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LISTED COMPANIES: WHAT TO EXPECT IN 2023 - PART 1

After a year shaped by geopolitical tensions, UK political turmoil, the fall-out from Covid-19 and economic volatility, we look at developments anticipated this year that will affect the rules and expectations around companies listed in the UK. In this first briefing we focus on what we expect to see in equity capital markets, particularly in relation to encouraging companies to list in London and making it easier for listed companies to carry out secondary fundraisings. A second briefing will look at areas we expect the FCA to focus on and changes to audit and corporate reporting.

Capital markets and funding

Russia's invasion of Ukraine dominated last year and, in terms of immediate impact on capital markets, investors were keen to allocate capital to "safer" assets and less willing to write equity cheques. At the start of 2023, with no clear path to a resolution of the conflict between Russia and Ukraine, the market volatility and uncertainty in terms of investor appetite are likely to continue for some time. Looking further ahead, both governments and investors are likely to be concerned about how the rebuilding of Ukraine after the war can be funded, particularly when many European economies are already fragile and facing recession.

Unsurprisingly, 2022 saw only a handful of commercial companies doing an IPO in London, and relatively few secondary fundraisings (although there were a number of smaller placings). Across the Atlantic, the picture in the US was broadly similar. SPACs also fell out of favour and, although a large number of SPACs are still looking for targets, generally it proved difficult for them to raise sufficient PIPE funding to complete an acquisition, so the option of going public or achieving an exit via a deSPAC transaction was far less viable than in recent years.

In 2023, many companies will need to hunker down as they continue to face the headwinds of high energy prices; broader inflationary pressures; higher interest rates; labour shortages; industrial action; disruption to supply chains, particularly until the UK and EU agree definitive steps towards reducing the frictions at UK borders; and the risks posed by climate change and steps needed to adapt to it. Consumer-facing businesses may well see revenue fall as inflation, higher mortgage payments and the cost of living crisis depress consumer demand, particularly for discretionary items. With the cost of borrowing now significantly higher, companies will need to conserve cash and look for creative ways to raise new funding, particularly until the capital markets loosen up again.

Capital markets in the UK and globally will come back on stream, but when this will occur depends on many factors and is therefore difficult to predict. Higher rates of interest, and rises in bond yields, tend to cause investors to shift capital away from riskier equities; but higher levels of inflation will also drive some investors to seek correspondingly higher levels of return that are typically available only through equities. Certainly the timing and size of interest rate rises in the UK, Europe and the US will be a particularly significant factor.

More listed companies are likely to tap the equity capital markets this year than last. Some companies – particularly those that have not fully recovered from the pandemic and that are now facing the pressures referred to above - will need to raise funds to increase liquidity and/or reduce debt. Discussions with auditors over the basis for financial statements to be prepared on a going concern basis could force the issue. Other companies will be looking to take advantage of opportunities to consolidate their market position through organic expansion or acquisitions. 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. (For more details of the issues companies should consider when planning a large equity raise like a rights issue see our April 2020 briefing.) As the Government, regulators and other bodies implement the recommendations

made by the Secondary Capital Raising Review, it should become quicker and easier for companies to raise larger amounts of money through a secondary fundraising (see further below).

Encouraging companies to list in London

In his “Edinburgh Reforms” speech in December, the Chancellor announced over 30 regulatory reforms designed to make the UK “the world’s most innovative and competitive global financial centre”. Most of the reforms were in fact already in train, and will primarily affect financial services firms rather than corporates, but if they are implemented successfully the improvements to the financial markets ecosystem in the UK should encourage investment in both listed and unlisted companies. (For further details see our briefing.)

In terms of encouraging companies to list on the London Stock Exchange, various initiatives are in progress. In particular:

- **Listing segments and the sponsor regime**: The FCA is planning to reform the listing segments and sponsor regime. In a Discussion Paper published in May 2022, it proposed that a single listing segment for equity shares issued by commercial companies should replace the current premium and standard listing segments of the FCA’s Official List. Companies would be subject to a single set of eligibility criteria based on the current premium listing eligibility requirements, subject to a few modifications. All companies listed on the single segment would be subject to one set of “mandatory” continuing obligations: these would be based on the current premium listing continuing obligations relating to related party transactions, cancellation of listing, rights issues and open offers, dealings in own securities and treasury shares and the comply or explain provisions relating to corporate governance, climate change reporting and diversity and inclusion. But companies would be able to opt in to further “supplementary” obligations, on an all or none basis, relating to controlling shareholders; the requirement to have an “independent business”; and the significant transactions regime. All companies would also continue to be subject to MAR and DTR obligations. The standard segment would be retained, albeit perhaps with a different name, but would be primarily for overseas companies wanting a secondary listing of shares in London, debt and debt-like securities, securitised derivatives, non-equity shares (such as preference shares) and depositary receipts.

