ICAEW REPRESENTATION 60/17

Review of the effectiveness of Primary Markets: The UK Primary Markets landscape

Review of the effectiveness of Primary Markets: Enhancements to the listing regime

ICAEW welcomes the opportunity to comment on

- the *Review of the effectiveness of Primary Markets: The UK Primary Markets landscape* published by Financial Conduct Authority in February 2017, a copy of which is available from this link; and
- the *Review of the effectiveness of Primary Markets: Enhancements to the listing regime* published by Financial Conduct Authority in February 2017, a copy of which is available from this link.

This response of 17 May 2017 has been prepared on behalf of ICAEW by the Corporate Finance Faculty. Recognised internationally as a source of expertise on corporate finance issues and for its monthly *Corporate Financier* magazine, the Faculty is responsible for ICAEW policy on corporate finance issues including submissions to consultations. The Faculty's membership is drawn from professional services groups, advisory firms, companies, banks, private equity, law firms, consultants, academics and brokers.

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MAJOR POINTS

1. The FCA's engagement on the UK Primary Markets landscape which started before the 2016 referendum, continues the longstanding debate regarding the ability of companies to access appropriate funding for their stage of growth. The discussion will yield market views which can help inform the FCA's post-Brexit mission and market positioning. But that mission must be framed within the post-Brexit political context, and it would be premature to finalise policy changes before that political context is clear.

2. Our responses to questions in chapters 1 to 4 of the discussion paper, DP17/2, are set out in paragraphs 4 to 27. Our major points are as follows:

   - the underlying rationale for standard listing continues to be relevant and the equality of treatment between UK and non-UK companies continues to be necessary;

   - the case for a distinct international segment in the current listing regime is not compelling at this time and the nature of differentiating factors is unclear;

   - the ability (or otherwise) of primary equity markets to provide capital for scale-up science and technology companies depends on the supply of investment funds rather than on structural issues. What will significantly increase the availability of capital is principally a matter of government policy.

3. ICAEW has also considered the FCA's consultation paper, CP17/4, with its proposed enhancements to the listing regime. Our members are broadly supportive of the proposals and certain drafting suggestions are set out in paragraph 28.

RESPONSES TO SPECIFIC QUESTIONS IN DP17/2

Q1.1: Are there any issues or aspects of the listing regime not covered in this paper that you think we should be discussing? If so, please provide more detail.

4. The FCA's initiative was already underway when the 2016 referendum resulted in Britain deciding to leave the European Union. The referendum outcome adds to the importance of ensuring an effective regime for companies to raise capital in the UK. While we have not identified further issues to address at this stage, we believe it would be sensible to resume the discussion. Once the political context for a competitive UK listing regime is clear, it will be possible to discuss what might be desirable for the regime to offer, as opposed to merely what is possible.

5. The listing regime will be framed by the FCA's post-Brexit mission. Will the FCA be a critical part, for example, of the UK's industrial strategy? Will there be merit in considering certain options that ceased with the implementation of the prospectus element of the European harmonisation programme – for example, in the light of consultation question 3.3, a UK trading facility for a company with a primary listing in certain overseas markets?

6. Growth Markets (as defined in the discussion paper) are recognised to be a valuable element of the UK's capital markets. Reviewing the listing regime should focus on the impact of regulatory changes and prospectus and disclosure regulatory requirements for Growth Markets and post Brexit, there may be opportunities to ensure the continued effectiveness of these. There will be many other considerations.

Q3.1: Do you have any comments on the underlying rationale for standard listing? Are the key assumptions on which the regime was built, including equality of treatment between UK and non-UK companies, still valid?

7. We agree with the rationale for standard listing. At present, there is a role for standard listing as an alternative to the super-equivalent regime, one that currently offers passporting

opportunities, and that competes with the regime available in major European capital markets and so offers choice to companies. The international nature of capital markets means that the key assumption of equality between UK and non-UK companies continues to be vital.

