SLAUGHTER AND MAY/

JULY 2022

IMPROVING SECONDARY SHARE ISSUES:

REVIEW GROUP PUBLISHES RECOMMENDATIONS

On 19 July 2022 the UK Secondary Capital Raising Review published its **final report**, which makes 21 recommendations designed to make it quicker and easier for listed companies to do a secondary (follow-on) equity fundraising. The recommendations are intended to represent broad consensus among exchanges, regulators, companies, investment banks, buy and sell-side investors, retail shareholder bodies and other market participants. They have been welcomed publicly by the **FCA** and the **Pre-Emption Group** and are understood also to have the support of HM Treasury. In order to balance the sometimes conflicting interests of market participants, the recommendations are presented as a package.

Implementing the recommendations will require co-ordinated steps to be taken by, among others, HM Treasury, BEIS, the FCA and the Pre-Emption Group. Some recommendations could be implemented within months; others will take much longer, particularly where primary legislation is required.

In this briefing we look at the recommendations most relevant to companies listed on the London Stock Exchange and what they would mean in practice.

Key recommendations

- The principle of pre-emption is an important shareholder protection in the UK capital markets and it should be preserved and enhanced.
- Investors should permit companies to issue for cash each year up to 20% of their share capital on a non-pre-emptive basis. This would effectively reintroduce on a permanent basis the approach taken by the Pre-Emption Group during the Covid pandemic.
- A company doing a placing should consider carefully how to involve as many of its shareholders are possible – for example, by including a retail offer via PrimaryBid or a similar platform, or by making a “follow-on offer” to shareholders who are not invited to subscribe in the placing.
- On a rights issue or open offer by a Main Market company, the FCA should require a prospectus in connection with the admission to trading of the new shares only where the company is issuing 75% or more of its share capital. A sponsor should not be required.
- Generally, a company doing a pre-emptive fundraising should not have to publish at the time of an offer information that essentially duplicates disclosures the company has already made. However, to make it easier to comply with US disclosure requirements, a company should be able to “opt in” to a new, enhanced continuous disclosure regime under which it would publish in its annual report or elsewhere certain additional information likely to be needed on a fundraising with a US element.
- The minimum period for which a rights issue or open offer must be open should be shortened from 10 business days to seven business days; and the Government should consider reducing the notice period for a shareholder meeting other than an AGM to seven business days.
- Working capital statements in prospectuses should be allowed to be more graduated and/or refer to a wider range of assumptions.

KEY RECOMMENDATION	IMPLICATIONS
PRE-EMPTION RIGHTS	
The principle of pre-emption is an important shareholder protection in the UK capital markets and it should be preserved and enhanced.	Despite calls from various quarters to dispense with statutory pre-emption rights - which have historically been a fundamental pillar of equity capital issues in the UK and are seen by many UK investors as an important protection, but which are not a feature of US and some other major capital market rules - the report comes down firmly in favour of preserving pre-emption rights broadly in their current form. In fact, some of the other recommendations seek to encourage companies to involve more of their existing shareholders in fundraisings.
PLACINGS AND OTHER NON-PRE-EMPTIVE ISSUES	
Percentage of shares that can be issued non-pre-emptively The Pre-Emption Group (PEG) should reintroduce on a permanent basis guidance saying that investors should support resolutions that allow a company to issue for cash on a non-pre-emptive basis shares comprising up to 10% of its share capital for any purpose and up to a further 10% for the purpose of an acquisition or a specified capital investment (rather than the current 5% plus 5%).	This will effectively reintroduce on a permanent basis the 20% threshold that applied during the Covid pandemic in 2020 and allowed many companies to raise substantial amounts of equity funding to tide them over. During the period that the temporary 20% threshold applied (from 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. The remaining 55 were non-pre-emptive placings, representing 73% by number and 54% by value of total secondary offers. This change would: • enable a company to raise an amount of cash nearly equivalent to 20% of its market cap in a matter of a couple of weeks, and without needing to produce a prospectus, hold an EGM or keep the offer open for a couple of weeks; • make it easier for listed companies to compete to buy assets, because they will be able to raise a larger amount of money quickly (rather than needing to do a rights issue or open offer or to arrange debt financing in advance). This will particularly help UK issuers compete for US targets; and • be particularly beneficial to those companies that expect to need to raise additional funding regularly - such as tech, life sciences and other high growth and acquisitive companies. Given recent experience with Covid and other market shocks, once the PEG guidelines are amended, we expect many companies to seek authority at their AGM to issue 10% plus an additional 10% “just in case”, even if they do not have any current plans to use the additional 10%.

