LISTED COMPANIES: WHAT TO EXPECT IN 2022

After another tumultuous year in 2021, we look at developments expected this year that will affect the rules and expectations around listed companies. In this first briefing we focus on what we expect to see in capital markets, particularly in relation to secondary fundraisings; possible changes to the listing segments and FCA rules for listed companies; and developments relating to financial reporting, including expected reforms to rules around audits. A second briefing will focus on non-financial reporting, including disclosure of climate-related information aligned with the TCFD framework, diversity on boards and other climate change and ESG developments.

Capital markets

Equity capital markets in the UK have been robust, if unspectacular, during the pandemic and we expect this to continue. In particular, 2021 saw a good number of sizeable IPOs. Periods of market volatility are again likely, though, particularly if dangerous new COVID variants appear and businesses again face falling revenues, staff absences and the uncertainty, cost and disruption associated with the pandemic and public health responses. In addition, many companies will feel the headwinds of high energy prices; broader pandemic-related inflationary pressures; labour shortages and disruption to supply chains (particularly as full customs controls come into force in the UK this year); and the risks posed by climate change and steps needed to adapt to it.

In Europe generally and the US, inflation is already rising and is widely expected to rise further. In response, the Bank of England has already raised interest rates. In the US, the Federal Reserve has indicated it intends to do the same several times this year. And the European Central Bank has said it plans to halt one of its asset purchase schemes by March. Rises in bond yields could result in investors shifting capital away from riskier equities.

While we do not expect 2022 to feature as many large secondary fundraisings as 2020, we do expect more listed companies to tap the equity capital markets this year than last. As in 2020, some companies – particularly those that have suffered most through the pandemic - will need to raise funds to increase liquidity and/or reduce debt, while others will be looking to take advantage of opportunities to expand their business, particularly through acquisitions (perhaps of competitors that have fared less well). As always, getting the equity story, amount of money and timing of the issue right will be critical to the success of any secondary fundraising. Given the likelihood of growing inflationary and interest rate pressure through the year, we expect many issuers will try to get ahead of any potential closing of the market by concentrating capital markets activity in the first half of the year. (For more details of the issues companies should consider when planning a large equity raise like a rights issue see our client briefing published in April 2020.) Recommendations for making secondary fundraisings quicker and cheaper are expected to be published later this year, and these could result in significant changes in rules and market practice being introduced by the end of the year: see further below.

On the IPO front, there continues to be a good pipeline of companies looking to go public and, barring any significant downturn in the pandemic or economic situation, we would anticipate IPO activity to remain at a similar level to last year. Changes made to the Listing Rules in December should help attract more companies to list in London: these changes reduced from 25% to 10% the percentage of shares that a listed company must have in public hands (free float) from admission onwards; and permit companies to list on the premium segment with a certain type of dual class share structure (DCSS) in which the unlisted high vote shares held by the founder director(s) can carry up to 20 votes on a resolution (i) to remove the founder as a director or (ii) on any matter following a change of control. (For more details of these changes see our client briefing published in December.) On 22 December 2021 FTSE Russell announced changes to the Ground Rules for its UK Index Series that broadly bring them into line with the new Listing Rules. This means that a UK-incorporated issuer will be eligible for inclusion in the UK Index Series if it has a free float of only 10% (although FTSE

Russell calculates this in a slightly different way to the FCA); and where a company with a DCSS is admitted to the premium segment and is therefore potentially eligible for inclusion in the UK Index Series, for the purposes of the index requirement that more than 5% of all the company's voting rights are in the hands of unrestricted shareholders (i.e. shareholders who count towards the free float), the unlisted high vote shares will be treated as having only one vote per share unless and until a change of control occurs. The changes to the Ground Rules will take effect from the next quarterly review date in March 2022.

On the debt side, the eurobond market has proved exceptionally resilient over the last couple of years, appearing to be largely immune to the pandemic, the transition from LIBOR to near risk-free rates, the end of the Brexit implementation period and other geopolitical shocks. The robustness of debt capital markets is expected to continue this year, with ESG-linked financing likely to continue to be very attractive in the aftermath of COP 26. Issuers will, however, be mindful of any increased cost of capital arising from the effects of inflation and central banks raising interest rates, as well as changes to the regulatory landscape. In particular, 2022 will see the EU Green Bond Standard take further shape, and the FCA is due to publish feedback on ESG integration in UK capital markets (topics we have covered in previous client briefings).