8. However, until the post-Brexit context for the UK's capital markets is clearer, it would not be sensible to preclude future options or to conclude definitively on the ongoing rationale and need for standard listing, and so this exercise should be revisited.

Q3.2: Do you think the name 'standard listing' is unattractive to prospective applicants? What alternative suggestions do you have?

9. It is not clear from the discussion paper whether the name 'standard listing', which replaced the label 'secondary listing' in 2009, proved more attractive to prospective applicants.

10. In any case, we do not consider that the name 'standard listing' is unattractive. On the contrary, it serves to recognise the step between the criteria and protections for this segment and the super-equivalent ones for 'premium listing'. Changing the name 'standard listing' will not (and should not) disguise the segment's less demanding regime when compared to that for 'premium listing'. More prominent positioning of standard listing will however help improve issuers' and overseas regulators' familiarity with the regime's features.

Q3.3: What are your views on development of a distinct international segment? If you think it would be beneficial, what investor protections should apply? What, if any, alternative proposals would you put forward to assist non-UK issuers wishing to raise equity capital in the UK?

11. Our response to this question is in the context of the current listing regime, not what might be the context post Brexit. We are not convinced with the rationale for creating a market segment for large overseas companies that do not meet the premium listing requirements.

12. In the experience of our members, there is a variety of reasons why prospective applicants for a premium listing do not meet the listing requirements including: the lack of a track record, the governance structure of a spinout from a private equity controlled business and the controlling rights of a business. Some of these also happen to be overseas companies. The range of reasons why a prospective applicant may be ineligible for a premium listing means that concessions could, in theory, be considered for noncompliance with each individual requirements.

13. The FCA's engagement suggests that 'overseas companies are reluctant to adopt the [standard] designation' (para 3.17). Some but not all of the cases reported by our members subsequently applied for a standard listing. The international recognisability of standard listing compared to the premium listing brand may be a contributing factor but we do not believe it is a compelling reason for creating an international segment.

14. In our view, further segmentation should only be considered on evidence of market demand and/or as a strategic measure to compete with another major capital market. There should be an assessment of the risk of damage to the premium brand that currently provides a competitive advantage for the UK market. Creating another segment risks creating confusion and we would expect to understand the differentiating factors for an international segment - for investors as well as prospective applicants - as well as the definition of an overseas company, eg based on operations or location of headquarters.

Q3.4: Do you think that the premium listing obligations for open-ended investment companies should be removed, and the securities category repositioned in the standard listing segment? In arriving at your view, what factors have you taken into account?

15. We have no comment on this proposal.

Q3.5: Are there any individual elements of the premium listing regime that should be retained for open-ended investment companies? If so, what are they and why should they be retained?

16. We have no comment on this proposal.

Q4.1: How effective are the UK's primary equity markets in providing capital for science and technology companies in the scale-up phase?

17. The ICAEW / IET policy paper Boosting Finance for Engineering and Technology found that for technology and engineering businesses, scale-up capital tends to be sourced from university collaborations, EU-led programmes, banks, angel investment, venture capitalists, private equity and on capital markets, as well as from the reinvestment of companies' own resources.

18. The Scale up report on UK economic growth reported that some UK scale-up companies find an insufficient pool of follow-on capital in the UK to match their needs and are forced to raise capital in the US or Asia. Judging by the significant government and private sector efforts to increase the diversity of alternative and innovative forms of finance and awareness of these among growth businesses, there may be scope to improve the effectiveness of primary equity markets on this measure. As outlined in ICAEW's response to the Green Paper on Industrial Strategy, calls for fiscal incentives, government funding and support and replacement of EU-derived funding as well as an increase in the interplay of different forms of investment are gaining traction. There could be a role here for public equity markets.

Q4.2: What are the factors that adversely impact the effectiveness of the UK's public equity markets in providing scale-up capital?

19. The principal factor is the lack of an investment willingness to invest at an early stage, and for the long-term. For some institutions this is due to regulatory constraints. The forthcoming Patient Capital Review, which will assess the extent to which equity finance supports the long-term growth of scale-up businesses, may have findings relevant to public equity markets.