KEY RECOMMENDATION	IMPLICATIONS
	A rights issue is still likely to be needed for larger acquisitions (broadly, where the cash element of the consideration represents 20% or more of the listed company's market cap) and for recapitalisations / rescues. But whether a prospectus is required, and the information it must include, will depend on how the FCA decides to amend the prospectus rules – see below.
Conditions Where shares are issued non-pre-emptively, a company should observe the same conditions that applied during 2020: • The company should explain the background to and reasons for the fundraising and the proposed use of proceeds. • As far as possible, the company should consult with a representative sample of its key shareholders. • As far as possible, the issue should be made on a "soft" pre-emptive basis – i.e. existing shareholders should as far as practicable be offered the chance to participate in the placing in proportion to their current holdings. • Company management should be involved in the allocation of shares.	Companies will need to document the thinking behind their decision as to which shareholders can participate in the placing, and about whether, and by what means, other shareholders should be given a chance to subscribe.
Involving other shareholders, including retail investors For all placings, the company should give "due consideration" to involving retail investors and other existing investors. In deciding how best to do this, the company should take into account both the company's and the market circumstances at the time of the placing as well as the constitution of the shareholder register. It may be appropriate to use PrimaryBid or another similar platform that provides its investor customers with an opportunity to subscribe on the same terms as placees. Alternatively, the company could include a "follow-on offer": this would take place after the institutional offer had closed, be made on the same terms and conditions and be open for five business days. If a follow-on offer is used, the company should ensure it is limited to no more than 20% of the size of the placing, with a monetary cap of £30,000 per investor. This	Nearly 30% of placings executed by Main Market companies since the beginning of 2020 included a retail offer, and this trend is likely to accelerate. During the Covid pandemic, the market has generally looked favourably on engaging with retail investors, and retail take-up in fundraisings has been strong. For retail investors who are already shareholders in the company, an offer to them will not constitute an offer to the public (see below): this will make it easier for a company to invite them to participate without having to publish a prospectus. Follow-on offers are not currently a feature of the UK market but they are used in some other jurisdictions. They provide a neat way of ensuring that retail shareholders also have an opportunity to buy further shares at the same discount to the market price, while ensuring that the company receives the bulk of the funds needed very quickly.

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amount would fall outside and be in addition to the up to 20% disapplication authority. A short document should be published containing key information about the offer and how the company will use the proceeds.	
Disclosure A company should report publicly after a placing, using a PEG-sponsored template form, on how it was carried out, including how the conditions were satisfied.	While the 20% threshold applied temporarily during the Covid pandemic, companies that issued up to 20% of their share capital were expected to disclose, alongside details of the issue, how they consulted major shareholders beforehand and what efforts they made to respect pre-emption rights in the time available. This recommendation adopts a similar approach but would introduce slightly more formality and consistency into company disclosures.
Newly-listed companies A company doing an IPO should be able to pass a resolution before admission authorising the board to issue a certain percentage of share capital non-pre-emptively each year for a specified period after IPO, provided details are fully disclosed in the prospectus.	Because a pre-IPO company is not subject to the PEG guidelines, in principle its pre-IPO shareholders could authorise the board to issue any percentage of shares non-pre-emptively for any number of years after IPO – e.g. where the company is likely to need significant amounts of additional funding. However, usually this will be feasible only with the support of investors who buy shares in the IPO; and the company will be able to issue new shares only once the typical contractual lock-up has expired (usually 180 days after admission). In addition, post-IPO shareholders who dislike such an arrangement might express their disapproval by voting against other resolutions at the AGM.
Cash box structures On an undocumented offer, a company should not use a "cash box" structure to issue a greater proportion of its share capital than shareholders approved at the last AGM.	Cash box structures are a convenient way to avoid the statutory restriction on issuing shares non-pre-emptively. However, in the longer term we expect they may become prohibited, particularly if companies find it sufficient to issue up to 20% of their share capital non-pre-emptively. Preferably, though, the other advantages of cash box structures should be retained somehow - e.g. by allowing a company to treat premium paid on the issue of the shares as distributable profits, subject to appropriate safeguards.

