

CONSULTATION RESPONSE

FCA CONSULTATION – UK PRIMARY MARKETS EFFECTIVENESS REVIEW

September 2021

This response represents the view of the PRI Association and not necessarily the views of its individual members.

PRI Association

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United Nations
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ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US \$121 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to FCA's consultation on the UK Primary Markets Effectiveness Review.

ABOUT THIS CONSULTATION

The Financial Conduct Authority (FCA) is consulting on a series of proposed reforms to improve the effectiveness of UK primary markets and how it might continue to develop to ensure they remain competitive and dynamic. The proposed reforms in this consultation address proposals made in two reviews undertaken in 2021: the [UK Listings Review](#) and the [Kalifa Review of UK FinTech](#).

These reviews made specific recommendations for improvements to the UK listing regime and the FCA's proposals seek to facilitate wider participation in public offerings, improve the quality of information that investors receive under the prospectus regime and ensure that regulation of prospectuses is more agile and dynamic.

This consultation includes proposals in relation to the following key areas:

- **Listing regime** – the FCA describes 4 different models to structure the listing regime and seeks views on further developing them into changes to the listing regime;
- **Dual class share structures** – the FCA proposes allowing dual class share structures (DCSS) within the premium listing segment in certain limited circumstances;
- **Minimum market capitalisation** – the FCA proposes increasing the minimum market capitalisation threshold for both the premium and standard listing segments for shares in companies other than funds from £700,000 to £50 million;
- **Free float** – the FCA proposes the percentage of shares required to be held in public hands will be reduced from 25% to 10%, both at listing and as a continuing obligation;
- **Track record requirements** – no changes are proposed at this stage to the track-record requirements for companies looking to list but, as per the Hill Review recommendation, FCA is seeking views on whether changes are needed to attract more high-growth companies.

FCA is also consulting on several minor changes to the Listing Rules, Disclosure Guidance and Transparency Rules and the Prospectus Regulation Rules to ensure they are simplified where appropriate and reflect current business practices.

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KEY RECOMMENDATIONS

The PRI recommend the FCA:

- Maintain the one-share, one-vote requirement in the UK premium listing segment rather than introducing dual class shares structures or otherwise, at minimum, adopt sunset provisions
- Maintain the free float for the UK premium listing segment at 25%

DETAILED RESPONSE

5 DUAL CLASS SHARE STRUCTURES

Question 18: Do you agree with our rationale for introducing DCSS to the premium listing segment? Is there any additional evidence that we should consider?

The PRI recommends maintaining the one-share, one-vote requirement rather than introducing dual class shares structures in the UK premium listing segment.

DCSS are not in the long-term interest of investors as they may hamper their power to hold companies accountable and undermine their ability to fulfil their stewardship responsibilities.

DCSS oppose the fundamental principle of corporate governance that voting power should be aligned with economic interest.¹ The mismatch of ownership and control through differential ownership rights can create significant governance risks for minority shareholders. Evidence demonstrates that DCSS presents the following main risks:

- **Diluting shareholder protections:** DCSS provide the owners of certain share classes with superior voting rights, giving them voting control over a company that is disproportionate to their equity shareholding.² In this structure, controlling shareholders gain private benefits of control at the expense of minority shareholders.
- **Management entrenchment:** DCSS may entrench management and, in case of company mismanagement, in turn enable management to pursue its own interests rather than protecting a firm's entrepreneurial vision and fostering long-term investment³ as the influence of minority shareholders' is reduced.⁴
- **Limited accountability:** DCSS can severely undermine the effectiveness of stewardship activities and the power of institutional investors to hold companies accountable and make their voices heard in the organisation's decision-making.⁵

In addition to that, evidence⁶ suggests that controlled companies with multiple share classes exhibit lower long-run stock returns, higher stock price volatility, and a higher likelihood of accounting-related

¹ ICGN (2015), [Differential voting rights: pros, cons and unintended consequences](#).

² CFA (2018), [Dual-Class Shares: the Good, the Bad, and the Ugly](#).

³ <http://alexedmans.com/wp-content/uploads/2015/03/Dual-Class-Shares.pdf>

⁴ Broccardo, E. and Hart, O., and Zingales, L. (2020). [Exit vs. Voice](#).

⁵ <http://alexedmans.com/wp-content/uploads/2015/03/Dual-Class-Shares.pdf>

⁶ Investor Responsibility Research Centre (2012): "Controlled Companies in the Standard & Poor's 1500: A Ten Year Performance and Risk Review." – retrieved from: <http://alexedmans.com/wp-content/uploads/2015/03/Dual-Class-Shares.pdf>

material weaknesses. As indicated by ICGN⁷, there is no strong evidence that differential voting rights provide companies with a better environment for long-term planning and execution; on the contrary, studies reinforce that, while in the short-term DCSS might shield companies from some pressures of financial markets, overall DCSS are not beneficial in the longer term for minority investors, or for the company itself⁸ with evidence suggesting that companies with DCSS tend to have lower governance quality.⁹

For many years the UK has been at the forefront of best corporate governance practices internationally, setting an example for other markets. The strong corporate governance requirements of the LSE's premium segment have inspired greater confidence in the UK premium listing market. Allowing DCSS would weaken the existing regime and risks undermining confidence by institutional investors in the UK premium listing segment.