  However, the proposals received mixed feedback from market participants and may therefore be revised. We expect the FCA to publish a further Discussion Paper or a Consultation Paper setting out its thinking in Q2 or Q3 of this year. A consultation by FTSE Russell on amending the eligibility criteria for the FTSE UK indices is likely to follow.

- **Investment research**: in his “Edinburgh Reforms” speech in December the Chancellor committed to establish a formal review of the provision of investment research in the UK (the independent Investment Research Review), including the effects of the unbundling rules in MiFID. In broad terms, the aim is to improve the quantity and quality of investment research published on UK companies, particularly smaller cap ones, and hence to improve price formation and facilitate investment in public equities. In our experience, the relative lack of high quality research has been one of the main concerns of companies when comparing the UK to other potential listing venues.

- **Capital Markets Industry Taskforce**: In July 2022 the London Stock Exchange created a Capital Markets Industry Taskforce, led by its CEO Julia Hoggett, to maximise the impact of all the capital market reforms. The Taskforce hopes to ensure that “the UK’s capital markets serve those who seek capital and those who have capital to invest; that they support the UK economy; and strengthen its role as a global financial centre”.

In addition, as Lord Hill recommended in his March 2021 *UK Listing Review*, the Government intends to make it easier for companies to include forward-looking statements - particularly in relation to expected financial performance - in IPO prospectuses, by raising the threshold for civil liability (for more details see our March 2022 and July 2021 briefings). Another Lord Hill recommendation that may be taken forward this year is a review by the FCA of its rules requiring companies and investment banks to give unconnected analysts equal access to management on an IPO.

Improvements to the secondary fundraising process

Companies listed in the UK 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, listed companies typically prefer to raise new equity funding via a placing to selected institutional investors, which can be planned and executed much more quickly (often 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 Listing Review therefore recommended that the Government, FCA and market participants should look at how to improve the efficiency of secondary capital raisings. In July 2022 the UK Secondary Capital Raising Review (SCRR) published its final report, which made 21 recommendations designed to make it quicker and easier for listed companies to do a secondary equity fundraising. We summarised the recommendations and what they would mean in practice for companies listed on the London Stock Exchange in our briefing published in July 2022. In the Chancellor's "Edinburgh Reforms" speech in December the Government reiterated its commitment to delivering the outcomes of the SCRR.

Issuing shares on a non-pre-emptive basis

One of the SCRR's recommendations was that investors should permit companies to issue for cash each year up to 20% of their share capital on a non-pre-emptive basis, provided they comply with certain conditions - effectively reintroducing on a permanent basis the approach taken by the Pre-Emption Group (PEG) during the Covid-19 pandemic.

In response, on 4 November 2022 the Pre-Emption Group published an updated version of its *Statement of Principles for the disapplication of pre-emption rights* and accompanying *Template Resolutions*. PEG now recommends that shareholders support AGM resolutions that permit a company to issue shares for cash on a non-pre-emptive basis in respect of up to 10% of issued share capital for any purpose and a further 10% for an acquisition or a specified capital investment that is announced contemporaneously with the issue or occurring in the previous 12 months (instead of 5% plus 5%).

When issuing shares non-pre-emptively for cash pursuant to a general disapplication of pre-emption rights, a company should, among other things, observe "soft" pre-emption rights as far as practicable and give due consideration to involving retail shareholders either via an offer made through Primary Bid or another platform and/or by making a "follow-on" offer to shareholders who are not allocated shares in the placing (see further below). To facilitate such follow-on offers, shareholders will also support resolutions that seek to disapply pre-emption rights in respect of up to an additional 20% of the amount of shares a company is authorised to issue in a placing. So if a company seeks authority to issue up to 10% (or 20%) of its issued share capital on a non-pre-emptive basis in one or more placings, it can also seek authority to issue up to an additional 2% (or 4%) of its issued share capital for one or more follow-on offers.

Follow-on offers to investors not allocated shares in a placing

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 shareholders who are not allocated shares in a placing have an opportunity to buy further shares at the same discount to the market price, while also ensuring that the company receives the bulk of the funds needed very quickly. As recommended by the SCRR, the 2022 PEG Principles stipulate that a follow-on offer should be:

- *announced as soon as reasonably practicable after the placing is announced;*
- *made at an issue price that is equal to, or less than, the offer price in the placing;*
- *open for at least five business days; and*
- *limited to not more than £30,000 per ultimate beneficial owner.*

For all non-pre-emptive cash issues, a post-transaction report in a prescribed format must be publicly announced via a RIS and filed with the Pre-Emption Group for inclusion in its Pre-Emption Database. Details must also be included in the company's next annual report.