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<tr><th>KEY RECOMMENDATION</th><th>IMPLICATIONS</th></tr>
<tr><td colspan="2">RIGHTS ISSUES, OPEN OFFERS AND OTHER LARGER FUNDRAISINGS</td></tr>
<tr><td>Rights issues - documentary requirements

In general, the FCA’s role on larger fundraisings should be eliminated or materially reduced; and companies should not have to publish at the time of an offer information that essentially duplicates disclosures they have already made.

A prospectus should be required on a pre-emptive issue only where the company is issuing 75% or more of its existing share capital.

Where a prospectus is not required, a company should be able to (or perhaps should be required to) publish a “cleansing notice” confirming that it has disclosed all the information it is required to and that it is not delaying the disclosure of any inside information. An offer without a US element could be made based on a cleansing notice, investor presentation and any additional short-form offer document or announcement.</td><td>Broadly speaking, a prospectus is currently required where either the issue constitutes an “offer to the public” or new shares will be admitted to trading on a regulated market that represent 20% or more of the existing share capital. HM Treasury is proposing to amend the prospectus regime so that an offer to existing shareholders will not constitute an offer to the public. It also intends to allow the FCA to set the percentage at which a prospectus is required in connection with admission to trading. (For further details see our briefing on the proposals by HM Treasury.)

If the FCA were to raise the threshold to 75% as recommended, a prospectus would typically be needed only on a rescue rights issue (e.g. a 3 for 4 issue or one that is more dilutive) or a rights issue to fund the acquisition of a target at least as large as the company itself. Other rights issues and open offers that are less dilutive would not need a prospectus, which would reduce significantly the amount of work needed.

However:

- It remains to be seen whether the FCA will require a company proposing to issue between 20% and 75% of its share capital to publish a shorter form of disclosure document (a prospectus-lite); what that document would have to include; whether FCA approval would be needed; and what role, if any, a sponsor should play in that process.

- In some circumstances US securities laws, and US investor expectations, will drive companies to disclose more information than is required under the amended UK prospectus rules. In a rights issue, the underwriting banks will be concerned about the risk of being left with rump shares that they will need to sell in order to avoid having to purchase them as principal. If a rights issue were to include an excess application facility, this would reduce the risk of underwriters being left with a rump; and similarly, if the offer period for a rights issue were to be shortened (see below), this might reduce the risk of the share price falling below the offer price during the offer period, which would in turn reduce the risk of underwriters being left with a rump.</td></tr>
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KEY RECOMMENDATION	IMPLICATIONS
	Nevertheless, in many cases underwriters are likely to be concerned about being left with a rump. Often they will want to be able to sell any rump shares to US investors in case there is insufficient demand elsewhere (or, if not, they may charge a higher underwriting commission). In addition, if the company's existing shareholders include a significant number of US investors, the company may want to include them in the offer. In either case, in order to protect both the company and the banks from liability under "anti-fraud" provisions of US securities laws, the company will usually be advised to publish (broadly) all the information that would be needed in connection with a US offering. This is likely to mean the company will need to publish a wider range of information than it has previously published, including risk factors and an OFR, and/or to update or expand on previous disclosures. US lawyers are unlikely to give a clean 10b-5 opinion (that all information needed by investors has been disclosed) unless all such information is published or incorporated by reference. As a result, even if under amended UK rules a prospectus is no longer required for issues of less than 75% of the issuer's share capital, if a rights issue below this threshold includes a US element the company will probably need to publish much the same information as it does now.
Opt-in enhanced disclosure regime To make it easier to comply with US disclosure requirements, a company should be able to "opt in" to a new, enhanced continuous disclosure regime under which it would publish in the annual report, on its website or elsewhere certain additional information - such as risk factors, a business overview and an operating and financial review (OFR) - likely to be needed on a fundraising. Alternatively, the company could include the additional information in an announcement made at the time of the offer.	An opted-in company proposing to do a fundraising that does not require a prospectus (which, under the recommendations, would be required only on the largest fundraisings - see above) would in principle simply need to publish a brief update plus details of the terms of the offer and how the proceeds will be used. Even where a prospectus is required, it should be easier for an opted-in company simply to incorporate its existing disclosures by reference. A company might therefore choose to opt in if, for example, it already makes similar, rigorously checked disclosures in order to comply with SEC or other overseas disclosure obligations; it expects to need to raise equity funding regularly; and/or it expects to do a rights issue that may involve shares being sold to US investors. It would be disproportionately burdensome to require all companies to comply with an SEC-style enhanced disclosure regime, so an opt-in mechanism seems sensible.

