for the content of the offer document, and how the position of the banks and other advisers named in the document can be clarified, to bolster confidence in the new process.

8.111 The Review believes that the 'recklessness' standard of liability for companies should apply to an offer document published when no prospectus obligation applies. It would also apply to an abbreviated offer document published alongside an offer announcement, as well as to the offer booklet referred to in Section 6 in relation to any follow-on offer after a non-pre-emptive placing. This approach adopts the standard that applies to a listed company's market disclosures, and so forms the basis of all secondary trading in the shares of an existing listed issuer.

8.112 A higher 'negligence' standard applies to prospectuses (summarised in Part 4 of Annex D), and the Review has considered whether this should be applied to an offer document (or an offer booklet published in relation to a follow on offer). We feel, however, it is appropriate to maintain a distinction between shares offered in an IPO, where a prospectus comprises the totality of information on which an investor has to make their decision, and a secondary offer of shares that are already trading on the basis of continuous disclosure obligations tied to the recklessness standard of liability. Offers to an issuer's existing retail investors are made directly by the issuer, and disclosure documents produced in connection with such offers should be clearly identified as the responsibility of the issuer.

8.113 The framework should also clarify the position of banks and other advisers to a listed company. The current prospectus regime makes the issuer (and its directors) responsible for an equity prospectus. The FCA's Prospectus Regulation Rules expressly provide that professional advisers are not responsible for prospectus content by reason only of the person giving advice about its contents in a professional capacity[88]. Notwithstanding this lack of formal responsibility, however, concerns around potential liability remain in particular for banks involved in marketing a deal. In the absence of a clear bar to doing so, investors may seek to claim that banks should be held responsible for deficiencies in disclosure, in particular in circumstances where the issuer itself is unable to meet claims,

8.114 The Review believes that the current prospectus framework should be strengthened to reduce these concerns, by providing a clear defence for banks and other advisers against any claim made in connection with the adequacy of prospectus disclosure. The same defence should be available where an offer uses a cleansing announcement, offer document (or announcement) or offer booklet outside the prospectus regime. We support the current policy objective that the issuer should take responsibility for its own offer information, and believe that a clearly defined defence to liability for other parties would benefit the market by encouraging adoption of streamlined disclosure practices.

International considerations

8.115 The Review acknowledges that, even if our recommendations on liability in the UK are taken forward, overseas securities regulations will impact the way in which responsibility applies in other jurisdictions in which the offer

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88 PRR 5.3.10R

document will be utilised. Market practice within the prospectus regime has been for these concerns to be dealt with via additional disclosure, over and above the strict UK Prospectus Regulation requirements, together with customary comfort from legal advisers and reporting accountants. We would expect a similar approach to be taken in relation to the offer document.

Incorporation by reference of existing disclosures

8.116 As noted above, we anticipate that issuers will wish where possible to incorporate by reference existing public disclosures, to streamline preparation of an offer document. Where international investors are expected to participate in the rump, this will require those existing disclosures to meet relevant standards.

8.117 We consider below how the existing continuous disclosure obligations of issuers, primarily in their annual report and accounts, could be enhanced and used to minimise the new disclosures required in an offer document. This would provide a disclosure package (as described above) that could form the basis for the traditional US legal and accounting comfort required by banks to provide a defence to any investor claims that could arise in connection with a placing into the US market. For an issuer, it would also simplify the process of producing an offer document, shortening the timetable to market.

Optional enhancements to continuous disclosure

8.118 We have considered whether it would be appropriate to require issuers to move to a formal ‘shelf’ document in order to make use of existing disclosures. The universal registration document (URD) in the current prospectus regime does, at least theoretically, already provide listed companies with a way to combine annual report obligations with a ‘shelf’ document that can be used in the disclosure package for a subsequent secondary issue. The URD has not, however, become a feature of the UK markets. While there are merits in a shelf approach, a system that requires additional steps to be taken by a listed company rather than making use of existing, extensive, annual report disclosures has faced barriers to adoption. In addition to the burden of duplicative disclosure, there is also a perception in the market that publication of a shelf document means a secondary offer is anticipated, an assumption that may prejudice an issuer.

Recommendation: Companies should be able to ‘opt-in’ to an enhanced continuous disclosure regime

8.119 The Review has therefore instead considered how a company that is likely to wish to include US or other international institutions in any future secondary issue could incorporate its existing market disclosures into a flexible offer document, alongside offer-specific information and bespoke additional disclosures as needed, to meet U.S. liability concerns. By way of background we set out some detail on the nature of the market standard US comfort sought by banks in in Part 5 of Annex F.

8.120 We set out below our suggested route for issuers wishing to streamline any future issue of shares into the US as part of a prospectus-exempt offer. We anticipate the same approach will meet standards required for offerings into other international jurisdictions.

Enhancement of annual report disclosure

8.121 We set out in Part 6 of Annex F the content requirements of a full and simplified equity prospectus (other than elements that relate to the offer itself), set alongside similar disclosures required in the annual report and accounts of an English premium listed company. The table also indicates a preliminary view of where enhancements could be made to meet key elements of typical offering disclosure. We discuss these further below.

8.122 The disclosure in the issuer's most recent annual report will need to be calibrated to meet US expectations in areas of disclosure relevant for a securities offering. We would suggest that the key elements of disclosure for US purposes and the steps that could be taken to enhance existing disclosure include the below. A US offering will require three years' historical financial information. In practice this will mean that financial information from the two most recent annual report and accounts will need to be incorporated into the enhanced disclosure package, alongside elements of narrative disclosure from the two most recent reports.

(a) **Risk factors:** A UK annual report and accounts will include risk disclosure, but this is an area in which the requirements of Companies Act 2006 conflict with US securities expectations. In particular, it is a Companies Act 2006 requirement that a company disclose a description of how it manages the principal risks it faces. The UK Corporate Governance Code also includes a requirement to include in the annual report an explanation of how principal risks are being managed or mitigated, and doing so is viewed as best practice. In contrast US practice does not permit mitigants to be mentioned alongside risks. An issuer seeking to use its annual report as a component of a future US disclosure package should therefore consider disclosing risk factors and mitigants in separate sections, to facilitate incorporation of the risk section into any future disclosure package.

Risk factors are typically a key focus of a prospectus drafting exercise. A heightened process will be appropriate where they will form part of an enhanced disclosure package. In particular risk disclosure should be drafted in line with the guidance in the UK version of ESMA's 'Guidelines on risk factors under the prospectus regulation'[89], covering matters such as specificity, materiality and presentation.

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89 esma31-62-1293_guidelines_on_risk_factors_under_the_prospectus_regulation.pdf (fca.org.uk)

Where mitigants are included in the annual report, it may also be appropriate to include cautionary language in that report setting out that mitigating actions may not be successful.

(b) **Business overview:** An annual report and accounts will contain an update on the business of the issuer over the year. Where use as an enhanced disclosure package is contemplated, the issuer should ensure that the report also contains a standalone summary of the business, providing a baseline for that review of recent developments and performance. It should also include a description of the industry in which the company operates and, where relevant, any dependency on patents or licences.

(c) **Operating and financial review:** The operating and financial review (OFR), often referred to as management's discussion and analysis (MD&A) in the context of a prospectus, is a key element of disclosure for the purposes of a US disclosure package. The presentation of this section in an enhanced annual report and accounts would need to align with the approach taken in a prospectus, which may be significantly different to the format used in their annual report at present for many (but not all) issuers. It will also need to cover all expected elements including, for example a discussion of cashflows and liquidity, including descriptions of outstanding indebtedness and bank facilities (including covenants).

As the OFR is expected to cover three years' historical financial information, some analysis will be incorporated from the two most recent annual reports. On first adoption this will include one report prepared prior to use of the enhanced regime. Issuers in this position whose financial reviews have not historically provided financial analysis and discussion which is substantially consistent with the enhanced disclosure regime should seek the advice of US securities counsel prior to any anticipated transaction. Where an issue is planned before enhanced disclosure has been made for two reporting cycles, it may be necessary to include additional disclosure in the offer document.

Guidance on the use of alternative performance measures (APMs) already applies to both annual reports and prospectuses and, where APMs are used, disclosure should adhere robustly to that framework, including with respect to consistency across periods, reconciliation to the nearest comparable GAAP measure and prominence.

(d) **Regulatory environment:** Where relevant, the annual report should also include a description of the issuer's regulatory environment and information on any policies or factors (governmental, economic, fiscal, monetary or political) that could materially affect its operations.

(e) **Third party/comparative information:** The annual report should specify information sourced from third parties, and provide a basis for any statements regarding the competitive position of the company.

(f) **Material contracts:** This would typically include description of funding documentation, including the terms and conditions of bonds in issue and details of bank facilities, and material non-ordinary course contracts (and more routine contracts where they account for the majority of the issuer's sales or costs).

(g) **Specialist issuers – experts' reports:** Where an expert's report (for example, in relation to mineral reserves) is included in, or incorporated by reference into, the annual report, information should be included on the expert providing that report.

(h) **US securities review:** Where a 10b-5 disclosure letter will need to be based in part on annual report disclosure it will in practice be desirable for US securities lawyers to have had the opportunity to review the relevant disclosure prior to its inclusion in the annual report. It will not be practical to leave this element of review until the point at which a secondary offer is made unless allowance is made for amendments or supplements to such disclosures in the offer document. This will be an additional annual cost to the issuer. Although this enhanced review will be required, the expectation would be that once the initial set of risk factors is in place subsequent reports will be able to build upon that disclosure by reference to changes over time.

8.123 These additions will add some time and cost to the process of preparation of a UK annual report. Unlike the integrated US system, the UK does not routinely use the same disclosure for the purposes of ongoing obligations and for the purposes of a securities offering, meaning differences in approach will need to be addressed. However we believe that for many issuers these steps will be worthwhile as it will allow those issuers to take advantage of a more streamlined approach to secondary offer documentation. US domestic companies and US-listed UK companies routinely engage US counsel in the preparation of their US annual reporting requirements for this reason.

Status of enhanced annual report disclosures

8.124 It is worth emphasising that we anticipate enhanced annual report disclosure being a voluntary, opt-in, approach for issuers that see it as representing a proportionate cost to ensure flexibility.

8.125 We have considered whether there would be value in reflecting the expectations of an enhanced disclosure regime in the FCA Handbook. This could be done on an 'opt-in' basis, as is currently the case for preliminary statements of annual results, where FCA requirements apply only if an issuer chooses to make a statement.

8.126 The advantage of an FCA Handbook approach would be clarity on the steps required of issuers. A consultation process could be undertaken by the FCA to ensure a robust set of requirements that imported the necessary elements of prospectus disclosure practice into the continuing disclosure documents of opted-in issuers. As noted, however, the purpose of enhanced disclosure would be to ensure that market-standard US and international comfort could be provided on any subsequent secondary issue while avoiding unnecessary duplication of existing market disclosure. Those requirements are driven by market practice rather than formal rules in the UK, US or another jurisdiction. Leaving the detail of an enhanced disclosure regime to develop in line with market practice might therefore be a more flexible approach.

8.127 We have also considered how to minimise concerns an issuer might have that an opt-in to an enhanced disclosure regime would signal the likelihood of a secondary offer, a factor that contributed to lack of adoption of the Universal Registration Document in the UK capital markets.

8.128 As such, we recommend that issuers complying with the enhanced disclosure regime should not be required to state that they have done so in their annual report. While, as noted above, review of disclosure by advisers to confirm compliance with the enhanced disclosure framework would typically be required at the point of publication of the annual report, issuers should only be required to liaise with their advisers at the point they are considering making a pre-emptive offer to ensure that their existing documentation is sufficient for the appropriate comfort to be given.

8.129 It will also be necessary to consider the position of issuers that do not choose to opt-in to this enhanced disclosure framework, but wish to market a subsequent large secondary offer on an international basis. We would expect that any offer document prepared by such issuers would need to contain all elements highlighted above, whether that is ultimately mandated by regulatory provisions or by the market. It is likely in these circumstances that the drafting and diligence process for the offer document will be extended, reducing agility and speed to market.

Verification of enhanced annual report disclosures

8.130 Under ISA 720 auditors are required to ensure the qualitative disclosure in the annual report is not materially misstated when compared to the financial information disclosed in the financial statements included in the annual report. The FRC has highlighted, in its news bulletin dated 6 December 2018[90], that auditors must improve their work on the 'front end' of company reports, as part of their consideration of whether the information provided is materially inconsistent with the audited financial statements or the auditor's knowledge. The FRC will review the requirements on auditors in this area as part of its current project reviewing Auditing Standards.

8.131 The FRC has indicated it expects auditors to, amongst other steps, pay more attention to the completeness of information, particularly in relation to

90 (News I Financial Reporting Council (frc.org.uk))

principal risk disclosures and their linkage to viability statements. Where enhanced disclosure in the annual report leads to greater disclosure in the front-end of the report, in particular around risk factors, this will need to be a factor considered by the FRC in that work. It will be a benefit to issuers if a clear pro-forma framework is in place to ensure consistency of practice in this area.

8.132 As noted above issuers wishing to streamline the US comfort process will in practice need to ensure US securities counsel review their disclosure at the point of publication of the annual report and accounts, to ensure it meets relevant standards. This will be a necessary step in order to ensure there are no delays at the point a future secondary offer is in contemplation.

SAS 72 comfort

8.133 In addition to a 10b-5 letter from legal counsel, banks underwriting a Rule 144A offer into the US will also expect an AU-C 920 letter (still widely referred to by its former name SAS 72) from the issuer's reporting accountants, which is a further key component of their defence to investor liability.

8.134 This requirement imposes a timing constraint on further issues, as an SAS 72 letter cannot be issued more than 135 days from the end of the issuer's latest results. For a company with a financial year end of 31 December 2021, no SAS 72 can be issued with a cut-off date after 14 May 2022. There will therefore be a gap in which standard US comfort will be unavailable until the issuer's half-yearly financial information is made available and reviewed by the company's auditors in accordance with ISRE 2410.

8.135 At present, issuers seek to ensure that a secondary timetable does not require US comfort during this gap period. Where this is unavoidable, the company will need to draw up off-cycle ISRE 2410-reviewed interim accounts under IAS 34 using a stub period, either at month or quarter end period, extending the 135 day period. This need will remain unless the company reports full IAS 34-compliant quarterly accounts.

9. INCREASE THE RANGE OF PRE-EMPTIVE FUNDRAISING STRUCTURES FOR COMPANIES

9.1 Our analysis has shown that placings are the most prevalent structure used for secondary capital raises in the UK. Placings are, however, non-pre-emptive in nature.

9.2 Feedback to the Call for Evidence cited that although companies would like to facilitate access to retail when conducting secondary offers (which could be by virtue of a fully pre-emptive offer), at present there are limited options available which can compete with the speed and flexibility afforded by undertaking an undocumented placing. Rights issues and open offers are therefore used as a last resort.

9.3 In previous sections we have detailed how companies can better facilitate the inclusion of retail when undertaking placings. Our recommendations to reform pre-emptive offer processes, combined with HM Treasury's prospectus regime reforms, have the potential to materially reduce the time and cost currently involved in fundraisings using this mechanism, improving the efficiency of secondary capital raisings in the UK. However, we recognise that these recommendations do not fully solve the issue of finding a transaction structure that provides issuers with the benefits of quick access to funds while permitting retail to fully mitigate the effects of dilution if they so wish.

9.4 A transaction option which both fully observes the principle of pre-emption and which provides the speed and flexibility of a placing would be extremely attractive to UK issuers and investors. Australia's experience demonstrates that pre-emptive offers and speedy access to capital can be compatible. A similar construct to Australia's accelerated rights issues could provide an additional option for UK companies combining the benefits of a placing and rights issue/open offer. We examine the merits of the Australian structure and the package of regulatory measures which enables them in greater detail below.

Summary of the different types of Australian offer structures

9.5 In addition to traditional rights issues, there are a number of additional recognised transaction models utilised in Australia which observe pre-emption.

9.6 Feedback to the Call for Evidence was unanimously in support of the Review examining in greater detail how such models could be used in the UK, noting that issuers are able to raise capital quickly and effectively whilst also observing pre-emption rights. Respondents cited the potential benefits of such transaction structures in their ability to balance the need for issuers to be able to raise funds quickly whilst also allowing retail to participate in fundraisings. They also highlighted the following features of the Australian market that support the use of pre-emptive structures:

(a) **Retail inclusion:** In Australia there is a long held expectation that retail should be included in an offering of securities. This expectation drives market practice around the choice of transaction structure.

(b) **Investment style:** Retail investors actively invest in individual stocks, in contrast to the UK where retail often invest through diversified funds.

(c) **Regulatory guidance:** Regulators in Australia have codified guidance around retail inclusion, further cementing the expectation of retail participation in primary issuances. Examples of such guidance are:

(i) Australian Securities and Investments Commission's (ASIC) 'equal opportunity principle' – RG189.8[91];

(ii) Report 605 'Allocations in equity raising transactions'[92], noting that whilst there is no legal right for pre-emption on a placement, observing it constitutes best practice.

9.7 The principal benefit of these structures is that they provide issuers with deal certainty alongside inclusion. A large swathe of the amount the issuer is looking to raise can be secured and settled quickly through an institutional bookbuild, with retail investors able to participate on the same key terms but on a more appropriate timeline. The variety of recognised structures also allow companies to tailor the offers to best serve their individual investor bases by, for example, making a renounceable or non-renounceable offer. Such options can also provide issuers with additional mechanisms to manage their underwriting costs.

9.8 Whilst Australian issuers have the option of undertaking a traditional rights issues, the use of these 'non-traditional rights issue structures' (which are otherwise known as accelerated rights issues) is far more common. In the UK the 2008 Rights Issue Review Group highlighted the use of the RAPIDs model (see AREO below). Whilst this is still used in Australia, additional transaction structures have been developed which incorporate different features.

9.9 These features include:

(a) **Dual-tranche:** Splitting the fundraise into an accelerated institutional tranche and a slower tranche aimed at retail investors, covering the entirety of the register[93];

(b) **Renounceable / non-renounceable:** Optionality around whether investors' entitlements as part of the offer should be renounceable or

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91 Regulatory Guide RG 189 Disclosure relief for rights issues (asic.gov.au)

92 Report REP 605 Allocations in equity raising transactions (asic.gov.au) (December 2018)

93 Issuers have the ability to restrict where the offer is being made geographically, so as not to trigger onerous overseas regulatory requirements.

non-renounceable (i.e. can value be obtained for any entitlements not taken up, either through an off-market or on-market mechanism);

(c) **Trading:** The ability to trade entitlements;

(d) **Bookbuild(s):** Single or multiple bookbuilds to cover shortfalls in institutional or retail tranches; and

(e) **Combinations:** Ability to combine the accelerated rights issue with a placement of shares, within the company's placing capacity.

9.10 The various types of accelerated rights issues are as follows. Full case studies are detailed in Annex G:

(a) **ANREO:** The ANREO, or Accelerated Non-Renounceable Entitlement Offer, is launched at a discount. Security holders only have the option to take up their entitlements, with no ability to trade and no compensation if they do not take up their entitlements (it is 'non-renounceable'). An institutional bookbuild is concluded within the first few days after launch of the offer. Following this, a retail entitlement offer is opened on the same terms, aimed at the remainder of the register that did not participate in the institutional fundraise. As the offer is non-renounceable, the offer is 'put up or shut up' – if an investor does not exercise their rights, then those rights are surrendered and the company and its underwriters will seek to raise equivalent funds through institutional bookbuilds at the end of the institutional and retail offers. There is no opportunity to trade entitlements.

(b) **AREO:** An AREO is similar to an ANREO, other than that under this accelerated renounceable entitlement offer holders have the option to renounce their entitlements, in which case they will potentially receive value for their rights through two bookbuilds; an earlier bookbuild in respect of the institutional offer and a subsequent bookbuild following the retail offer period. The value is derived from any premium achieved in the bookbuild over the offer price. There is no option to trade rights.

(c) **PAITREO / AREORT:** The PAITREO, or Pro-rata Accelerated Institutional, Tradeable Rights Offer is otherwise known as an Accelerated Renounceable Entitlement Offer with Retail Rights Trading. This offer is similar to an AREO in that it provides compensation for the renouncing shareholder through two bookbuilds of rights that have been renounced at the end of the institutional and retail offer periods. However, the PAITREO provides an added option for retail investors to trade their rights during a retail entitlement offer window. This means that the retail investor may be able to sell their rights in the market at a better price than the premium which may be obtained if they were to let their rights lapse and be compensated through a bookbuild at the end of the retail offer period. It is the gold standard of retail offers.

(d) **SAREO:** The Simultaneous Accelerated Renounceable Entitlement Offer differs from an AREO in that all renounced rights are sold through a single (rather than dual) book-build which takes place after both the institutional and the retail offer windows have closed. There is no trading of retail rights. This structure of offer was designed to put retail shareholders on a more equal footing; institutional investors need to wait until the end of the retail offer period before they receive compensation along with retail investors through the shortfall bookbuild at the end of the offer period. However this structure is seldom used in contrast to the other offer types outlined.

9.11 Each alternative structure has a number of different features which can be more or less attractive for issuers and investors, summarised in the table below.

		ANREO	AREO	PAITREO	SAREO
	Interaction with regulator / Exchange	Agree timetable (same day)	Agree timetable (same day)	Agree timetable (same day)	Agree timetable (same day)
Institutional Tranche	Trading Halt imposed	Yes	Yes	Yes	Yes
	Separate Institutional Entitlement offer	Yes	Yes	Yes	Yes
	Timing of Institutional Entitlement offer	Within 2-3 days of trading halt	Within 2-3 days of trading halt	Within 2-3 days of trading halt	Within 2-3 days of trading halt
	Pricing of offer	Notified to market at start of trading halt	Notified to market at start of trading halt	Notified to market at start of trading halt	Notified to market at start of trading halt
	Proceeds received quickly?	Yes	Yes	Yes	Mostly, depending on initial uptake by institutions
	Ability to trade institutional rights?	No	No	No	No
	Institutional Entitlement offer shortfall bookbuild	Yes	Yes	Yes	Yes
	Timing of Institutional shortfall bookbuild	Within 2-3 days of trading halt	Within 2-3 days of trading halt	Within 2-3 days of trading halt	At culmination of the retail offer
	Market disclosures associated with institutional offer	Market announcement + Investor presentation	Market announcement + Investor presentation	Market announcement + Investor presentation	Market announcement + Investor presentation
	Cleansing notice	Yes	Yes	Yes	Yes

		ANREO	AREO	PAITREO	SAREO
Retail tranche	Trading Halt imposed for retail offer?	No	No	No	No
	Pricing of offer	Same price as institutional tranche	Same price as institutional tranche	Same price as institutional tranche	Same price as institutional tranche
	Renounceable (compensatory)?	No	Yes	Yes	Yes
	Ability to trade rights?	No	No	Yes	No
	Timing of retail offer	c. 3 weeks or longer	c. 3 weeks or longer	c. 3 weeks or longer	c. 3 weeks or longer
	Retail shortfall bookbuild	Yes	Yes	Yes	Yes
	Investor perspectives	Investors cannot sell their rights.	Retail investors who do not take up their rights have their entitlements sold in a bookbuild a number of weeks post the institutions.	Gold standard for retail shareholders. In practice, trading of rights by retail is low, however it is perceived as valuable.	Institutions have to wait to get their entitlements sold. Whilst technically available, seldom used.

Regulatory recognition and the equal opportunity principle

9.12 As a general point, regulatory involvement in accelerated rights issues is very light touch in comparison to UK markets. ASIC, the Australian equivalent of the FCA, does not pre-vet documents and the route makes use of a 'low doc' offer regime (see the discussion later in this section on market disclosures). This removes a key element which needs to be managed in the pre-launch stage of a transaction, and is a clear point of distinction with the UK regime. ASIC do retain the right to intervene in an offering on an ex-post basis if necessary.

9.13 ASIC also specifically states that although an accelerated rights issue is made on different terms to institutional investors and retail holders, the differences are minimal and do not contravene the 'equal opportunity principle'. It also states that it considers that the relief is likely to result in more retail investors having the opportunity to participate in rights issues than would be the case if accelerated rights issues had to be made under a prospectus or a Product Disclosure Statement (another Australian offer document type)[94]. An accelerated rights issue is recognised as a separate regulatory construct, but with similar features to a traditional rights issue.

94 See "Rationale for accelerated rights issues relief" in Regulatory Guide 189: Disclosure relief for rights issues, ASIC (March 2016), RG189.36 to RG189.37.

9.14 From an exchange perspective, the Australian Securities Exchange (ASX) has mandated timetables[95]. Prior to launching an offer, issuers agree a timetable with ASX, although in practice if the template timetable has been strictly adhered to this is a very quick (e.g. same day) interaction requiring no notice.

9.15 Entities are required to disclose any issue or proposed issue of securities to the ASX immediately, as required under Listing Rule 3.10.3 and 3.10.5. If the proposed issue is pro rata, the entity must complete a specified form of announcement of a proposed issue of securities[96] and send this to the ASX at the time of disclosure.

9.16 The combination of the above measures means that issuers can be comfortable launching offers at short notice in the knowledge that there is a tried and trusted process they can follow which should not be of concern to regulators. If a similar process is to be adopted in the UK, a number of different approaches could be taken to facilitate this. These include:

(a) **Listing Rule changes:** Specific Listing Rules on accelerated rights issues, codifying the expected form and timetables of offers to differentiate them from existing rights issues and open offers.

(b) **FCA guidance:** Guidance issued from the FCA (either in the form of FCA Knowledge Base articles or as Listing Rule guidance), acknowledging that an offer may be split into institutional and retail investor components from a timetable perspective without being considered to be two separate transactions, and that doing so would not contravene equal treatment requirements[97].

(c) **Market practice:** A combination of either or both of the above approaches, once market practice has developed.

9.17 We do not believe that it is appropriate to mandate a specific course of action at this stage, noting that use of these structures is dependent on a number of other variables that we discuss in this section.

Trading Halts

9.18 Companies are required to comply with ASX requirements[98] relating to the 'Immediate notice of material information' at all times. The equivalent in the UK is a company's obligation to publish inside information under Article 17 of the UK Market Abuse Regulation (UK MAR). In Australia, if trading may happen between the time an obligation arises and the company's ability to put

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95 Set out in Appendix 7A of the ASX Listing Rules.

96 Appendix 3B of the ASX Listing Rules.

97 LR 7.2.1A Premium Listing Principle 5 in the FCA's Listing Rules, DTR 6.1.3(1) in the FCA's Disclosure Guidance and Transparency Rules.

98 Listing Rule 3.1 of the ASX Listing Rules.

out an announcement, a company can request a trading halt from the ASX under Listing Rule 17.1 which may last no more than two business days. ASX publish guidance noting that an acceptable reason for requesting a trading halt may be a pending material announcement about a proposed capital raising. It is possible to request back-to-back trading halts in association with an accelerated capital raising involving a significant issue of securities that is essentially pro rata to all holders[99].

9.19 Trading halts are differentiated from voluntary suspensions. Given that trading halts can last no longer than two business days (four days if back to back requests are made), a voluntary suspension may be appropriate if longer pauses in trading are required. However, extended use of such a suspension can cause a company to be ineligible for the short-form disclosure regime under the Australian Corporations Act, meaning a prospectus would be needed. Preparation of a prospectus would materially adversely affect the attractiveness of the accelerated rights issue structure.

9.20 Companies who apply for a trading halt need to make certain confirmations to the market, both at the time of instigating the halt[100] and with respect to the cleansing notice released in association with a lifting of the trading halt[101]. Written confirmations to the exchange are notified and form part of the recognised package of standard form notifications which signal the use of an accelerated rights issue.

Ability for investors to participate

9.21 The trading halt can also serve commercial purposes. By signalling the start of the institutional offer period, it provides existing institutions on the register with a signal to contact the company and its advisers in short order – should they not have already been contacted – with the two to three day window providing sufficient time for them to review the relevant documentation even if they have not been contacted with regard to the proposed transaction ('wall-crossed') earlier in the process. For investors, it also gives them the ability to recall stock lent to other investors where this is necessary in order to participate. Respondents to the Call for Evidence also highlighted that a trading halt during the institutional bookbuild would have the potential to limit volatility during that phase of the offer.

9.22 There are opposing views. Certain investors put forward the view that if an offer is live, any institution has the ability to register their interest to participate, and therefore it is incumbent on the professional investor to contact the lead bank if they have not been approached. This is part of the

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99 ASX Guidance Note 16 – Trading Halts and Voluntary Suspensions (link)

100 See, for example, Aristocrat's request for a trading halt at the time of its PAITREO: (link)

101 Section 708AA(2)(f) of the Corporations Act 2001 as modified by Australian Securities and Investments Commission Corporations (Non-Traditional Rights Issues) Instrument 2016/84 and ASIC Corporations (Disregarding Technical Relief) Instrument 2016/73

service that they are providing for their client (the beneficial investor). Arguments were also cited that trading halts prejudice the interests of the wider market; if an investor has not been wall-crossed, is unconstrained in their ability to trade and has a need for liquidity or a desire to purchase stock, philosophically there should be no reason why an investor should not be able to buy or sell in an active market.

Trading Halts and underwriting

9.23 A lack of volatility has implications for underwriters. Whereas in the UK it is usual for a rights issue to be launched at a deep discount, in Australia accelerated rights issues tend to be issued at a tighter discount to the prevailing market price at the time of suspension. In a scenario without a trading halt, a deterioration in the underlying share price of the issuer could mean that the exercise price for the accelerated rights issue quickly became 'out of the money', meaning investors would be unwilling to participate in the transaction and the underwriting bank would be left with a far greater exposure. An investment bank's willingness to accept an underwriting mandate in such circumstances may be diminished. In contrast, in a placing using an ABB structure the pricing of the offer narrows during the time that it is open in a live market situation. The final price is only announced at the completion of the placing in the results announcement, allowing the investment bank to reduce their exposure to effectively settlement risk.

9.24 On the contrary, the Review also received investor feedback to suggest that trading halts should not be considered necessary for capital raising. These responses noted that major capital markets around the world (for example the US) are consistent in their approach in not implementing a trading halt for capital raises and trading halts tend to be adopted in smaller capital markets, if at all.

9.25 We also received feedback that from an efficient markets perspective, if market offers are done during trading hours and a price is moving, any discount negotiated during the bookbuild process will be based upon a true, rather than stale, price. Investors look at sector trends, meaning investor decisions reference the performance of other stocks in a sector, not just the issuer undertaking the capital raise. A discount negotiated on a price prior to the imposition of a trading halt may be inappropriate where there is positive or negative market sentiment on the issuer or the sector which has not been factored in. Furthermore, movements in collateral/stock lending also feed into price formation. Where such movements have been unable to occur, this can contribute to a mispricing.

9.26 As previously noted, UK markets operate under a regime of continuous trading. The FCA provides guidance as to when the FCA may suspend trading in LR5.1.2G, but broadly the FCA will intervene only if the smooth operation of the market is, or may be, temporarily jeopardised or it is necessary to protect investors. In particular, the FCA will not suspend the listing of a security to fix its price at a particular level[102].

9.27 We also note that in the context of issuers who are dual-listed conducting a capital raise in a jurisdiction which employs a trading halt and a jurisdiction which does (for example an Australia-UK dual-listed issuer), we are not aware of any evidence to demonstrate that trading remaining open results in disorderly markets. For example, there are many examples of dual listed companies on Australian and UK markets conducting issues during a trading halt in Australian markets, whilst trading remained live in the UK.

In January 2020, Resolute Mining Limited (RSG) requested a trading halt on ASX, pending an announcement. The company announced an equity raise of up to A$196m, made up of an institutional placement tranche to raise A$146m, a placing to RSG's largest shareholder and to directors of the company for A$25m, and a share purchase plan subject to a maximum size of A$25m[103]. Trading was expected to resume by Thursday 23 January 2020 at the latest. During that period, trading continued on AIM. During this period the price increased from A$1.175 to A$1.2, a 2% increase, as shown in Figure 10.

9.28 Whether negotiations based on live pricing lead to fairer outcomes for issuers in terms of them obtaining tighter discounts is difficult to assess without undertaking an in-depth study of discounts achieved compared to post issuance share price movements. We understand the scepticism surrounding the imposition of trading halts for capital raising, noting that this would be a step change in the approach to how UK markets are operated. We are therefore unconvinced of the requirement for a trading halt purely for the purposes of a fundraising, noting that there is insufficient evidence of the benefits this would bring to counteract the corresponding drawbacks of a loss of liquidity for investors. The Review recommends that any further consideration of the implementation of a trading halt reviews available academic literature on this theme.

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102 LR 5.1.3G of the FCA's Listing Rules.

103 See RSG announcements between 20th Jan 2020 and 2 Feb 2020

FIGURE 10: SHARE PRICE MOVEMENT FOR RESOLUTE MINING LIMITED BETWEEN 20 JANUARY AND 23 JANUARY 2020

Market disclosures and cleansing notices

Recommendation: The concept of a 'cleansing notice' should be adopted in the UK where a secondary issue involving a public offer does not require a prospectus

9.29 Changes to Australia's securities laws were introduced in 2007 to permit ASX-listed companies to undertake 'low-doc' rights issues, by way of releasing a 'cleansing notice' to the market at the time of announcing the rights issue, instead of issuing a prospectus[104].

9.30 The cleansing notice is a positive affirmation made to the market by the company that it is in compliance with its continuous disclosure obligations. It also level sets the market where certain institutional investors may have been wall-crossed in advance of the offer to gauge their support. A cleansing notice is required to be released for the securities to be freely sold in the 12 months following the issue without the need for a prospectus/disclosure statement. This means that in some circumstances early disclosure of information that is otherwise not required to be released to the market must be made.