Financial reporting

Corporate governance and audit reforms

The perennial topics of corporate governance and auditing will inevitably attract lots of attention this year, particularly when the Government publishes further details of the reforms it intends to introduce. Numerous reforms were proposed by the Kingman review of the FRC, the CMA's review of the statutory audit market and the Brydon review of audit, and in March 2021 BEIS published a White Paper, Restoring trust in audit and corporate governance, indicating those the Government is minded to introduce. Proposals include:

- requiring the annual report to include a directors' statement about the effectiveness of internal controls (although this is likely to be less onerous than the assurance process required under the US Sarbanes-Oxley Act);
- tightening up the rules around dividends;
- replacing the going concern and viability statements with a new "resilience statement" on short term, medium term, and long-term resilience;
- requiring UK-registered FTSE 350 companies to have managed shared audits (with one firm being outside the Big Four), subject to limited exceptions;
- allowing the FRC to publish its corporate reporting reviews of specific companies without their consent (subject to certain safeguards);
- imposing certain requirements on audit firms designed to bolster the operational separation of audit practices from other parts of the firm;
- significantly expanding the role and powers of the FRC (to be re-named the Audit, Reporting and Governance Authority or ARGA).

Unsurprisingly, many of the proposals have been controversial. In November, the Financial Times reported that the Government planned to scale back the extent of the proposed reforms in response to concerns from business about the associated costs and the potential impact on the attractiveness of the UK as a place to set up and run a business. Some audit firms have also argued that the proposed reforms will reduce the burden on companies and directors while unfairly increasing the burden on audit firms.

Originally the Government was expected to publish by the end of last year further details of its chosen reforms, but the timetable has slipped and details are now expected to be published early this year. As further consultation is likely to be needed on many aspects, some of which will require primary legislation as well as structural changes to the FRC and perhaps within audit firms, it is likely to be at least another year before the changes actually take effect. Certainly for the 2022 reporting season no changes should be needed to auditor's reports because of the reform proposals.

ESEF reporting

For financial years starting on or after 1 January 2021, listed companies subject to DTR 4 must prepare their annual financial reports in a structured XHTML web browser format (known as the European single electronic reporting format or ESEF). Those that report under IFRS must also mark up certain disclosures with tags selected from a permitted taxonomy. Reports must be filed with the FCA by uploading them to the NSM. Such "structured" reports are designed to be machine-readable and hence to improve the accessibility, analysis and comparability of their contents.

A few companies have already produced structured reports voluntarily, but for most the ESEF requirements will be new and challenging. Most companies, particularly those with a calendar year end, should already be well prepared to comply with the ESEF requirements, but others may find it helpful to refer to the guidance and resources on the FCA webpage and the Financial Reporting Lab's resource sheet (September 2021) and report (October 2021).

Companies can, if they wish, continue to publish a pdf version of their annual financial report in addition to the ESEF version.

RIS announcements of financial results

Under a new rule introduced on 10 January this year (DTR 6.3.5(1A)), instead of having to ensure that an RIS announcement of annual financial results includes in unedited full text at least the key information that must be included in a half-yearly financial report, a company can simply state in the announcement that the full annual results (in unedited full text) have been uploaded to the NSM. As now, the announcement will also have to include details of the website – which is almost always the company's own website - on which the annual financial results are available. Similarly, with half-yearly results, the RIS announcement can simply state that the half-yearly results (in unedited full text) have been uploaded to the NSM and give details of the website where they are available. For companies that produce reports on payments to governments, a similar approach can be taken.

Deadline for publishing annual and half-yearly results

In March 2020 the FRC, FCA and PRA announced various temporary measures to help companies deal with the challenges posed by the pandemic. These included allowing listed companies that are subject to DTR 4.1 six months, instead of four, to publish their audited annual financial reports. Subsequently, a similar dispensation was granted in respect of half-yearly reports, which currently must be published within four months of the half-year end (rather than three months).