For these reasons, the PRI urges the FCA to maintain one-share, one-vote requirement for a company to be listed in the UK premium segment. The PRI considers this a preferable arrangement to DCSS, as it promotes simplicity, transparency, and accountability in companies' governance. The one-share, one-vote arrangement offers a preferable option to responsible investors as each vote has equal weight and allows visibility of shareholder influence in the company. It also facilitates minority shareholders' understanding of how best to hold companies to account and ensures that there are no conflicts of interest that will compromise the company from an operational, reputational, legal, or financial perspective.¹⁰

Question 20: Do you consider that a five-year sunset period for DCSS in the premium listing segment is the correct length to protect companies from unwanted takeovers? Please provide evidence for your answer.

The PRI welcomes the proposed sunset provision, as it can ensure that preferential class shareholders do not retain superior voting rights at the expense of the enterprise value and minority shareholders' rights past the 5-year mark.

As indicated in our response to question 18, the PRI does not support the adoption of DCSS within the UK premium listing segment. However, the PRI recognises that various jurisdictions have opted to accommodate DCSS, and in those cases PRI strongly recommends the inclusion of a sunset provision. Where DCSS are in place, there should be a clear set of mechanisms to provide accountability and transparency and ensure a transition away from DCSS in a way that preserves company value and shareholder rights.

We note that there is not academic consensus on the appropriate length of sunset periods.^{11,12} Nevertheless, considering that: the benefits of DCSS are likely to decline years after the IPO¹³; DCSS

⁷ICGN (2017), [Differential share ownership structures: mitigating private benefits of control at the expense of minority shareholders.](#)

⁸ ICGN (2020), [UK Listings Review Call for Evidence.](#)

⁹ Larcker, D. and Tayan, B. (2016), Corporate Governance Matters. Retrieved from: ICGN (2017), [Differential share ownership structures: mitigating private benefits of control at the expense of minority shareholders.](#)

¹⁰ ICGN (2017), [Differential share ownership structures: mitigating private benefits of control at the expense of minority shareholders.](#)

¹¹ Fisch, J.E and Solomon, S. D. (2019), [The Problem of Sunsets.](#)

¹² Moore, M. T. (2020), [Designing Dual-Class Sunsets: The Case for a Transfer-Centered Approach.](#)

¹³Bebchuk, L. A., and Kastiel, K. (2017), [The Untenable Case for Perpetual Dual-Class Stock](#)

can lead to value deterioration over the years¹⁴; and the academic evidence referenced by FCA in the consultation paper¹⁵; a five-year sunset period seems to be an adequate length.

7 MINIMUM NUMBER OF SHARES IN PUBLIC HANDS – ‘FREE FLOAT’

Question 25: Do you agree with our proposal to reduce free float to 10% and to remove current guidance on modifications? Please give your reasons.

The PRI recommends maintaining the free float percentage at 25% rather than reducing free float to 10%. 25% free float better ensures liquidity and that enough minority shareholders can raise concerns with management in an effective way, which in turn offers better protection for investors.

One of the purposes of the minimum free float requirement is to provide non-controlling shareholders minimum conditions for exercising their rights as established in regulation and guidance, such as the UK Corporate Governance Code. A free float lower than 25% can erode long-term investors’ rights, affecting minority shareholders in particular, and hinder the accountability of executive managers to shareholders. For instance, the UK Companies Act 2006¹⁶ determines that special resolutions, such as an amendment to a company’s Articles of Association, need to be approved by a majority of at least 75% of shareholders - a free float of 10% would compromise minority shareholders possibility of preventing these types of changes.

Another objective of the free float requirement is to ensure sufficient liquidity in the traded shares. In this sense, evidence demonstrates that the increase in the minimum UK FTSE free float requirements in 2011, from 15% to 25%, had a positive impact on stock liquidity.¹⁷ Moreover, shares with higher free float have a higher level of liquidity, and this relationship is more pronounced when the legal structure and corporate governance environment is strong.¹⁸

Therefore, the PRI urges the FCA to maintain the free float percentage at 25% for the UK premium listing segment as a reduction will affect minority shareholders rights and compromise the UK’s high corporate governance standards.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of FCA in improving the UK’s market effectiveness.

Question or comments related to this response can also be sent to policy@unpri.org.

¹⁴ SEC’s Commissioner Robert J. Jackson Jr. (2018), [Perpetual Dual-Class Stock: The Case Against Corporate Royalty](#)

¹⁵ FCA consultation paper, CP21/21.

¹⁶ <https://www.legislation.gov.uk/ukpga/2006/46/section/283>

¹⁷ El Nader (2018): [Stock Liquidity and free float: Evidence from the UK](#).

¹⁸ Xiaoya (Sara) Ding, Yang Ni, Ligang Zhong (2016), [Free float and market liquidity around the world](#).