9.31 Cleansing notices may only be issued in limited circumstances including:

(a) **Class:** The securities issued are of a class that were quoted securities for at least the previous three months;

(b) **Suspension limits:** Trading in the class of securities has not been suspended for more than, generally, five trading days in the previous 12 months (excluding the days the company was in a trading halt); and

(c) **No exemptions:** The company was not covered by certain exemptions or orders under the Corporations Act.

9.32 Section 708A(6) of the Corporations Act sets out the details cleansing notices must include. Most importantly a cleansing notice must include any 'excluded information', which includes information:

(a) The company is presently not releasing to the market due to a continuous disclosure carve out in Listing Rule 3.1A (common examples include but are not limited to an incomplete and confidential acquisition, sale or new material customer contract negotiation, plans for an imminent capital raising, results of studies or experiments and exploration results); and

(b) That investors and their professional advisers would reasonably require to allow them to make an informed assessment of the company's assets, liabilities, financial position, performance and prospects or the rights attaching to the securities issued.

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104 Tapping the markets – director decision-making when raising equity (Allens Arthur Robinson)

Aristocrat confirms the following:

(a) The New Shares will be offered for issue without disclosure to investors under Part 6D.2 of the Act and without a prospectus being prepared.

(b) This notice is being given under section 708AA(2)(f) of the Act, as modified by the Legislative Instruments.

(c) As at the date of this notice, Aristocrat has complied with:

  (i) the provisions of Chapter 2M of the Act as they apply to Aristocrat; and

  (ii) sections 674 and 674A of the Act.

(d) As at the date of this notice, there is no excluded information of the type referred to in sections 708AA(8) and 708AA(9) of the Act that is required to be set out in this notice under section 708AA(7)(d) of the Act.

(e) The potential effect that the issue of the New Shares will have on the control of Aristocrat, and the consequences of that effect, will depend on a number of factors, including investor demand and existing shareholdings. However, given:

  (i) the size and pricing of the Entitlement Offer;

  (ii) the structure of the Entitlement Offer as a pro rata issue:

  (iii) the underwriting arrangements in place for the Entitlement Offer; and

  (iv) the current level of holdings of substantial holdings (based on substantial holding notices that have been given to Aristocrat and lodged with ASX on or prior to the date of this notice).

Aristocrat does not expect that the Entitlement Offer will have a material effect on the control of Aristocrat and, as such, does not expect any material consequences to flow from that.

An example of the confirmations made by Aristocrat Leisure Limited, in association with a PAITREO launched to fund its offer for Playtech Ltd

Institutional offer presentations

9.33 Companies undertaking an accelerated rights issue prepare presentations in association with their institutional offer. There is no standard template for such documents, but the information included in the investor presentation, accompanying announcement and previous notifications allows the company to issue a cleansing notice (see section above).

9.34 Investor presentations are also provided to investors participating in transactions in the UK. However, these are not generally uploaded to RNS as any information required to be notified would be included within the prospectus or market announcement. This could, however, be done if an issuer felt it was desirable to do so. Issuers in the UK are functionally able to upload PDF versions of PowerPoint presentations through Primary Information Providers such as RNS, where an uploaded PDF document is hosted by RNS and can be linked to in the RNS announcement. This is frequently done for prospectuses[105].

[105] See example: Royal Bank of Canada, publication of prospectus (Jan 5, 2022)

Retail disclosures

9.35 The retail component of an accelerated rights issue is made pursuant to section 708AA of the Corporations Act (as notionally modified by ASIC Corporations (Non-Traditional Rights Issues Instrument 2016/84 and ASIC Corporations (Disregarding Technical Relief) Instrument 2016/73), which allows entitlement offers to be made without a prospectus or other disclosure document. This wording is included in the rubric at the beginning of a retail entitlement offer booklet that is sent to eligible shareholders.

9.36 A retail entitlement offer booklet is very different to a UK prospectus. Such documents have developed over time and there are no strict content requirements that an issuer must follow. There are typically five general sections, as set out in the table below.

Retail Entitlement Offer booklet

Section	Content
Details of the entitlement offer	An overview of the offer; its purpose; eligibility to participate; Entitlements and any trading arrangements; Shortfall bookbuilds; reconciliation arrangements; underwriting; effects on the issuer's capital and control of the company; CHESS arrangements.
How to apply	Options available to shareholders; treatment of ineligible shareholders; payments; declarations made in accepting the offer; responsibilities of custodians and nominees; withdrawal of the offer.
Important information	Statement that the document is not a prospectus; foreign jurisdiction restrictions and limitations; summary of underwriting arrangements; risks; cooling off rights.
Australian tax implications	General tax implications; issue of entitlements; selling entitlements in a retail shortfall bookbuild; exercise of entitlements; dividends on new shares as a result of entitlements taken up; disposal of new shares.
Company Announcements	Any announcements released prior to the retail information booklet relevant to the offer, including the investor presentation published in connection with the institutional bookbuild.
Glossary	Glossary of key terms in the document.

Source: SCRR analysis (see Superloop for an example)

9.37 Additionally, top-up facilities can be included in the retail offer. This allows any 'Eligible Retail Shareholder' taking up their full entitlement to apply for additional shares under a top-up facility at the same offer price. Any shares not taken up by the closing date of the retail entitlement offer are then allocated on a pro-rata basis to those shareholders applying for additional entitlements through the top up facility.

9.38 From an issuer's perspective, preparation of the retail offer booklet is significantly easier than producing a prospectus.

Terms of the offer

9.39 In order to qualify for the disclosure exemption (from the requirement to produce a prospectus), an offer needs to be made to each relevant member on the same terms.

9.40 ASIC provide guidance that the terms of an accelerated rights issue offer must be the same, apart from:

(a) Different offer periods and dates of allotment for institutional investors and retail holders; and

(b) Rights trading being offered to retail but not institutional holders.

9.41 Additionally, Australia incorporates additional protections for shareholders, such as around AGMs. Companies should not schedule a general meeting during the period of an offer if early allotment to institutional investors would distort voting (RG189.33).

Combinations of offer types

9.42 In Australia, companies are limited to issuing up to 15% of their issued share capital through a placing. There is an additional 10% available for companies who are not in the ASX300 index and have a market cap equal to or less than A$300m[106].

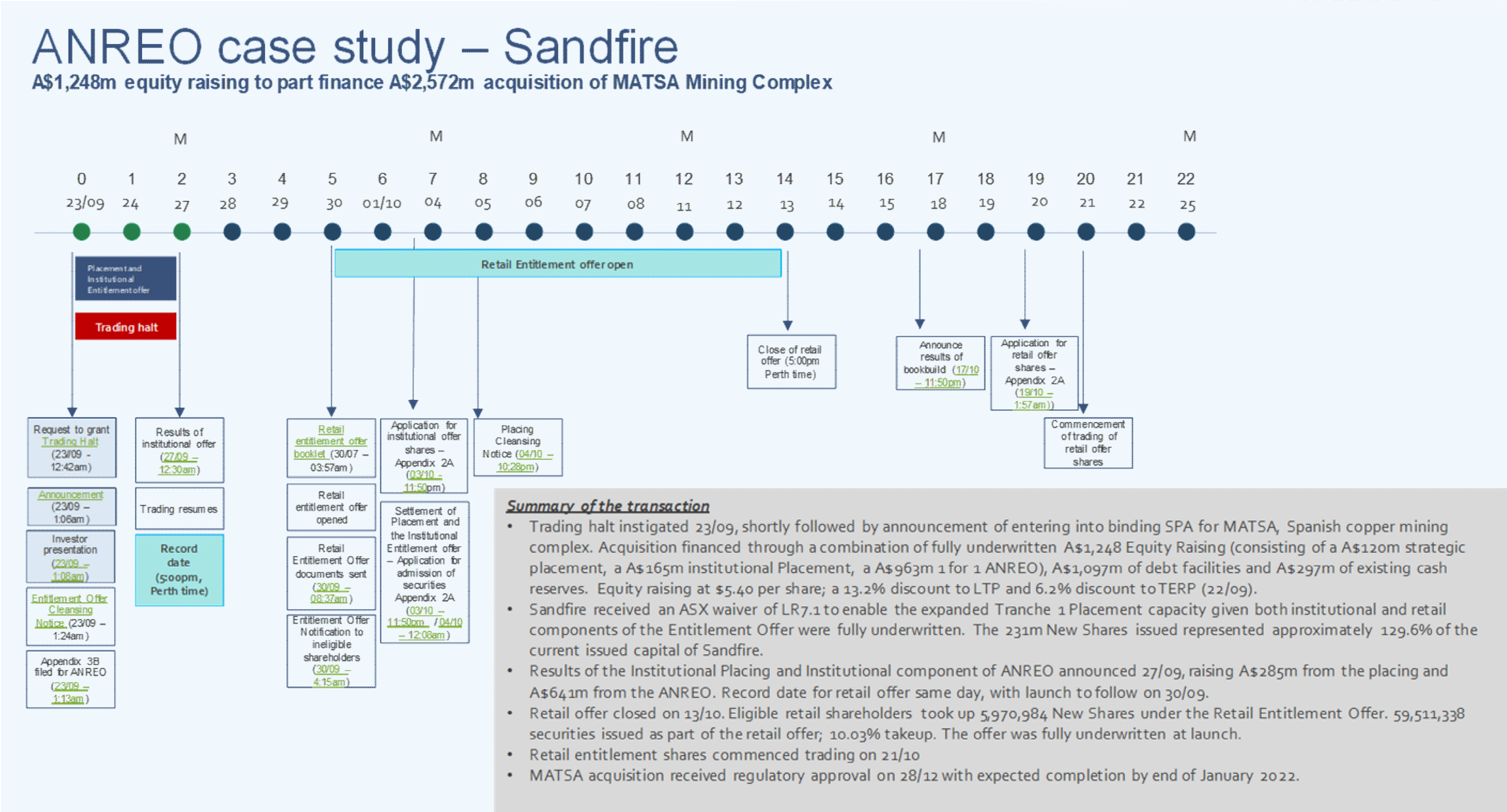
9.43 However, structures can be linked. An issue is exempt from the above limitations where the offer is made pro rata (i.e. including Alternative and traditional rights issues)[107]. Instead, alternative rules apply as set out in Listing Rule 7.1.1. For non-renounceable offers (such as an ANREO), the ratio of securities offered must not be greater than one security for each security held. This effectively limits the company to raising up to 100% of its existing market capitalisation, assuming the offer is made at market price, where a non-renounceable structure is employed.

9.44 A company can therefore raise significant amounts of capital in short order without needing specific shareholder approval. The case study of Sandfire in Figure 11 highlights how an issuer was able to raise 130% of their market capitalisation to fund an acquisition through the way the Australian rules are calibrated.

106 See ASX Listing Rule 7.1, and 7.1A within that chapter for additional placing capacity for SMEs.

107 See ASX Listing Rule 7.2, Exception 1

FIGURE 11: SANDFIRE CASE STUDY



Could accelerated rights issues feasibly be adopted in the UK?

9.45 As noted above, key features of the Australian regulatory regime are a lack of regulatory review of offering documents, trading halts, cleansing notices, publication of institutional offer presentations, retail booklets, and regulatory guidance around equality of treatment of shareholders.

Recommendation: The principles of accelerated fundraising structures– including speed and observance of pre-emption rights – should be adapted for use in the UK market

9.46 We have highlighted that we are unconvinced of the requirement for trading halts. As such, the remaining key features highlighted above predominantly concern disclosure. In this regard, a key consideration for the adoption of such structures in the UK will be the extent to which such an offer could trigger a prospectus; as such until such time as HMT's prospectus reforms are implemented, we do not consider it likely that an accelerated rights issue can be meaningfully be employed in the UK.

Pricing

9.47 With respect to trading halts and pricing, we are cognisant that a lack of trading halt could create an impediment to the efficient functioning of a UK equivalent to an accelerated rights issue given that underwriters may be unwilling to take on such risks, particularly for larger deals. One way of addressing this could be for a deal to be structured so that the firm placing takes place without a trading halt, and the price achieved then sets the terms for the ensuing open offer/rights issue. This would need to be tested with the market.

9.48 In addition to the regulatory aspects and associated impact on underwriting discussed above, there are also operational issues to consider which we set out below.

Ability to quickly identify institutional and retail investors

9.49 As the key feature of Australian models is the ability to quickly raise funds from institutions, in an accelerated rights issue process it is key to identify the investment managers who can make decisions as soon as possible. As company registers are not static, reconciliations of the register are performed in the lead up to launch of an offer so that institutional investors can be accurately identified and contacted, catering for an environment where companies can raise funds quickly. This also allows investors to recall stock lent if they wish to participate in the offer, if necessary.

The authority to connect with decision makers – s672

9.50 Company law in Australia permits companies to identify not only those with an interest in their shares, but also decision makers who have given the person with an interest in the shares instructions relating to those shares[108]. This allows companies and intermediaries to identify who the decision maker will be for the purposes of a fundraising. Whilst the law does not specify electronic contact details, in practice such details are also collected.

> **672B Disclosure by member of relevant interests and instructions**
>
> (1) A person given a direction under section 672A must disclose to the person giving the direction:
>
> (a) full details of their own relevant interest in the shares or interests in the scheme and of the circumstances that give rise to that interest; and
>
> (b) the name and address of each other person who has a relevant interest in any of the shares or interests together with full details of:
>
> (i) the nature and extent of the interest; and
>
> (ii) the circumstances that give rise to the other person's interest; and
>
> (c) the name and address of each person who has given the person instructions about:
>
> (i) the acquisition or disposal of the shares or interests; or
>
> (ii) the exercise of any voting or other rights attached to the shares or interests; or
>
> (iii) any other matter relating to the shares or interests;
>
> together with full details of those instructions (including the date or dates on which they were given).

The UK approach – s793

9.51 In the UK s793 provides the legal mechanism for companies to request information from those who they believe have an interest in their shares.

> 793 Notice by company requiring information about interests in its shares
>
> (1) A public company may give notice under this section to any person whom the company knows or has reasonable cause to believe-
>
> (a) to be interested in the company's shares, or
>
> (b) to have been so interested at any time during the three years immediately preceding the date on which the notice is issued.
>
> (2) The notice may require the person-
>
> (a) to confirm that fact or (as the case may be) to state whether or not it is the case, and
>
> (b) if he holds, or has during that time held, any such interest, to give such further information as may be required in accordance with the following provisions of this section.
>
> (3) The notice may require the person to whom it is addressed to give particulars of his own present or past interest in the company's shares (held by him at any time during the three year period mentioned in subsection (1)(b)).
>
> (4) The notice may require the person to whom it is addressed, where-
>
> (a) his interest is a present interest and another interest in the shares subsists, or
>
> (b) another interest in the shares subsisted during that three year period at a time when his interest subsisted,

[108] See s.672B of the Australian Corporations Act (link)

to give, so far as lies within his knowledge, such particulars with respect to that other interest as may be required by the notice.

(5) The particulars referred to in subsections (3) and (4) include-

(a) the identity of persons interested in the shares in question, and

(b) whether persons interested in the same shares are or were parties to-
(i) an agreement to which section 824 applies (certain share acquisition agreements), or
(ii) an agreement or arrangement relating to the exercise of any rights conferred by the holding of the shares.

(6) The notice may require the person to whom it is addressed, where his interest is a past interest, to give (so far as lies within his knowledge) particulars of the identity of the person who held that interest immediately upon his ceasing to hold it.
(7) The information required by the notice must be given within such reasonable time as may be specified in the notice.

9.52 However, this can be a slow process which is complicated to administer. Responses can be received in varying formats or with incomplete information. The information received often necessitates a further s793 notice to a further custodian referenced in the s793 reply. Whilst companies can impose draconian measures on those who do not respond[109], judgements on when to impose such measures are subjective and a last resort. Dealing with such extensive administrative issues – even where legal remedies exist to ultimately obtain the desired information – is incompatible with an accelerated fundraising timeline.

9.53 The law commission's scoping paper[110] highlighted the issues with the s793 process, considering it from a broader corporate governance perspective. It raised that:

(a) **Contact details:** s793 does not require the provision of contact details for ultimate investors, meaning that companies may have immediate access to names of ultimate investors only;

(b) **Snapshot:** s793 only provides a snapshot of ownership at a given time, and depending on the level of transactions a list of beneficial owners may change significantly. The process imposes a costly administrative burden on companies; and

(c) **Members only:** Only members of a company can require a company to use its powers under s793.

9.54 In the narrower context of fundraising, respondents to our Call for Evidence highlighted that the company or Central Securities Depository (CSD) instigates such s793 requests, but other intermediaries are not able to do so.

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109 Non-compliance with a s793 notice is a criminal offence and the company may seek court orders imposing restrictions on transfer, voting and the payment of dividends in respect of shares. Companies may supplement this statutory regime by bespoke provisions in their articles of association to enable directors to impose such restrictions without having to go to court.

110 Corporations Act 2001 (legislation.gov.au), s.672B.

Similarly, whilst many platforms do hold electronic details for underlying investors, these are not required to be supplied on the response to the s793 notice. Similarly, responses received to a UK request do not always provide the level of specificity that is useful to the requester – particularly in the case of large institutional investors who may have holdings spread across multiple funds run from different jurisdictions. The response may highlight that an institutional investor holds the shares, but will only provide generic contact details meaning it is difficult to isolate the decision maker within the investment firm who would have responsibility for making a decision in respect of pre-emptive rights in the required timeframes.

9.55 The law commission[111] set out a number of possible solutions in this area, including amending subsection (5) of section 793 to include a requirement that a person who received a notice under section 793 must provide the identity and contact details of the person interested in the shares. We would however recommend that more extensive changes are made to s793 to facilitate the development of accelerated fundraising structures.

Recommendation: Section 793 of the Companies Act 2006 should be amended to additionally require disclosure of the identity of the ultimate investment decision maker or beneficial owner in relation to a share

9.56 In this regard, key requirements for accelerated fundraising structures are that the medium of communication involved in a s793 request enables investors to be contacted quickly and that the information goes beyond the legal holder to the decision maker in respect of the shares. We would therefore recommend the following:

(a) **Decision-maker:** The Companies Act 2006 should explicitly set out that a company may request information on the decision maker in respect of shares it has issued.

(b) **Contact details:** 'Contact details' of the person interested in the shares should relate to both the legal holder and the decision maker specified above and should include an electronic means of communication in both instances, including an email address at a minimum.

(c) **Delegation:** There should be a formal mechanism for a company to delegate the ability to request information to a third party.

The '1 – institutions = retail' approach

9.57 Australia's ability to identify decision makers and link these to the legal holdings on the register allows the company and its advisers to build up a picture of who should be contacted for the purposes of the accelerated tranche of an offering.

111 Law Commission, Intermediated Securities Scoping Paper (3.133)

9.58 Whilst accelerated rights issues are described as split between institutional and retail, there is no prescriptive regulatory classification specifying who should be included in either tranche. As such, the retail pool of investors could include some institutional investors who for whatever reason did not participate in the accelerated tranche of the offer (for example if they were not identified as institutional in the pre-launch register checks, or did not respond). This flexibility ensures that all investors have an opportunity to participate in the pre-emptive offer. The diagram in Figure 12 demonstrates how this split effectively occurs in the case of a dual bookbuild structure (such as an ANREO or AREO), reorganising the register into accelerated and 'retail' tranches with bookbuilds occurring at different times for any shortfalls in each tranche.

Register checking

9.59 An important aspect of the Australian accelerated rights issue is the process of co-ordinating and undertaking pre-launch register checks in the context of the transparency framework highlighted above, to understand which investors need to be accelerated. Orient Capital were the first firm to perform this role in Australian markets in 2004[112].

9.60 Importantly, the process of scrubbing the register before the launch of an offer is not considered to amount to 'pre-announcing' the transaction. Requests are sent to nominees rather than to underlying investors. Nominees are accustomed to these sorts of requests given the popularity of the accelerated rights issue structure, typically receiving them on a daily basis. Benign justifications are provided, such as at the issuer's request. Nominees will generally respond in advance of launch of the offer, and will clearly do so post-announcement as it is in their interest to ensure that they are not at fault if an underlying institutional investor wants to participate in the accelerated tranche. As such, the process has become a well understood back-office process in Australia.

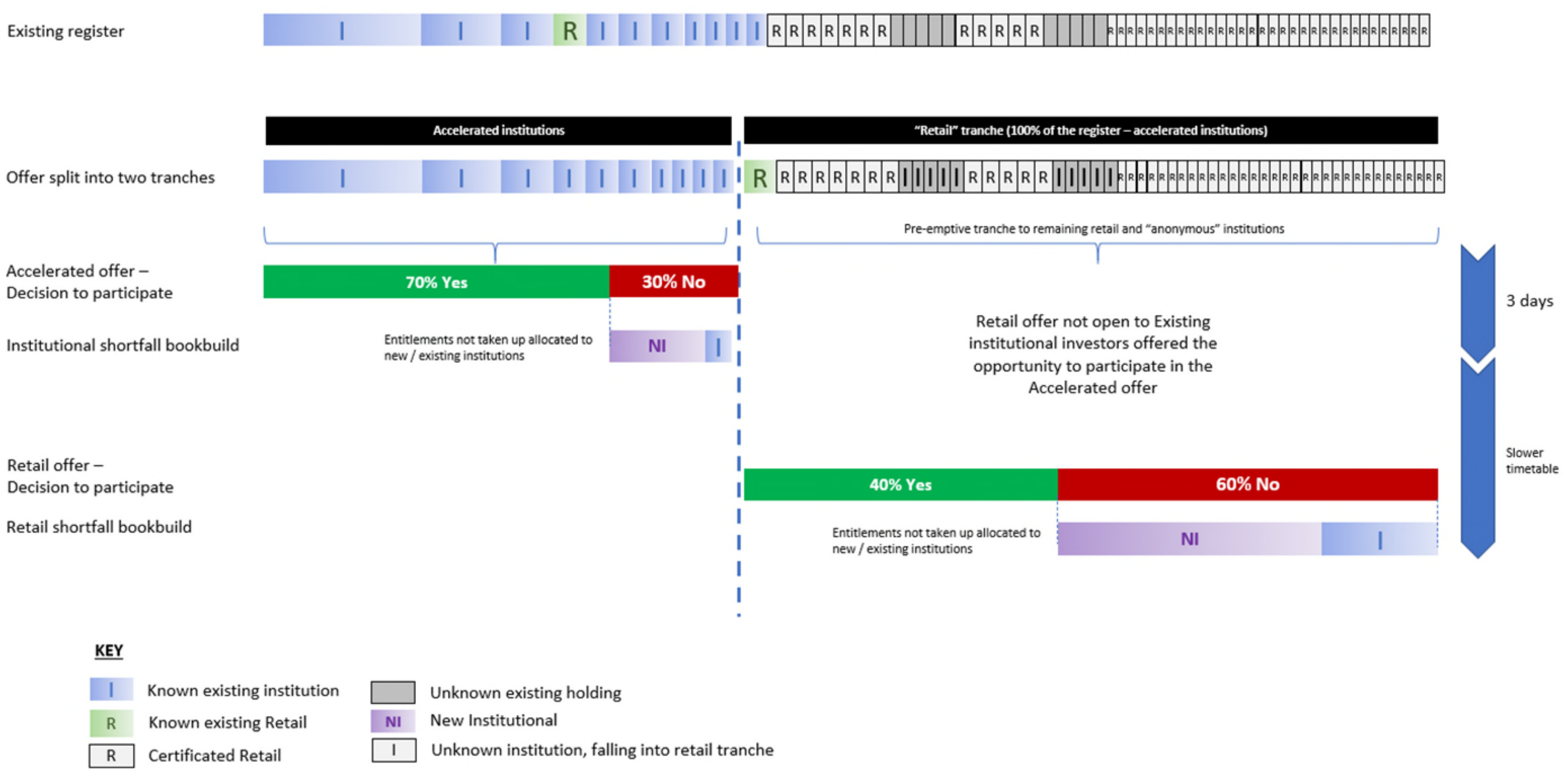
9.61 Issuers will receive a daily report on the shape of the register, and deal teams will discuss any changes and implications on who should and should not be invited into the accelerated portion of the offer. This daily analysis is performed for the ten days up to the record date, checking on factors such as stock lending to make sure recall notices are coming in as appropriate.

9.62 Whilst listed issuers will have a large degree of commonality in terms of their underlying shareholders (in particular institutions), the fact that every register is unique means that a substantial database is required to track legal ownership to beneficial owners, with a significant degree of complexity where there is a lengthy custodial chain and a large team to be able to deal with the inevitable volume of responses and manual intervention that will invariably be required to deal with anomalies. The operator of the database also needs to have strong

112 Orient Capital | About Us

relationships and procedural links with global custodians, and as custodians cannot ask for a fee to respond (given that the request is based on a legal obligation) it is important for the database operator to make things as easy as possible for custodians to respond to notices.

FIGURE 12: AUSTRALIAN ACCELERATED RIGHTS ISSUES: SPLIT BETWEEN ACCELERATED AND RETAIL TRANCHES



Source: SCRR

9.63 In the context of the adoption of accelerated rights issues in the UK, it would be essential for a similar provider to perform this role in the UK. A key dependency will therefore be changes to the Companies Act 2006 to allow such a provider to request and collate the required information on behalf of an issuer in a manner which is consistent with the speed of an accelerated rights issue.

Master ECM terms

9.64 To ensure that accelerated rights issues can be made to a number of institutions quickly and efficiently, Australian market practitioners utilise standard ECM terms[113]. These help to significantly speed up the process of communication with institutional investors.

9.65 Without such forms, each bank and institutional investor share legal agreements with slightly different terms. Minor differences require additional legal review, adding time and complexity to the process. In standard ECM terms, warranties are standardised.

9.66 Standardised terms in Australia were first agreed in 2010 and have been refreshed at least yearly since then[114]. They are published and co-ordinated by AFMA, the Australian Financial Markets Association, a trade body for financial markets participants. As such the development of the terms was led by the AFMA ECM legal committee involving numerous investment banks and law firms active in equity capital markets. AFMA's ECM Legal Committee maintains the terms through a review process every six months and updates them as required to take account of legal developments[115].

Recommendation: Standard form terms and conditions with institutional investors for use on secondary fundraises should be agreed and made available publicly

9.67 The fact that such terms were developed after the introduction of the accelerated rights issue structure in Australia demonstrates that it is not a dependency for the use of such structures. However, discussions with Australian market participants have suggested it is a key feature that removes friction in the Australian market. Furthermore, the development of such master terms in the UK would deliver benefits not only in terms of the development of accelerated rights issues but also for wider secondary capital raising options. We would therefore recommend that similar ECM terms are developed for UK capital markets.

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113 Master Terms available at Master-ECM-Term-AU-8-March-2021.pdf (afma.com.au)

114 Archived-Master-ECM-Terms | AFMA

115 Standard Documentation | AFMA

10. START AN AMBITIOUS 'DRIVE TO DIGITISATION'

The importance of underlying infrastructure for secondary capital raising

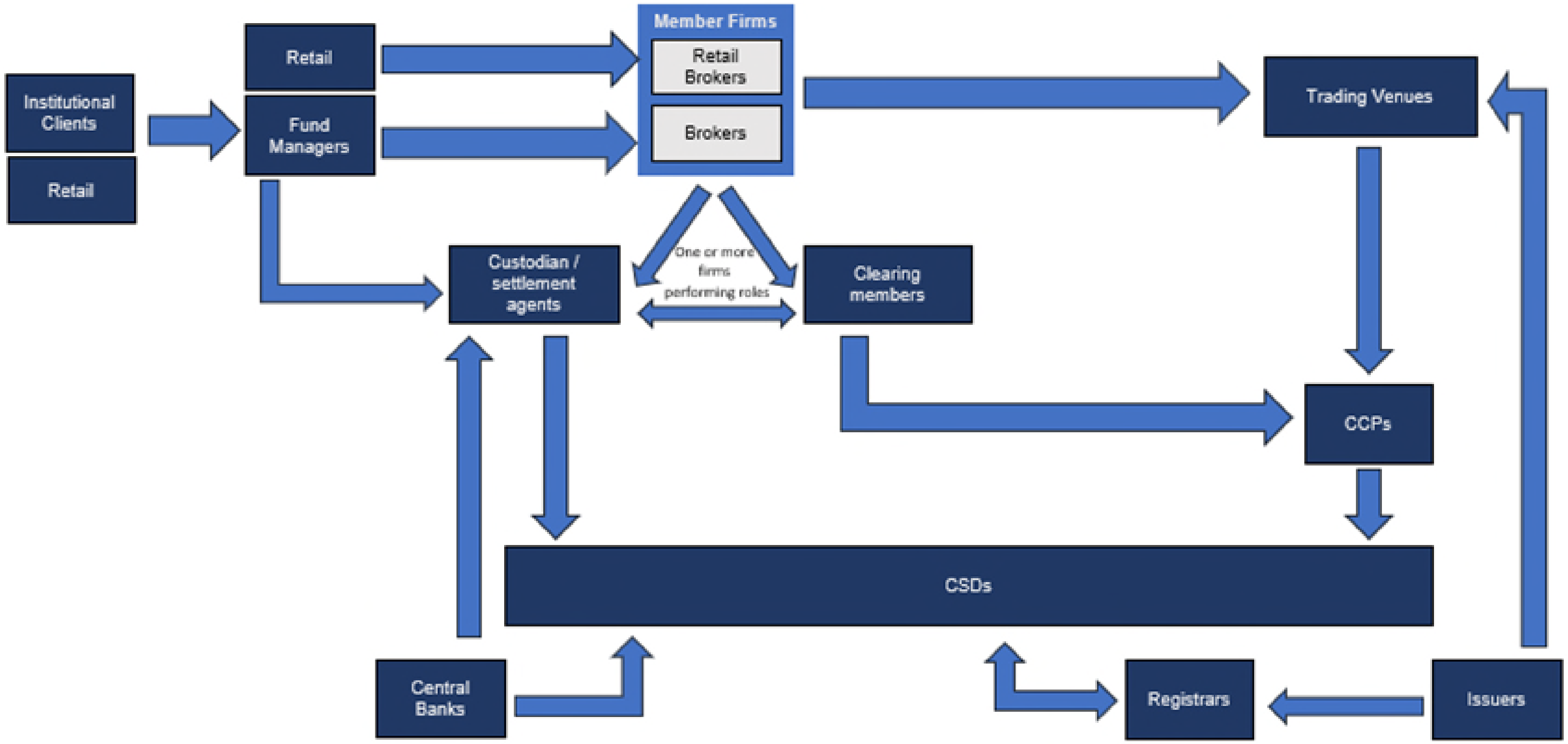
10.1 Whilst much of the focus of the Review has been on the regulatory environment relating to companies' ability to offer shares to investors, it is important not to overlook the important role that market infrastructure plays, including processing information flows to enable investment decisions, transferring cash from investors to issuers and updating recognised registers to ensure securities are issued and transferred in accordance with the applicable law.

10.2 These activities involve the services of a number of different actors. When raising capital, careful co-ordination is needed with a significant body of regulation governing those performing associated activities. Intermediaries rely on robust systems, procedures and controls to ensure that they are capable of dealing with the sheer volume of transactions on public markets, that they can comply with their regulatory responsibilities and that mistakes are avoided in processing asset flows and information flows. The responsibilities of all of these actors extend beyond capital raising, with important implications for corporate actions, including participating in fundraisings, as well as voting. Figure 13 demonstrates these interactions.

10.3 However, it would be remiss to describe the system as perfect. The level of intermediation and specialisation has also arguably become a barrier to progress, where changes that could deliver more meaningful progress for end users of the system – primarily companies and investors – cannot be implemented without co-ordinated investment along the value chain. This can be difficult for some intermediaries to justify when it does not clearly benefit their immediate clients and they do not have complete control over the timing and success of the initiative when reporting back to their owners. Delays by one link in the chain can contribute to inertia in the evolution of the supporting infrastructure as a whole. As such, whilst cost has been reduced and efficiency increased by individual actors along the intermediary chain, frequently this has come at the expense of co-ordinated facilitation of shareholder rights. Those at the end of such investor chains – such as retail investors – have relatively little power to demand reform.

10.4 Given the important role that the supporting infrastructure plays in capital raising, a number of the recommendations suggested in this Review risk not being fully effective if they are not supported by associated development in the processes employed by the chain of intermediaries who are essential in making the fundraising work. This Review has provided the opportunity to bring together all of the relevant actors, to ensure that the capital raising framework is fit for purpose and is capable of adapting to new technologies and trends in the future.

FIGURE 13: INTERACTION OF SELECTED MARKET PARTICIPANTS IN CAPITAL MARKETS



10.5 However the opportunity presented by digitisation extends beyond capital raising to broader stakeholder engagement and corporate governance issues. As noted by Ferran, “market structures that have developed through ‘haphazard happenstance and necessity’, and that reflect incumbencies and inequalities of bargaining power do not necessarily align with the set of efficient arrangements that are most conducive to improving corporate governance for the benefit of society overall”[116].

Historical interest in this area and opportunity for reform

10.6 There is a wealth of literature covering the intermediation chain. In the last 10 years, a number of in-depth reviews have either been wholly focused on or have looked into this area in substantial detail.

2020	Law commission scoping paper on intermediated securities	Link
2017	Report of the European Post Trade Forum (EPTF) – *including UK*	Link
2016	BIS: Exploring the Intermediated Shareholding Model	Link
2014	An independent Review for the Secretary of State for Business, Innovation & Skills: IPOs and Bookbuilding in Future HM Government Share Disposals	Link
2014	Law commission: Fiduciary Duties of Investment Intermediaries	Link
2012	The Kay Review	Link

10.7 In a post-Brexit context, the UK is now in an ideal position to leverage the valuable work undertaken as part of these reviews. The Government have published a number of opportunities for regulatory reform[117], with dematerialisation of shares specifically mentioned, reflecting the prominence of this topic for both the Government and the market.