The FCA said these temporary reliefs would remain in place until the pandemic-related disruption had abated, and that plenty of notice would be given of their withdrawal. Although to date the FCA has not given any indication that it intends to withdraw the reliefs, as companies and their auditors have now had over a year to adjust to the "new normal" it is unlikely to be too long before the FCA decides to withdraw the reliefs. Companies that have taken advantage of the extended deadlines should therefore prepare to resume publishing their annual and half-yearly results in accordance with the pre-COVID deadlines of four and three months respectively.

Secondary fundraisings

Improvements to the secondary fundraising process

Companies tend to be deterred from doing rights issues and other pre-emptive offers by the high costs, length of the process (typically two to three months), uncertainty and the requirement to produce a prospectus. Instead, companies typically prefer to raise new equity funding via a placing to selected institutional investors, which can be planned and executed much more quickly (perhaps in as little as a week or so) and without needing a prospectus. However, using this structure limits the amount of money that can be raised and, because it is non-pre-emptive and existing shareholders who do not participate in the offer receive no compensation for being diluted, placings can attract criticism from shareholders who are not invited to participate.

Lord Hill’s UK Listings Review, published last March, therefore recommended that the Government, FCA and market participants should look at how to improve the efficiency of further capital raisings. In response, the Government published a Call for Evidence in October seeking views on various topics, including:

- How the duration and cost of the rights issue process could be reduced.
- Whether the UK could adopt features of the capital-raising models used in Australia or elsewhere.
- How technology could be used to speed up the information flow to shareholders and help them exercise their rights.
- Whether placings could be facilitated or otherwise improved – for example, by reinstating on a permanent basis the 20% threshold in the Pre-Emption Group guidelines that applied for most of 2020, perhaps subject to the same kind of conditions that applied during that period.

The Review group is expected to publish its recommendations in April. Following this, HM Treasury and the FCA are likely to consult on changes to the rules needed to implement the Review’s recommendations. HM Treasury has already proposed to make various significant changes to the prospectus regime – for example, so that an offer made solely to existing shareholders would not be treated as an “offer to the public” – and the FCA is likely to consult on, among other things, when a prospectus should be required in connection with the admission of shares to a regulated market, and what information should have to be included. (For more details of the HM Treasury proposals see our client briefing published in July.) As there is wide consensus that changes are needed, and the Government and FCA seem broadly sympathetic, the necessary rule changes could be introduced by the end of this year.

Similar issues are being discussed in the EU. In November the European Commission published a consultation paper seeking views on, among other things, whether prospectuses could be made shorter, particularly for secondary fundraisings; whether the current EU rules on minimum market capitalisation, three year track record and free float percentage should be dropped or amended; and whether companies should be permitted to list on an EU regulated market with a DCSS structure. However, it is likely to be at least 2023 before changes are made at an EU level.

Retail participation

As last year, we expect to see a continuation of the trend for companies to include a retail offer – using Primary Bid or a similar platform - alongside any institutional placings, particularly where the company has a significant retail shareholder base. As shown on the IPOs of Deliveroo and other companies, Primary Bid or other solutions can also be used to reach retail investors on documented equity offerings.

However, as such offers are not fully pre-emptive, and are effectively available only to those shareholders who subscribe to the relevant platform and can commit to invest in a short timescale (usually around 24 hours), we expect the Review group to recommend other ways for companies to enable more of their shareholder base to participate in undocumented secondary issues.

Listing segments and continuing obligations

Lord Hill’s UK Listing Review also recommended that the standard listing segment should be re-branded and re-purposed. Responding to this, in its consultation paper published last July (CP 21/21) the FCA floated various options for reforming the listing segments and their rules. Options include replacing the premium and standard segments with a single segment whose rules would broadly reflect either the current standard segment rules or the current premium segment rules, perhaps subject to certain adjustments; or keeping two segments but making changes designed to ensure that the standard segment is specifically suited to certain types of company and not simply seen as inferior.

We expect the FCA to consult later this year on the details of its proposed changes to the listing segments and the rules that companies on each segment must comply with. Proposals could include relaxing some of the “super equivalent” rules that premium segment companies must comply with, such as the requirement to seek shareholder approval for Class 1 transactions.

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