Doing a large placing before the company's next AGM

A company that wants to do a placing or other non-pre-emptive issue before its next AGM can take advantage of the new, more relaxed guidelines by following the transitional arrangements on pp56*ff* of the SCRR: these have been extracted and re-published by the PEG as a separate document. In summary, if a company wants to do a placing that exceeds the amount authorised at its 2022 AGM (which typically will be limited to 5% of its issued share capital, for any purpose; plus an additional 5% for an acquisition or specified capital investment), the company will need to use a "cash box" structure: investors will not object to this provided the company complies with the conditions specified in the updated PEG Principles, including making a post-transaction report.

Should companies seek authority at their next AGM to issue a greater percentage of issued share capital on a non-pre-emptive basis?

When a company drafts its 2023 AGM notice, it will need to decide whether to seek the new, larger authority permitted under the updated PEG Guidelines. In our view, it makes sense for a company to do so unless there are unusual circumstances – for example, if the company has one or more large shareholders that will not want their holding to be diluted, or if the company has a history of share capital resolutions being opposed by a significant minority of shareholders. However, some companies may adopt a "wait and see" approach – i.e. at this year's AGM stick to their previous percentage for disapplying pre-emption rights, and decide what to do next year in light of emerging market practice.

Whether a company should seek authority to issue up to 20% of any placing shares for the purposes of a "follow-on" offer is more nuanced. Although in many cases it will make sense for a company to give itself the flexibility to make a follow-on offer, because many investors will not be familiar with them we expect take-up of this option to be slower.

Prospectus reforms

In March 2022 HM Treasury published a policy paper setting out in broad terms how it intends to reform the UK prospectus regime. We summarised the proposed reforms and their implications for issuers of equity and debt securities in this briefing.

Implementing the reforms will require amendments to, among other things, the Financial Services and Markets Act 2000 and the onshored version of the EU Prospectus Regulation. The path will be laid by the Financial Services and Markets Bill, which is currently making its way through Parliament and expected to receive Royal Assent by Spring this year. It will also enable the FCA to consult on changes to various aspects of the prospectus regime, including when a prospectus should be required in connection with the admission of shares to a regulated market; what it should have to include; and how it will be approved. We expect the FCA to publish a consultation paper in H1 of this year.

Other reforms recommended by the SCRR

We expect to see further steps taken this year towards "digitising" shareholdings – i.e. moving to a system where all shareholders, both institutional and retail, hold their shares in fully digitised form. In July 2022, in response to a SCRR recommendation, the Government established a Digitisation Taskforce chaired by Sir Douglas Flint, the Chair of abrdn plc and previously Group Chair of HSBC. The taskforce is due to publish a report on its progress and initial findings by Spring this year, and to publish final recommendations and an implementation plan by Spring 2024. However, the complexity of the issues involved and conflicts of interest between stakeholders mean that progress on implementing reforms in this area is likely to be slow and incremental.

Depending on progress towards digitisation, and in solving problems associated with intermediated shareholdings, we may also see the FCA consult on shortening the minimum period for which a rights issue or open offer must be open from 10 business days to seven business days and/or the Government legislating to shorten the notice period required for a shareholder meeting other than an AGM to seven business days. Ideally the problems with the "Gazette route" – i.e. the statutory rules and process for offering new shares to existing shareholders in proportion to their existing holdings – would be fixed at the same time, making rights issues and open offers easier.

EU developments

In December the European Commission published details of changes it intends to make to the EU rules on prospectuses, market abuse and certain other rules affecting listed companies. Many of the changes are similar to those being implemented in the UK. In particular, the Commission proposes to raise from 20% to 40% the threshold at which a prospectus would be required where securities are admitted to trading on an EU regulated market; and, where a prospectus would otherwise be required, it proposes substantially to reduce the information that must be published on a secondary fundraising by a company with shares already listed on an EU regulated market or an EU Growth Market.

Changes to EU MAR are also proposed. In particular, there will be more clarity, and harmonisation between member states, as to when regulators expect inside information to be announced in a protracted process and in certain other circumstances. To date, neither HM Treasury nor the FCA has publicly indicated any intention to review UK MAR, but the EU proposals may prompt them to do so. One area that is particularly ripe for reform is the rules around PDMR dealings: these cause a headache for companies and sometimes result in information being announced to the market that is of little use to investors. But in relation to inside information, any substantial changes are likely to be contentious and companies will want to be confident that the advantages (e.g. of obtaining more clarity in certain areas) clearly outweigh the disadvantages (e.g. of potentially making the regime more onerous and of having to change long-standing policies and procedures that generally function well).

The Commission's proposals are part of a wider range of proposals to improve EU capital markets and cross-border transactions. Other proposals include:

- Allowing companies with a dual class share structure to join an SME Growth Market, provided certain conditions are met.
- Encouraging the publication of more investment research on SMEs by relaxing the rules in MiFID and creating a new category of "issuer-sponsored research".
- Harmonising member state rules on marketing offers of securities in the EU.
- Exempting small and medium cap issuers from certain rules for five years after IPO.

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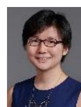
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