What do we mean by ‘digitisation’ and why should we care?

10.8 When considering this topic, it is important to avoid any ambiguity over the objectives of this opportunity, given that a process for holding security interests in digital form – starting with the process of dematerialisation – already exists in the UK. Indeed, this is the main mechanism supporting the trading of shares on public exchanges.

10.9 Dematerialisation is a legal concept which was defined at the time that a legally-recognised computer-based mechanism was introduced in addition to the paper-based mechanism that was in place for the administration of a company’s shares – shares were capable of being ‘dematerialised’ into an

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116 Ferran, Eilis, Shareholder Engagement and Custody Chains (December 1, 2021). University of Cambridge Faculty of Law Research Paper No. 1/2022, Available at SSRN: https://ssrn.com/abstract=4001702

117 Brexit opportunities: regulatory reforms – GOV.UK (www.gov.uk)

electronic-based form. This was a “big bang” event in the development of capital markets affecting all participants in the industry.

10.10 Whilst these two methods of dematerialisation and paper-based recording of the securities issued by a company co-exist, the UK’s capital market infrastructure is forced to accommodate both legal mechanisms, in itself creating frictions. However as we explain in this section, we believe that ‘digitisation of shareholdings’ should encompass not only the initial method of recording securities but improving and reforming the entire intermediated shareholder framework, part of which would result in the eradication of paper-based processes in the securities settlement infrastructure for capital markets. As such, the ambition of digitisation should extend beyond the simple replacement of share certificates with pdfs.

10.11 A ‘drive to digitisation’ could radically overhaul the system to improve end investors’ ability to exercise their shareholder rights and for issuers to know who is on their shareholder register, including the ultimate beneficial owner. Taken to its extreme, this process would necessarily require changes that were both legal and operational in nature for the benefit of not just capital raising processes but wider shareholder rights and engagement in stewardship and other Environmental, Social and Governance (ESG) related activities.

The system as it stands in the UK

How are shares issued today?

10.12 The Law Commission’s scoping paper on intermediated securities from November 2020 provides a detailed description of the legalities of share issuance in the UK. This Review has not had the time to and has not in any event sought to repeat the admirable work that the Law Commission has already performed and documented in this area. However, we do summarise some of the key concepts for context. We have referenced areas of the intermediated securities paper that readers of this Review may wish to consult for more detailed information.

Paper or computer-based systems

10.13 In the UK, when issuing shares the company is required to maintain a register of shareholders, in accordance with the Companies Act 2006 (i.e. they are issued in ‘registered form’). A company can choose to issue securities in two forms, either as certificates or as ‘dematerialised’ securities (i.e. electronically). The company’s register can therefore be split into two parts; an issuer record of members holding their securities in paper form as certificates; and an ‘operator record’ for holdings issued in dematerialised or electronic form.

10.14 For securities to be issued in dematerialised form, formalities in the Uncertificated Securities Regulations (USRs)[118] must be followed. These

[118] Uncertificated Securities Regulations 2001/3755

provide that securities recorded on the operator record must be evidenced and transferred under a 'relevant system'[119]. Currently the only such system approved under the USRs is the CREST system operated by the UK Central Securities Depository (CSD), which is Euroclear UK & International[120]. For a listed company whose shares are traded on a liquid public market, computer-based systems offer the most practical means of issuing and transferring shares and for this reason eligibility for electronic settlement is a condition of admission to the public market in the UK.

Dematerialisation versus immobilisation

10.15 An additional option to computerise records of ownership is Immobilisation. This entails placing securities issued in paper form in the custody of a central party, who becomes the legal owner of the securities. Other investors hold through that depository. In contrast, securities issued in dematerialised form in CREST are not legally held by CREST; it is maintaining the register of legal owners rather than holding securities on custody. This nuance is important, as CREST does not appear on the register of dematerialised securities whereas in an immobilisation model, the central party providing custody services will be the only legal member for securities issued through a computer-based system on the company's register.

Listing, CSDR and Exchange rules

10.16 A number of interacting regulations ensure that shares which are traded on public markets can be issued and transferred in a seamless manner. It is an essential feature of listed shares that they are freely transferable, as required by the FCA's Listing Rule 2.2.4R[121].

10.17 Additionally, companies which are admitted to listed markets must comply with the UK Central Securities Depositories Regulation (CSDR)[122]. From a practical perspective, the impact of CSDR is that companies with their securities admitted to trading on venues need to have arrangements in place for their securities to be recorded in book entry form – utilising either immobilisation or dematerialisation. CSDR places a number of requirements on CSDs to ensure that they are subject to robust operational and governance standards.

10.18 Immobilisation models are common in the EU. This may be due to the fact that bearer shares – where the owner of a share is the person in physical possession of the certificate, rather than the named person on the register maintained by the company – are more prevalent. For example in France, 75%-100% of securities are issued in bearer form, whereas UK companies

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119 USRs, SI 2001 No 3755, reg 2

120 See Law Commission Intermediated Securities Scoping Paper, section 7.21 (link)

121 FCA Listing Rule 2.2.4R

122 Central securities depositories | FCA

have been prohibited from issuing bearer shares since May 2016[123]. The process of immobilisation and of dematerialisation of physical securities has reduced the distinction between bearer and registered securities, as once securities are deposited or recorded in a CSD, settlement takes place in book-entry form. This allows for a convergence in operational processes and legal rights for all types of securities[124].

10.19 Exchange venues also include provisions in their admission standards to ensure that securities are eligible for electronic settlement[125]. Notwithstanding the practical advantages of trading securities in this way, such as lower cost transfers, this means that public companies listed on UK markets need to ensure that they have arrangements in place to transfer their securities at a CSD in addition to more manual arrangements for those shareholders holding certificates. In the UK, the only registered CSD is CREST, meaning that companies using CREST employ a dematerialisation model rather than an immobilisation model as this is the framework in which CREST operates. A key aspect of a CSD's role is to ensure settlement finality[126], mitigating the systemic risk implications of any failure in the finality of a payment or transfer of title of securities in payment systems and securities settlement systems. CREST falls under the regulatory remit of the Bank of England.

Dematerialisation and CREST

10.20 CREST came about following the collapse of the Taurus settlement project in 1993. As highlighted in reporting at the time, whereas the intention for Taurus was to eradicate the use of certificates and for all shareholders of a company to participate in the system, this caused many problems. The failure of Taurus was blamed on the fact that the system was too complicated, with immense technical difficulties in tying together databases in a secure and error-free manner and complications in aiming to achieve many purposes, and keep many groups happy, at the same time[127].

10.21 The creation of CREST is recognised as being a success, not least because it succeeded where Taurus had not. There were some key differentiators in the two proposals. Whereas Taurus had sought to become a mandatory solution for all shareholders, the CREST model instead focused on the wholesale market. This was a conscious decision – the Bank of England Task Force charged with delivery of the project noted that a "cardinal principle of the

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123 See table 2, ECDSA Registration Report (2016)

124 See 3.1.2.2 Legal form of securities – EPTF Report – Annex 3 (2017)

125 See London Stock Exchange Admission and Disclosure Standards (section 2.7) or AQSE Main Market Admission and Disclosure Standards (Part 1,section 4)

126 Euroclear UK and International is a designated UK-law system under the Settlement Finality Regulations (Bank of England)

127 Taurus: Learning lessons from failure (1993)

design for CREST is that it will be voluntary"[128]. Commentary at the time of CREST's inception highlighted that this focus on the wholesale market could lead to a tendency for retail shareholders to have to hold through nominees. The use of nominees was noted as a legal quick-fix, designed to reconcile the old paper-based systems with new demands[129]. The downsides of holding through a nominee were recognised by the Taskforce at the time – "this route may impede the flow of benefits and ownership rights stemming from company membership." For this reason, the model of sponsored membership of CREST was highlighted as an important additional option[130]. In contrast to Taurus, CREST also focused on integration with payments systems, removing market risk that a counterparty would fail through achieving delivery versus payment (DVP).

10.22 Today, from a practical perspective if an investor does not want to hold paper share certificates their shares will need to be held in 'dematerialised' form via the CREST system.

10.23 Legal entities that wish to hold shares in their own name in 'dematerialised' form typically either become:

(a) a CREST Member (which involves investing in hardware (a 'Gateway computer') to connect to the CREST system via an EUI 'accredited network provider'); or

(b) a CREST Sponsored Member participant (which involves entering into an arrangement with a 'CREST Sponsor' who will connect to the CREST system on the Sponsored Members behalf via an EUI 'accredited network provider')[131].

10.24 Retail investors that wish to hold their shares in 'dematerialised' form typically either:

(a) **CREST Personal Member:** Hold their shares in their own name using a CREST Personal Member – this is a CREST Sponsored Member. The retail investor is the legal holder and their name will appear on the legal register, but communication with the CREST system will take place via a Sponsor connected to the CREST system. The CREST Sponsor is typically the retail investor's stockbroker[132]; or

(b) **Nominee:** Hold their shares through an intermediated shareholding model. Typically, the retail investor's stockbroker will offer a

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[128] Quarterly Bulletin February 1995 (bankofengland.co.uk)

[129] CREST: Little Taurus (1993)

[130] See footnote 10

[131] Euroclear UK & International – Quick guide to CREST membership (September 2021)

[132] Euroclear UK & International - Personal membership

'Nominee service' where a subsidiary nominee company acts as legal holder of securities on the retail investor's behalf. The retail investor can choose the type of shareholding model they wish to use, either:

(i) **Pooled:** A pooled nominee account (the shares are held in the name of the nominee company in an account together with the other clients of the same broker); or

(ii) **Segregated:** A segregated nominee account (the shares are held in the name of the nominee company, but in an account purely for the retail investor and separate from other clients of the same broker)

10.25 As highlighted in Euroclear's account segregation guidance, these models are operated through the prism of Users (CREST Sponsors are Users who operate a connection to the CREST system on behalf of participants), Participants (a legal holder of the security, the name on the register) and Member Accounts (designations on the register). Euroclear does not mandate model architectures for participants; an entity may have one or more separate participant accounts in the CREST system. Whilst all may be in the same name, they each have unique participant IDs, are functionally separate and any securities held within them are segregated from each other on the records of the issuer. [133]

How do investors hold shares

10.26 Institutional investors will almost universally hold their shares in electronic form and utilise the services of custodians who legally hold shares on their behalf and deal with the associated share administration. Practices amongst retail investors are more mixed. Whilst the majority of retail investors are likely to use retail platforms – who in turn hold clients' assets in a nominee at a custodian bank whose legal name is on the register – a minority of retail investors still hold their shares in paper form. Furthermore, retail investors may hold their shares through a number of different means, i.e. with some of their holdings in certificated form and other investments held through platforms. There is no uniform method of holding shares, through the involvement of private client brokers who can be classified as institutions or retail, execution-only or discretionary depending on the circumstances[134].

10.27 Using a comparison of the number of shares admitted to trading on LSE versus the number of shares admitted to CREST as a proxy for the percentage of the total number of shares issued which are in dematerialised form, we estimate that for issuers in the FTSE 100 and those in the Premium Equity Commercial Companies segment of the Official List, it is most common for 3% or less of an issuer's total shares in issue to be issued as certificates. For companies on

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[133] Euroclear UK & International account segregation - July 2022

[134] See Law Commission Intermediated Securities Scoping Paper, s. 2.80 (link)

AIM, this is frequently also the case, although it appears there may be more certificated holders[135].

10.28 In practice, for retail investors the most common form of holding method is to hold through a nominee account operated by a broker. Whilst some retail platforms offer an individual CREST account (i.e. sponsored CREST membership), this option is generally more expensive for the investor[136]. Investors may also not be aware of the finer details of their interest in shares where the platform, understandably, seeks to simplify the user experience and only includes a description of the legal arrangements in lengthy terms and conditions which may not be reviewed in detail by the retail investor.

10.29 Surveys by BIS in 2016 identified that between 3-4% of retail investors hold shares in a personal CREST account. The same report estimated that there are approximately 20,000 CREST personal members nationally, out of an estimated 12 million -13 million retail shareholders in the UK[137]. The Law Commission provided updated statistics in their November 2020 scoping paper, noting that the number of individuals holding securities directly through CREST has decreased from approximately 50,000 members in 2003 to 4,200 members in 2020[138]. Meanwhile, the popularity of retail platforms continues to grow, as detailed in Annex H.

10.30 The incentive to hold investments in tax-efficient wrappers such as SIPPs and ISAs can also indirectly lead to investors holding their investments through nominees. Whilst the BIS paper highlights that this is not the only method set by HM Treasury and HMRC, it is the only one used in practice. ONS statistics detail that in 2019, £48bn of shares[139] was held in Stocks and Shares components of ISAs.

10.31 As a consequence of the variety of holding methods available and preferences of retail shareholders and platforms, theoretically a large number of follow-on sub-custody relationships can arise. For example, considering computer-based shareholding methods, the schematic below models different scenarios of ownership which can arise from the intermediaries chain subsequent to involvement of a CSD:

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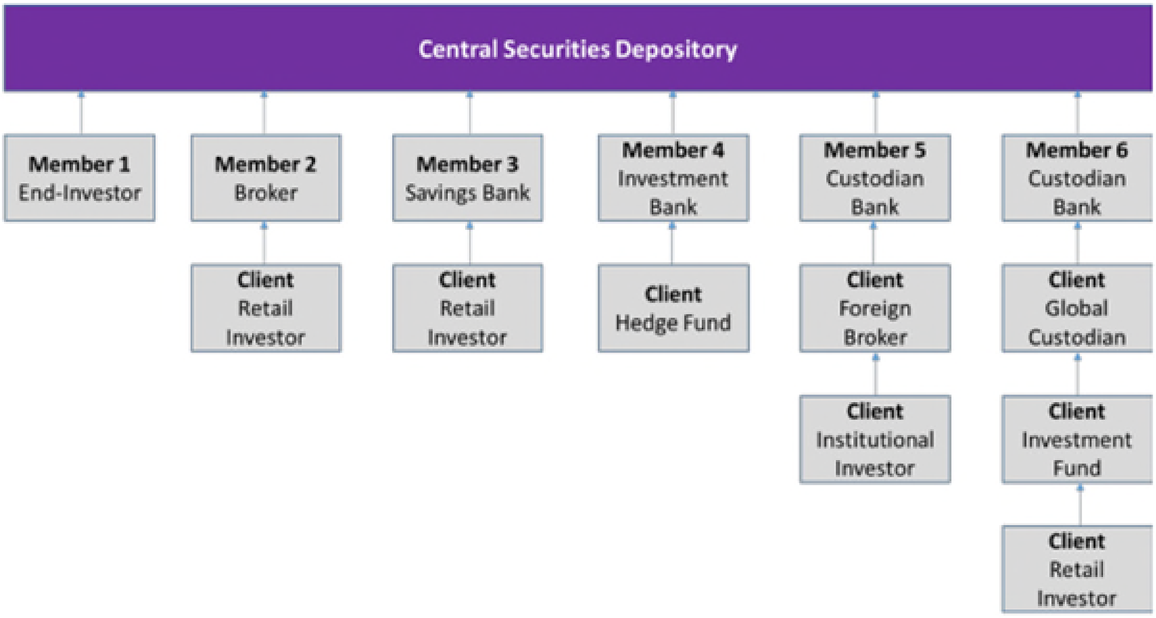
135 See Annex H for details.

136 Law Commission intermediated securities scoping paper , section 8.77 (link)

137 BIS, Intermediated Shareholding Model (2016)

138 Law Commission intermediated securities scoping paper, section 2.58 (link)

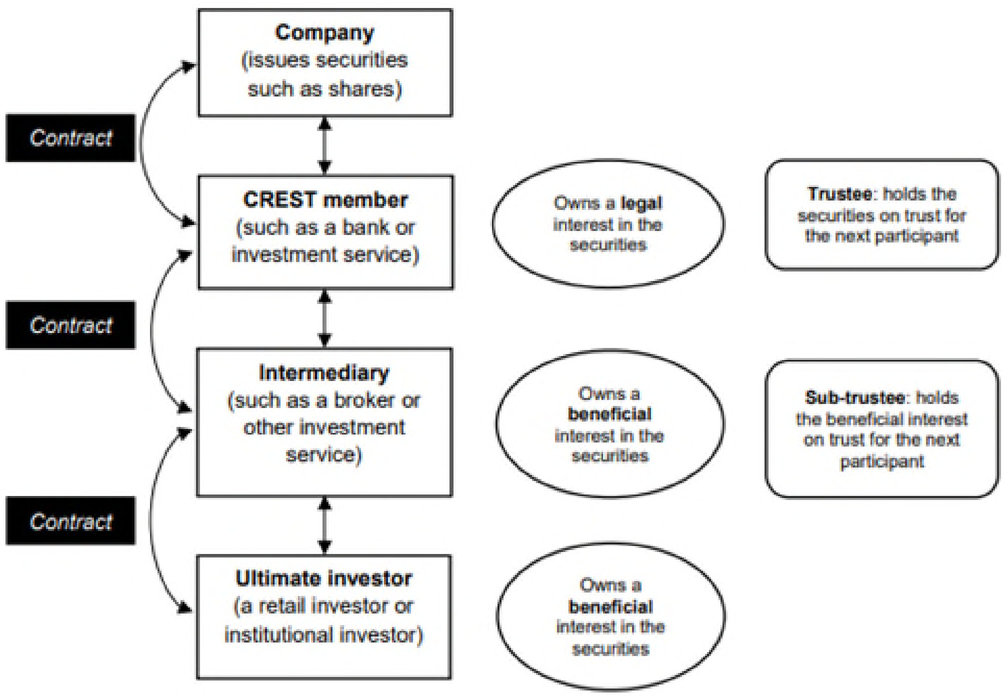
139 Amounts held across Shares or EEA shares, ISA Statistics (ONS)



Source: EPTF (2017)

The legal implications of the custody chain

10.32 Under UK law, where an intermediary is holding on behalf of another investor, the intermediary is the legal owner and is the name that will appear on the company's shareholder register. The underlying shareholder, or Ultimate Beneficial Owner (UBO), only has a beneficial interest in the shares notwithstanding that it is the beneficiary that is the ultimate controller / decision maker in respect of the investment. This can be illustrated as follows:



Source: Law Commission Intermediated Securities Scoping Paper (link)

10.33 The control and use of this beneficial interest in the shares is entirely reliant on the intermediary chain. From a legal perspective, the relationships between the parties in an intermediated securities chain are characterised as trusts, overlaid with contracts agreed between parties at each level of the chain[140].

10.34 The consequence of the above is that the UBO will only benefit from the legal rights enjoyed by the legal owner of the share (in the case above, the CREST member) to the extent that all intermediaries in the chain agree to pass these on to the UBO. Passing on of rights is governed by the terms and conditions agreed at each stage of the chain including those that a UBO signs up to when onboarding with an intermediary; these terms and conditions form the contractual relationship between the parties.

10.35 Given the complex nature of this passing on of rights, retail investors may be unaware when signing up to the terms and conditions of a particular platform if they are by default foregoing any rights enjoyed by the legal owner of the share. A lack of ability to easily compare platform providers' service offerings exacerbates the issue. And whilst certain investment platforms have differentiated themselves through enabling retail activism, such an approach is the exception rather than the rule.

Options available to issuers to understand their shareholder base

10.36 Companies who wish to understand who the UBOs are that sit behind the intermediaries shown on their shareholder register therefore need to follow this chain of custody to its conclusion. Companies have some tools that they can use to do this. The Companies Act 2006 provides a mechanism for a company to request details from its members, including details of underlying beneficial holders[141]. We have discussed suggested amendments to the s793 process in Section 9.

10.37 Additionally, the FCA's DTR provisions require shareholders in companies on regulated markets (such as the LSE's Main Market) to provide transparency about their holdings if they are sufficiently large – i.e. if they hold over 3% of a company's voting rights[142]. Similar provisions are included within the AIM Rules (a multilateral trading facility or MTF, not a Regulated Market)[143]. Shareholding information required by the DTRs is notified via a Primary Information Provider (in template form called a TR-1[144]) ensuring public dissemination. AIM companies are required to include this on the 'AIM Rule 26' section of their website. This provides one mechanism for companies to obtain transparency on their large underlying shareholders on an ongoing basis.

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140 See 2.6.7, Law Commission Intermediated Securities Scoping Paper (link)

141 Companies Act 2006, Section 793

142 See DTR Chapter 5 for detailed rules and thresholds.

143 See guidance notes to AIM Rule 17

144 See DTR5.8.10R

10.38 In the context of a company with a large market capitalisation, a 3% holding may nevertheless be a large investment, even for an institutional investor. As such, it is common that many institutional investors are not required to disclose their shareholding as they do not trip over the 3% threshold. Such institutional shareholders can therefore remain unknown to the company, in particular where they have more of a passive investment style or are not located in the same geography as the company's principal operations. Institutional UBOs can intentionally remain anonymous, even if they are at over 3%, as the only public record will be the nominee.

10.39 Larger companies are likely to have dedicated investor relations teams who will have the capacity to collect as much information as possible on their shareholders – for example through proactive engagement with shareholders – to supplement the above regulatory process.

Fundraising

10.40 The intermediated shareholding chain has the following implications in the context of fundraisings.

Non-pre-emptive offers

10.41 Where a non-pre-emptive offer to institutions is made on a soft pre-emptive basis, a company can typically, with the help of its advisers, generate a list of which investors should be approached relatively quickly, without impacting the timetable of the offer. New, incoming investors who may be able to provide strategic input to the company can often be accommodated. For existing investors, the company will often be aware of which investors should be offered an allocation through a mixture of DTR or equivalent transparency requirements, discussions with its registrars and engagement with such investors by the company's investor relations team.

10.42 As communications in relation to the offer are targeted at individuals within institutional investor firms, in comparison to a fully pre-emptive offer that includes a broad range of investor types, it is easier to achieve a two-way dialogue in a short period of time. Institutional investors use electronic communications (i.e. email/telephone) in relation to any placing. In this regard communicating information on the offer, review by the decision maker, mobilisation of any required funds and communicating the investment decision can all be conducted relatively quickly, meaning a placing can be conducted within two to three business days (with the bookbuilding process taking a matter of hours). Whether such practices have arisen because of or despite the opacity of a company's register is a matter for debate, however it is reasonable to conclude that any lack of full visibility of underlying investors on a company's register does not act as a significant barrier to an institutional offer.

10.43 Notwithstanding that the timeframe is shorter than for a pre-emptive offer, we have received feedback from investors that the majority of processes are still heavily manual. A number of fintech companies are seeking to integrate automated software into the bookbuild process to further streamline the exercise.

Pre-emptive offers

10.44 In contrast to the above, for any pre-emptive offer entitlements must only be offered to existing investors in the first instance and must be offered in proportion to their existing holdings. The company is obliged to approach all investors[145] including the certificated portion of the company's register and participants on the CREST register.

10.45 In contrast to a non-pre-emptive offer, a pre-emptive offer is therefore directed from the register outwards; it requires a clear reconciliation between (i) positions on the register as at a specified record date for the transaction; and (ii) the entitlements created as part of the offer. As all investors need to be approached – but the company will not have full visibility on all ultimate beneficial owners – the offer needs to take into account the time required for details of the offer to pass along the custodial chain. The timetable for a pre-emptive offer is in part therefore driven by the lowest common denominator in that custodial chain i.e. the certificated retail investor.

10.46 Communications in relation to the offer are distributed via a Primary Information Provider (such as RNS) and a prospectus is produced. The company pools together acceptances from its investor base via its registrar. Cash proceeds are usually sent in by cheque (for certificated investors such as retail), or via a Many-To-Many (MTM) instruction to be settled in accordance with the CREST Real Time Gross Settlement (RTGS) payment mechanism (via a CREST member) for those with dematerialised holdings.

Market standards for corporate actions processing

10.47 Significant complexity can arise as a result of the intermediary chains involved with securities ownership, in particular where such custody chains extend beyond national borders. Corporate actions processing is deemed to be one of the most complex areas of the post trading structure[146]. This is important, given that 56.3% of UK quoted shares are beneficially owned by investors outside of the UK, a figure which has been steadily increasing over time[147].

10.48 This issue has been long recognised. The Giovannini Group reports in 2001 and 2003[148] into Cross-Border Clearing and Settlement Arrangements in the European Union identified this as a key barrier preventing efficient cross-border clearing and settlement in the EU (Giovannini barrier number 3). Attempts were made to harmonise national rules relating to corporate actions, with a Corporate Actions Joint Working Group agreeing and endorsing market

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145 Unless it is restricting participation so as not to make an offer into certain jurisdictions where onerous regulatory requirements would otherwise apply, such as the US.

146 Corporate Actions Joint Working Group Standards (2012)

147 See Table 1, ONS statistics (2020)

148 2001 and 2003

standards in 2012, which the UK contributed to as a member of the union. Additional standards were agreed for EU countries whose CSDs were migrating on to the common T2S platform in the Euro area in 2017[149]. For intermediaries, moves to globally adopted standards helped to reduce operational complexity with local deviations not in their interest. The Securities Market Practice Group attempts to create globally agreed market practices for the securities industry[150].

Wall-crossing institutions

10.49 Wall-crossing is a feature of both non-pre-emptive and pre-emptive offers. In this process, selected investors are contacted and briefed on a confidential basis about the issue, in compliance with the UK Market Abuse Regulation. Typically institutions who already own shares are wall-crossed, although non-shareholders are occasionally pre-briefed at the same time. Investors who agree to take part in this pre-marketing stage are said to be 'wall-crossed' and cannot trade on, or disclose, information they receive until it is made public[151]. This normally occurs a few days before the launch of an issue, however it is possible that investors can be wall-crossed only a few hours before an accelerated offering is launched. Certain investors may not wish to be wall-crossed for deals, given the practical obligations this imposes on them such as restricting their ability to trade in the relevant security – increasing their compliance risk. This is a particular issue for larger investors where there may be multiple portfolio managers with interests in any one security, meaning that if one is wall-crossed the investor needs to have in place procedures to appropriately restrict the use of that information for all portfolio managers across the firm.

10.50 Given that it is impractical to wall-cross large numbers of investors, retail investors will not, as a principle, be wall-crossed unless they are deemed to have a strategically significant shareholding in a company – in which case they may be able to qualify as a professional investor given the net assets available to them.

Challenges with the current system and fundraising

10.51 In the context of the features of the UK's secondary capital raising infrastructure highlighted above, there are a number of areas where improvements could be made.

Intermediation creates opacity for issuers

10.52 Investor holding methods have real consequences for companies as regards their ability to use their register to understand their investor base. Nominee

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[149] See 3.5.4.3 in EPTF report Annex 3

[150] About (smpg.info)

[151] See 4.25, Office of Fair Trading, Equity underwriting and associated services, An OFT market Study, January 2011 (accessed 11/02/22 here)

accounts are typically labelled with the names of the custodian banks used by intermediaries and asset managers. Given the variety of underlying clients serviced by those custodian banks, naming conventions for nominees may not be instructive as to the underlying holders. Indeed, such nominee arrangements could be used to obscure the underlying holder's identity: the issuer would have no way of knowing from the register whether opacity was intentional or just a by-product of market structure.

10.53 Nominees will represent a small number of the named holders on the register but will often hold the majority of issued shares. One nominee could represent a large number of underlying investors (a one-to-many relationship) whereas those holding certificated shares will have an individual entry on the register (a one to one relationship). BIS have previously highlighted that, in this sense, there is no overall transparency around share ownership[152].

JD Wetherspoon plc

The register of members (dated June 2020) shows that there were 120,380,155 issued shares, held by 3,782 shareholders. 106 shareholders with "nominee" in their name held 80,062,314 (66.5%) of the issued shares.

Sirius Minerals plc

The register of members (dated January 2020) shows that there were 7,019,632,060 issued shares, held by 4,624 shareholders. 116 shareholders with "nominee" in their name held 6,194,667,754 (88%) of the issued shares.

Unilever plc

The register of members (dated July 2020) showed that there were 1,168,530,650 issued shares, held by 34,005 shareholders.148 shareholders with "nominee" in their name held 496,893,284 (42.5%) of the issued shares.

Source: Law Commission Intermediated Securities Scoping Paper

10.54 This opacity is less of an issue for placings. The company can observe soft pre-emption as it should be aware of which investors should be offered an allocation through a mixture of DTR or equivalent transparency requirements, liaison with its registrars and engagement with investors through the company's investor relations activities. These mechanisms do not typically rely on a real-time reconciliation to the register.

10.55 In contrast if the company is looking to make a fully pre-emptive offer, this lack of transparency means that an issuer and its advisers cannot quickly identify from reviewing a company's register who is institutional and who is not institutional, whether retail or some other classification. This would, for example, become a barrier to the efficient inclusion of all institutional

152 BIS, Intermediated Shareholding Model (2016)

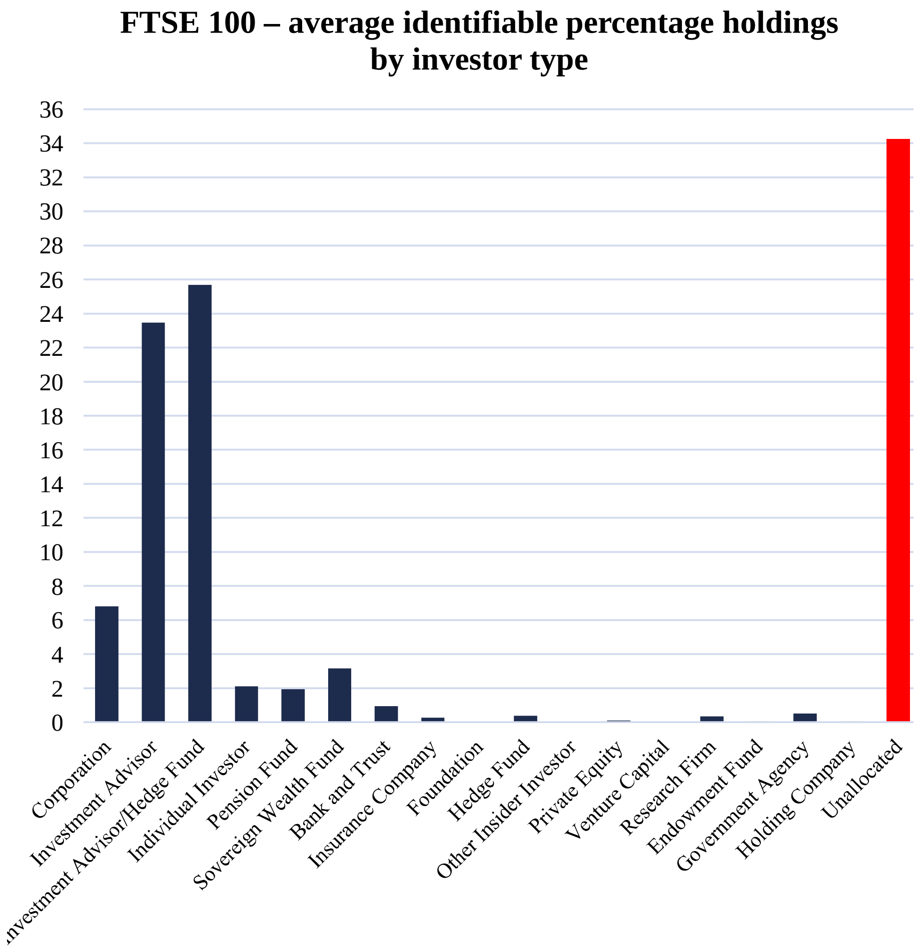
investors in the accelerated tranche of an accelerated rights issue as set out in Section 9.

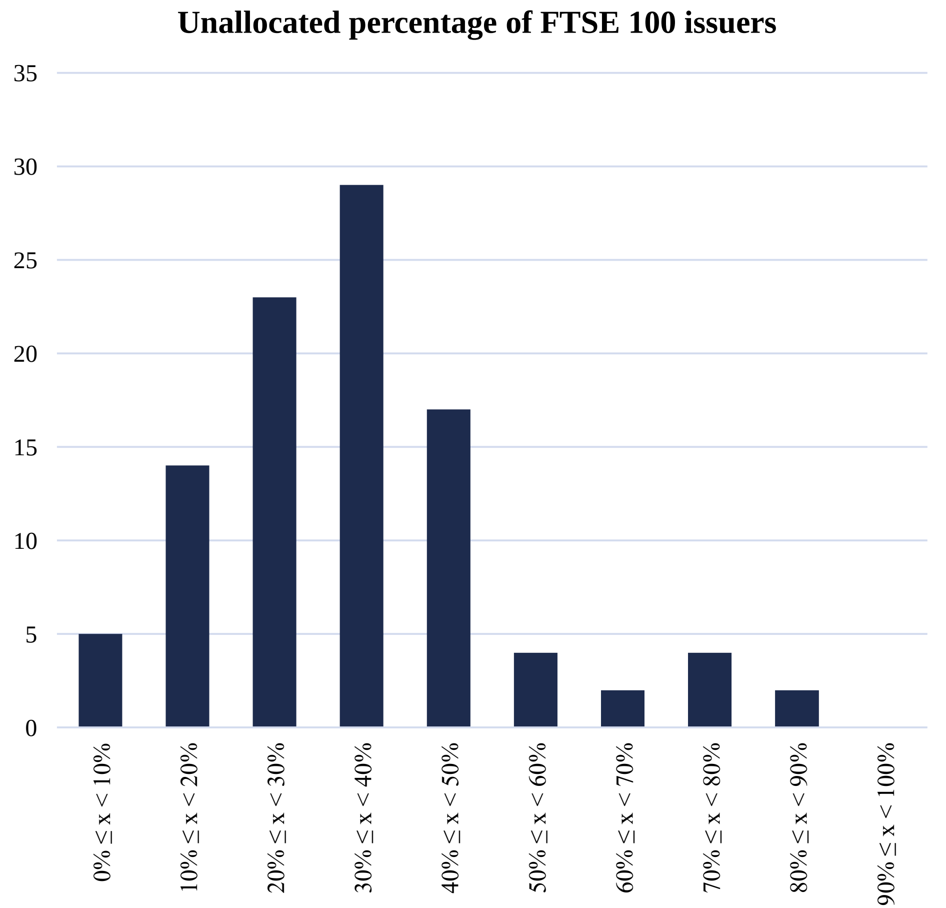
10.56 Furthermore, this opacity can have implications for voting on transactions as an issuer may be unable to meaningfully engage with the unallocated proportion of its shareholder base in advance of a vote.

