



ICGN

International Corporate Governance Network
Inspiring good governance & stewardship

Primary Markets Policy Team
Financial Conduct Authority
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28 June 2023

Dear Sir or Madam,

Subject: Proposed equity listing rule reforms

The International Corporate Governance Network (ICGN) appreciates the opportunity to comment on the Financial Conduct Authority (FCA)'s consultation CP23/10¹, which sets a blueprint for reform to the UK listing rule, as part of the Primary Markets Effectiveness Review.

Led by investors responsible for assets under management of \$77 trillion, ICGN is an authority on global standards of corporate governance and investor stewardship. Headquartered in London, our membership is based in more than 40 countries - largely in Europe and North America, with growing representation in Asia. The ICGN Global Governance Principles and Global Stewardship Principles, written from an investor perspective, are widely used by our members in their company assessments and voting decisions, and by regulators when developing corporate governance rules.

ICGN understands the important objective to preserve and develop the UK's attractiveness as a global financial centre. We also recognise the challenges that the UK market faces in response to global competition and resultant reduced number of IPOs over recent years. However, we do not believe that changes to the existing listing regime would result in radical improvement. As the FCA acknowledges, "a company's decision on both whether to list and, if so, where to list is driven by a range of factors".²

While it is unclear whether the changes proposed to the listing rule would help attract listing in the UK, ICGN is concerned that the proposed reforms will harm the UK's reputation as a market with robust investor protection, high corporate governance standards and a stable policy environment. We are particularly concerned by the proposal to dilute investor

¹ [CP23/10](#)

² The FCA's consultation paper acknowledges that "a company's decision on both whether to list and, if so, where to list is driven by a range of factors, including whether staying private or accessing non-listed markets can provide more efficient access to capital. If a company does decide to go public, its choice of listing location may be driven by factors such as valuations, depth and liquidity of capital markets and breadth of investor base, comparable peers, investor / analyst expertise, taxation, director remuneration requirements, indexation, founder preferences, location of main operations, customer base or competitors now or in the future, political support and media coverage, among other things". CP23/10, p.5

protection mechanisms, given the important stewardship role investors play in holding corporations to account for preserving and enhancing long term value creation. Ultimately, the proposals will expose investors to further undue risk - with potentially significant implications for underlying beneficiaries incusing pensioners and retail investors' savings.

1. Votes on related party transactions

The FCA proposes to remove the requirements for a mandatory independent shareholder approval of related party transactions at or above the 5% threshold, or for related party transactions involving a controlling shareholder. ICGN strongly opposes this proposal. We do not believe that the FCA has adequately made the case that relaxing the existing rules in this way would be beneficial for market participants.

The existing rules were introduced to provide the necessary checks and balances to protect the interests of minority shareholders from potential abuse. A key concern about related party transactions is that they might not be undertaken at market prices, as there might be a conflict of interest for some person(s) in the company. Related party transactions can be used as a mechanism for extracting private benefits of control at the cost of other shareholders. This can range from mild to extreme degrees of expropriation. It is important for minority shareholders to be able to verify the integrity of such transactions, to help prevent fraud and misuses of company assets.

In this regard, we refer you to the ICGN Global Governance Principles,³ which state that:

Shareholders should have the right to approve significant related party transactions above an appropriate materiality threshold, and this should be based on the approval of a majority of disinterested shareholders. The board should submit the transaction for shareholder approval in the notice of the meeting and disclose (both before concluding the transaction and in the company's annual report):

- a) the identity of the ultimate beneficiaries including, any controlling owner or business group and any party affiliated with the controlling owner with any direct / indirect ownership interest in the company;
- b) other businesses in which the controlling shareholder has a significant interest; and
- c) shareholder agreements (e.g. commitments to related party payments such as licence fees, service agreements and loans).

We recommend that the FCA maintains the mandatory shareholder vote. Should the FCA decide to pursue this reform, a more balanced approach could be to increase the existing threshold nominally, rather than removing the vote entirely.

2. Vote on significant transactions

Regarding significant transactions, the FCA proposes to remove the current 'Class 1' obligations to obtain prior shareholder approval of a transaction on the basis of information provided in a detailed shareholder circular approved by the FCA, except for a significant transaction that constitutes a reverse takeover. ICGN does not support this proposal, which

³ [ICGN Global Governance Principles](#)

could leave major transactions without shareholder scrutiny. While we understand that the FCA might want to raise the threshold, we do not support removing the vote altogether. We are concerned that minority investors will be unable to vote on transactions that could negatively impact shareholders' returns.

In addition, the FCA proposes to set a significantly higher threshold for when a company is required to make a 'Class 2 announcement'. As we find that the current rule is not particularly burdensome for companies, we suggest increasing the threshold to 10%, rather than to 25% as proposed by the FCA.