Q4.3: What potential enhancements to the primary market regulatory framework could contribute to improving the provision of scale-up capital?

20. The ability of companies to raise scale-up capital on the primary market depends more on investors' willingness to provide funds at an early stage rather than on whether the structure of the primary market is conducive to making such investments. Poor experiences from the last technology bubble, together with taxation policies and regulatory obligations on institutional trustees, all discourage the flow of institutional funds into scale-up businesses. We consider it unlikely that enhancements that 'tinker' with the primary markets framework will result in a significant change in investor appetite to provide scale-up capital.

Q4.4: Should science and technology companies have reached a certain stage of business maturity before accessing public equity markets? If so, how should that stage of maturity be defined?

21. No. Institutions that invest in such businesses at an early stage display a stock-specific risk appetite and they should be left to decide the risk they are willing to bear.

22. It would also be challenging to define a universal stage of maturity for such a diverse group of businesses. The current concessionary route to premium listing for scientific research based companies waives the requirement for a three-year revenue earning track record. Defining a stage of maturity - such as profit generation - could create a disadvantage for the UK market compared to other international markets specialising in technology companies.

Q4.5: What are the characteristics of the capital market structures that drive short-term behaviours?

Q4.6: What are the drivers of these characteristics, and how important is regulation in this context? What changes could be made to help address these drivers?

23. The drivers of short-term behaviour were explored extensively in the Kay review of UK equity markets and long-term decision making – the review concluded that 'short-termism is a problem in UK equity markets, and that the principal causes are the decline of trust and the misalignment of incentives throughout the equity investment chain'. The review outlined 10 principles for equity markets to guide market participants, regulators and the government so as to encourage behavioural and cultural change. In its response to the aforementioned Green Paper on Industrial Strategy, ICAEW called for an assessment of the progress made by all parties concerned.

Q4.7: The current public equity capital market model provides different things. How important are each to the long-term investor? How important are each to early-stage issuers? Are there additional important features of public equity markets not mentioned below?

- **a. Corporate transparency (through listing documentation, periodic financial information, and ad hoc announcements)**
- **b. Due diligence by experts and third parties (such as lawyers, accountants, sponsors and sector specialists)**
- **c. Investor stewardship**
- **d. Regulatory oversight (such as the assessment of issuers against eligibility criteria, and the scrutiny of listing documentation)**
- **e. Corporate governance requirements or other investor protections (such as pre-emption rights)**
- **f. 'Listed' status (e.g. for investment mandate or tax purposes)**
- **g. Coverage by research analysts**
- **h. A platform for further fund-raising from existing or new investors**
- **i. Indexation**
- **j. The ability to trade investments**
- **k. Price discovery and value discovery**

24. Both long-term investors and early-stage issuers will rely to an extent on the range of features of public equity markets.

25. Such investors have a stock specific appetite so will focus on the quality of a management team, the business model and scalability. Features that particularly facilitate this include a., e. and k. Even though they are prepared to invest for the long term, j. and k. will also be important to such investors at differing stages, dependent on what they consider to be 'long term'.

26. Early stage issuers will seek certainty of follow-on, evergreen funding, for example market features like f., g. and h. A feature of private equity that early stage businesses value hugely is the 'in kind' support that is typically available from providers of such capital – that may be operational, commercial, market or other expertise. An issue for potential further consideration is whether the institutions can emulate 'in kind' support specific to science and technology.

Q4.8 What features would a long-term capital market need to have, and need to avoid, to be effective?

27. Please refer to our response in paragraph 23.

COMMENTS ON PROPOSED DRAFTING IN CP17/4

28. In revised Listing Rule 6.3 (Annex D, page 11 of 32) it may be useful to replace the term ‘representative financial information’ with a new term ‘representative revenue-earning track record’. The new term could be defined as ‘revenue earning track record that is representative of its business’.