10.57 Although in practice the information available to an individual issuer will be supplemented by other forms of shareholder engagement, considering the public filings available to a FTSE 100 issuer, on average there is a lack of transparency on ownership for 34% of a company's register (see Figure 14 below). However this average belies the fact that variances amongst issuers are extremely high. In the FTSE 100, 29 issuers have an unallocated percentage of over 40% of their shareholder base; a significant percentage in the context of a vote requiring a simple majority.

FIGURE 14

Source: SCRR analysis of Refinitiv data





The process for requesting information on beneficial owners can be improved

10.58 A company looking to understand the make-up of its register will therefore need to look through an underlying nominee or employ advisers to do the same.

10.59 Shareholdings in a company are of course not static. In the ordinary course of business, companies do not need to be notified of changes in beneficial owner at the level below the nominee, which does not involve a change of legal holding on the register (either on the certificated register or operator record). The company will likely not receive notifications for changes of shareholding which fall beneath thresholds set in the DTRs or equivalent legislation or regulation.

10.60 As such a company is unlikely to have a complete picture of its share ownership at any one point in time. When a company is undertaking an offer – to existing or new investors – it will be important for them to understand how many investors they are making the offer to, what their status is (either institutional or retail) and where they are based geographically as these are generally key factors when considering the application of securities law. For example, where there are EU retail investors on the company's register, an offer to more than 150 retail individuals per Member State would trigger the requirement for an EU prospectus, requiring regulatory review and approval prior to publication which would significantly elongate the timetable for a transaction.

10.61 At present, the use of nominees means that a company will be unable to readily obtain these details quickly. A company can manage this risk in a number of ways; they can rule out entire geographies when making the offer, or they can simply forego a pre-emptive offer. A lack of visibility of beneficial owners may mean that a company can have limited information on which to make this decision from a commercial perspective.

Retail rights are not passed down the custodial chain

10.62 Aggregating investor holdings is a manual process. On the contrary in Australia, each individual investor holding through the CHESS system is assigned a unique HIN[153], or Holder Identification Number, and that register of HINs and related contact details is made available to the issuer.

10.63 We have highlighted that where retail investors do not hold their shares as certificates, they predominantly hold their securities through nominee accounts. Whilst the chain is always likely to maintain an economic interest in

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153 Account and Holder Creation Overview – CHESS Replacement – Confluence (atlassian.net).

It is worth highlighting that individuals can hold securities outside of the Australian CSD – CHESS – in which case they will have a SRN rather than HIN. A SRN is issued for each security and therefore there are similar issues as regards aggregation at this level. SRN – what it is, how to find it (commsec.com.au) the underlying securities – given that in a majority of cases investors' primary incentive in investing is to increase their capital – the ability for underlying owners to exercise entitlements around voting or to participate in fundraises is not uniformly enabled across retail platforms.

10.64 In the context of fundraisings specifically, breakdowns in information flows can relate to voting at meetings and exercising entitlements in connection with a pre-emptive offer, but also to documentation supplied in association with an offer. In a premium listed context, fixing these issues could increase the effectiveness of key protections such as shareholders' ability to vote on significant transactions, related party transactions, the election of independent directors where there is a 'controlling shareholder' and the cancellation of listing.

10.65 Legislative procedures exist to allow for rights to be passed on to retail investors. Companies can choose to include provision in their articles to allow their members (e.g. firms which are legal owners on the CREST register) to nominate another person to exercise their rights as a member. Alternatively, members can allow a member to appoint indirect investors as proxies to exercise voting rights. However, both of these are voluntary mechanisms relying on either a proactive approach by the intermediary or contractual arrangements between the firm and the investor. A retail investor may not be aware that such options are available if they are not actively made aware of these options by the intermediary they contract with.

10.66 This issue has been highlighted by the Law Commission and is frequently raised in the context of the inability of retail investors to exercise voting rights either effectively or at all where they hold via online platforms. Respondents have highlighted that certain retail platforms have developed functionality to enable this, however this is not applied consistently across the industry.

10.67 The principal reasons put forward as to why platforms fail to do this consistently is that they have limited incentive to incur the associated administrative costs involved. Such retail platforms also cite that where they do make such functionality available, retail engagement is low, making it not worthwhile. There is a cogent argument that this logic is circular and creates a self-fulfilling prophecy, where firms do not invest in easy to use services or place high charges on them and do not actively market them, leading to such services being unattractive to or not known about by retail investors, which is then used as a justification for lack of investment by intermediaries. This cycle needs to be broken.

10.68 The consequence of the above issues introduced by intermediation is that retail investors who hold certificated shares are arguably better able to exercise their shareholder rights than retail investors who have an interest in dematerialised shares held through an intermediary chain via CREST.

Retail investors may be unaware of corporate events

10.69 Linked to the above concern that detail about shareholder rights may not uniformly be passed down the intermediary chain to retail investors, the medium of making information relating to a transaction 'public' – through a Primary Information Provider (PIP)[154] – relies on all investors proactively monitoring such channels. Notification of a corporate event through a PIP ensures that such information is broadcast as widely as possible including to financial newswires and major news outlets, and in legal terms that it is 'made public'. This will come up on the newsfeeds that institutional investors typically receive and monitor but it does not guarantee that such coverage will receive prominent coverage, particularly in the case of transactions by issuers with smaller market capitalisations – and therefore does not guarantee that it will immediately come to the attention of retail investors. A lack of standardisation in the ways in which intermediary platforms pass on information to underlying investors (or a lack of functionality to process instructions) means that retail investors may often be simply unaware of significant events relating to their holdings.

Corporate access is an issue for retail investors

10.70 Institutional investors may have the added benefit of being able to meet with executives from the issuer to hear key messages directly from management. Such conversations can happen face to face – however it would clearly be impractical for an issuer to be able to schedule such meetings with its entire shareholder base due to time constraints. Given this, such meetings are usually reserved for strategically significant institutional investors. The use of virtual technologies, which has accelerated significantly since the beginning of the Covid-19 pandemic, has shown significant potential to enable a broader distribution to a wider audience including retail investors.

Timetables for offers to retail are driven by certificated holders

10.71 For a company to be able to make a pre-emptive offer, it needs to interact with its register of members. This allows it to ensure that the number of shares to be issued are allocated in proportion to existing members' holdings.

10.72 However, to make an offer pre-emptive, it needs to, in legal terms, have made the offer to the entirety of its shareholder base or have shareholder authority to restrict the offer[155]. This means that the speed of the retail offer in the post-launch period is in large part dependent on the slowest link in the chain, i.e. the certificated holder needing information mailed to them by post. In the pre-launch phase, any extension of an offer to retail triggers a prospectus as it constitutes a non-exempt offer to the public[156].

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154 Regulatory Disclosures | FCA

155 For example to restrict participation so as not to make an offer into certain jurisdictions where onerous regulatory requirements would otherwise apply.

156 As discussed elsewhere in this report, this is subject to change following implementation of HMT's reform of the UK's prospectus regime.

Payment methods are outdated and marginalise shareholders

10.73 It is important not to overlook the critical movement of cash when issuing securities. Participation in many rights issues relies on investors submitting cheques in order to fund the take up of their entitlements. This creates, amongst other issues, a generational conflict where younger investors who have not been issued with a cheque book are unable to participate.

10.74 When considering ISA statistics as a proxy for the age profile of holders of UK listed companies, it is clear that the size of ISA holdings increases with age. However, a significant proportion is also held by younger investors, who may be more likely to use digital, app-based banks where the issue of a cheque book is by no means guaranteed. Figure 15 shows a breakdown of ISA holdings by age.

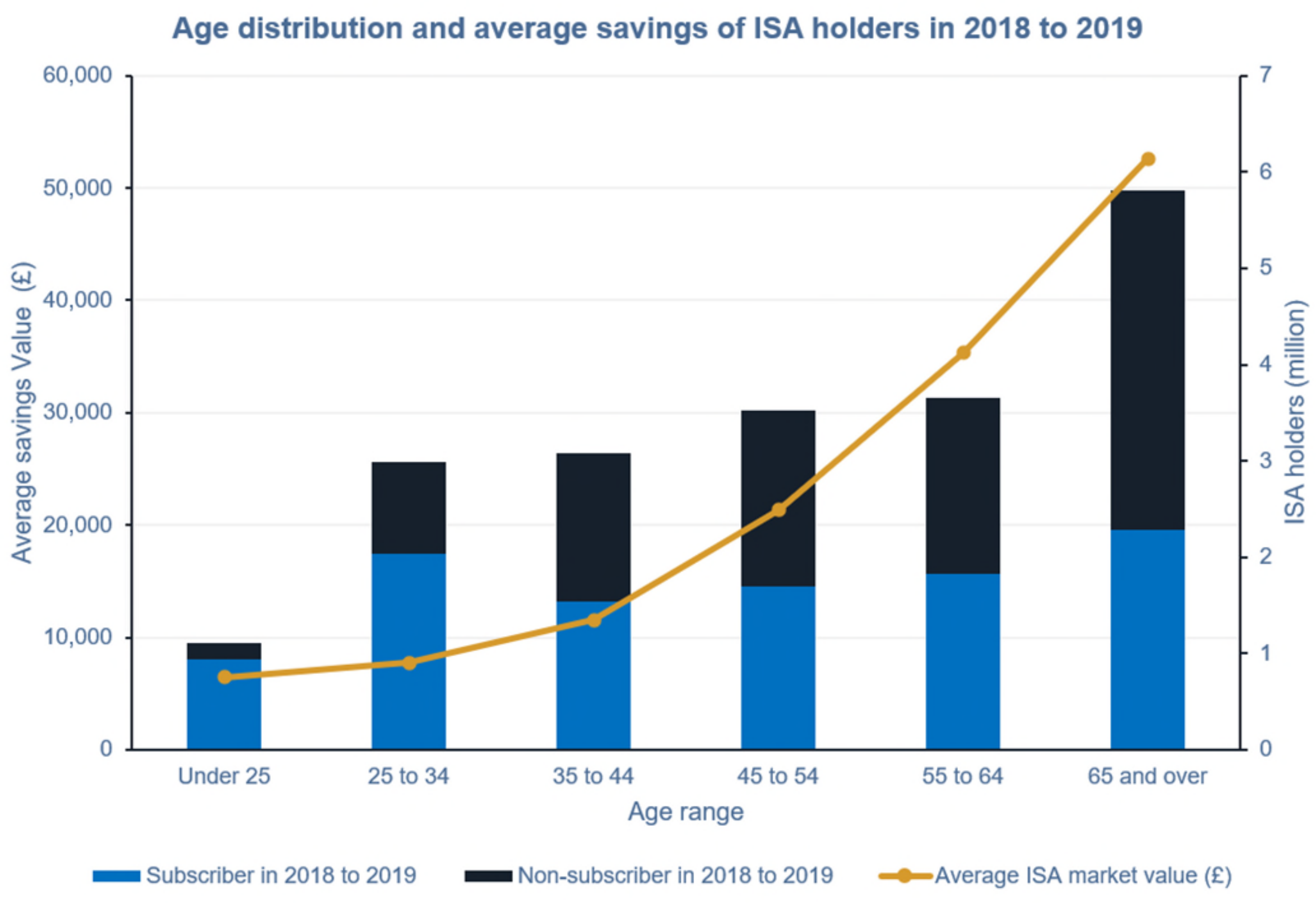
10.75 There is therefore a contradiction in that the transaction timetable for a pre-emptive offer is in part constructed so as to allow for the time to navigate the postal system for investors who are more used to dealing with paper communications, whereas the payments leg of the transaction has not evolved to accommodate investors who may only have online access to their bank account.

The industry has suffered from a lack of investment

10.76 Linked to the reliance noted above on cheques, the Review received anecdotal evidence that the post-trade infrastructure supporting capital markets has suffered from historic under-investment. Whilst individual firms invest in their own systems, such investment has not always been made with a view to creating alignment across the custodial chain with the purpose of improving the end user experience. Firms, probably understandably, have sometimes been reluctant to spend money on customer experience when it is not their direct customer who benefits.

10.77 This problem is exacerbated by the fact that parts of the industry operate on the basis of high volumes and low margins, requiring extensive development and testing. As such whilst there are examples of technological advances such as the deployment of web-based apps/automated notifications for the management of corporate actions, their use has not become standardised. Consumers’ lack of willingness or ability to switch service providers, particularly in time-intensive situations around transactions, mean that a lack of functionality may not become apparent to an end user until it is too late.

FIGURE 15: AGE DISTRIBUTION AND AVERAGE SAVINGS OF ISA HOLDERS 2018-2019



Source: Commentary for Annual savings statistics: June 2021 – GOV.UK (www.gov.uk)

Some institutions do not get sufficient warning of transactions

10.78 However, issues are not limited to retail investors. Certain institutional investors have highlighted that it is useful to have some lead time to consider the merits of a deal prior to needing to make an investment decision to participate.

10.79 Investors have their own processes from firm to firm. However it is relatively common that any decision to invest needs to be taken to an investment committee including portfolio managers. This could for example be scheduled on a weekly basis. As analysts within investment firms need to prepare briefings for the investment committee to make a decision on demand, if an investor is not given notice to participate, it potentially becomes practically difficult to mobilise decision makers and bring together the information they need to inform an investment decision.

Bookbuilding mechanisms create operational risks for investors

10.80 Certain institutional investors have highlighted that the process for applying for any kind of new issue is still rooted in manual processes. Large orders need to be subject to four eye checks and submitted via dedicated portals run by banks.

10.81 However, such portals tend to only be web interfaces, meaning institutional investors are unable to link inputs and create straight through processes from their order management systems, which would better facilitate the involvement of pre-trade compliance.

10.82 The manual process of upload can mean that orders can be lost, duplicated or changed. This is incongruous with general operations in secondary markets, where messaging is supported by dedicated protocols such as FIX.

10.83 We are aware that a number of service providers are seeking to provide digital solutions to replace activities which still rely on extensive manual involvement, such as bookbuilding. Their adoption should be encouraged as part of the modernisation of capital raising in UK markets.

Intermediaries need to work to international timetables

10.84 We reference above that many intermediaries have to work within a complex regulatory framework and have sought to harmonise standards. However, whilst these standards have been successful in providing a common framework for the processing of corporate actions, national divergences do persist. For example, notwithstanding that cross-border settlement was highlighted as an issue in the Giovannini reports in 2003, a European Post Trade Forum report of 2017 highlighted that full implementation was still to be completed[157].

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[157] EPTF Report – 15 May 2017 (europa.eu)

Barriers to entry are significant for new service providers

10.85 Intermediaries often hold specific regulatory permissions along the custody chain, meaning it is challenging for a firm operating outside the industry to gain visibility as to how all of the different participant systems interact. This increases the barriers to entry for new entrants to enter the market and compete through technical innovation, as efficiencies in any one area can be commercially difficult to achieve.

Recommendation: Moving to a system where all shareholders – institutional and retail – hold their shares in fully digitised form

10.86 The way in which the UK's capital markets have evolved over time has given rise to a number of issues where meaningful reform and progress will require the involvement and support of the entire industry. These issues go beyond capital raising and extend to fundamental building blocks of a well-functioning capital market such as investors' ability to take decisions in respect of their investments and for issuers to engage effectively and efficiently with their entire shareholder base.

10.87 We believe that a unifying event is needed as a catalyst for reform. Given the complexity of the UK's settlement infrastructure, adopting a piecemeal approach to change – for example targeting areas such as voting or shareholder identification in isolation – runs the risk of introducing solutions which are effective but implemented by a narrower set of the participants in the chain, increasing the overall complexity of the system. We believe that a 'Big bang' –a 'Drive to Digitisation' – is the opportunity to deliver the wholesale and co-ordinated changes that simplify the post-trade architecture for the benefit of all participants including issuers, intermediaries and investors.

10.88 In this regard we have highlighted that digitisation should mean more than just the eradication and the 'electronification' of paper certificates. Reforms which only seek to mirror paper processes in electronic form – for example by informing all those with paper certificates that they are now required to dematerialise their holdings through an intermediary – will not address wider issues around retail participation in fundraising and voting, however the opportunity presented by digitisation extends beyond this topic. We as a market should be ambitious and brave in thinking about what digitisation can and should mean, which we discuss further below.

10.89 This is no small task. As we have noted, the significant number of reviews that have already been undertaken covering this area demonstrate that meaningful progress will require not only regulatory reform but also a high level of supportive industry engagement to align processes along a complex intermediary chain. In order to deliver this, we believe that it is essential that the industry first commits to the creation of a clear timeline for delivery.

10.90 The report of the Taskforce on Innovation, Growth and Regulatory Reform made clear in September last year that it is the intention of the Government to work with industry, regulators and shareholders in the medium term to determine the best mechanism for converting all shares to electronic form. We believe that a digitisation taskforce, supported by Government, should be established and look to set a concrete and feasible timeline for implementation of its recommendations following a careful assessment of what is feasible.

10.91 However, it is clear that a drive to full dematerialisation will not be achieved by simply removing or imposing regulatory requirements and expecting a fully digitised system to develop as a consequence. There is a clear interdependency between appropriate regulation and commercial reality. It is essential that a clear mechanism for delivery is created and close industry engagement is secured.

The importance of the process being driven by a digitisation taskforce, led by an independent Chair

10.92 The simple fact that regulations are changed to enable activity to occur, does not mean that intermediaries will be required to change their associated processes and procedures. Indeed, it is specifically noted that in the failure of Taurus, "legal problems do not appear to have contributed to the failure."[158].

10.93 Similarly, legislation that places restrictions on the way in which activity can occur risks requirements being interpreted differently by different parts of the industry (e.g. too narrowly or too broadly). Such legislation can also risk stifling innovation in the future. Both of these outcomes can be as damaging as a lack of change.

10.94 The work of the Digitisation Taskforce therefore needs to be driven through both regulatory and commercial lenses. In the case of the latter, an independent Chair will be able to make recommendations in relevant areas without the perception of vested interests. We would recommend that the independent Chair is given the resources to bring together an appropriately qualified team with the regulatory and commercial expertise to be able to assist in a review of this nature.

10.95 It is clear that a strong leader would be needed at the helm of such a review. An independent review lead would need to make decisions which may come under the prospect of significant pressure from incumbent industry participants. Such a person or institution would need to have the authority to bring together a range of different industry actors, from issuers to investors and including the range of intermediaries, including registrars, CSDs, brokers, trading venues, retail platforms and wealth managers. Significant legal support will be necessary noting the breadth of law governing the shareholding framework, which would benefit from involvement of representative bodies such as the Financial Markets Law Committee and City of London Law Society.

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158 Taurus: Learning lessons from failure (Practical Law, 1993)

Evaluating appropriate mechanisms for delivery

10.96 Ensuring that the industry is incentivised to implement the recommendations of the Digitisation Taskforce will be an important consideration, in addition to any regulatory requirements imposed on market participants. Similarly, it will be important to ensure that no one intermediary is unduly burdened by the costs of reform.

10.97 As part of its work, the Digitisation Taskforce may wish to evaluate key lessons of success from the CREST project[159]. It is notable that many of the problems articulated above were also problems facing the Bank of England at the inception of CREST.

10.98 In the case of CREST, B.I.S.S Research cites that one of the potential reasons for the Bank of England's success was the corporate structure adopted. When CRESTCo was first established, 69 institutions were asked to subscribe £12m in share capital[160].

The corporate structure of the new company CRESTCo, encouraged users to become stakeholders, which created a momentum to succeed and meet targets, and in the early days helped to quickly establish CREST. The structure had four subscription bands, allowing small firms to have a stake alongside larger ones. Thus, investing in the new system, gave them a direct interest in its success.

This decision avoided one of TAURUS's many problems, where vested interests protected the status quo, rather than achieved the effective outcome[161].

10.99 Whilst the approach taken in the case of CREST of introducing a new corporate structure or role may by no means be required to deliver the work of the digitisation taskforce, it provides an interesting case study as to how alignment was created across the industry where wholesale, co-ordinated reforms to an industry approach were required.

The need for agreed upon principles for reform

10.100 Recognising the depth and breadth of improvements which need to be made to create a securities settlement system which is fit for purpose, it is important to outline key principles which should underpin development

10.101 From our discussions with market participants, the following areas have been identified as suggested principles for further consideration.

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159 Bank of England, Building the market infrastructure of tomorrow: CREST, RTGS and the Bank of England, 20 years on (20 September 2016)

160 Ibid

161 B.I.S.S Research Ltd, CREST Revealed: From Paper to Automation – Streamlining UK Securities Settlement (link)

10.102 A fit for purpose dematerialised securities settlement system should:

(a) **Analysis:** Enable issuers, investors and intermediaries to undertake detailed analysis of a company's shareholder base

(b) **Equality:** Strive to enable equality of participation in corporate actions, irrespective of company or investor profile

(c) **Communication:** Enable efficient two-way communication between the company and its entire shareholder base

(d) **Simplification:** Reduce cost and complexity for issuers, investors and intermediaries

10.103 It will be important for the government to work with users of the system at the outset to establish the key principles to guide the Taskforce's work, recognising that the principles we set out above may not be complete and there may be further areas of digitisation for the Taskforce to pursue. We detail suggestions on potential approaches in each of the principles areas we have identified below, which the taskforce may wish to consider when framing its work.

Enabling issuers, investors and intermediaries to undertake enhanced analysis on a company's shareholder base direct from the register

10.104 In Section 9 we detailed that companies can find it problematic to gain a complete, up-to-date breakdown of those who are making decisions in respect of their shares, due to the legal mechanism of holding shares in the UK through a nominee. To remedy this, there are a number of factors which should be considered.

10.105 Firstly, a settlement system would need to maintain records of and be capable of tracking changes in beneficial interests in shares. Such a system would require each beneficial investor to be provided with a unique identifier – similar to the Australian Holder Identification Number – which could be used to provide visibility of aggregate holdings across legal methods of ownership. Use of such an identifier would need to be mandatory, similar to the requirement for listed issuers to use an LEI[162].

10.106 The unique identifier could be issued by a centrally recognised party, similar to the issuance of ISINs for securities through National Numbering Agencies[163]. This would ensure that consistent standards are used, enabling future codification of qualitative information on the underlying shareholder (such as jurisdiction, regulatory status, any elections) into the identifier.

[162] GFMA | Global Financial Markets Association | Legal Entity Identifier (LEI)

[163] ISIN Services | LSEG

Potential approach: mandate use of identifiers for beneficial owners and create standards for the issuance of investor identifiers

10.107 Secondly, we believe that such a system would need to link the concept of beneficial ownership to the decision maker in respect of those shares, and that a company should be able to request contact details for such decision makers. We discuss the potential benefits of this in the context of accelerated rights issues observing pre-emption in Section 9.

10.108 Given that certain investors may employ the services of others to manage their investments on a discretionary basis, for an issuer looking to understand who makes decisions in respect of what proportion of its register it will be insufficient to solely obtain information on the ultimate beneficial owner.

10.109 As the Law Commission review highlighted, a section 793 'sweep' only provides a snapshot of ownership at a point in time. Depending on the level of transactions, the list of beneficial owners may change significantly. It is also dependent for its efficacy on responses to the sweep being provided, as well as being a costly and time-consuming method of ascertaining who is on a company's shareholder register.

> "We think that the "snapshot in time" problem would require a technological solution of a register of beneficial ownership of shares, which could update in real time or sufficiently frequently to be accurate. Such a register would have the obvious benefit of allowing companies to identify their ultimate investors accurately"[164]

10.110 The Digitisation Taskforce may wish to appraise the feasibility of the Law Commission's suggestion, and that if it is taken forward the changes we suggest in relation to s793 are integrated into the design of such a register so that the legal basis for requesting and obtaining such information is clear to all concerned.

Potential approach: provide issuers with contact details for those with decision making capacity in respect of ultimate beneficial owners.

10.111 Thirdly, intermediaries should be under obligations to collect specified information from their clients on the basis of its utility to other intermediaries in the custodial chain. Such information could be grouped into mandatory and optional information.

10.112 For example, issuers are likely to need to understand the nationality of underlying investors and/or whether they are classed as institutional investors or not, for the purposes of understanding how to structure an offer of securities which complies with securities laws.

Potential approach: industry standards should be employed to define which information is needed and for what purpose. An architecture for permissions which

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[164] See 3.135, Law Commission review.

balances data privacy needs whilst reducing barriers to entry for providers of third-party tools could be explored.

10.113 Fourthly, a fully dematerialised settlement system needs to contemplate the fact that the information being collected will be sensitive for competitive or data protection reasons.

10.114 As such a system would need to carefully consider the issue of granting authorisations to access data and whether this should be granted on a permanent, deal specific or time limited basis, with differentiated access for issuers, investors and intermediaries.

10.115 Additionally, layers of abstraction could be considered, so that qualitative markers can be collected on investors (i.e. markers that are useful for issuers and advisers when structuring offers) whilst respecting privacy. A key aim of the system should be to break down barriers to entry for third parties who wish to develop analytical tools which can be used to improve the capital raising process.

Strive to enable equality of participation in corporate actions

Potential approach: enable self-designation of retail investors as "accelerated". Retail platforms to update platform functionality to enable participation in fundraisings as standard.

10.116 Issuers should be able to work to different timetables for different constituencies of their register. We have previously highlighted that issuers are currently far more likely to approach institutional investors because of the perception they can respond to an offer more quickly than retail investors. An issuer can also, with its advisers, identify existing and new investors who are likely to have the capacity to support the company's desired funding requirement. Offers to retail investors incorporate a number of protections, meaning they are usually made on a slower timetable. A company should have the ability to target investors who can react quickly so that it can take advantage of market events.

10.117 Retail investors could and should have a greater number of options to participate in public markets and more efficient means of doing so. This is widely agreed. However, the assumption that all retail investors need extra time to reach a decision may not always be accurate. Some retail investors may be able to operate on a similar timetable to institutional investors and may have the requisite liquidity to be able to support a company. However, if an issuer wished to make an accelerated offer to such investors, it is unlikely that it would be able to identify and direct a non-pre-emptive offer to them. In such circumstances a company would either need to make an offer fully pre-emptive (with the associated timetable implications) or exclude all retail investors.

10.118 Post-trade infrastructure could therefore seek to enable equality of participation in corporate actions by requiring retail intermediaries to provide decision makers in respect of retail holdings with the opportunity to designate themselves as, for example, a 'quick responder', who could potentially be dealt with on the same timetable as institutions.

10.119 Furthermore, given that issuers and intermediaries will be unclear as to a retail investor's ability to provide finance (in comparison to a large institutional investor who will be able to demonstrate a track record in funding similar size transactions), underwriters may play an increasingly important role if retail are to participate to a greater extent in fundraisings in this way. It is fair to say that, to date, in times of stress and when funding needs to be secured quickly, institutional investors have been the source of these crucial funds for companies.

10.120 Where UK retail investors hold their shares on digital broker platforms, these platforms should have the ability to provide near real time access to the individuals who hold shares in the company which is raising capital and allow them to make digital purchases. This would require the ability to designate within nominees those investors who are deemed 'quick responders'. This could be augmented by an obligation on the issuer to notify the shareholder at regular intervals with details of how it has been designated, to allow the investor to re-appraise its decision. Platforms could be required to opt investors into such communications by default, giving them the option to opt out. The example of the adoption of a default opt-in approach for retail investors for voting at AGMs and for other voting events has demonstrated how such an approach could work in practice[165].

10.121 Companies should be able to gain visibility on the quantum of such investors in advance of launching an offer, so that they may understand the implications for underwriting of an offer.

Potential approach: A range of payment and communication options should be provided so as not to marginalise particular investor groups.

10.122 Retail is not a homogenous class. When considering the needs of retail investors, it is important to consider that the needs of different retail investors can vary significantly. A drive to digitisation should seek to ensure that all relevant stakeholder groups are catered for to promote financial inclusion as much as possible.

10.123 As noted above, participation in many rights issues relies on investors submitting cheques to fund exercise of their entitlements. This can create, amongst other issues, a generational conflict where younger investors who have not been issued with a cheque book are unable to participate.

10.124 The longer-term reliance on cheques as the principal payment method should be phased out and replaced with payments using electronic communications. This could include on-line, real-time clearance of funds providing certainty of call monies, or automated payments by phone (as offered by many utilities

[165] ii empowering investors to vote at AGMs, creating industry 'tipping point'

providers) for those without access to web-based services. A range of payment mechanisms should be allowable. Where possible, the system should also contemplate for future developments – such as the potential development of Central Bank Digital Currencies (CBDCs)[166].

Potential approach: Digitisation Taskforce, FCA and Stock Exchanges to engage to explore means of facilitating primary capital raising via a direct listing.

10.125 A fully dematerialised post-trade infrastructure should also contemplate future methods of fundraising for companies who do not need to rely as heavily on underwriting. For example, US regulators have approved models for a company to raise primary proceeds as part of a direct listing, i.e. where demand is sourced via an on-exchange lit order book[167].

10.126 Such a fundraising method may provide a facility for at-market offerings – similar to the pricing mechanic for Swiss rights issues, where pricing is determined via the whole market (including institutions and retail), with the potential to minimise issues of dilution in comparison to the issue of shares to investors at a discount to market price. It may also provide one solution for investors looking to harmonise compliance processes across primary and secondary market activities.

10.127 Where an existing listed issuer wishes to open up an issue of new securities to new institutional and retail investors via an exchange auction, a key consideration will be the requirement for a prospectus in such circumstances. In this regard, we note that HMT have set out that the government intends to give the FCA enhanced rule-making responsibilities regarding admissions of securities to trading on UK regulated markets, allowing the FCA to specify in its rulebook if and when a prospectus is required, including for a further issuance by an existing listed issuer.

10.128 Such reforms will provide an opportunity to consider how direct listings involving a primary capital raise can be accommodated under a reformed prospectus framework. In this regard, consideration could be given to both IPOs and secondary capital raisings given the similar mechanics involved in the issuance and admission to trading of shares.

Enable efficient two-way communication between the company and its shareholder base

Potential approach: Bridge the dissemination of regulatory disclosures and digital shareholder engagement tools, through the use of digital communications which can be targeted at existing investors through the intermediary chain as appropriate.

10.129 Having enabled issuers to undertake more detailed analysis of their shareholder base, it will be important to ensure that methods of

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[166] Central bank digital currencies | Bank of England

[167] Nasdaq obtained SEC approval 19/05/21, following NYSE approval on 22/12/20

communication with shareholders also evolve. In this respect we note the increased use of hybrid or virtual AGMs during the Covid-19 pandemic and the increasing use of virtual roadshows and communications for fundraising and investor relations activity.

10.130 From the perspective of communicating information on offers, we would recommend that any offering to a broad spectrum of the shareholder base makes use of widely available and understood digital technologies such as digital roadshow and engagement tools, in addition to the provision of mandated regulatory information. Recognising that institutional investors will generally benefit from preferential access to management, digital solutions should be employed to narrow this gap.

10.131 We believe that the use of such tools should be inherently linked to the regulated disclosures released by the company via a Primary Information Provider (PIP). However, announcements released via a PIP are designed to be broadcast as widely as possible, which means the significance for a particular investor can be lost amongst wider market issues.

10.132 Critically, a drive to digitisation could enable a linkage between regulated disclosures and information flows with existing investors. It could also enable digital investor engagement tools to target their communications at existing investors where appropriate. For example, the existing use of Stock Situations Notices[168] demonstrates how intermediaries can make use of existing market services to ensure that they can provide summarised critical corporate action information from an RNS announcement in a clear and concise format within hours of an announcement.

10.133 During the pandemic, the increased use of video conferencing has also highlighted how corporate presentations, events and meetings can be broadcast either live or as pre-recorded webcasts, reaching a far greater proportion of an issuer's investor base than ever before. As such technology has fast become an accepted part of many working and social lives, offering video communication in addition to RNS should be seen as a default option for issuers, helping to bridge issues of inequality of access between institutional and minority investors.

Potential approach: Electronic communications should be the default for all aspects of a capital markets transaction.

10.134 In respect of mandatory legal documentation (such as a prospectus or method of acceptance), electronic communications should be the default and paper communications should be eradicated. As noted in Section 9 we recommend that issuers should have access to email addresses through s793 requests. In

[168] See Corporate Actions | LSEG. SSNs are distributed via a commercial LSEG service.

this regard, it is notable that Cyprus, Estonia and France already require email addresses to be collected[169].

10.135 Any use of paper should be built on the principle that a paper experience should be underpinned by an automated process. A paper exceptions routine could be retained for a phased period for the certificated audience. Areas of reform could include:

(a) **Receipts:** automated production of printable “receipts” of dematerialised holdings, providing evidence for investors who wish to hold paper documentation.

(b) **Digital PAL:** for rights issues, digital provisional allotment letters.