KEY RECOMMENDATION	IMPLICATIONS
Rights issues and open offers - annual authority to allot shares The Investment Association should continue to allow companies to seek annual authority from their shareholders to allot up to two-thirds of their issued share capital, but this should apply to open offers and other forms of fully pre-emptive offer as well as to rights issues.	In an open offer, shareholders have an opportunity to take up further shares in proportion to their holdings, but the timetable is shorter than for a rights issue (so the issuer receives the proceeds more quickly but shareholders have less time to respond) and shareholders who don't take up their entitlements do not receive any compensation. Recommending that it should be easier for companies to do larger fundraisings by means of an open offer, rather than a rights issue, can therefore be seen as an attempt to strike a balance between the interests of existing shareholders and those of issuers.
Rights issues and open offers - minimum offer period The period for which a rights issue or open offer must be open should be shortened from 10 business days to seven business days.	Following the report of Rights Issue Review Group in 2008, the minimum offer period under the Listing Rule was reduced from three weeks to 10 business days. Since then, shareholders have become far more used to electronic communication with companies and, arguably, to being asked to make financial decisions more quickly. However, although seven business days is unlikely to be problematic for institutional investors who hold shares directly or through a short chain of intermediaries, it will be challenging for retail investors and those who hold via longer chains of intermediaries to ensure they return the application form and organise payment of funds to the company within such a short period. Both the company and its underwriting banks will want to ensure that take-up is as high as possible. Key shareholders are likely to have committed in advance to take up their entitlements, but the company will need to weigh up the risks of leaving the offer open for longer against the benefits of maximising take-up among other shareholders. If an excess application facility is included (see below), and the company expects the issue to be over-subscribed, it may be happy for the offer period to be as short as possible. This recommendation will require a change to the Listing Rules. In principle this could be done within months, but the FCA may come under pressure from retail investor bodies not to shorten the offer period until further steps have been taken towards digitisation (see below).
Rights issues and open offers - notice period for general meetings The Secretary of State should be empowered to make Regulations shortening the notice period for a shareholder meeting other than an AGM to seven clear days.	An EGM can be required on a fundraising for various reasons. In particular, if the authority to allot shares that was granted to the board at the previous AGM is insufficient to cover the offer; if the company needs to disapply pre-emption rights to the offer because it cannot use the Gazette route; or if the fundraising is to finance an acquisition that is a Class 1 or related party transaction. In a rights issue, the offer period cannot commence until the new shares have been validly issued. This means that where shareholder approval is needed, the offer period cannot start until

KEY RECOMMENDATION	IMPLICATIONS
	after the EGM has taken place - i.e. the notice period and offer period run consecutively - which usually means the whole process takes around 30 calendar days. During this period, the company is at risk of its share price falling below the issue price; short selling; and other events occurring that could jeopardise the success of the issue (execution risk). Underwriting banks face similar risks. Underwriting costs partly reflect the length of time banks are on risk, so a longer period prima facie results in higher costs. In an open offer, the offer period and the notice period for any EGM can run concurrently, so the execution risk is slightly lower. This recommendation is therefore principally designed to reduce execution risk, although it may also lower underwriting costs slightly, particularly where standby underwriting is put in place. Implementing it would require a change to CA 2006. This is unlikely to occur any time soon. It could perhaps be incorporated into other amendments relating to corporate governance and audit reform, but even these look unlikely to be introduced until next year at the earliest. As a policy matter, the Government may be unwilling to reduce the notice period until more holdings have been digitised and it is easier for retail investors who hold through intermediaries to receive key documents and communicate their wishes to the company by the specified deadline (see below). But an EGM would be needed less often if other recommendations were implemented - for example, if the Investment Association were to permit two-thirds of a company's share capital to be issued in an open offer as well as a rights issue (see above); and if the deficiencies with the Gazette route were to be fixed (see below).

