ICGN
International Corporate Governance Network

Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Proposal to create a new premium listing category for sovereign controlled companies

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By email: cp17-21@fca.org.uk

Background on ICGN

The International Corporate Governance Network (ICGN) is a global investor-led body based in London, whose mission is to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies world-wide.

ICGN was established in 1995, and today our network of governance professionals spans over 45 countries and includes investors representing assets under management in excess of US$26 trillion. As such, ICGN offers an important investor perspective on corporate governance to help inform public policy development and the encouragement of good practices by capital market participants. For more information on the ICGN, please visit www.icgn.org. Our policy positions are guided by the ICGN Global Governance Principles and Global Stewardship Principles, both of which have been developed in consultation with ICGN Members and as part of a wider peer review.[1]

Proposal to create a new premium listing category for sovereign controlled companies

ICGN is pleased to respond to the Financial Conduct Authority (FCA) consultation regarding its proposal to create a new premium listing category for sovereign controlled companies. Many of our investor members either own or manage assets listed in the UK, and therefore will be affected by the consultation's outcome.

Our starting point is to recognise that the UK is a well-established global leader with regard to its financial markets and regulation, as well as a leader in the area of corporate governance. We share and support the FCA's ambition of promoting the growth and competitiveness of the UK market.

At the same time we believe that the UK's reputation for high quality listing and governance standards is both a competitive advantage and a positive differentiator for the UK market in a global context. In the quest to grow and develop further, market integrity is something that must be preserved, and not diluted. In promoting

[1] ICGN Global Governance Principles: http://icgn.flpbks.com/icgn-global-stewardship-principles/#p=1

the development of the UK markets it is therefore fundamentally important that the market's standards remain strong, both in substance and in reputation.

Against this background, ICGN and its investor members are concerned about the implications for the quality and integrity of the UK market and the LSE of introducing a new listing category for sovereign controlled companies – particularly under the banner of a "premier" listing. We believe such a development would be anathema to the high standards of governance that represent premium listed companies in the UK market.

The Issue

It is clear that the development of this proposed segment would be attractive to issuers and underwriters in the London market, but from an investor perspective the benefits are much less clear. In their "buy-side" capacity investors serve as fiduciary intermediaries to generate stable returns to their end beneficiaries -- many of whom are pension fund members and long term savers. From an investor perspective the addition of a new market segment introducing sovereign controlled issuers with watered down minority shareholder protections would create an investable segment with significant governance risks.

The fundamental concern relates to minority shareholder rights and protections. State controlling ownership of listed companies can be problematic given potentially conflicting agendas between the state and the interests of minority investors to generate returns on invested capital for their beneficiaries. A sovereign state's interest in a controlled company may only have a limited focus on generating returns on capital and will likely have political and social considerations that may not be shared by minority shareholders.

These private benefits of control therefore create potential conflicts of interest that can pit the interests of minority shareholders against those of the controlling state owner. Moreover, this form of ownership can lead to entrenchment of control and an erosion of accountability to minority shareholders and other stakeholders. With limited voting rights (particularly, where free float is below 50%) the voice of the investor is marginalised, which runs counter to the UK's emphasis on investor stewardship as embodied in the UK Stewardship Code.

In short, **state ownership results in significant corporate governance risks that could impact the potential for value creation – and impair investors' ability to provide sustainable returns for their end beneficiaries**.

To be clear, we do not object to state owned companies with public listings per se in the UK market. However, we do believe that such listings should offer appropriate protections for minority investors to mitigate the governance risks. Alternatively, such listings should only be permitted in market segments that limit participation to sophisticated professional investors.

Therefore, rather than enhance minority protections, the proposal has the net effect of increasing the overall risk by removing key governance protections required of

premium listed issuers, including those pertaining to related party transactions and controlling shareholder rules (including shareholder agreements and independent directors). We believe this is objectionable, as these protections were among the most important for minority shareholders. We do not understand why a sovereign controlled company should get a "free pass" to avoid implementing these key protections, particularly given their intrinsic conflicts of interest. Waving these requirements certainly would make the London market look more attractive from an issuer perspective, as well as make the underwriter's life easier. But this would be at the investor's expense.

Perhaps our greatest objection is the proposal to establish this segment as a "premium" market, badged with the same term of art meant to reflect super equivalent corporate governance standards. Given the proposed relaxing of the key governance provisions for this sovereign segment we believe this is a misleading, if not cynical, application of the term "premium".