10.136 Any signing mechanisms should enable electronic signing, taking into account the increasing use of electronic signature providers and the findings of the Law Commission’s report into the electronic execution of documents[170].

Potential approach: Intermediaries could be placed under obligations to receive and transmit information relating to corporate actions to prescribed timetables. BEIS should revisit implementation of SRD II in the UK to ensure obligations go beyond intermediaries acting on behalf of the legal holder of securities on the company’s register of members.

10.137 In the context of the above aims, it should be recognised that firms’ primary responsibility is to their own clients; in an intermediated system, companies and their investors may be many steps removed. Any breakdown in the linkage can lead to incomplete information.

10.138 Issuers, intermediaries and UBOs of securities should have confidence that they can request, receive and respond to information in a timely manner in respect of corporate actions. Intermediaries should be under obligations to receive and transmit information relating to corporate actions to prescribed timetables. As part of this exercise, BEIS should revisit the implementation of Shareholder Rights Directive II (SRD II) in the UK to ensure obligations go beyond the legal holder of securities on the company’s register of members.

Reduce cost and complexity

Potential approach: Standardised processes enabling straight-through-processing should be deployed by the industry where possible. Standards which are adopted globally should be reviewed and incorporated into the UK framework as appropriate

10.139 To achieve this goal, it will be necessary to create standardised processes, enabling straight through processing where possible. This will be particularly important for long chains of intermediaries involving global firms.

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169 See table 2, Report on shareholder identification and communication systems (ESMA, 5 April 2017)

170 Law Commission Electronic execution of documents

10.140 Standards which are adopted globally should provide the benchmark, so that any UK amendments incorporate best practice from international jurisdictions. A review should seek input from recognised bodies such as the Securities Market Practice Group to consider which standards should be employed (e.g. ISO 20022[171]).

Potential approach: Evaluate technologies which show potential to improve the UK's financial markets infrastructure, ensuring any chosen technology is proven and scalable. Use of Distributed Ledger Technology (DLT) specifically should be explored, leveraging work undertaken as part of the government's Financial Market Infrastructure (FMI) Sandbox.

10.141 With respect to the type of technology employed, it will be important that the choice of technology is proven and scalable. DLT was cited by a number of respondents, however the majority noted that it was a technology worth investigating and none expounded on its benefits. Certain respondents actively warned against recommending such technology without a detailed cost-benefit analysis.

10.142 We agree that a cost-benefit analysis is essential before any commitment to a particular technology is made. As the UK does not find itself in the same position as we were at the outset of CREST – where there was genuinely a settlement 'crisis'– settlement in the UK is not fundamentally broken.

10.143 It is not within the remit of this Review to opine on the appropriate underlying technology that should be employed in a fully dematerialised settlement system. As with any new technology, it is important to be sure that many of the claims of proponents are subject to appropriate scrutiny. In this regard, a recent report on the use of DLT in post-trade processes concluded that "the adoption of DLT-based solutions could be driven by projected cost savings and efficiency gains. Nevertheless, the use of DLT would entail similar challenges to those faced by solutions relying on conventional technology (such as fragmentation and interoperability issues) and would potentially create new ones (for instance relating to the legal validity of tokens)."[172].

10.144 DLT has shown growing traction amongst financial market infrastructures[173]. In 2017, ASX announced that its settlement system, CHESS, would be replaced with distributed ledger technology. An Industry Test Environment is scheduled to open to support industry wide testing prior to go live[174].

10.145 In particular, DLT could harmonise systems of engagement through the offering of common digital engagement platforms with different modes of

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171 Frequently asked questions | ISO20022

172 The use of DLT in post-trade processes (europa.eu)

173 IMF: Fintech Notes: Distributed Ledger Technology Experiments in Payments and Settlements (June 2020)

174 About CHESS Replacement (asx.com.au)

access. In this regard, it is notable that as part of their migration to a DLT platform, ASX are offering three options for users to connect to the CHESS replacement, including industry adopted ISO messaging, a Node as a Service, and a web-based option for low activity users and business continuity support purposes[175].

10.146 We believe that the role DLT may be able to play should be explored as part of a Drive to Digitisation. Work undertaken as part of the FMI sandbox the Government is seeking to establish[176] could play a key role, noting its focus on the potentially transformative benefits of DLT from the perspectives of enabling data to be synchronized and shared in a decentralised way to potentially achieve greater efficiency, transparency and resilience.

175 Distributed Ledger Technology in practice – Perspectives from ASX | The World Federation of Exchanges (world-exchanges.org)

176 Government sets out plan to make UK a global cryptoasset technology hub – GOV.UK (www.gov.uk). Also see keynote Speech by John Glen, Economic Secretary to the Treasury, at the Innovate Finance Global Summit during Fintech Week 2022 (Link)

Annexes

Annex A Introduction (Overview)

International models highlighted in the Call for Evidence

1.1 In the following sections, we summarise the approach taken in jurisdictions which were highlighted during the Call for Evidence period, before examining which features warrant more detailed investigation.

Case Study: Trading halts (Belgium)

1.2 Respondents to the Call for Evidence highlighted that trading halts are employed in Belgium, which may help address issues of market volatility during pricing of offers.

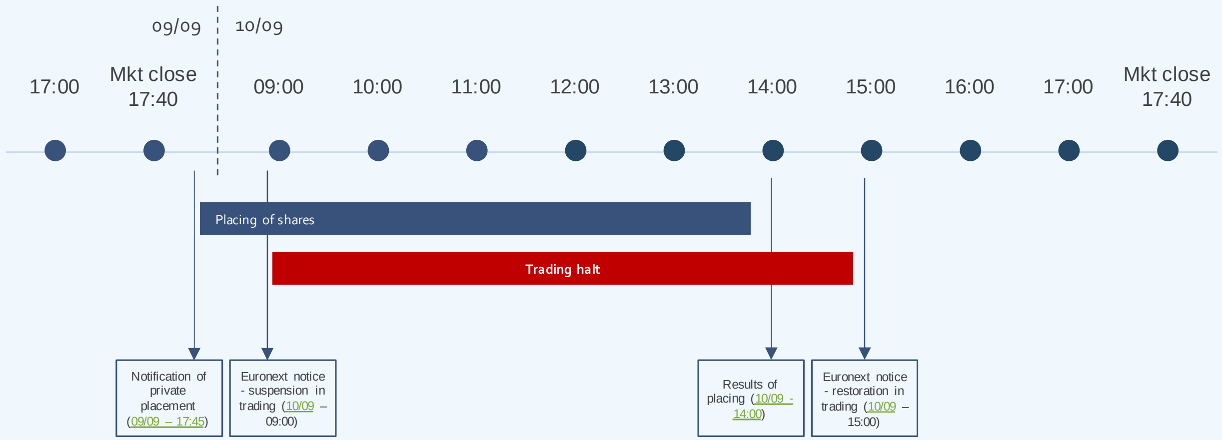
1.3 A suspension of trading can be requested before an important announcement and/or in order to prevent or halt market abuse or disorderly market conditions[177]. This is based on market practice, rather than emanating from a specific rule or guidance setting out specific circumstances when a trading halt is required. Market practice has developed such that a capital increase by way of an accelerated book build that takes place inside market hours requires a trading halt through the application of general market abuse rules. For this reason, many ABBs in Belgium are launched and completed outside of market hours, so that no trading halt is needed.

[177] Vade-Mecum Euronext Brussels Regulated Market

1.4 The above approach is adopted irrespective of whether the offer is being made to institutional or retail investors.

Trading Halts – Deceuninck

Significant private placement of shares to institutional investors



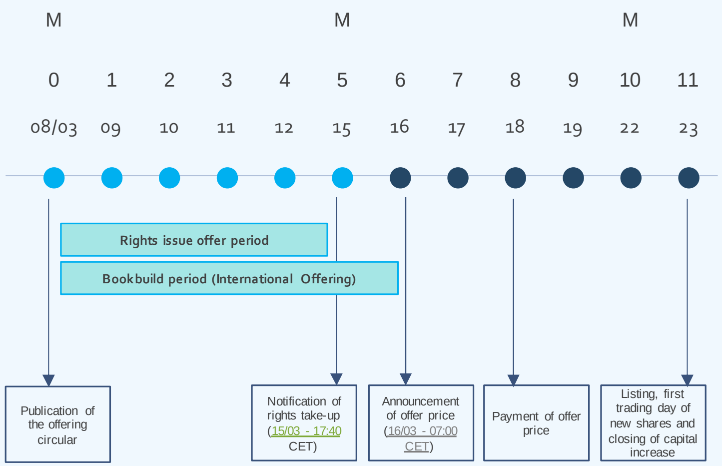
Summary of the transaction

- 137,925,108 shares in issue as at 04/06. Share price as at close on 09/09 €3.79, giving a market capitalisation of €522,736,159
- Deceuninck releases a press release after market close on 09/09 detailing that it has been notified that a placing between shareholders is imminent, and that a trading halt will be imposed if the results of the placing are not known by market open (9am)
- Suspension in trading from market open on 10/09
- Results of placing announced at 14:00 10/09
    - Private placement of 11,768,072 shares to a broad base of institutional investors at a price of €3.50 per share - €41.2m transaction
- Trading restored at 15:00.

Case study: At-market rights issues (Germany / Austria / Switzerland)

At-market rights issue - Swiss steel

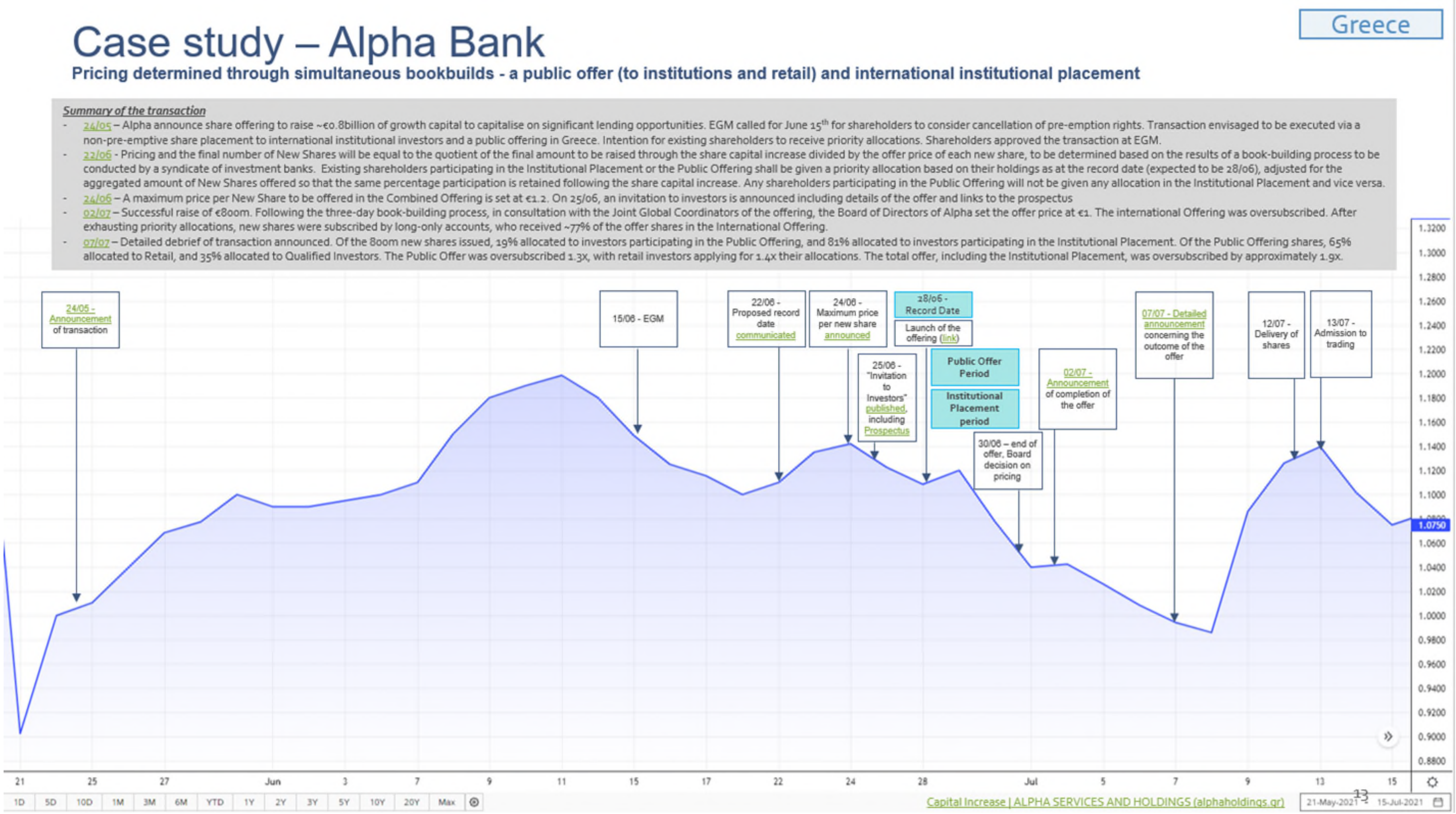
Alternative rights pricing dynamics



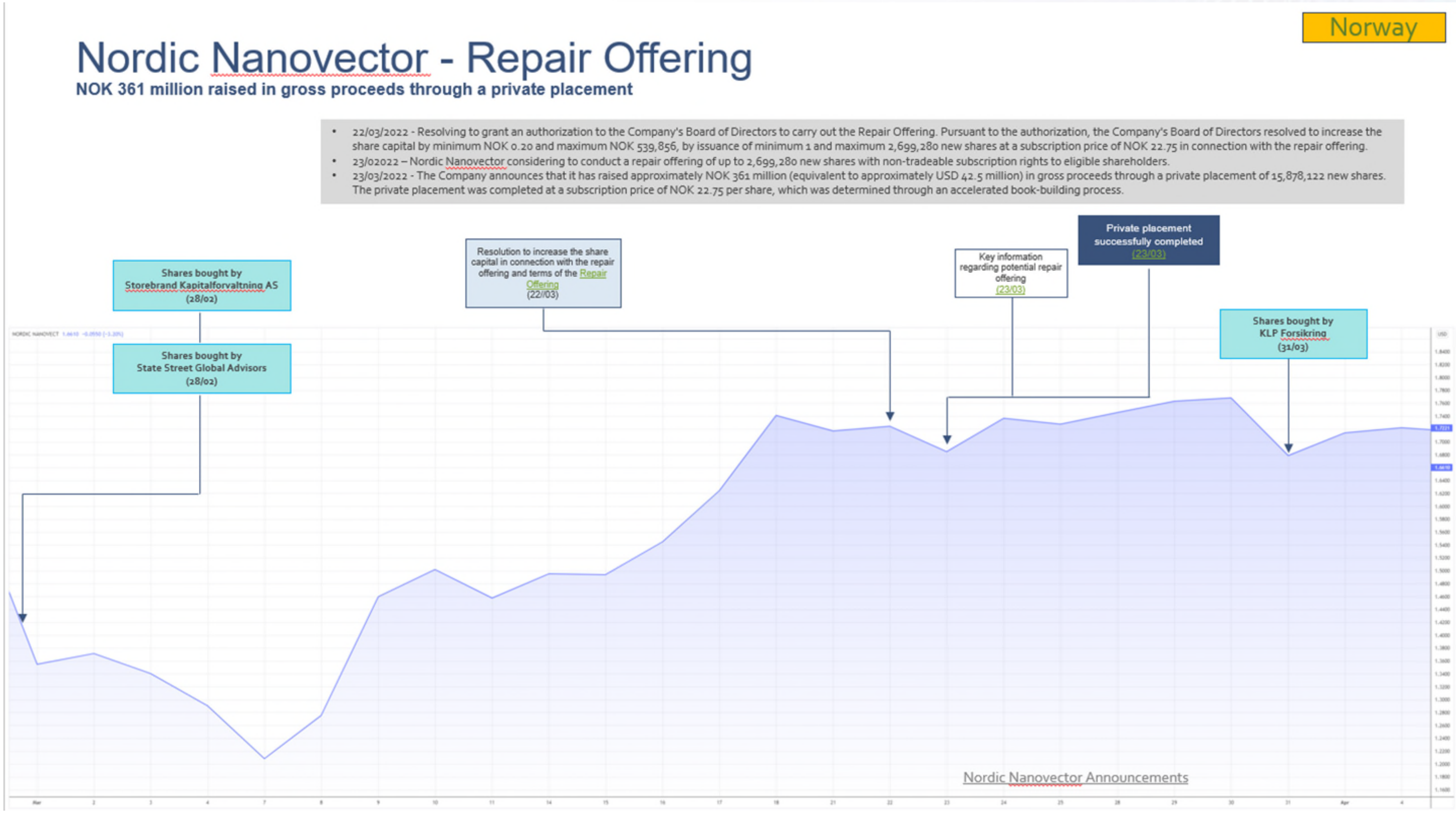
Summary of the transaction

- Swiss steel announce on 01/01/20 its intention to raise €200m, underwritten by BigPoint Holding AG at €0.21 per share, by way of a rights issue. The announcement notes that:
  'The subscription price for the new registered shares will be determined by the Board of Directors after the end of the subscription rights exercise period based on market conditions, taking into account the number of exercised subscription rights, the demand in the book building process and the backstop obligation of BigPoint Holding AG. If the subscription price, which will be determined by the Board of Directors, is above the backstop price, the Company may achieve gross proceeds of more than EUR 200m. As usual for capital increases at market conditions, no subscription rights trading will take place.' Swiss Steel press release (01/12/20)
- The capital raise is delayed following an unsuccessful legal challenge from Liwet Holding AG, with the timetable for the rights offering ultimately announced on 02/03
- On 15/03, Swiss steel announce details of take-up of the offer. Rights have been exercised for 905,622,732 new shares, corresponding to 87.9% of the new registered shares offered. The remaining 124,901,406 shares not taken up are to be offered to investors by way of a public offering in Switzerland and private placements to qualified investors outside of Switzerland and the US.
- 16/03 – offer price set at CHF0.24 per new share, raising €247m gross and €241m net. During the time of the offer, the price moved from CHF0.27 to CHF0.24.

Case study – short retail offers – Greece (Alpha Bank)



Case study: Repair offer



Annex B – Pre-emption rights regime

Part 1 – Pre-emption rights

What is a pre-emption right?

1.1 A pre-emption right is a 'right of first refusal' for an existing shareholder. When a company issues new shares in return for cash, a shareholder with a pre-emption right is entitled to subscribe for those shares in proportion to their existing shareholding in the company. The shares can only be offered to other investors if the existing shareholder declines this opportunity to subscribe.

1.2 Pre-emption rights only apply on any issue of new shares for cash consideration. This means they do not apply when a company wants to issue shares in return for something else, for example shares in another company in connection with an acquisition.

1.3 Pre-emption rights can also be disapplied by shareholders, either on a standing basis (typically up to a ceiling amount) or in relation to a particular issue of shares.

What gives shareholders pre-emption rights?

1.4 Shareholders in companies incorporated in England and Wales have pre-emption rights as a result of provisions in the Companies Act 2006. In addition, the FCA's Listing Rules require all companies (wherever incorporated) that have shares admitted to trading on the premium listing segment to provide a form of pre-emption right to their shareholders. Both sets of rules apply to a premium listed company incorporated in England and Wales.

1.5 Although based on the same principle, the Companies Act 2006 and Listing Rule provisions are not identical. In broad terms, the Listing Rules give more flexibility to companies to manage practical difficulties with pre-emptive offers to a wide shareholder base. We discuss these differences further in Section 8 when we discuss how to improve existing pre-emptive fundraising structures.

1.6 Companies may also have provisions granting pre-emption rights in their Articles of Association. As the company law of England and Wales already contains pre-emption provisions, this is more common for London listed companies incorporated overseas. Overseas companies may include pre-emption rights in their constitution to comply with the premium segment Listing Rule requirement mentioned above, and because inclusion in the UK FTSE indices requires premium listed issuers incorporated overseas to publicly acknowledge adherence to the principle of pre-emption rights[178].

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[178] FTSE_UK_Index_Series.pdf (ftserussell.com)

Part 2 – The Pre-Emption Group

What is the Pre-Emption Group?

2.1 The Pre-Emption Group (PEG) is an investor group comprising representatives of listed companies, investment institutions and corporate finance practitioners.

What is its role?

2.2 The stated role of the Pre-Emption Group is to:

(a) Monitor the development of practice in relation to the disapplication of pre-emption rights and report regularly on the application of the Statement of Principles.

(b) If necessary, agree to any revisions of the Statement of Principles after consultation with interested parties, and promote awareness of the revised Principles.

(c) Examine whether the processes relevant to pre-emptive issues could operate more efficiently for the benefit of companies and shareholders, and where appropriate make recommendations to the appropriate authorities.

(d) Provide the market with a clear view of what is regarded as acceptable practice when raising equity and equity-related capital non-pre-emptively in the UK equity capital markets.

2.3 The Pre-Emption Group will not express a view on, or otherwise intervene in, individual cases.

What documents has the Pre-Emption Group published?

2.4 The PEG publishes voluntary guidance in its Statement of Principles[179] on the disapplication of pre-emption rights, and periodically monitors and reports on how this guidance is applied. It has also published template disapplication resolutions[180].

2.5 The Statement of Principles aims to provide clarity on the circumstances in which the flexibility to make non-pre-emptive issues might be appropriate, and the factors to be taken into account when shareholders are considering the case for disapplying pre-emption rights and a company wishes to make use of an agreed authority for a non-pre-emptive share issue. The PEG has indicated that its principles are not to be taken as a set of rules but are instead intended to provide a basis for discussion of the business case between companies and their investors.

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[179] PEG Statement of Principles (2015) (frc.org.uk)

[180] PEG-Template-resolution-for-disapplication-of-pre-emption-rights.pdf (frc.org.uk)

To which companies does the Statement of Principles apply?

2.6 The principles relate to issues by premium listed companies, although adoption by other issuers is encouraged. In practice the PEG principles are not routinely followed by companies on other markets. For example on AIM significantly higher disapplication resolutions (up to 100%) are often seen, reflecting the different size and stage of growth of these companies as against those on the main market.

2.7 We consider the detail of the PEG guidelines on the parameters of non-pre-emptive offers of shares in Part 2 of Annex C.

What are the sanctions for breach of the PEG guidelines?

2.8 The Pre-Emption Group's Statement of Principles are investor guidance, and as such there are no formal sanctions for failure to comply. The PEG principles note, however, that companies that do not comply – both in letter and in spirit – are likely to find that their shareholders are less inclined to approve subsequent requests for a general disapplication.

Can companies seek general disapplications that go beyond the PEG guidelines?

2.9 The principles are not intended to rule out companies asking their shareholders for a larger general disapplication of pre-emption rights, but they do not ease such approvals. Requests beyond the guidelines will require consideration by shareholders on a case-by-case basis, and the PEG indicates such requests should only be made when the company is in a position to justify its approach by providing relevant information.

2.10 In practice, in the years 2017 to 2021, over 98% of annual general meeting disapplication resolutions sought by FTSE 350 companies were within the thresholds regarded as routine by the PEG guidance[181].

Does the PEG expect disclosure about non-pre-emptive issues?

2.11 The PEG expects a company that has made a non-pre-emptive issue of shares pursuant to a general disapplication of pre-emption rights to disclose the following in its next annual report:

(a) the actual level of discount achieved;

(b) the net proceeds raised;

(c) how those net proceeds were used; and

(d) the percentage increase in issued share capital due to non-pre-emptive issuance for cash over the three-year period preceding the issue.

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[181] *Source: SCRR analysis of Practical Law What's Market data*

Part 3 – Current members of the Pre-Emption Group:

3.1 The current membership of the Pre-Emption Group (as at 8 July 2022):

Rupert Krefting, Acting Chair of the Pre-Emption Group, Head of Corporate Finance and Stewardship, M&G Investments

Richard Colwell, Head of UK Equities, Columbia Threadneedle Investments

Robert Hingley, NED

Simon Lee, Head of M&S Pension Trust and Chief Investment Officer at Marks and Spencer [affiliated to the Pensions and Lifetime Savings Association]

James Brotherton, Chief Financial Officer, Breedon Group, [affiliated to the Quoted Companies Alliance]

Caroline Stockmann, Chief Executive, Association of Corporate Treasurers

Charles Wilkinson, Managing Director, UK Corporate Finance, Deutsche Bank [affiliated to the Association for Financial Markets in Europe]

Julia Wilson, Group Finance Director, 3i [affiliated to the 100 Group]

Andrew Ninian, Director, Stewardship and Corporate Governance, Investment Association

Charles Henderson, Chair, UK Shareholders' Association

David Styles and Stephanie Blenko, Financial Reporting Council, Secretariat

Annex C – Smaller fundraisings

Part 1 – How do shareholders disapply their pre-emption rights?

1.1 For companies incorporated in England and Wales, section 570 of the Companies Act 2006 allows shareholders to agree that shares can be allotted to new investors without first being offered to existing shareholders in proportion to their holdings. A resolution to disapply pre-emption rights in this way must be passed by a majority of not less than 75% (a 'special resolution'). It is also possible for shareholders to disapply pre-emption rights for a specific allotment of shares (s571 Companies Act 2006).

1.2 Where a resolution disapplying pre-emption under the Companies Act 2006 has been passed (or the appropriate equivalent for an overseas company), the FCA Listing Rule pre-emption provisions also do not apply (LR 9.3.12R).

1.3 Listed companies typically ask their shareholders to pass a general pre-emption disapplication resolution at their annual general meeting, at the same time as they authorise the directors to make allotments of shares. General disapplications (where there is no specific issue planned) are usually limited to a specified proportion of the company's share capital, to balance company flexibility with the right of shareholders to avoid dilution.

Part 2 – The Pre-Emption Group Statement of Principles

General disapplications of pre-emption rights

2.1 The 2015 PEG Statement of Principles suggests that listed companies limit non-pre-emptive issues for cash for general corporate purposes to 5% of existing issued share capital in any one year (and to 7.5% in any three-year rolling period). If an issue is being made in connection with an acquisition or 'specified capital investment' (announced contemporaneously with the share issue or occurring in the previous six months), an additional 5% can be used per year. Companies should only seek general disapplication authorities in line with these '5% + 5%' recommendations on an annual basis.

Discounts on non-pre-emptive issues

2.2 Discount is important as it represents a transfer of value away from existing shareholders. While the FCA's Listing Rules permit a discount for a non-pre-emptive issues of up to 10%, the PEG recommends that the discount on a non-pre-emptive offer is limited to 5%.

Specific disapplications of pre-emption rights

2.3 The PEG does not set any limit on the level at which a company can seek a specific disapplication of pre-emption rights for the purpose of an identified, proposed issue of shares. Shareholders will be able to consider transaction-specific requests on their individual merits.

'Look through' principle

2.4 The guidelines also look through the 'form' of an offer, meaning that they apply to any issue undertaken to raise cash, including those structured as 'cash box' issues (these are discussed in Section 5).

Part 3 – Conditions to PEG temporary 20% disapplication

3.1 In in its April[182] and September[183] 2020 announcements, the PEG set out a number of conditions it expected companies to meet if the additional flexibility were used.

1 April 2020 announcement conditions

3.2 The 1 April conditions were that:

(a) the particular circumstances of the company should be fully explained, including how they are supporting their stakeholders;

(b) proper consultation with a representative sample of the company's major shareholders should be undertaken;

(c) as far as possible, the issue should be made on a soft pre-emptive basis; and

(d) company management should be involved in the allocation process.

3.3 In addition the 1 April statement:

(a) indicated that companies would be expected to disclose alongside the issuance information about the consultation undertaken prior to the issuance and the efforts made to respect pre-emptive rights, given the time available; and

(b) reminded issuers of the expectation under the Appendix of Best Practice in Engagement and Disclosure[184] that should publish in their next annual report:

(i) the actual level of discount achieved;

(ii) the net proceeds raised;

(iii) how those net proceeds were used; and

(iv) the percentage increase in issued share capital due to non-pre-emptive issuance for cash over the three-year period preceding the issue; and

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[182] PEG Statement 1 April 2020 (frc.org.uk)

[183] PEG Statement 4 September 2020 (frc.org.uk)

[184] PEG Appendix of Best Practice in Engagement and Disclosure (frc.org.uk)

(c) indicated that existing share awards should not be normalised to negate the dilutive effect of the extended issuance, with a reminder that the directors of the company would be held accountable for their decisions at the AGM.

4 September 2020 announcement conditions

3.4 In its 4 September announcement extending the period of the relaxation to 30 November 2020, the PEG reiterated that a company looking to use the additional flexibility should:

(a) only do so if it is experiencing extreme circumstances, and issuance is required to fund an immediate concern;

(b) fully explain the particular circumstances of the company, including how the company is supporting its stakeholders;

(c) undertake effective consultation with a representative sample of its major shareholders, and as outlined in the PEG's Appendix of Best Practice in Engagement and Disclosure, would be expected to disclose information about the consultation undertaken prior to the issuance;

(d) give consideration to the effect of the issuance on retail shareholders, and consider how they may be able to take part in some aspect of the issuance;

(e) clearly disclose the date at which the status of shareholding is assessed for the purposes of pre-emption and, as far as possible, make the issue on a soft pre-emptive basis;

(f) ensure company management is involved in the allocation process; and

(g) not normalise existing share awards to negate the dilutive effect of the issuance.

Part 4 – Breakdown of market activity in the period 1 April to 30 November 2020[185]

4.1 During the period that the PEG disapplication relaxation was in force, 1 April 2020 to 30 November 2020, there were 75 secondary offers by companies listed on the main market. Of these secondary offers, only 20 included a pre-emptive offer element, of which 12 were structured as open offers and eight as rights issues.

4.2 The remaining 55 were non-pre-emptive placings, representing 73% by number and 54% by value of total secondary offers. Of the 33 placings of over 10% of existing share capital, 28 used a cash box structure. This is not surprising, since by the time of the PEG's first relaxation announcement most companies were already past the point in the year when they could reflect the

185 *Source: SCRR analysis of Practical Law What's Market data*

revised guidance in their AGM disapplication request to shareholders. The table below gives a more detailed breakdown of placings in this period.

Placings 1 April to 30 November 2020, London main market issuers

Offer size (as a percentage of existing share capital)	5% or less	>5% to 10%	>10% to 15%	>15% to 20%
Total number of placings	8	14	12	21
Number of placings using a cash box structure	0	0	11	17
Retail offer included	2	3	3	7

4.3 While 60% of placings took advantage of the PEG disapplication relaxation to allow larger non-pre-emptive offers over 10%, almost 62% of placings had a size of 15% or less. This distribution suggests that even when greater flexibility was available, listed companies continued to be mindful of the need to raise capital only as required, rather than to build a war chest.

Part 5 – Background on soft pre-emption

5.1 Soft pre-emption is not a concept found in company law or the FCA's Listing Rules. Where statutory, and in consequence FCA Listing Rule, pre-emption rights are disapplied by shareholders there is no restriction on the investors with whom shares can be placed. Soft pre-emption does not represent an entitlement of a shareholder, but rather describes the process by which a non-pre-emptive placing should seek to invite participation from existing shareholders.

5.2 The concept of soft pre-emption came to prominence during the Covid-19 pandemic. On 1 April 2020 the Pre-Emption Group issued a temporary relaxation of the guidance in its Statement of Principles[186], recommending that investors support pre-emption disapplication requests up to 20%. This advice was accompanied by conditions that should be met by issuers seeking to make use of the higher threshold, including that as far as possible, the issue should be made on a soft pre-emptive basis. The PEG also recommended that company management be involved in the allocation process. These conditions were reiterated in the PEG's 4 September 2020 announcement of an extension of the relaxation to 30 November 2020, with the addition of a requirement that issuers disclose the date at which the status of shareholdings would be assessed for the purposes of soft pre-emption. This announcement also required issuers to consider the impact of the issue on retail shareholders and

186 PEG Statement 1 April 2020 (frc.org.uk) and 4 September statement PEG Statement 4 September 2020 (frc.org.uk)

the ways in which they could participate some aspect of the issuance. The involvement of retail is considered more in Section 6.

5.3 In its 8 April 2020 statement on smaller issues[187], the FCA set out its understanding of the soft-pre-emption requirement (in relation to a placing of shares) as being 'where a bookrunner allocates shares to investors in accordance with an allocation policy that seeks, to the extent possible within the constraints of the exercise, to replicate the existing shareholder base'. The FCA noted, however, that in contrast to a formal right of pre-emption, the limitations of a soft pre-emption exercise mean that it is likely not all shareholders will be able to participate.

5.4 In its statement the FCA also highlighted the way in which issuers can influence the delivery of soft pre-emption, by exercising their right to be involved in allocation of new issues. Article 40(5) of UK Regulation 2017/565 (part of the retained body of EU law relating to markets in financial instruments), requires that bookrunning banks 'involve the issuer client in discussions about the placing process in order for the firm to be able to understand and take into account the client's interests and objectives. The investment firm shall obtain the issuer client's agreement to its proposed allocation per type of client for the transaction in accordance with the allocation policy.'.

Part 6 – What is a 'cash box'?

6.1 A 'cash box' is a way of structuring an issue of shares so that pre-emption rights do not apply. This means the company is free to issue the shares to new investors without first offering them to its existing shareholders.

6.2 A cash box structure is most commonly seen in relation to a placing. The listed company issues shares in return for the transfer to it of shares in another company (the assets of which comprise entirely cash). As the issue of shares by the listed company is not made in return for cash consideration, pre-emption rights do not apply under either the Companies Act 2006 or the FCA's Listing Rules.

Why do companies use a cash box structure?