KEY RECOMMENDATION	IMPLICATIONS
Gazette route - fixing the deficiencies The statutory rules and process for offering new shares to existing shareholders in proportion to their existing holdings (known as making a Gazette route offer) should be amended to: - permit a company to exclude shareholders in overseas jurisdictions where the cost and burden of extending the offer to them would be disproportionate - deal with fractional entitlements by aggregating and selling them in the market - permit the new shares to be offered to securities holders with a contractual right to them - such as convertible bondholders, warrant holders and preference shareholders.	If these deficiencies were fixed, most companies doing a pre-emptive offer would be content simply to comply with the statutory rules (follow the Gazette route). It would therefore no longer be necessary for companies to seek annual shareholder approval to issue shares for cash on a pre-emptive basis but without complying with the statutory rules (a "technical" disapplication of statutory pre-emption rights). And where an ordinary resolution of shareholders is needed to authorise directors to allot shares in connection with a specific pre-emptive issue (where the existing authority to allot is not large enough), it would not also be necessary to obtain a special resolution of shareholders to disapply statutory pre-emption rights to that issue. This could be advantageous where the company is confident of obtaining a simple majority of votes cast but not of obtaining a 75% majority.
Rights issues - excess applications The Listing Rules should be amended to allow companies to include an excess application facility in a rights issue where existing shareholders can apply to take up shares not taken up by other shareholders at the offer price.	A similar mechanism is often included in capital raises by Spanish companies, and a version of it was used on IAG's € 2.75 billion capital raise in 2020. Effectively the mechanism enables existing shareholders with sufficient resources who believe in the company's prospects to increase the proportion of the company's shares they hold. Such shareholders could even commit in advance to stand their corner and apply for excess shares. The ability for existing shareholders to subscribe for additional shares (beyond their pro rata percentage) should reduce the risk of some shares not being taken up, and hence the size of the "rump" that banks will need to sell. In turn this would reduce the risk of underwriting banks being left with a "stick" which, in a perfect market, would result in lower underwriting costs.

KEY RECOMMENDATION	IMPLICATIONS
Rights issues - working capital statement in prospectus Where a working capital statement is required, the FCA should reconsider the current requirement for the statement to be either clean or negative - for example, by allowing it to be qualified by particular factors or to be based on specific, disclosed assumptions.	While markets were affected by the Covid pandemic, the FCA temporarily allowed companies to disclose Covid-related modelling assumptions underpinning the reasonable worst-case scenario in an otherwise clean working capital statement. However, from 28 June this year the FCA reverted to its pre-Covid approach. In practice an enormous amount of work usually has to be done to support the working capital statement. Although the proposed change is unlikely to reduce significantly the amount of work needed, companies will welcome the additional flexibility and we expect investors to be supportive provided the basis for the statement is made clear and the company's plans are otherwise coherent.
Rights issues - sponsor A company should not have to appoint a sponsor on a secondary fundraising.	This recommendation reflects concerns among issuers and their advisers about the amount of work currently required to provide the sponsor with comfort in relation to, for example, working capital. The issuer's working capital position tends to be heavily diligenced anyway - particularly to support warranties given by the company to the banks and the going concern statement in any financial statements published at the time the issue is launched - so arguably the process whereby sponsors seek comfort from the company and its accountants about its working capital position confers little extra benefit. Nevertheless, where a secondary fundraising is to finance a Class 1 acquisition, sponsor's declarations will continue to be required. In its May 2022 Discussion Paper on proposed reforms to the listing segments, the FCA said many investors continue to value the sponsor's role and therefore proposes to retain the existing requirements for companies to appoint a sponsor in certain circumstances. The FCA may therefore decide to require a sponsor where a prospectus is published (although this would be only on the largest fundraisings), although it is consulting on whether to simplify some of the record-keeping and other requirements that apply to sponsors.