The premium label has become an attractive kite mark for quality in the UK market, and can allow for issuers to be eligible for inclusion on benchmark indices. Given the growth of index-based passive investment strategies this results in a "captive market" of passive investment funds, and ultimately **distribution to retail savers and pensioners** who otherwise might not wish to hold shares in sovereign controlled companies with diminished investor protections. This is a matter of concern to ICGN members, particularly those with large passive portfolios.

Conclusion

In keeping with the strong reputation and standing of the UK's financial markets globally, we believe both the FCA as well as the London Stock Exchange (LSE) must consider this proposal's acceptability from all stakeholder perspectives. We believe this proposal has skewed outcomes that would benefit the underwriting community as a service provider to the UK markets, but create undue risk for the investor -- as a customer of these markets. We have no objection to London developing its market to accommodate sovereign controlled issuers, but we object to the watered down governance provisions which increase risk and the "premium" labelling, which we believe is misleading.

We appreciate the FCA seeking innovative ways for the UK market to grow and to remain competitive with other exchanges. But the competitive market for new listings should not prompt the FCA or LSE to dilute their quality standards for investors, and we are concerned that competitive pressures between the UK and other global markets can risk a "race to the bottom" in terms of regulatory quality.

In many ways the purpose of financial markets is to provide cost efficient capital to users of capital and sustainable returns to providers of capital. For the FCA and LSE this requires a long-term perspective and balanced playing field between issuers and investors. We would like to encourage a regulatory "race to the top" as a guiding strategy for the UK's market leadership and differentiation. Taken in this light the proposal for this new listing category must be viewed as fundamentally flawed.

Questions

Our assessment of the issue as presented above leads to the following answers to the specific consultation questions:

Q1: Do you agree with the overall proposal outlined in this paper of creating a premium listing category for sovereign controlled companies?

No, we disagree.

Q2: Do you agree that the changes proposed are best effected through the addition of a new listing category?

No, we disagree.

Q3: Do you agree that the threshold for control should be set at 30%?

While we oppose this proposal, if it were to be realised we would agree that 30% would be a reasonable threshold, particularly as it is an established threshold for takeovers in UK regulation.

Q4: Do you agree that eligibility for the new category should not be restricted on grounds of national identity of the controlling shareholder? Do you agree that it should also not be restricted on grounds of country of incorporation of the company?

While we oppose this proposal, if it were to be realised there should be some form of quality standard relating to country risk. But we would agree that there should be no general or specific restriction for individual countries. Given the lack of minority shareholder rights a sovereign controlled issuer in many ways resembles a fixed income instrument, reflecting the financial strength of the country, possibly in the form of a credit rating. The FCA may wish to consider credit quality or some other financial strength measure for any sovereign controlled issue to be placed with a "premium" quality standard.

Q5: Do you agree that independent shareholder approval should be required for a transfer from an existing premium listing into the new category?

While we oppose this proposal, if it were to be realised we agree that shareholder approval should be required.

Q6: Do you agree that the sovereign controlling shareholder should not be considered a related party for the purposes of the Listing Rules?

No, we do not agree. Related party transactions (RPTs) are fundamental governance risks, and the listing rules should not be compromised here.

Q7: Do you agree that MAR-mandated disclosures are sufficient to secure the necessary at-the-time transparency?

It is not clear to us how effective these disclosures will be in preventing RPTs that disadvantage minority shareholders.

Q8: Do you agree that controlling shareholder provisions should not apply in respect of the sovereign controlling shareholder for companies listed in this category?

No, we do not agree. This would amount to a fundamental watering down of minority protections.

Q9: Do you agree that DRs over equity shares should be eligible for this category?
While we oppose this proposal, if it were to be realised we believe DR shares should be eligible as long as DR shareholders are able to exercise voting and other ownership rights on a similar level with other minority shareholders.

Q10: Do you agree that full pass-through of voting and other rights on the basis described should be a requirement for eligibility of DRs for listing in the proposed category?

While we oppose this proposal, if it were to be realised we agree that a full pass-through should be a requirement for DR eligibility.

We hope our comments are useful for your deliberations. Should you wish to discuss this matter further, please contact me or George Dallas, ICGN's Policy Director, by email at george.dallas@icgn.org.

Yours faithfully,

Kerrie Waring
Executive Director, ICGN
kerrie.waring@icgn.org

Copy:

George Dallas, ICGN's Policy Director: george.dallas@icgn.org.

Bram Hendriks, Co-Chair, ICGN Shareholder Rights Committee,
BHendriks@ktmc.com

Eugenia Jackson, Co-Chair, ICGN Shareholder Rights Committee,
Eugenia.Jackson@AllianzGI.com