6.3 Unless a cash box structure is used, an issue to new investors must stay within a company's existing authority to disapply pre-emption rights . A company with greater funding needs can go back to shareholders to ask them to increase the available authorities, but this may not always be a practical option, for example where funds are required quickly. A company may instead choose to use a cash box to issue shares in excess of existing limits. There is also another, more technical, consequence of using a cash box, which is that it can increase the funds available to a company to use to pay dividends (by

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[187] Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis | FCA

increasing its 'distributable reserves' – this was the purpose of using a cash box on, for example, the Eircom cash box rights issue and that for Provident Financial plc).

Do any rules or guidance apply to cash box issues?

6.4 While as a technical matter pre-emption rights do not apply to cash box issues, the Pre-Emption Group's guidelines 'look through' the structure and apply the same discount and size guidelines.

Part 7 – Draft Template Reporting Form

Name of issuer	
Transaction details	*To include:* • *offer size, including the percentage of issued share capital that it represents; and* • *settlement date*
Use of proceeds	*Use of proceeds of the offer, including details of any acquisition or specified capital investment*
Quantum of proceeds	*To include details of the gross proceeds and net proceeds raised by the offer*
Discount	*Discount issue price represented to market price*
Allocations	*To include:* • *whether the shares were allocated on a soft pre-emptive basis,* • *details of any allocations made other than on a soft pre-emptive basis; and* • *the role played by management in the allocation process*
Consultation	*Confirmation appropriate consultation of major shareholders carried out prior to launch, to extent reasonably practicable and permitted by law*
Retail investors	*How due consideration was given to the interests and involvement of retail investors and existing investors not allocated shares as part of the soft pre-emptive process and an explanation of the approach taken*

Annex D – Retail investors

Part 1 – Institutional placing structure

1.1 A placing is a non-pre-emptive issue of new shares for cash to institutional and, in some cases and to a limited extent, retail investors. They are sometimes referred to as 'ABBs' where they make use of an 'accelerated bookbuild' structure. A cash placing is the quickest way for a listed company to recapitalise.

Shareholder approvals

1.2 A placing can usually take advantage of a company's existing authority to allot shares, and will either fall within the limits of an existing disapplication of pre-emption rights or use a cash box structure (we discuss cash box structures in Section 5). This means that no transaction-specific shareholder approvals are needed.

Timing

1.3 A placing can be completed on a very short timetable. It is common for placings to have a compressed preparation period of a few days to a week, which will include discussions with potential investors to gauge their appetite for the issue and get views on price and terms. This is referred to as a wall-crossing, or market sounding, and is typically kept to a limited number of investors to maintain confidentiality of market sensitive information.

1.4 Placings are commonly launched out of market hours, to avoid marketing while the share price is moving during live trading. They may be launched early in the morning (for example where domestic or European demand is anticipated) or after market close in the afternoon (common where US investors are likely to be involved). The offer will be kept open for as short a window as possible to complete the bookbuild, with offers often open for only a couple of hours.

Are placings subject to any restrictions?

1.5 In practice placings are restricted in relation to their size and in the type of investors that can participate. There are also rules and guidance on the level of discount at which shares can be placed.

(a) **Size:** The size of a placing is usually limited to avoid the need to publish a prospectus when the shares are admitted to trading on the London Stock Exchange. This means that a placing must be for less than 20% of the existing issued share capital of the issuer. In practice most placings observe Pre-Emption Group guidance, meaning placings are generally used up to 5%, or 10% when related to an acquisition or specified capital investment.

Following implementation of HMT's UK Prospectus Regime Review, the FCA will be delegated the power to decide when an admission to trading prospectus is required. This Review has suggested that the

FCA raise the existing 20% threshold to 75%. If adopted, there would longer be a structural limit of 20% on the size of an institutional placing. Instead, the upper limit would be set by the size of the disapplication of pre-emption rights authority approved by an issuer's shareholders, which this Review has suggested be 20% (on a 10%+10% basis). Although a cash box structure (as discussed in Section 5) could be used to circumvent this limit, we expect the market to follow guidance from the Pre-Emption Group that cash boxes should be used only up to the level of shareholder pre-emption disapplication approval.

Finally, there remains a further limit on the size of a non-pre-emptive placing, and that is the authority to allot shares given by shareholders to the directors on an annual basis. Companies typically follow the guidance of the Investment Association[188] and restrict this authority to allot to one third of existing share capital for non-pre-emptive offers. We discuss our recommendation in relation to this authority to allot in Section 8, including broadening the type of pre-emptive offers eligible to allot up to two-thirds of existing share capital. We do not propose any increase in the authority available to an institutional placing, which we believe should remain within the one-third cap.

(b) **Discount:** For a premium listed company the discount to the current share price that can be offered on a placing is limited to 10% under the FCA's Listing Rules. In practice investor guidelines from the Pre-Emption Group mean a lower threshold of 5% is usually observed.

(c) **Investors:** The investors taking shares in a placing must fall within a UK Prospectus Regulation exemption to avoid making a public offer that would require a prospectus (as noted above, this will change with the implementation of upcoming reforms). The typical placing structure also assumes that all investors will fall within an exemption from the financial promotion regime, which avoids the need for announcements in relation to the placing to be approved as financial promotions.

Both of these objectives are most easily achieved by limiting participation in a placing to institutional investors. Institutions will generally be both exempt 'qualified investors' for the purposes of the UK Prospectus Regulation, and either exempt from the financial promotions regime as an 'investment professional'[189] or 'high net worth entity'[190].

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[188] 20160701-SCM-Share-Capital-Management-Guidelines.pdf (theia.org)

[189] Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

[190] Article 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

Part 2 – Norwegian repair offer

What is a repair offer?

2.1 A repair offer is an offer to a company's existing shareholders to subscribe for shares on a pro rata basis at the same offer price as the initial placing. It is not fully pre-emptive, however, as it is made only to shareholders who did not participate in an earlier placing. The structure is typically used where the initial placing was subject to a minimum application amount of EUR 100k and certain other applicable exemptions from the prospectus requirements, with the subsequent repair offer used to give other shareholders the opportunity to subscribe on similar terms.

2.2 Although terms and conditions vary, a repair offer is generally open to shareholders on the register prior to launch of the initial placing but who were not allocated shares as part of that offer. The right to subscribe for shares in the repair offer is not tradeable, although eligible shareholders (and, at the option of the issuer, sometimes new investors – including those who participated in the initial placing) may be able to request additional shares over and above their pro rata allocation. Any such excess application is at the discretion of the issuer but as the repair offer will not allow for full repair of the dilutive effect of the private placement, it is very rare not to allow eligible shareholders to over subscribe.

Why are repair offers common in Norway?

2.3 Norway requires equal treatment of shareholders. For differential treatment to be acceptable it should have a factual basis in the common interest of the company and its shareholders, and the relevant benefits and detriments must be proportionate.

2.4 A repair offer after a non-pre-emptive placing can be used as part of the evaluation of factual justification, including the requirement for proportionality. The aim is to partly 'repair' the dilution and financial disadvantage caused to shareholders who could not participate in the initial placing.

Process

2.5 The Norwegian regime starts from the assumption that the repair offer should be carried out as quickly as possible following the initial placing, and at the same price. It should also offer a sufficient number of shares to allow those shareholders who did not participate in the initial placing to repair the dilutive effect of the initial placing.

2.6 Issuers can, however, deviate from this starting point if there is factual justification in their particular circumstances. Repair offers can, for example, exclude shareholders located in jurisdictions where the offer would be unlawful or where the issuer would otherwise have to comply with onerous local requirements.

2.7 The size of a subsequent repair offer is typically significantly lower than the size of the initial placing. The size of a repair offer will depend on an assessment of a number of factors, such as the including discount from trading price, dilution in the initial placing and the number of shareholders not allocated shares in the initial placing. In recent repair offerings, the repair offerings have ranged from 5-10% of the initial placing size.

2.8 A repair offer in Norway may will require publication of a prospectus, either a Norwegian national prospectus, if the offering is between EUR 1,000,000 and EUR 8,000,000, or an EEA-prospectus if the offering exceeds EUR 8,000,000, in which case there may be a gap of several weeks between the initial placing and launch of the subsequent repair offer. An EEA-prospectus has to be approved by the Financial Supervisory Authority of Norway and the approval process is usually between 6-8 weeks.

Cancellation

2.9 If during the period between the initial placing and the launch of the repair offer the share price of the issuer trades, in sufficient volume and over a sufficient period, at or below the placing price, an issuer may decide to cancel the repair offering. This is on the basis that shareholders wishing to neutralise the dilutive effect of the placing can do so by making a market purchase. It is therefore unnecessary for the issuer to go to the trouble and expense of making a repair offer.

Part 3 – Circular requirements

What is a circular?

3.1 The FCA's Handbook defines a 'circular' as:

'any document issued to holders of listed securities including notices of meetings but excluding prospectuses, listing particulars, annual reports and accounts, interim reports, proxy cards and dividend or interest vouchers.'

Must a circular be approved by the FCA?

3.2 Most circulars do not require approval by the FCA before they are sent to shareholders. In general terms circulars only require approval when they relate to particularly complex transactions.

3.3 Circulars requiring approval include, broadly, those relating to significant transactions (Class 1 under LR 10) or related party transactions and certain other circulars that are required by relevant rules to include a working capital statement (in connection with a reconstruction or refinancing, or the repurchase of a company's own shares). Approval is also needed for circulars in relation to a cancellation of listing or transfer of listing segment.

What content requirements apply to a circular?

3.4 LR 13 sets out requirements that apply to the content of all circulars, as well as specific content requirements for particular types of circular.

Contents of all circular (LR 13.3)

3.5 We set out below the general content provisions of LR 13.3.1. Italics denote provisions in italics unlikely to be relevant for an offer booklet.

LR 13.3.1 R Contents of all circulars

Every circular sent by a listed company to holders of its listed securities must:

(1) provide a clear and adequate explanation of its subject matter giving due prominence to its essential characteristics, benefits and risks;

(2) state why the security holder is being asked to vote or, if no vote is required, why the circular is being sent;

(3) if voting or other action is required, contain all information necessary to allow the security holders to make a properly informed decision;

(4) if voting or other action is required, contain a heading drawing attention to the document's importance and advising security holders who are in any doubt as to what action to take to consult appropriate independent advisers;

(5) if voting is required, contain a recommendation from the Board as to the voting action security holders should take for all resolutions proposed, indicating whether or not the proposal described in the circular is, in the Board's opinion, in the best interests of security holders as a whole;

(6) state that if all the securities have been sold or transferred by the addressee the circular and any other relevant documents should be passed to the person through whom the sale or transfer was effected for transmission to the purchaser or transferee;

(7) if new securities are being issued in substitution for existing securities, explain what will happen to existing documents of title;

(8) not include any reference to a specific date on which listed securities will be marked "ex" any benefit or entitlement which has not been agreed in advance with the RIE on which the company's securities are or are to be traded;

(9) if it relates to a transaction in connection with which securities are proposed to be listed, include a statement that application has been or will be made for the securities to be admitted and, if known, a statement of the following matters:

(a) the dates on which the securities are expected to be admitted and on which dealings are expected to commence;

(b) how the new securities rank for dividend or interest;

(c) whether the new securities rank equally with any existing listed securities;

(d) the nature of the document of title;

(e) the proposed date of issue;

(f) the treatment of any fractions;

(g) whether or not the security may be held in uncertificated form; and

(h) the names of the RIEs on which securities are to be traded;

(10) if a person is named in the circular as having advised the listed company or its directors, a statement that the adviser has given and has not withdrawn its written consent to the inclusion of the reference to the adviser's name in the form and context in which it is included; and

(11) if the circular relates to cancelling listing, state whether it is the company's intention to apply to cancel the securities' listing.

Part 4 Current liability framework

Prospectus regime

4.1 The persons responsible for a prospectus in relation to the issue of shares are set out in the FCA's Prospectus Regulation Rules (PRR 5.3).

4.2 Those responsible include the company issuing the shares and its directors (including any person who has agreed to become a director, and the senior executives of any external management company of the issuer). Persons responsible also include anyone who accepts, and is stated in the prospectus as accepting, responsibility for the prospectus (in whole or in part) and any person who has authorised the contents of the prospectus (again, in whole or in part). Examples of persons who authorise sections of a prospectus in this way might include an expert preparing a valuation report. The persons responsible are required to make a declaration in the prospectus that, to the best of their knowledge, the information contained in it is in accordance with the facts and contains no omission likely to affect its import (item 1.2, Annex 1 and item 1.2, Annex 11, UK Prospectus Delegated Regulation).

4.3 A person responsible for the prospectus is liable to pay compensation to a person who has acquired shares and suffered loss in respect of them as a result of any 'untrue or misleading statement' in the prospectus or any omission of required information (s90 FSMA). Liability may also attach in certain circumstances in relation to the summary included within the prospectus (UK PR Art 7).

4.4 There are various exemptions from liability under s90 FSMA that are available to responsible persons (FSMA Schedule 10). This includes, where relevant conditions are met, if the person reasonably believed that the relevant statement was true and not misleading, or that the matter the omission of which caused the loss was properly omitted. For this exemption to apply the person responsible must have made such enquiries, if any, as were reasonable before coming to their belief. This is commonly referred to as a 'negligence standard' of liability.

4.5 A due diligence and verification exercise is undertaken in relation to a prospectus to ensure that this standard is met.

Listed company liability for published information

4.6 Listed companies publish information regularly as part of their continuing obligations under, for example, the FCA's Listing Rules and Disclosure Guidance and Transparency Rules and UK Market Abuse Regulation (UK MAR). This information is typically made available through a Regulatory Information Service, or RIS.

4.7 Liability attaches under s90A FSMA where persons suffer loss as a result of a misleading statement or dishonest omission in certain published information relating to listed shares, or a dishonest delay in publishing such information. This is the standard that applies to, for example, the annual report and accounts of a listed company, or to its disclosure of inside information under Art 17 UK MAR. Liability applies to the company only where a person discharging managerial responsibilities within the company knew the statement to be untrue or misleading, or was reckless as to whether it was or, for omissions, if such a person knew the omission to be a dishonest concealment of a material fact (Schedule 10A FSMA). This is commonly referred to as a 'recklessness standard', and is less strict than the negligence standard that applies to prospectuses. In contrast to the position for an equity prospectus, liability attaches solely to the company, and the directors do not have any individual liability.

4.8 In addition the FCA's Listing Rules require that an issuer take reasonable care to ensure that any information it notifies to an RIS or makes available through the FCA is not misleading, false or deceptive and does not omit anything likely to affect the import of the information (LR 1.3.3R). Premium listed companies are also required to communicate information to holders and potential holders of its shares in such a way as to avoid the creation or continuation of a false market in those shares (Premium Listing Principle 6, LR 7.2.1AR). Regulatory sanctions apply for breach of FCA Listing Rules, for the listed company and any director knowingly concerned in its (s91 FSMA).

Part 5 – Financial promotion regime

Why do we have a financial promotion regime?

5.1 The financial promotion regime is specific to the UK. It and seeks to protect consumers by ensuring they can rely on the information they get from financial promotions when making decisions about their investments. It does this by requiring persons authorised by the FCA to take responsibility for the content of financial promotions. When an authorised person makes or approves a financial promotion, it has to confirm that the communication complies with relevant FCA rules, including ensuring that the financial promotion is fair, clear and not misleading. The approval process requires the authorised person to undertake a due diligence exercise to verify its content.

What is a financial promotion?

5.2 A financial promotion is, broadly, any communication that invites or induces a person to engage in an investment activity, such as buying or selling shares.

What restrictions apply to the making of financial promotions?

5.3 The making of financial promotions is restricted by section 21 of the Financial Services and Markets Act 2000 (FSMA). If a person wants to make a financial promotion in the course of business, they must either be a person authorised to do so by the FCA or have the communication approved by a person who is so authorised. Alternatively, they can ensure that the communication is made in such a way that the financial promotion regime does not apply, because it falls into an exemption. Contravention of section 21 is a criminal offence[191], and any resulting contract is unenforceable[192].

Who are authorised persons?

5.4 Listed companies are not usually authorised persons for the purposes of the financial promotion regime. Any financial promotions made in the course of a secondary offer of shares will therefore need either to be exempt or approved by an authorised person, such as an investment bank or retail platform provider.

What are the usual exemptions for secondary offers of shares?

5.5 The most commonly used exemptions for placings to institutional investors are those for communications to 'investment professionals'[193] and 'high net worth entities'[194] in the UK. These can be used alongside the exemption for communications that are otherwise directed only to persons outside the UK[195], where overseas investors are also permitted to participate.

5.6 Rights issues and open offers typically make use of two exemptions that permit a listed company to communicate a financial promotion about its own issue of shares to its own shareholders[196], and the promotion of securities already admitted to listing and trading[197]. A prospectus prepared as part of a

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191 Section 25 Financial Services and Markets Act 2000.

192 Section 30 Financial Services and Markets Act 2000.

193 Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

194 Article 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

195 Article 12 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

196 Article 43 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

197 Article 69 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

right issue or open offer is also permitted to contain financial promotions[198] without requiring approval.

5.7 Where retail investors generally are invited to participate in a placing, the announcement of that offer will need to be issued or approved as a financial promotion by an authorised person.

[198] Article 70 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

Annex E – Regulatory involvement

Part 1 – What is a sponsor?

1.1 Sponsors are firms, commonly investment banks, that are approved by the FCA to advise premium listed companies on certain of their ongoing obligations under the listing regime. Sponsor investment banks will also advise companies seeking admission to trading on the premium listing segment of the Financial Conduct Authority's Official List. A sponsor owes regulatory obligations to the FCA pursuant to the sponsor regime in the FCA's Listing Rules and these take precedence over its contractual obligations to its issuer clients.

What is the sponsor regime?

1.2 As set out above and in Listing Rule 8.3.1 the sponsor performs two key roles; first, providing the FCA with assurances, explanations and confirmations relating to Listing Rule compliance by companies with or applying for a premium listing of equity shares; and secondly, providing guidance to companies with or applying for a premium listing of their equity shares in understanding and meeting certain of their ongoing responsibilities under the Listing Rules, disclosure requirements (set out in Articles 17, 18 and 19 of the UK Market Abuse Regulation) and transparency rules[199].

Part 2 – Sponsor roles in other major markets

2.1 This Review has examined practice across other main market European jurisdictions (see Part 4 of this Annex E). Prominent markets such as France, Netherlands, Spain, Italy, Germany and Switzerland take a more simplified approach to sponsor involvement, if any, on secondaries with varying degrees of involvement depending on the listing venue.

2.2 For example, in France and the Netherlands, there is no formal requirement for a sponsor to be instructed on a secondary capital raise by the local regulator. The regulator simply requires sign off from the directors of the company on regulatory matters with input from the accountants, lawyers and underwriting banks on specific areas of comfort such as working capital and prospectus content verification.

2.3 Other jurisdictions such as Spain and Italy have the concept of a sponsor and nominated advisor respectively, however these are only required for companies listed on the alternative, growth markets with the rationale being that larger issuers are more sophisticated, have the required level of knowledge and have been through capital raises previously.

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199 UKLA Technical Note Sponsors: Application of principle to deal with the FCA in an open and co-operative manner (fca.org.uk)

Part 3 – The working capital report

What is the basis for preparing a working capital report?

3.1 The directors of a company are responsible for preparing the projections together with detailed underlying assumptions to support their working statement in accordance with paragraphs 128 to 165 of the FCA's Primary Market Technical Note 619.1[200].

The base case scenario

3.2 The directors will prepare a base case scenario which should be consistent with the 'equity story' as set out in the prospectus. If there are other experts' reports (e.g. valuation reports) the working capital projections should be consistent with these.

3.3 The period of assessment is 12 months from the date of the prospectus. The directors will prepare a financial model (known as a working capital model for this exercise) which will include actual historical trading with two years of comparative financial information and the forecast information will be modelled off the underlying assumptions.

3.4 The accountants will form an assessment of the base case in terms of its basis of preparation including how it was compiled and by whom, the timescales and review procedures adopted. The assumptions which underpin key risks and judgement areas is also a critical part of the accountant's diligence exercise in addition to external expert views on market conditions. Visibility over forecast trading through contracted amounts e.g. order book etc. should be considered when assessing forecast assumptions in connection with historical trading.

3.5 The base case should represent the director's reasonable expectation of the likely performance of the business and should not be overly optimistic or unduly cautious.

The downside scenario (reasonable worst case scenario)

3.6 Paragraph 136 of the FCA's Primary Market Technical Note 619.1 guidance requires the company directors to consider whether the company has adequate facilities (e.g. revolving credit facility) and headroom (to cover financial covenants and cash/liquidity) to cover a reasonable downside scenario known as a 'reasonable worst case' scenario.

3.7 The reasonable worst case scenario is not defined and is a matter of judgement and interpretation and the directors, sponsor and accountants will be involved in the discussions as to what constitutes a reasonable worst case scenario.

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200 Guidelines on disclosure requirements under the Prospectus Regulation and Guidance on specialist issuers – Primary Market/TN/619.1

These discussions will take place early on in the process to ensure the financial model can be appropriately scrutinised by the sponsor and accountants.

3.8 The reasonable worst case scenario will include sensitivities being applied to the company, with examples of these being reductions to trading volumes, increases in costs, interest rate rises, margin reductions and one off cash impacts and so forth.

3.9 In connection with secondary capital raises, it is critical to understand whether the proceeds will be fully underwritten or not and a common sensitivity will include a scenario where the new share issue does not take place to assess whether the group has sufficient working capital excluding the capital raise, or whether the transaction is a construction or financing under Listing Rule 9.5.12.

What if the company does not have sufficient working capital?

3.10 If, following the application of sensitivities, the company does not have sufficient headroom it must consider reasonable mitigating actions it could take to remedy the breach. These may include for example cancelling discretionary spend such as bonuses, dividends or expansionary capital expenditure. Due consideration is given to the impact these mitigating actions may have on the under trading.

3.11 Once the directors have a finalised their view of the working capital model, the reporting accountant will complete their due diligence procedures and provide a private opinion to support the clean working capital statement made in the prospectus or circular.

Part 4 – How do other jurisdictions approach the working capital exercise on secondary capital raises?

4.1 This Review has examined market practice across other European jurisdictions (see below for a comparison of different jurisdictions) and has found varying levels of practice in terms of how a working capital statement is prepared and the level of due diligence performed for the directors to be comfortable with the statement made.

4.2 European jurisdictions such as in Spain and the Netherlands place greater emphasis on the going concern statement made in a company's annual report, signed off by the Company's auditor, with a review of the business plan performed either by the auditor or investment bank.

4.3 In France, the exercise will be scoped based on the level of liquidity or cash headroom the company has and the general operating environment the company finds itself in. For example, if an issuer has significant levels of liquidity headroom it is typically not common practice for a working capital report to be commissioned at all with the directors being comfortable to sign off with no additional review whereas if liquidity headroom is tighter a more thorough due diligence process will be undertaken by the auditors to establish the robustness of the directors' assumptions. A similar approach is taken in the

Netherlands whereby reliance is placed on the going concern statement however the company and its advisers will scope the exercise based on the current position the company is in and the circumstances in which the capital is being raised and from there, decide whether it requires a full working capital report. It should be noted however, this is for the comfort of the directors and underwriting bank. In the event of a secondary capital raise to mitigate a rescue scenario, it is market practice for a reporting accountant to be engaged to prepare a working capital report.

4.4 In Italy the business plan will be assessed on the basis that the proceeds have not been raised and from there the auditors will assess the financial position of the company. If it is concluded that the company is in financial difficulty or headroom is not as sufficient as initially thought and the proceeds were being used to mitigate a working capital shortfall, the company, the auditors and the underwriting bank will perform a deeper dive into the due diligence.

4.5 In Germany it is not market practice for a reporting accountant to be engaged by the company to issue a private opinion to support the working capital statement however the company may choose to do so if they wish. It is market practice in Germany however for the company's auditors to perform an independent review of the company's working capital model, forecasts and sensitivities whilst gaining an understanding of how the forecast has been prepared.

4.6 Based on the scenarios analysed across different European jurisdictions it is clear that the approach taken is less scripted, more flexible and more prescribed to the scenario in hand. We believe this approach would benefit the UK's secondary capital raising process such that it places more onus on the directors to make an informed decision as to whether it needs to go through a full working capital exercise.

WORKING CAPITAL REQUIREMENTS – INTERNATIONAL COMPARATIVES

Area	UK	Germany	France	Spain
Role of 'sponsor'/bank	• Sponsor will perform its own due diligence and place reliance on the reporting accountant's report • Provide confirmation to the regulator on working capital statement	• A sponsor is not required on secondaries, the underwriting bank will perform its due diligence procedures	• A sponsor is not required on secondaries, the underwriting bank will perform its due diligence procedures	• Sponsor/NOMAD only a requirement on Spain's alternative market (BME Growth) • Sponsor/NOMAD will review business plan and valuation assumptions
Reporting accountant / auditor	• Reporting accountant instructed on all secondary transactions where a working capital statement is made	• Auditor will only review going concern as part of the audit	• Auditor performs review of working capital	• Auditor performs review of working capital
Working capital report	• Market practice for a working capital report to be prepared on all transactions that trigger a working capital statement to be made by the directors in a public document • Detailed report which is addressed to the company and sponsor	• Not market practice for a working capital report to be prepared • No formal documentation submitted to the regulator • If requested, the auditor can issue a comfort letter under IDW AuS 910	• Not market practice for a working capital report to be prepared • Completion Letter submitted to the regulator • Completion letter states the accounts are audited, the auditor has read the prospectus and performed diligence on the working capital statement • Guidance followed by the publication from the CNCC, The Interventions of the External Auditor relating to the Prospectus, chapter 6	• Not market practice for a working capital report to be prepared • No formal documentation submitted to the regulator
Level of due diligence	• Standard scope across all diligence exercises, including an assessment of liquidity and covenant headroom after the application of sensitivities • Robust procedures to demonstrate the working capital statement has been prepared accordingly	• Underwriting bank and directors will perform their own due diligence to gain comfort over the working capital statement rather than instruct a third party reporting accountant	• Underwriting bank and directors will perform their own due diligence to gain comfort over the working capital statement • Scope is based on level of headroom and use of professional judgement • If the issuing company has significant headroom (cash and/or credit facility), limited procedures are performed (i.e. review cash forecast, projections and assumptions). Limited sensitivity analysis will be performed • If headroom is tight, professional judgement will be applied and if required the auditor will perform a deeper dive into the projections.	• Underwriting bank and directors will perform their own due diligence to gain comfort over the working capital statement • Not market practice to commission a third party review • A detailed exercise is only be performed in distressed scenarios • This will be performed across all markets by the auditor with a second review performed by the sponsor/financial advisor depending on the market
Reliance on going concern statement	• Limited reliance however consistency will be required in relation to sensitivity analysis	• Reliance is placed on the going concern statement made in the annual report and accounts by the regulator and underwriting bank	• Reliance is placed on the going concern statement made in the annual report and accounts by the regulator and underwriting bank	• Reliance is placed on the going concern statement made in the annual report and accounts by the regulator and underwriting bank • Going concern statement can take into account transactional proceeds

Area	UK	Netherlands	Switzerland	Italy
Role of 'sponsor'/bank	• Sponsor will perform its own due diligence and place reliance on the reporting accountant's report • Provide confirmation to the regulator on working capital statement	• A sponsor is not required on secondaries, the underwriting bank will perform its due diligence procedures	• A sponsor is not required on secondaries, the underwriting bank will perform its due diligence procedures	• **Main Market:** • Sponsor bank relies on budget comfort letter • **Euronex Growth Milan:** • Working capital report and comfort letter issued to the nominated advisor and the company
Reporting accountant / auditor	• Reporting accountant instructed on all secondary transactions where a working capital statement is made	• Due diligence performed by a reporting accountant on a secondary transaction	• Auditor will review going concern as part of the audit and review the Business Plan	• Auditor performs review of Business Plan for Main Market • Auditor performs review of working capital for Euronext Growth Milan market
Working capital report	• Market practice for a working capital report to be prepared on all transactions that trigger a working capital statement to be made by the directors in a public document • Detailed report which is addressed to the company and sponsor	• Market practice for a working capital report to be prepared on a secondary transaction	• Not market practice for a working capital report to be prepared • No formal documentation submitted to the regulator	• **Main Market:** • Not market practice for a formal report to be prepared • Comfort Letter on budget data issued to the bank and the company • **Euronex Growth Milan Market:** • Market practice for a working capital report to be produced • Working capital comfort letter issued to the bank and company (whose directors release a declaration on Prospectus)
Level of due diligence	• Standard scope across all diligence exercises, including an assessment of liquidity and covenant headroom after the application of sensitivities • Robust procedures to demonstrate the working capital statement has been prepared accordingly	• Underwriting bank and directors will perform their own due diligence to gain comfort over the working capital statement rather than instruct a third party reporting accountant • The exercise is scoped to meet the needs of the situation in which the company is raising secondary capital	• Underwriting bank and directors will perform their own due diligence to gain comfort over the working capital statement rather than instruct a third party reporting accountant	• **Main market:** • The exercise is scoped to analyse the financial viability, consistency and financial sustainability of the business plan in line with market trends and strategies. • **Euronex Growth Milan:** • The exercise is scoped based on the level of liquidity and covenant headroom without proceeds. • If proceeds are required to maintain liquidity headroom, a deeper dive of analysis will be performed • Nominated advisor will run its own formal analysis to gain comfort over thee working capital statement
Reliance on going concern statement	• Limited reliance however consistency will be required in relation to sensitivity analysis	• Reliance is placed on the going concern statement made in the annual report and accounts by the regulator and underwriting bank	• Reliance is placed on the going concern statement made in the annual report and accounts by the regulator and underwriting bank	• Reliance is placed on the going concern statement made in the annual report and accounts by the regulator and underwriting bank

Area	UK	Hong Kong	Singapore
Role of 'sponsor'/bank	• Sponsor will perform its own due diligence and place reliance on the reporting accountant's report • Provide confirmation to the regulator on working capital statement	• A sponsor is not required on secondaries, the underwriting bank will perform its due diligence procedures	• A sponsor is required on secondaries on the Catalist exchange (Singapore's growth market)
Reporting accountant / auditor	• Reporting accountant instructed on all secondary transactions where a working capital statement is made	• Auditor will review going concern as part of the audit and review the Business Plan	• Auditor will review going concern as part of the audit and review the Business Plan
Working capital report	• Market practice for a working capital report to be prepared on all transactions that trigger a working capital statement to be made by the directors in a public document • Detailed report which is addressed to the company and sponsor	• Not market practice for a working capital report to be prepared • No formal documentation submitted to the regulator	• Not market practice for a working capital report to be prepared • No formal documentation submitted to the regulator
Level of due diligence	• Standard scope across all diligence exercises, including an assessment of liquidity and covenant headroom after the application of sensitivities • Robust procedures to demonstrate the working capital statement has been prepared accordingly	• Underwriting bank and directors will perform their own due diligence to gain comfort over the working capital statement rather that instruct a third party reporting accountant	• On the Catalist exchange, a sponsor must perform its own due diligence to gain comfort over the working capital statement • It must not outsource its responsibility or rely on third party reports
Reliance on going concern statement	• Limited reliance however consistency will be required in relation to sensitivity analysis	• Reliance is placed on the going concern statement made in the annual report and accounts by the regulator and underwriting bank	• Reliance is placed on the going concern statement made in the annual report and accounts by the regulator and underwriting bank

Annex F – Existing fundraising structures

Part 1 – Key features of rights issues and open offers

1.1 Where a feature results from provisions in the Companies Act 2006, FCA Listing Rules, UK Prospectus Regulation or investor guidance this is noted in italics.

Features common to both rights issues and open offers

1.2 Rights issues and open offers have a number of features in common.

(a) **Pre-emptive offers:** Both a rights issue and an open offer are an offer of equity securities made to existing shareholders on a pre-emptive basis in proportion to their existing holdings, to be subscribed in cash (nearly always at a discount to the market price). As such either structure will satisfy the statutory Companies Act 2006 and FCA Listing Rule pre-emption requirements. *(Companies Act 2006 and FCA Listing Rules)*

(b) **Prospectus:** A prospectus will generally be required on both a rights issue and an open offer.

(i) **Public offer:** A rights issue or open offer will usually require a public offer prospectus to make pre-emptive offer to its shareholders. The wide shareholder base of a listed company is unlikely to allow reliance on an exemption. Implementation of HMT's UK Prospectus Regime Review will remove the requirement to have a prospectus for a public offer of securities, and empower the FCA to determine when a prospectus is required for an admission to trading.

(ii) **Admission to trading:** A rights issue or open offer will also typically involve the issue of new shares equivalent to more than 20% of the existing share capital of the issuer, triggering the obligation to publish a prospectus for the subsequent admission to trading of those shares.

As noted above, implementation of HMT's UK Prospectus Regime Review will allow the FCA to determine when a prospectus is required for securities to be admitted to trading on a UK regulated market. The FCA could therefore change the current 20% threshold. The Review recommends that if so empowered the FCA raise this admission to trading prospectus threshold to 75%.

(*UK Prospectus Regulation*)

(c) **Shareholder approval:** A general meeting may be required for either a rights issue or an open offer, for example if the directors do not have sufficient authority to allot shares or it is intended to disapply statutory pre-emption rights and sufficient disapplication authority is not already in place. *(Companies Act 2006)*

(d) **Circular:** If a company needs to call a general meeting of shareholders, it will need to publish a circular. Where a prospectus is also required, the two documents can be prepared as one combined document.