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<tr><td>Liability of banks for a misleading prospectus

To facilitate the move to shorter, non-duplicative offer documents instead of long, duplicative prospectuses, the liability regime that applies to announcements and circulars should apply to any document published in connection with a secondary fundraising that is not a prospectus.

HM Treasury should consider amending the Financial Services and Markets Act to make clear that investment banks and financial advisers, acting in any capacity, are not liable for errors or omissions in a prospectus or any other type of offer document published by a company or in any information incorporated into such a document by reference.</td><td>Making clear that banks are not liable for a prospectus or other offer document would provide banks with comfort that, in ordinary circumstances, they will not be liable to pay damages to investors under English law if the prospectus is misleading. However, banks are likely to remain concerned about the risk of being liable to pay damages to investors under US securities law. We therefore do not expect this change by itself to make much difference in practice.</td></tr>
<tr><td colspan="2">OTHER ISSUES</td></tr>
<tr><td>Pre-Emption Group

PEG should be put on a more formal and transparent footing and given appropriate resources. It should have a more formal and transparent governance structure, including revised terms of reference, a transparent, formal and objective appointment process for members, and a website with a searchable database of pre-emption-related information.</td><td>This would be a welcome development. Despite the fact that the PEG guidelines have become quasi-regulation, and have a very significant influence over companies fundraising activities, currently the membership and operating model of PEG are rather ad hoc and opaque. This can make it difficult for market participants to make a particular case for change, and to predict how and when PEG will respond to market and regulatory developments.</td></tr>
<tr><td>Standard form terms and conditions

Standard form terms and conditions for institutional investors to use on a secondary fundraising (along the lines of the Master ECM Terms in Australia) should be agreed by the market and published.</td><td>In principle, this would also be a welcome development that should remove the need to agree any bespoke terms with investors at the time of an offer. This should reduce costs and increase speed.</td></tr>
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KEY RECOMMENDATION	IMPLICATIONS
Digitisation HM Treasury and BEIS should make it a higher priority to "digitise" shareholdings – i.e. move to a system where all shareholders, both institutional and retail, hold their shares in fully digitised form. As a start, the practice of investors holding certificates should be eradicated in a way that preserves their rights to vote, receive information and participate in corporate actions. The initiative should be led by a Digitisation Task Force with an independent chair and a clear set of principles to be followed.	The intermediated shareholding system currently used in the UK offers advantages in the form of efficiencies and economies of scale and can make trading quicker, cheaper and more convenient. But it also makes it more difficult for investors, particularly retail investors, to receive all company documents and exercise their voting rights where they wish to do so. Reforms are needed to the intermediated shareholding system to make it easier for companies to identify and engage with the ultimate beneficial owner of shares and/or the person who takes investment decisions relating to them and, conversely, for them to engage with the company. Many companies would also like to move towards a paperless system for evidencing title to shares and for transferring shares. Introducing sensible reforms will require engagement from Government, regulators, companies, registrars, clearing systems and banks as well as other market participants. Given the complexity involved, changes are likely to be introduced piecemeal, rather than in one big bang. But, as the report puts it, "*digitisation is a key part of the UK positioning itself as a pro-innovation jurisdiction… Now is the perfect time to turbo charge this ambitious drive to digitisation*".

CONTACTS

REBECCA COUSIN
T: +44(0) 20 7909 3049
E: rebecca.cousin@slaughterandmay.com

RICHARD SMITH
T: +44(0) 20 7909 3386
E: richard.smith@slaughterandmay.com

JOHN PAPANICHOLA
T: +44(0) 20 7909 3031
E: john.papanichola@slaughterandmay.com

PETER BATEMAN
T: +44(0) 20 7909 4577
E: peter.bateman@slaughterandmay.com

YVONNE LEE
T: +44(0) 20 7909 3839
E: yvonne.lee@slaughterandmay.com