3. Dual class shares

In December 2021, the FCA finalised rules allowing dual class shares structures within premium listing, with certain limits and safeguards in place. As stated in the consultation document, "this was intended to allow founders of innovative companies to exercise enhanced voting rights in relation to the removal of the holder as a director and after a change of control of the company on any matter, to enable them to implement their vision and keep control of the company." Under the current rules, enhanced voting rights expire after 5 years.

We are therefore surprised that the FCA, only 18 months after the introduction of the new rules, proposes to remove these safeguards. Our position is clear:

- We do not support the proposal that **enhanced voting rights could be exercised on almost all matters and at all times**, not just to prevent a change of control or to protect a founder's position as a director. We recommend that the FCA maintains its current approach. As highlighted in ICGN Global Governance Principle 9, minority shareholders should have an equal say at least in decisions that can materially impact the investment case for the company.
- We do not support the proposal to remove limits on the maximum **enhanced voting ratio** that can be attached to enhanced voting rights shares.
- We believe it is essential that **sunset clauses** should specify that any multiple class share mechanisms will automatically lapse after a certain period or events. Academic research shows that multiple class shares do not benefit minority investors or companies in the long-term. The FCA proposes to extend the sunset clause from 5 to 10 years. This would only be acceptable on a case-by-case basis, if supported by a vote of independent shareholders after 5 years, and followed by an annual rolling vote.
- We support the requirement that enhanced voting rights shares can be held only by directors of the company and the FCA's proposal to **restrict the transfer** of such shares, whereby shares with enhanced voting rights will automatically convert to ordinary listed shares upon the holder ceasing to be a director.

Principle 9 of the ICGN Global Governance Principles emphasises the importance of equal voting rights for all shareholders, according to the 'one share, one vote' standard. We believe shareholders' influence on the company's decision-making should be proportionate to their economic exposure. Unequal voting rights are problematic because they dilute the voice of minority shareholders. They may serve to entrench management and allow founders and controlling shareholders to monopolise the decision-making, potentially putting minority

shareholder interests at risk. In extremis such structures create opportunities for expropriation, with controlling shareholder gaining private benefits of control at the expense of minority shareholders.⁴

In the event of the existence of multiple class shares, strong safeguards must be in place. Therefore, we recommend that the FCA maintains the approach it introduced in 2021.

4. Eligibility criteria

The FCA proposes to remove premium listing eligibility requirements to have: a three-year representative revenue earning track record; three years of audited historical financial information that represents at least 75% of the issuer's business; and a 'clean' or unqualified working capital statement. ICGN is concerned that removing these eligibility criteria would increase the level of risks for investors.

Conclusion

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 company listings, market integrity is something that must be preserved, and not diluted. We encourage the UK to maintain its advanced standards, which have inspired regulators worldwide and which investors have used as a gold standard when commenting on other markets' listing requirements.

ICGN is concerned by the "race to the bottom" that is taking place in many markets, in which the dilution of shareholder rights is regarded by some policymakers, regulators and stock exchanges as justified to attract company listings. We believe the weakening of corporate governance standards is more likely to lower the reputation of these markets over time. Furthermore, we are concerned by the change of paradigm proposed by the FCA in this consultation paper, with a move towards a light touch regulatory regime. The example of the 2008 financial crisis showed us the limits of such an approach and the global impact thereafter of financial harm to investors and companies alike.

Finally, and perhaps most importantly, we see some contradictions in the different workstreams of the FCA. On the one hand, UK authorities focus on preventing fraud and having strong controls in place, and on the other hand, the FCA's proposal would remove shareholders' ability to vote on related party and significant transactions. Also, at a time when the FCA is encouraging investors to play a greater, and more responsible, role in monitoring company governance and engaging with companies, the imposition of unequal voting rights has the effect of watering down investor influence. Voting enables investors to properly hold company boards to account and is an important escalation tool when engaging with investee companies, as part of their stewardship duties. For example, investors may decide to vote against the re-election of board members when they have not taken any measures to manage climate change risk. They may vote against the CEO's remuneration plan if it does not incentivise him/her to act in the long-term interest of the company.

To conclude, we encourage the FCA to explore other avenues to strengthen the attractiveness of its capital markets. You may wish to consider the recent publication by UK

⁴ See [ICGN Viewpoint differential share ownership](#), 2017

Finance and EY on this topic.⁵ More generally, many of our members would have preferred a longer time period within which to respond, given the extent of the proposed reform and its implications for shareholder rights.

Thank you for the opportunity to share our perspective on the proposed equity listing rule reform and we remain at your disposal should you have any questions or comments. In this regard, please contact our Global Policy Director, Séverine Neervoort (severine.neervoort@icgn.org).

Yours faithfully,



Kerrie Waring
Chief Executive Officer, ICGN

⁵ UK Finance and EY, [UK Capital Markets Building on Strong Foundations.pdf](#), May 2023