Only certain circulars require approval by the FCA. A circular for a rights issue or open offer will only usually require approval if the company is undergoing a reconstruction or refinancing (commonly referred to as a 'rescue' deal), or if there is an associated transaction of sufficient size (a 'Class 1' transaction under Chapter 10 of the FCA's Listing Rules, which requires shareholder approval). General content requirements for a circular are set out in Chapter 13 of the FCA's Listing Rules. *(FCA Listing Rules)*

(e) **Offer period:** The FCA's Listing Rules require that both a rights issue and an open offer remain open for 10 business days. Where statutory pre-emption rights are not disapplied, Companies Act 2006 s560(4) requires that a company incorporated in England and Wales keep both types of offer open for 14 calendar days. *(Companies Act 2006 and FCA Listing Rules)*

(f) **Gazette route:** Companies incorporated in England and Wales that want to carry out a rights issue or open offer without disapplying pre-emption rights under the Companies Act 2006 can make use of a mechanism called the 'Gazette route'. The Gazette route is a way for a company to respect the pre-emption rights of all its shareholders, even where it does not have an address for that shareholder in the UK or EEA to which it can send details of the offer. The offer can be made to all shareholders by publishing a notice in the London Gazette. The Gazette route allows an offer to include shareholders located in jurisdictions to which offer documentation cannot be sent without triggering onerous local requirements. Although technically included, however, shareholders in such jurisdictions cannot typically take-up their shares.

We discuss the Gazette route more below. *(Companies Act 2006)*

Additional features of a rights issue

1.3 The main points of difference for a shareholder if the offer is structured as a rights issue include:

(a) **Tradeable rights:** In a rights issue each shareholder is given a right to subscribe for new shares and is able to trade this right in the market without itself paying to subscribe for the shares first (called a 'nil paid right'). In hardcopy form this is known as a Provisional Allotment Letter or PAL (in electronic form, it can be represented by a credit to the shareholder's CREST account).

Rights issue tradeable entitlements are admitted to trading on the London Stock Exchange and can be bought and sold during the rights issue offer period. *(FCA Listing Rules)*

(b) **Cashless take-up:** Tradeable rights facilitate another important feature of a rights issue, the ability for shareholders to effect a 'cashless take-up' (sometimes referred to as 'tail-swallowing'). This takes advantage of the ability of shareholders to trade rights nil-paid. The cash received from the sale of a proportion of holder's entitlement can be used to fund the subscription price of shares taken through the rights they keep. This allows shareholders to reduce their dilution without advancing any new money. *(FCA Listing Rules)*

(c) **Compensation for non-participating shareholders:** In a rights issue arrangements will be made so that a shareholder that takes no action in relation to the rights issue offer made to it will still receive the profit made on the sale of the shares it could have taken up when those shares are sold in the market on its behalf (if a premium to the subscription price is achieved on that sale – expenses must also be paid, and proceeds can be retained by the company if below a de minimis amount of £5). This is referred to as placing of the 'rump' of shares not taken up. On an underwritten rights issue, where rump shares cannot be placed into the market at or above the offer price, they will be taken by the underwriters (shares taken by the underwriters are referred to as the 'stick'). *(FCA Listing Rules)*

(d) **Pre-placing of rights:** The FCA Listing Rules contain provisions that allow a listed company to place rights in advance of launching a rights issue, subject to compliance with certain conditions. Taking this route could in theory reduce the underwriting risk associated with shares not taken up, if the placing were subject to clawback into the rights issue. Alternatively if the rights were placed on a firm basis it would be useful primarily when a major shareholder indicated in advance of launch that it would not be taking up its rights. *(FCA Listing Rules)*

1.4 The main points of difference for the listed company include:

(a) **No limits on discount:** There are no rules or guidance restricting the level of discount that can be offered on a rights issue. This reflects the protection that tradeable rights and compensation for non-participating shareholders provide against dilution. *(FCA Listing Rules and investor guidance – Investment Association)*

(b) **No limits on size:** There are no rules or guidance restricting the size of a rights issue. Investment Association guidelines allow a company to use the whole of the usual standing authority to allot shares for a fully pre-emptive rights issue (two-thirds of existing share capital), and no guidance seeks to place limits on a company seeking specific shareholder approval for a higher threshold. *(Investor guidance – Investment Association)*

(c) **Consecutive notice period and offer period:** Where a listed company making a rights issue needs to call a general meeting of shareholders, for example to increase its existing authority to allot shares or to disapply pre-emption rights, it will need give notice of the meeting to its shareholders. For a company incorporated in England and Wales, the required notice period is generally 14 clear days[201]. The offer period for a rights issue can only begin at the end of the general meeting. This is because, as rights issue entitlements are admitted to trading (see 1.3(a)) they cannot be issued on a conditional basis. This gives certainty to market participants trading in the rights, but means that shareholders must have given their approval before the nil-paid-rights are issued. As such the timetable for a right issue that involves a general meeting is extended by an additional two weeks. *(FCA Listing Rules)*

(d) **Unconditional underwriting:** On a rights issue there must be no conditions to the underwriting commitment of the banks underwriting after the admission of the nil paid rights are admitted to trading. This means that the underwriters have a 'hard' unconditional underwriting commitment for the whole of the offer period, typically two weeks. *(FCA Listing Rules)*

Additional features of an open offer

1.5 The main points of difference for a shareholder if an issue is made as an open offer include:

(a) **No tradeable rights:** In an open offer a shareholder is not provided with a tradeable PAL or CREST entitlement, instead receiving a non-renounceable application form. This means a shareholder cannot trade its right to participate in an open offer without itself paying to subscribe for the shares first. *(FCA Listing Rules)*

(b) **No compensation for non-participating shareholders:** Open offers do not include arrangements to sell shares not taken up for the benefit of shareholders, meaning a shareholder that takes no action in relation to the open offer will not receive the profit made on the sale of the shares it could have taken up. Instead shares not taken up are either allocated to shareholders making excess applications (see below), are taken by placees (where the open offer is made in conjunction with a placing subject to clawback) or, on an underwritten open offer, taken by the underwriters.

As noted above, compensation for non-participating shareholders can be added to the traditional open offer. This sort of 'compensatory open

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201 Although section 307A(1)(b) Companies Act 2006 specifies a minimum notice period of 21 clear days' notice, listed companies typically take steps to meet the conditions necessary to shorten this to 14.

offer' includes a rump placing of shares not taken-up that sees profits returned to non-participating shareholders as on a rights issue. Only two compensatory open offers have been made, both in 2009[202]. *(FCA Listing Rules)*

(c) **Excess applications:** In an open offer shareholders are commonly invited to apply for any number of shares, with a guaranteed 'minimum entitlement' representing an amount in proportion to their existing holding. If any shareholder declines their minimal entitlement, those shares are allocated to shareholders that applied for shares in excess of their minimum entitlements. If excess applications cannot be met in full, applications are scaled down.

1.6 The main points of difference for the listed company include:

(a) **10% discount limit:** For a premium listed issuer, the Listing Rules limit the maximum discount (to the mid-market price at the date the offer is announced) in an open offer to 10%. A higher discount is permitted only if the terms of the offer are specifically approved by shareholders or if the offer is made under a pre-existing general disapplication of pre-emption rights (where companies follow the 5% pre-emption disapplication limit suggested by the Pre-Emption Group, this will not be of use for larger open offers). Historic shareholder guidance[203] has suggested a preference for a rights issue where the discount on a pre-emptive offer is greater than 7.5%. *(FCA Listing Rules)*

(b) **Offer size:** While there are no formal restrictions on the size of an open offer, historic shareholder guidance has suggested that a rights issue should be preferred for larger offers between 15% and 18%[204]. *(Investor guidance – Investment Association)*

(c) **Concurrent notice period and offer period:** Although the general notice and offer periods are the same for a rights issue and open offer, in an open offer the two periods can run concurrently. This is because there are no tradeable rights in an open offer, and entitlements can therefore be issued on a conditional basis subject to subsequent shareholder approval at the general meeting. If shareholders do not approve the open offer, entitlements lapse. For a company incorporated in England and Wales, this shortens the timetable for an open offer by two weeks.

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202 Lloyds Banking Group placing and compensatory open offer, 18 May 2009. Songbird Estates plc placing and compensatory open offer,24 Sep 2009.2.

203 ABI-Encouraging-Equity-Investment-report-July-2013.pdf (ivis.co.uk)

204 Ibid

(d) **Clawback:** As noted above, an open offer by main market companies is typically accompanied by a placing where the placed shares are subject to ‘clawback’ into the open offer if there is sufficient demand from existing shareholders. This has the benefit of reducing the underwriting risk involved in an open offer, as shares not taken-up are automatically allocated to the placees.

(e) **Firm placings alongside a placing subject to clawback:**. There may also be an additional ‘firm’ placing, which guarantees placees a set number of shares. A firm placing can be used alongside a placing subject to clawback and open offer where one or more shareholders has committed to the company that it will not take up its pro rata entitlement in the open offer. The listed company can then offer these shares to a new investor on a firm basis, guaranteeing a desired stake in a way that is not possible in the placing subject to clawback. This is a feature that can be a benefit to a listed company looking to reset or refresh its investor base while respecting pre-emptive rights.

Part 2 – Allotment authorities

How are directors authorised to allot shares?

2.1 Authority to allot and issue new shares is routinely given to directors by a resolution passed by shareholders at a company’s annual general meeting (s551 Companies Act 2006). A resolution to authorise the allotment of shares must be passed by a simple majority (50%+).

What limits are usually put on the authority to allot?

2.2 Companies typically follow guidance published by the Investment Association (IA) in giving authority to allot to directors. This guidance has been in place without substantive change since December 2008[205].

2.3 The guidance recommends that IA members regard as routine an authority to allot up to two-thirds of a company’s existing share capital (excluding treasury shares), but that any amount over one-third should be applied to fully pre-emptive rights issues only. The authority should last until the next annual general meeting.

2.4 The IA indicates the higher authority is reserved for fully pre-emptive rights issues as appropriate protections against shareholder dilution are provided by pre-emption rights and the FCA Listing Rule significant transaction rules (where the most significant transactions require an explanatory circular and prior shareholder consent).

[205] The Investment Association - Share Capital Management Guidelines (theia.org)

Part 3 – The different forms of pre-emption

Companies Act 2006

3.1 Under the Companies Act 2006 a company must not allot equity securities (this term includes ordinary shares and securities that convert into ordinary shares – for example, convertible bonds), or sell shares held by the company in treasury (s560(3)), to a new investor on any terms unless it has offered to allot them to each existing holder of ordinary shares (this does not include holders of convertible securities) in proportion to their existing holding on the same or more favourable terms (s561)(1)). No offer needs to be made to the company as a holder of shares in treasury, and treasury shares are not counted for the purpose of calculating proportions (s561(4)).

3.2 A pre-emptive offer to existing shareholder may be made in hard copy or in electronic form (s562(2)). If the shareholder has no registered address in the UK or an EEA state, and has not given the company an address in the UK or an EEA state for service of notices, then the offer can be made to them by the company publishing a notice in the Gazette (s562(3)).

3.3 The offer to shareholders must be kept open for 14 days (beginning on the date on which it is sent electronically, sent or supplied in hard copy or the date of publication in the Gazette) (s562(5)) and cannot be withdrawn before the end of that period (s562(4)). The offer to new investors can only proceed when the period during which the offer to existing shareholders may be accepted has expired, or all relevant shareholders have notified their acceptance or refusal (s561(1)(b)).

3.4 Pre-emption rights do not apply to issues made wholly or in part for non-cash consideration (s565). Exemptions also apply in relation to bonus shares (s564), employees' share schemes (s566) and in certain circumstances in relation to companies in financial difficulty (s566A).

FCA Listing Rules

3.5 A premium listed company (other than a premium listed open-ended investment company) proposing to issue equity securities (this term includes ordinary shares and securities that convert into ordinary shares – for example, convertible bonds) for cash must first offer them in proportion to existing holdings to existing holders of that class of shares (and to holders of other equity shares who are entitled to be offered them – this does not include holders of convertible securities). No offer needs to be made to the company as a holder of shares in treasury (LR 9.3.11R(1)).

3.6 Pre-emption rights under the FCA Listing Rules do not apply to an issue in relation to which statutory pre-emption rights under the Companies Act 2006 (LR 9.3.12R(1)) or equivalent for companies incorporated outside England and Wales (LR 9.3.12R(4)) have been disapplied. It also does not apply to the sale of treasury shares for cash to an employee share scheme (LR 9.3.12(3)).

3.7 LR9.3.11R does not apply to a company undertaking a rights issue or open offer provided the disapplication of pre-emption rights is with respect to equity securities representing fractional entitlements, or equity securities which the company considers necessary or expedient to exclude from the offer on account of the laws or regulatory requirements of a territory other than its country of incorporation unless that territory is the UK (LR 9.3.12R(2)).

'Voluntary' pre-emption

3.8 As noted in Section 8, companies commonly ask their shareholders to disapply the statutory pre-emption rights in the Companies Act in order to apply a modified form of pre-emption to rights issues and open offers. Disapplication of the Companies Act 2006 pre-emption rights also disapplies pre-emption under the FCA's Listing Rules (LR 9.3.12R(1)). The aim is to allow the directors to make appropriate exclusions and other arrangements to resolve legal or practical problems which, for example, might arise in relation to overseas shareholders.

3.9 Shareholders are typically asked to disapply pre-emption rights for any pre-emptive offer up to 33.3% of existing share capital, or up to 66.6% if the offer is structured as a rights issue, as long as in either case the offer complies with modified pre-emption requirements. A greater size is permitted for rights issues as investor guidance limits use of the directors' authority to allot shares in excess of 33.3% to this type of offer.

3.10 The modified pre-emption requirements typically require the offer to be made both to ordinary shareholders in proportion to their existing holdings and to holders of other securities where required by the rights of those securities (or, if the directors consider it necessary, where it is permitted by the rights of those securities). Companies with convertible preference shares or other securities that are entitled by their terms to have an offer extended to them will need to disapply the Companies Act 2006 pre-emption provisions in order not to breach their obligations to the holders of such securities.

3.11 The directors are also usually given authority to impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of, any territory or any other matter. This allows the exclusion of shareholders in difficult jurisdictions, where the company would otherwise need to comply with onerous registration or other requirements, as well as providing flexibility to the directors to deal with other administrative matters that may arise when making an offer to a wide shareholder base.

Part 4 – Comparison of key differences between Companies Act 2006, FCA Listing Rule and voluntary pre-emption

	Requirements of statutory pre-emption under Companies Act 2006	Requirements of FCA Listing Rules (premium listed companies)	Common approach taken when statutory (and LR) pre-emption rights disapplied
Fractional entitlements	Must be included No alleviation for fractional entitlements	Can be excluded Pre-emption rights need not be applied to equity securities representing fractional entitlements (LR 9.3.12R(2)). If a shareholder's entitlement includes a fraction, it should be sold for the benefit of the shareholder (unless its value net of expenses does not exceed £5, in which case it may be sold for the benefit of the company). (LR 9.5.13R).	Can be excluded Directors typically given authority to impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with fractional entitlements. Listed companies follow the FCA Listing Rule requirements, typically provide that fractional entitlements can be sold and proceeds of £5 or less retained by the company.
Shareholders in 'difficult' jurisdictions	Must be included While an offer need not be sent to a holder without a registered address in the UK / EEA, Companies Act 2006 s562(3) provides for them to be included through publication of a Gazette notice. It is not possible to exclude shareholders in a particular jurisdiction.	Can be excluded Pre-emption rights need not be applied to equity securities which the company considers necessary or expedient to exclude from the offer on account of the laws or regulatory requirements of a territory other than its country of incorporation unless that territory is the United Kingdom (LR 9.3.12R(4))	Can be excluded Directors typically given authority to impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with legal, regulatory or practical problems in, or under the laws of, any territory. Listed companies commonly exclude from the offer shareholders in jurisdictions where onerous requirements would otherwise apply, for example, the United States, Australia, Canada, Japan and South Africa.
Treatment of holders of convertible securities	Excluded Holders of convertible securities do not have a right of pre-emption under s561, meaning the pre-emptive offer must be made solely to holders of ordinary shares.	Excluded No alleviation that would allow an offer to be extended to holders of convertible securities.	Can be included Directors are typically authorised to include in the offer people who hold other equity securities, if this is required by the rights of those securities or, if the directors consider it necessary, as permitted by the rights of those securities.

Part 5 – Potential U.S. liabilities

What is Rule 144A?

5.1 All offers or sales of securities must, under US securities law, be either registered with the SEC, exempt from, or not subject to registration. "Rule 144A offerings" rely on exemptions from registration for offers and sales made only to 'qualified institutional buyers' (or QIBs), as defined in Rule 144A, in the US.

Potential liability

5.2 Where a Rule 144A offer is made, the company and its directors, as well as the sponsor and the other banks involved in the selling effort, may be liable under United States federal and state securities laws in respect of improper disclosure in the offer documents. The most important provision under US federal law in the context of a 144A offering of rump shares in the United States, under a valid exemption from registration, is Rule 10b-5 under the United States Securities Exchange Act of 1934, as amended (although there others, such as Section 17 of the Securities Act and the securities laws of the individual states of the United States, each of which also prohibit sales of securities by means of material misstatements or omissions).

What does Rule 10b-5 say?

5.3 The company, its directors and the banks involved in the selling effort will have potential liability under Rule 10b-5 for making any untrue statement of material fact or failing to state a material fact necessary in order to make statements made, in light of the circumstances under which they were made, not misleading. This standard of liability will apply to any statements or omissions made in connection with the sale of the shares, including those made in any prospectus or other document used publicly or in connection with the selling effort.

5.4 A misstatement or omission is deemed "material" if there is a substantial likelihood that a reasonable investor would consider such information important in deciding whether to subscribe for, purchase or sell shares.

5.5 To be liable under Rule 10b-5, the company and its directors and the banks involved in the selling effort must be found to have acted with intent or reckless disregard with respect to the misstatement or omission. To enable the company and its directors and the banks involved in the selling effort to rebut any claim that it did not act with the appropriate standard of care under Rule 10b-5:

(a) it is the practice to prepare the prospectus taking into account US disclosure standards; and

(b) to follow certain established due diligence procedures. For underwriters, these procedures typically involve the receipt of a so-called 10b-5 disclosure letter by legal counsel both to the issuing company and the underwriting banks, and the provision by the issuer's auditors of a SAS-72 letter (sometimes also referred to as an AU 634 or AS 6101 letter).

Both 10b-5 letters and SAS72 letters help the underwriters evidence the extent of their due diligence investigation to establish a due diligence defence against potential liability under Rule 10b-5 of the Securities Exchange Act of 1934.

U.S. disclosure standards

5.6 Part of the defence for underwriters offering securities into the US under the exemption in Rule 144A is to ensure that the level of disclosure provided to those investors is of a similar standard to that required in relation to a US registered offering. While there are no specific disclosure requirements that must be met, and there is a broad overlap between the requirements of a UK prospectus and US disclosure, there will typically be a renewed focus on particular areas. For example, the risk factor disclosure and the discussion of the financial statements (referred to as the operating and financial review (OFR) in a UK prospectus, or management's discussion and analysis (MD&A) in a US context) should meet US expectations.

What is a 10b-5 disclosure letter?

5.7 A 10b-5 disclosure letter confirms that legal counsel have no reason to believe that the disclosure documents contain any untrue statement of material fact, or omit to state a material fact necessary in order to make the statements made not misleading, in light of the circumstances under which they were made. It is addressed to the underwriters, and provided by both the underwriters' lawyers and the issuer's lawyers. It is usually a condition precedent to the underwriting commitment.

What is a SAS72 letter?

5.8 A SAS72 letter from the issuer's reporting accountants or auditors provides assurances about the financial information contained in an offering document, and compares certain financial information included in the offer documentation to the company's audited and unaudited financial statements. The letter may also discuss the results of certain additional agreed upon procedures undertaken by the accountants.

What liability could underwriters face under Rule 10b-5 and Section 17?

5.9 A private party in an action under Rule 10b-5 is entitled to its out-of-pocket losses, which will generally be the difference between the price paid by the plaintiff for the shares and the mean trading price of the shares during the three months following corrective disclosure to the market. In addition, the U.S. Securities Exchange Commission (***SEC***) may sue for injunctive relief or seek civil penalties or criminal sanctions.

5.10 Section 17 contains a broad anti-fraud provision, which mirrors closely the language of Rule 10b-5. Unlike Rule 10b-5, however, actions under Section 17 do not require proof of fraudulent intent or recklessness, but may be brought where a person has been negligent. However, most courts have held that there is no private right of action under Section 17, therefore actions may only be brought by the SEC.

Part 6 – Comparison of full / simplified registration document content and proposed enhanced continuous disclosure framework

Brief description	Annex 1 – standard equity registration document	Annex 3 – simplified equity registration document	Annual report requirement / other continuing obligation	Proposed enhanced continuous disclosure framework
Persons responsible, third party information, experts' reports and competent authority approval				
Persons responsible for information in prospectus	✓ Item 1.1	✓ Item 1.1	Responsibility statements – DTR 4.1.12 – DTR 4.1.13	**No additional requirement**
Responsibility statement	✓ Item 1.2	✓ Item 1.2	Responsibility statements – DTR 4.1.12 -DTR 4.1.13 UK Corporate Governance Code 2018: Provision 27	**No additional requirement**
Information about experts whose statements or reports appear in the prospectus	✓ Item 1.3	✓ Item 1.3	No specific requirement	**Where an expert's report (for example, in relation to mineral reserves) is included in, or incorporated by reference into, the annual report, information should be included on the expert providing that report.**
Requirements for information sourced from third parties	✓ Item 1.4	✓ Item 1.4	No specific requirement	**The annual report should specify information sourced from third parties**
Statement concerning approval of the prospectus	✓ Item 1.5	✓ Item 1.5	N/A	**N/A**
Statutory auditors				
Details of auditors	✓ Item 2.1	**Reduced** Item 2.1 – addresses not required	Auditor's report to include name of auditor – Companies Act 2006 s503(1)	**No additional requirement**
Resignation, removal or non-re-appointment of auditors	✓ Item 2.2	✗ Item 2.2	Description of the work of the audit committee, including approach taken to appointment / reappointment of external auditor – UK Corporate Governance Code 2018: Provision 26	**No additional requirement**

Brief description	Annex 1 – standard equity registration document	Annex 3 – simplified equity registration document	Annual report requirement / other continuing obligation	Proposed enhanced continuous disclosure framework
Risk factors	✓ Item 3.1	✓ Item 3.1	Companies Act 2006 s414C(2)(b), s414CB(2)(d) DTR 4.1.8R UK Corporate Governance Code 2018: Provision 28 FRC Guidance on the Strategic Report paras 7B.27-7B.33 FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting Section 6 Paragraph 6, Schedule 7, Large and Medium-sized Regulations DTR 4.1.11R(6)	**Enhanced disclosure should:** • **Reflect the UK version of ESMA's Guidelines on risk factors under the Prospectus Regulation.** • **Ensure that risks and mitigants are disclosed in distinct sections. Consider the inclusion of cautionary language in relation to mitigants.**
Information about the issuer				
Name of issuer	✓ Item 4.1	✓ Item 4.1	Companies Act 2006 s406	**No additional requirement**
Place of registration, registered number and LEI	✓ Item 4.2	**Reduced** Item 4.2– LEI only	Companies Act 2006 s406 – not LEI	**No additional requirement**
Date of incorporation, length of life	✓ Item 4.3	✗	*Companies House filings publicly available*	**No additional requirement**
Domicile, legal form, legislation under which operates, issuer details	✓ Item 4.4	✓ Item 4.2	Companies Act 2006 s406 *Companies House filings publicly available*	**No additional requirement**
Business overview				
Principal activities	✓ Item 5.1.1	**Reduced** Item 5.1 – brief description, significant changes since last audit date	Companies Act 2006 s414C(2), s414C(8)(b), s414CB(2)(a) DTR4.1.8R(1)	**Enhanced disclosure should** • **provide a standalone summary of the business in addition to a review of development / performance over the year; and** • **include a description of the industry in which**
Significant new products / services	✓ Item 5.1.2		No specific requirement	
Principal markets	✓ Item 5.2	✗	No specific requirement	

Brief description	Annex 1 – standard equity registration document	Annex 3 – simplified equity registration document	Annual report requirement / other continuing obligation	Proposed enhanced continuous disclosure framework
Important events in development of business	✓ Item 5.3	✗	Paragraph 7(1)(a) and 7(2), Schedule 7, Large and Medium-sized Regulations DTR 4.1.11R(1)	**the company operates.**
Strategy and objectives	✓ Item 5.4	✗	s414C(8)(a) FRC Guidance on the Strategic Report paras 7B.7-7B.13	
Dependency on patents or licences where relevant	✓ Item 5.5	✗	Paragraph 7(1)(c) and 7(2), Schedule 7, Large and Medium-sized Regulations DTR 4.1.11R(3)	**Enhanced disclosure should describe any dependency on patents or licences, where relevant.**
Basis for competitive position statements	✓ Item 5.6	✗	No specific requirement	**Enhanced disclosure should provide the basis for any statements made on the competitive position of the company.**
Investments for period of HFI	✓ Item 5.7.1	**Reduced** Item 5.2 – since date of last published HFI, fewer details	[Notes to the accounts]	**No additional requirement**
Investments in progress / firm commitments	✓ Item 5.7.2		[Notes to the accounts]	
Joint ventures	✓ Item 5.7.3	✗	[Notes to the accounts] Companies Act 2006 s409	
Environmental issues affecting use of tangible assets	✓ Item 5.7.4	✗	Section 414C(7) DTR 4.1.9R(2) FRC Guidance on the Strategic Report paras 7A.35 to 7A.58 and 7B.35 to 7B.47	
Organisational structure				
Brief description of group	✓ Item 6.1	✗	[Notes to the accounts]	**No additional requirement**
List of significant subsidiaries	✓ Item 6.2	✗	[Notes to the accounts] Companies Act 2006 s409	**No additional requirement**
Operating and financial review				
Financial condition				

Brief description	Annex 1 – standard equity registration document	Annex 3 – simplified equity registration document	Annual report requirement / other continuing obligation	Proposed enhanced continuous disclosure framework
Review of issuer business for period of historical financial information	✓ Item 7.1.1	✗	Companies Act 2006 s414C(2)(a) and s414C(3), (4) and (5) and (12) FRC Strategic Report Guidance paras 7B 59-65 UK version of ESMA's Guidelines on Alternative Performance Measures DTR 4.1.9R(1) – (3)	**The presentation of the OFR in an enhanced annual report and accounts would need to align with the approach taken in a prospectus.** **Guidance on the use of alternative performance measures (APMs) already applies to both annual reports and prospectuses and, where APMs are used, disclosure should adhere robustly to that framework.**
Likely future development, activities in R&D	✓ Item 7.1.2	✗	Paragraph 7(1)(b) and (c) and 7(2), Schedule 7, Large and Medium-sized Regulations DTR 4.1.11R(2) and (3)	**No additional requirement**
<u>Operating results</u>				
Significant factors affecting income from operations	✓ Item 7.2.1	✗	s414C(7)(a) FRC Guidance on the Strategic Report paras 7B.21-7B.26	**No additional requirement**
Narrative discussion of any material changes in net sale / revenues	✓ Item 7.2.2	✗	Companies Act 2006 s414C(12) FRC Strategic Report Guidance paras 7B 59-65 UK version of ESMA's Guidelines on Alternative Performance Measures DTR 4.1.9R(1) – (3)	**No additional requirement**
<u>Capital resources</u>				
Issuer's capital resources	✓ Item 8.1	✗	Paragraph 6, Schedule 7, Large and Medium-sized Regulations DTR 4.1.11R(6) FRC Strategic Report Guidance paras 7B 59-65 Companies Act 2006 s410A	**No additional requirement**
Sources and amounts of issuer's cash flows	✓ Item 8.2	✗		
Borrowing requirements and funding structure	✓ Item 8.3	✗		
Any restrictions on the use of capital	✓ Item 8.4	✗	No specific requirement	**No requirement**

Brief description	Annex 1 – standard equity registration document	Annex 3 – simplified equity registration document	Annual report requirement / other continuing obligation	Proposed enhanced continuous disclosure framework
Anticipated sources of funds to meet future investments	✓ Item 8.5	✗	No specific requirement	**No requirement**
Regulatory environment	✓ Item 9	**Reduced** Item 5.1 – material changes since the period covered by the latest published audited financial statements only	s414C(7)(a) FRC Guidance on the Strategic Report paras 7B.35-7B.47	**Where relevant, the annual report should also include a description of the issuer's regulatory environment and information on any policies or factors (governmental, economic, fiscal, monetary or political) that could materially affect its operations.**
Trend information	✓ Item 10	✓ Item 6.1	s414C(7)(a) FRC Guidance on the Strategic Report paras 7B.21-7B.26 Paragraph 7(1)(a) and 7(2), Schedule 7, Large and Medium-sized Regulations DTR 4.1.11R(1)	**No additional requirement**
Profit forecasts or estimates	✓ Item 11	✓ Item 7	LR 9.2.18	**No additional requirement**
Administrative, management and supervisory bodies and senior management				
Details of senior management	✓ Item 12.1	**Reduced** Item 8.1 – certain items required only if not already disclosed / in relation to new members, no need to disclose relevant management expertise / experience	Companies Act 2006 s416(1)(a)	**No additional requirement**
Conflicts of interest within management	✓ Item 12.2	✓ Item 8.2	No specific requirement (procedural disclosures recommended by investor guidance)	**No additional requirement**
Remuneration and benefits	✓ Item 13	✗	Companies Act 2006 s420(1)) – directors' remuneration report UK Corporate Governance Code 2018: Provision 41	**No additional requirement**

Brief description	Annex 1 – standard equity registration document	Annex 3 – simplified equity registration document	Annual report requirement / other continuing obligation	Proposed enhanced continuous disclosure framework
Board practices	✓ Item 14	✗	Paragraph 13, Schedule 7, Large and Medium-sized Regulations DTR 7.2.1R to DTR 7.2.11R UK Corporate Governance Code 2018: Provisions 10,11, 14, 15 FRC Guidance on Board Effectiveness para 39	**No additional requirement**
Employees	✓ Item 15	✗	[Notes to the accounts] s414C(7)(b)(ii) s414CB(1)(b) FRC Guidance on the Strategic Report paras 7A.35 to 7A.58 Reporting on employee engagement – paras 11, 11A and 11B Sch 7 to the 2008 Regs UK Corporate Governance Code 2018: Provision 5	**No additional requirement**
Major shareholders				
Notifiable interests in issuer's shares	✓ Item 16.1	✓ Item 9.1	Paragraph 13, Schedule 7, Large and Medium-sized Regulations LR 9.8.4R(14) LR 9.8.6(2) *DTR 5 announcements publicly available, showing the voting rights held (broadly 3%+ UK issuers, 5%+ non-UK, although exemptions apply a higher threshold in certain circumstances – e.g. trading book, market makers)*	**No additional requirement**
Whether major shareholders have different voting rights	✓ Item 16.2	✓ Item 9.2		
Control of the issuer	✓ Item 16.3	✓ Item 9.3		
Arrangements relating to change of control	✓ Item 16.4	✓ Item 9.4		

Brief description	Annex 1 – standard equity registration document	Annex 3 – simplified equity registration document	Annual report requirement / other continuing obligation	Proposed enhanced continuous disclosure framework
Related party transactions	✓ Item 17.1	**Reduced** Item 10.1 – covers period since last financial statements only	[Notes to the accounts]	**No additional requirement**
Financial information concerning the issuer's assets and liabilities, financial position and profits and losses				
Historical financial information	✓ Item 18.1	**Reduced** Item 11.1 – 12 months only	DTR 4.1.3	**No additional requirement**
Change of accounting reference date	✓ Item 18.1.2	✗	*Companies House filings publicly available*	**No additional requirement**
Accounting standards	✓ Item 18.1.3	✗	DTR 4.1.6	**No additional requirement**
Change of accounting framework	✓ Item 18.1.4	✗	No specific requirement	**No additional requirement**
Requirements where audited financial statements prepared according to national accounting standards	✓ Item 18.1.5	✗	N/A	**N/A**
Consolidated financial statements	✓ Item 18.1.6	✗	DTR 4.1.6	**No additional requirement**
Age of financial information	✓ Item 18.1.7	✗	N/A	**N/A**
Interim and other financial information	✓ Item 18.2.1	✗	N/A DTR 4.2 requires half-yearly reports	**N/A**
Auditing of historical financial information	✓ Item 18.3.1	**Reduced** Item 11.2.1 – true and fair view statement can be replaced by statement on auditing standards applied and explanation of significant differences from IAS	DTR 4.1.7	**No additional requirement**

Brief description	**Annex 1 – standard equity registration document**	**Annex 3 – simplified equity registration document**	**Annual report requirement / other continuing obligation**	**Proposed enhanced continuous disclosure framework**
Other information audited by the auditors	✓ Item 18.3.2	✓ Item 11.2.2	No specific requirement	**No requirement**
Source of information not extracted from audited financial statements	✓ Item 18.3.3	✓ Item 11.2.3	UK version of ESMA's Guidelines on Alternative Performance Measures	**No additional requirement**
Pro forma financial information	✓ Item 18.4.1	✓ Item 11.5	No specific requirement	**No requirement**
Dividend policy	✓ Item 18.5.1	**Reduced** Item 11.6 – no requirement for a negative statement	s416(3) FRC Financial Reporting Lab study – Disclosure of dividends – policy and practice	**No additional requirement**
Amount of dividend per share for historical financial information period	✓ Item 18.5.2	**Reduced** Item 11.6.1 – last year only	[Notes to the accounts]	**No additional requirement**
Legal and arbitration proceedings	✓ Item 18.6.1	✓ Item 11.3	[Notes to the accounts]	**No additional requirement**
Significant change in the issuer's financial position	✓ Item 18.7.1	✓ Item 11.4	DTR 4.1.11 [Notes to the accounts] Companies Act 2006 s414C(2)(a) and s414C(3) FRC Guidance on the Strategic Report paras 7B.59-7B.65	**No additional requirement**
Additional information				
Share capital				
Shares in issue, reconciliation for year	✓ Item 19.1.1	✗	*Companies House filings publicly available* Paragraphs 13 and 14, Schedule 7, Large and Medium-sized Regulations	**No additional requirement**

Brief description	**Annex 1 – standard equity registration document**	**Annex 3 – simplified equity registration document**	**Annual report requirement / other continuing obligation**	**Proposed enhanced continuous disclosure framework**
Details of shares not representing capital	✓ Item 19.1.2	✗	*Companies House filings publicly available* Paragraphs 13 and 14, Schedule 7, Large and Medium-sized Regulations	**No additional requirement**
Shares in the issuer held by the issuer	✓ Item 19.1.3	✗	[Notes to the accounts] *DTR 5.6.1R requires monthly disclosure of the total number of voting rights attaching to shares of the issuer which are held by it in treasury*	**No additional requirement**
Amount of convertible securities and the conditions governing conversion	✓ Item 19.1.4	✓ Item 12.1.1	*Companies House filings publicly available* Paragraphs 13 and 14, Schedule 7, Large and Medium-sized Regulations	**No additional requirement**
Details of acquisition rights over authorised but unissued share capital	✓ Item 19.1.5	✓ Item 12.1.2	[Notes to the accounts] Paragraphs 13 and 14, Schedule 7, Large and Medium-sized Regulations	**No additional requirement**
Capital under option	✓ Item 19.1.6	✗	[Notes to the accounts] Paragraphs 13 and 14, Schedule 7, Large and Medium-sized Regulations	**No additional requirement**
History of share capital	✓ Item 19.1.7	✗	[Notes to the accounts] *Companies House filings publicly available*	**No additional requirement**
<u>Memorandum and Articles of Association</u>				
Register, entry number, objects and purposes	✓ Item 19.2.1	✗	*Memorandum and Articles of Association publicly available at Companies House* Paragraphs 13 and 14, Schedule 7, Large and	**No additional requirement.**
Details of different share classes	✓ Item 19.2.2	✗		

Brief description	**Annex 1 – standard equity registration document**	**Annex 3 – simplified equity registration document**	**Annual report requirement / other continuing obligation**	**Proposed enhanced continuous disclosure framework**
Provisions in Articles of Association that would delay change of control	✓ Item 19.2.3	✗	Medium-sized Regulations	
Summary of relevant regulatory disclosures over last 12 months	✗	✓ Item 13.1	*UK MAR and other regulatory disclosures publicly available (NSM, issuer website).*	**No additional requirement.**
Material contracts	✓ Item 20.1	**Reduced** Item 14.1 – summaries can be 'brief'	Paragraph 13, Schedule 7, Large and Medium-sized Regulations	**Enhanced disclosure should include a description of funding documentation, including the terms and conditions of bonds in issue and details of bank facilities, and material non-ordinary course contracts (and more routine contracts where they account for the majority of the issuer's sales or costs).**
Documents available	✓ Item 21.1	✓ Item 15.1	*Memorandum and Articles of Association available at Companies House* No requirement in relation to 'reports, letters, and other documents, valuations and statements prepared by any expert at the issuer's request'.	**No additional requirement.**

Annex G – Increase the range of pre-emptive fundraising structures for companies

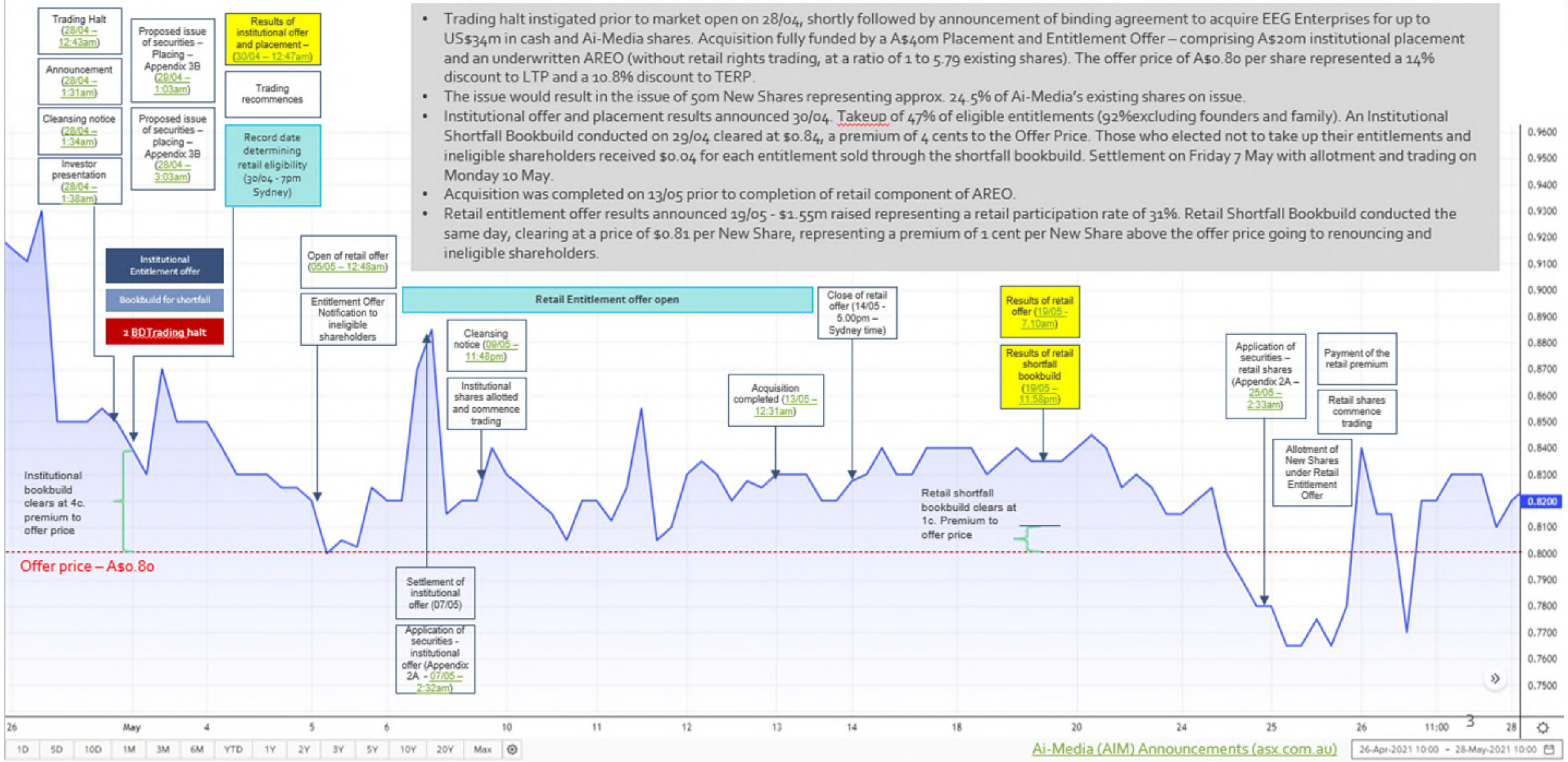
1. Case studies for an ANREO, AREO, PAITREO and SAREO are detailed below.

Australia

AREO case study – AI-Media

US$34m acquisition of US-based video and captioning technology company, financed via a A$40m Placement and Entitlement Offer

- Trading halt instigated prior to market open on 28/04, shortly followed by announcement of binding agreement to acquire EEG Enterprises for up to US$34m in cash and Ai-Media shares. Acquisition fully funded by a A$40m Placement and Entitlement Offer – comprising A$20m institutional placement and an underwritten AREO (without retail rights trading, at a ratio of 1 to 5.79 existing shares). The offer price of A$0.80 per share represented a 14% discount to LTP and a 10.8% discount to TERP.
- The issue would result in the issue of 50m New Shares representing approx. 24.5% of Ai-Media's existing shares on issue.
- Institutional offer and placement results announced 30/04. Takeup of 47% of eligible entitlements (92%excluding founders and family). An Institutional Shortfall Bookbuild conducted on 29/04 cleared at $0.84, a premium of 4 cents to the Offer Price. Those who elected not to take up their entitlements and ineligible shareholders received $0.04 for each entitlement sold through the shortfall bookbuild. Settlement on Friday 7 May with allotment and trading on Monday 10 May.
- Acquisition was completed on 13/05 prior to completion of retail component of AREO.
- Retail entitlement offer results announced 19/05 - $1.55m raised representing a retail participation rate of 31%. Retail Shortfall Bookbuild conducted the same day, clearing at a price of $0.81 per New Share, representing a premium of 1 cent per New Share above the offer price going to renouncing and ineligible shareholders.

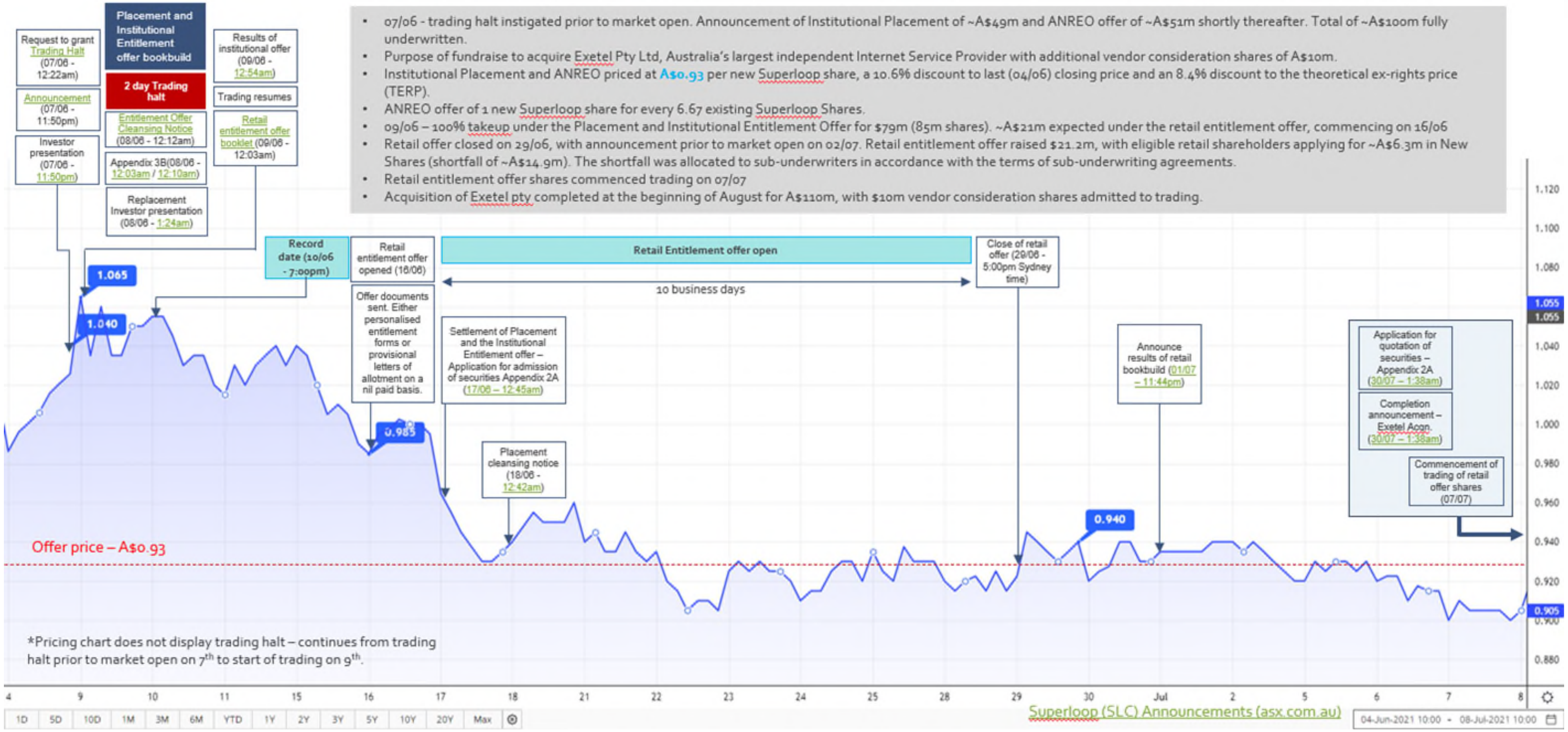


Australia

ANREO case study – Superloop Limited acquisition of Exetel

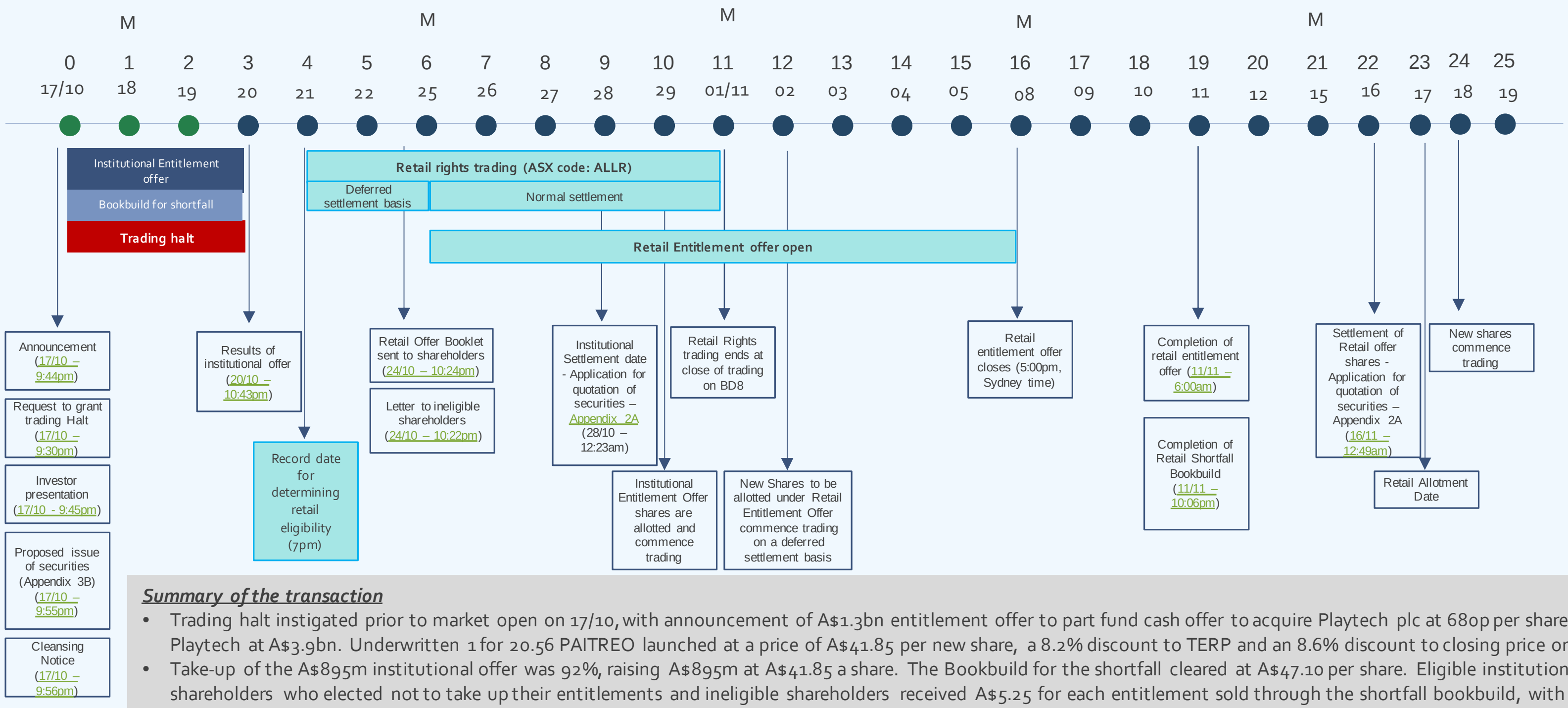
A$110m acquisition financed via a A$49m Institutional placement, $51m ANREO and A$10m vendor placing

- 07/06 - trading halt instigated prior to market open. Announcement of Institutional Placement of ~A$49m and ANREO offer of ~A$51m shortly thereafter. Total of ~A$100m fully underwritten.
- Purpose of fundraise to acquire Exetel Pty Ltd, Australia's largest independent Internet Service Provider with additional vendor consideration shares of A$10m.
- Institutional Placement and ANREO priced at A$0.93 per new Superloop share, a 10.6% discount to last (04/06) closing price and an 8.4% discount to the theoretical ex-rights price (TERP).
- ANREO offer of 1 new Superloop share for every 6.67 existing Superloop Shares.
- 09/06 – 100% takeup under the Placement and Institutional Entitlement Offer for $79m (85m shares). ~A$21m expected under the retail entitlement offer, commencing on 16/06
- Retail offer closed on 29/06, with announcement prior to market open on 02/07. Retail entitlement offer raised $21.2m, with eligible retail shareholders applying for ~A$6.3m in New Shares (shortfall of ~A$14.9m). The shortfall was allocated to sub-underwriters in accordance with the terms of sub-underwriting agreements.
- Retail entitlement offer shares commenced trading on 07/07
- Acquisition of Exetel pty completed at the beginning of August for A$110m, with $10m vendor consideration shares admitted to trading.



AREORT/PAITREO case study – Aristocrat Leisure Limited (ALL)

A$1.3bn entitlement offer, to part fund cash acquisition of Playtech Plc



Summary of the transaction

- Trading halt instigated prior to market open on 17/10, with announcement of A$1.3bn entitlement offer to part fund cash offer to acquire Playtech plc at 680p per share – valuing Playtech at A$3.9bn. Underwritten 1 for 20.56 PAITREO launched at a price of A$41.85 per new share, a 8.2% discount to TERP and an 8.6% discount to closing price on 15/10.
- Take-up of the A$895m institutional offer was 92%, raising A$895m at A$41.85 a share. The Bookbuild for the shortfall cleared at A$47.10 per share. Eligible institutional shareholders who elected not to take up their entitlements and ineligible shareholders received A$5.25 for each entitlement sold through the shortfall bookbuild, with payment occurring on 29/10.
- Record date for retail offer on 21st November, following which retail rights trading commences on a deferred settlement basis until the formal open of the retail entitlement offer on 25/10. Retail offer remained open for two weeks, with retail rights trading closing on 1/11 – 9 business days after commencement. Retail offer closes on 08/11 – having been open for two weeks – with announcement of the completion of the offer and results of the retail shortfall bookbuild on 11/11.
- Retail entitlements worth ~$10.1m (1.8m retail entitlements) were sold on ASX during the retail trading window at a VWAP of $5.52. The retail offer had been open to 41,800 retail shareholders, with 20,400 electing to partially or fully take up their Retail entitlements. $317m was raised; a participation rate of 78% by value and 49% by number of shareholders. The retail shortfall bookbuild was conducted after market close on 11/11, clearing at $46.60, a premium of 11.4% to the offer price and 2.2% to the TERP.

SAREO case study – CSR limited

First issuer to use SAREO structure, raising €375m

M						M					M					M					M					M		
0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28
25/10	26	27	28	29	30	02/11	03	04	05	06	09	10	11	12	13	16	17	18	19	20	23	24	25	26	27	30	01/12	02

Trading halt

Institutional Entitlement offer

Retail Entitlement offer open

Trading Halt (25/10 – 10:19pm)

CSR demerger proposal, equity raising and half year results (26/10 – 1:39am)

Cleansing Notice (26/10 – 1:51am)

Appendix 3B (26/10 – 2:00am)

Completion of institutional entitlement offer (27/10 – 10:11pm)

ASX Circular – Accelerated Renounceable Offer (28/10 – 12:17am)

Record Date (29/10 7:00pm)

Retail Entitlement Offer Document (1/11 – 10:45pm)

Letter to ineligible retail shareholders (1/11 – 10:48pm)

Despatch of entitlement and acceptance forms to retail shareholders

Allotment and issue under Institutional Entitlement Offer (09/11 – 9:35pm)

Retail offer close - 5pm (AEDT)

Entitlement offer and indicative shortfall (25/11 – 5:17am)

Successful completion of entitlement offer (25/11 – 10:30pm)

Allotment and Issue of Ordinary Shares under Retail Entitlements (2/12 – 9:15pm)

Appendix 3B (2/12 – 9:27pm)

Summary of the transaction

- CSR undertook Australia's first Simultaneous Accelerated Renounceable Entitlement Offer (SAREO) in October 2009 in order to pay down debt and fund the company's demerger plans.
- Offer announced 26/10 – $375m offer, eligible shareholders offered the opportunity to acquire CSR shares at €1.66 each on the basis of 7 new ordinary shares for every 40 existing ordinary shares. The entitlements of renouncing retail and institutional shareholders and of ineligible shareholders sold by way of a single bookbuild after the close of the retail offer. Those shareholders received a cash payment for their renounced entitlements for any proceeds over the offer price of €1.66.
- The issue price represented a 13.3$ discount to the dividend adjusted theoretical ex-entitlement price and a 15.3% discount to the dividend adjusted closing price of CSR shares on 23.09.
- Institutional entitlement offer completed on 26/10, with over 99% of entitlements taken up. $192m worth of shares were taken up. The entitlements attributable to renouncing institutional and ineligible shareholders were to be placed in the Shortfall Bookbuild alongside retail shareholders.
- Retail Entitlement Offer opened on 02/11, staying open for three weeks. During this time, the institutional offer was issued and allotted.
- The Retail Entitlement offer received valid applications for 62.3m New Shares, or 57% of the retail entitlements offered.
- The Shortfall bookbuild was conducted on 25 November, selling the remaining 47,524,988 New Shares not taken up in the Institutional and Retail offers. The Shortfall Bookbuild priced at €1.795, a premium of 9 cents over the offer price of €1.66.

Annex H – Drive to digitisation

(i) Certificated shareholdings

Obtaining information at an aggregate level on the number of certificated shareholdings in issue is complex, due to the fact that the only true way to obtain a complete and accurate understanding is to approach each individual issuer directly.

Noting the practical difficulties with the above approach, the below tables compare the number of shares admitted to London Stock Exchange versus the dematerialised holdings in CREST. Conclusions should be considered to be indicative only, noting that the number of shares that the company has sought admission for may not be reflective of the total number of shares in issue due to a combination of factors including treatment of block listings, treasury shares, share buybacks and timing of filings/administrative processes. Similarly, any bespoke arrangements to cater for overseas elements of a company's investor base, or lock up arrangements, may lead to shares not being dematerialised in CREST.

The below figures are based on analysis of the position as at July 2022. Only GB ISINs were included in the analysis.

FTSE 100

% of shares admitted to LSE that are dematerialised in CREST	Number of issuers (FTSE 100)	% of FTSE 100 issuers with GB registers
97 < x ≤ 100	61	69%
95 < x ≤ 97	12	13%
90 < x ≤ 95	7	8%
0 < x ≤ 90	9	10%
Totals	89	100%

Premium listed issuers

% of shares admitted to LSE that are dematerialised in CREST	Number of premium-listed issuers (commercial companies)	% of premium listed issuers with GB registers
97 < x ≤ 100	258	67%
95 < x ≤ 97	38	10%
90 < x ≤ 95	26	7%
0 < x ≤ 90	65	17%
Totals	387	100%

AIM

% of shares admitted to LSE which are dematerialised in CREST	Number of AIM listed issuers	% of AIM issuers with GB registers
97 < x ≤ 100	197	30%
95 < x ≤ 97	59	9%
90 < x ≤ 95	86	13%
0 < x ≤ 90	306	47%
Totals	648	100%

Source: SCRR analysis, London Stock Exchange, Euroclear UK & International (for FTSE 100, Premium-list, AIM)

(ii) Retail platform growth

Please refer to the links provided for each platform's commentary on definitions underlying their key performance indicators and reasons for changes year on year.

Hargreaves Lansdown	Active clients	Link
2021	1,645,000	Hargreaves Lansdown Report and Financial Statements 2021
2020	1,412,000	
2019	1,224,000	
2018	1,019,000	
2017	954,000	

Interactive investor	Total customers	Link
31/12/20	276,676	Annual report & accounts for the year ended 2020
31/12/19	272,548	
31/12/18	306,000	Annual report & accounts for the year ended 2018
31/12/17	342,000	

AJ Bell	Number of retail customers	Link
2021	382,754	Key Performance Indicators | AJ Bell
2020	295,305	
2019	232,066	

Appendix 1 – List of submissions

Submissions to the Call for Evidence were received from a number of individuals as well as the organisations listed below. The Review also received input from a broad range of market participants through numerous roundtables and bilateral discussions.

AFME

Company Law Committees of the City of London Law Society and the Law Society

Confederation of British Industry

Crowdcube

Equiniti

Euroclear UK & International

FCA's Listing Authority Advisory Panel & Market Practitioner Panel

FinnCap Ltd

GC100

Hargreaves Lansdown

Herbert Smith Freehills

Institute of Chartered Accountants in England and Wales

Interactive Investor

Investment Association

Investor Forum

Link Group

London Stock Exchange Group

Marks and Spencer plc

Novum Securities

Numis Securities

Peel Hunt

Personal Investment Management & Financial Advice Association

LSE's Primary Markets Group

PrimaryBid

Quoted Company Alliance

Receiving Agent Group (Chartered Governance Institute Registrar's Group)

Redmile Group

Rothschild

RPC

RWC partners

ShareSoc

The Deal Team

UK BioIndustry Association

UK Equity Markets Association (UKEMA)

UK Finance

UKSA

Appendix 2 –Terms of reference[206]

Context

In March 2021, Lord Hill of Oareford CBE published the UK Listings Review, an independent review commissioned by the Chancellor in November 2020. The Chancellor asked Lord Hill to make recommendations on how to encourage more high-quality UK equity listings and public offers. Lord Hill's independent review makes fourteen recommendations both to Government and to the Financial Conduct Authority aimed at ensuring we make full use of the opportunity presented by having regained responsibility for our own financial services rulebook.

Among his recommendations, Lord Hill calls for more to be done to empower retail investors and improve equity capital raising for existing publicly traded issuers.

He argues that UK capital markets functioned effectively during 2020 and fulfilled a key role of funding the real economy, raising around £30bn of new equity capital for companies. Lord Hill praises regulators and industry bodies for moving swiftly to assemble a package of emergency measures which aided this rapid raising of large amounts of capital.

However, due in part to the relaxation of its guidelines by the Pre-Emption Group during the Covid-19 pandemic, much of this new capital was raised via private placings which exclude and dilute existing shareholders in the company. By contrast, only nine rights issues occurred. Given the choice between a fully pre-emptive secondary offer such as a rights issue or open offer, which offers new shares to all existing shareholders pro rata but with greater cost, time and uncertainty and involves the preparation and publication of a prospectus, and the speed and certainty of using an undocumented secondary capital raising model, companies often opted for the latter.

Citing the example of the 2008 Rights Issue Review Group – commissioned on the previous occasion markets had been asked to respond with significant new capital for publicly traded companies facing a severe economic shock – Lord Hill recommends a new group is formed to make recommendations on improving the capital raising process.

The Chancellor has accepted this recommendation and has asked Mr Mark Austin to convene and lead an independent expert review that will make recommendations on improving the UK capital raising process for publicly traded companies.

Objective

The UK Secondary Capital Raising Review is asked to make recommendations as to how to improve capital raising processes for existing publicly traded issuers.

Its focus should include the improvement of processes like rights issues which aim to preserve, so far as is possible, the interests of existing investors in the company.

[206] UK_Secondary_Capital_Raising_Review__terms_of_reference.pdf (publishing.service.gov.uk)

Companies are more likely to choose such mechanisms if they offer them greater speed, certainty and reduced cost.

The Review should seek input and evidence from market participants, expert practitioners, representative bodies and academics. It should consider international comparators. In evaluating options, it may consider both legislative and non-legislative measures, including measures which may fall to the Financial Conduct Authority (FCA) or industry standard setters to consider.

In developing recommendations, the Review should pay full regard to London's reputation as a world-class market for company listings that promotes high standards of corporate governance, shareholder rights and transparency.

Scope

The UK Secondary Capital Raising Review is asked in particular to focus on:

- Whether the overall duration of the secondary capital raising process can be reduced including, in relation to rights issues, by reducing the period during which shareholders trade their rights.
- Whether new technology can be brought to bear on the process in order to ensure shareholders can receive relevant information rapidly and exercise their rights.
- Other fund-raising mechanisms that may be worth considering in the UK, including the Australian 'RAPIDS' model as well as structures to facilitate enhanced retail investor participation in capital raisings. It should also consider what barriers, if any, there are to wider adoption.
- Whether the greater transparency around short selling brought in after the financial crisis has benefited the rights issue process (noting the contribution short selling makes to price formation) and whether more can be done.
- Whether there are any other ways of improving the capital raising process by UK publicly traded companies which are consistent with the UK's commitment to high standards.
- Whether any outstanding recommendations from the 2008 'Rights Issue Review Group should be pursued.

This is not an exhaustive list and the Review may consider other matters that it considers to be relevant to its objective. In particular, it may wish to consider issues related to information provision to investors. However, the Review should remember that the Government is also carrying out a review of the UK prospectus regime. That review will consider, among other things, prospectus content and measures to eliminate disincentives to wider participation in public traded companies stemming from the public offering rules set out in the regime. It is recognised that there may well be some interconnection between the recommendations of the Secondary Capital Raisings Review and the work of the UK prospectus regime review.

Governance, engagement and timetable

Mr Austin has been asked to provide a report and recommendations to the Government in spring 2022. It will be for him to decide the nature of any process or group he may require to support him.

The Review's work will be carried out in consultation with a cross-section of relevant stakeholders including the Government and the FCA as well as buy-side, sell-side and issuer interests, seeking input from legal and academic experts as necessary.

Appendix 3 – Call for Evidence[207]

In November 2020, the Chancellor asked Lord Hill of Oareford to conduct an independent review of the UK equity markets and to propose a range of recommendations for how to boost the UK as a destination for IPOs and to optimise the capital raising process for companies seeking to list on the main UK markets.

After extensive market consultation, Lord Hill submitted his report to HM Treasury on 3 March 2021. Lord Hill made wide-ranging recommendations addressed at both the Government and the FCA. Those aimed at HM Treasury have been accepted and are being taken forward by the Treasury, while the FCA has already implemented the rule changes recommended in relation to special purpose acquisition companies (SPACs) and has carried out a consultation in relation to others.

One of Lord Hill's recommendations was to consider how to improve the efficiency of further capital raisings by listed companies through re-establishing a group such as the 2008 Rights Issue Review Group. Lord Hill recommended that a new review should reconsider the 2008 group's outstanding recommendations, particularly in terms of capital raising models used in other jurisdictions. This is including in light of technological advances since 2008. The opportunity exists to facilitate a quicker and more efficient process of raising capital for existing listed companies and more easily to involve retail investors.

This Review is HM Treasury's response to Lord Hill's recommendation. Its scope and objectives are set out in the Terms of Reference, published on the Government website at https://www.gov.uk/government/publications/uk-secondary-capital-raising-review, which have been drawn up by HM Treasury in order to establish the Review.

It is my great pleasure to accept the Chancellor's request to lead the Review. As independent chair I am very keen to hear a wide range of views as to how we can improve these vital processes.

This Call for Evidence is the first step in the Review. I ask all interested parties, including market participants, expert practitioners, representative bodies and academics, to provide views on the key themes of the Review.

The questions in respect of which views are sought include:

1. Can and should the overall duration and cost of the existing UK rights issue process be reduced? In what ways?

2. Should new technology be used in the process to ensure that shareholders receive relevant information in a timely fashion and are able to exercise their rights and, if so, how?

3. Are there fund-raising models in other jurisdictions that should be considered for use in the UK? For example, the use of cleansing notices in lieu of prospectuses on

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[207] Call_for_Evidence_UK_Secondary_Capital_Raising_Review.pdf (publishing.service.gov.uk)

secondary capital raisings in Australia and also the Australian ANREO, AREO (or RAPIDS), SAREO and PAITREO structures?

4. Has the greater transparency around short selling that was introduced after the financial crisis benefited the rights issue process and is there more that can and should be done in this area?

5. Are there any refinements that should be made to the undocumented secondary capital raising process in light of recent experiences during the Covid-19 pandemic?

6. Are there any other recommendations or points made by the Rights Issue Review Group in 2008 that should be investigated further?

7. In what other ways should the secondary capital raising process in the UK be reformed?

The questions above are not intended to be an exhaustive list and nor should respondents feel obliged to answer all or even any of the questions. Interested parties are encouraged to provide input and views generally in relation to secondary capital raisings in the UK and how they can and should be reformed to improve the process for both issuers and investors.

Responses will be welcomed and considered in any written format, including by e-mail, and in as fulsome or annotated a form as respondents wish. The Review considers it more important that all interested parties submit thoughts than the form which that input takes.

The Call for Evidence will be open for five weeks. Please could all responses be sent to SecondaryCapital.RaisingReview@hmtreasury.gov.uk by 5pm on 16 November 2021. A list of respondents will be published but the actual responses will not be.

The Call for Evidence is only part of the consultative process and, once it has closed, the Review will hold a series of discussions with interested parties to explore the issues raised further. The Review will then report to HM Treasury in Spring 2022.

The Review very much looks forward to engaging with all interested parties in the coming weeks and months.

Mark Austin

Chair of the UK Secondary Capital Raising Review

12 October 2021


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