SULLIVAN & CROMWELL LLP

S&C memo

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Further Proposals to Reform the UK's Capital Markets

The Secondary Capital Raising Review Has Delivered 21 Recommendations to Improve Secondary Capital Raisings in the UK and Provides a "Once-in-a-Generation" Opportunity for Meaningful Reform.

SUMMARY

On July 19, 2022, the Secondary Capital Raising Review (the "**SCRR**") published its recommendations for reform of the UK's capital markets. As suggested by the UK Listing Review (on which we reported here), the SCRR was established by HM Treasury with a view to making recommendations on how to improve the efficiency of further capital raising processes by companies already listed on the main market of the London Stock Exchange. The SCRR also interacts with other ongoing reviews, including the UK Prospectus Regime Review (on which we reported here) and the Primary Markets Effectiveness Review (on which we reported here and here).

The SCRR has made 21 recommendations. These seek to make secondary capital raisings cheaper and more efficient, diversify fundraising structures and extend retail investor participation – all whilst preserving pre-emption rights for existing shareholders, which has long been a key feature of the UK's capital markets. By extension, if the recommendations achieve these aims, the proposed reforms should enhance London's attractiveness as a venue for companies seeking to list. The recommendations have been developed in dialogue with listed companies, investors, trade bodies, industry groups and other stakeholders.

Since the recommendations were published, key stakeholders have expressed support for taking them forward. The suggested timeframes for their implementation range from immediately, near-term and medium-term, depending on the recommendation in question.

THE RECOMMENDATIONS

The SCRR has made 21 recommendations targeting seven objectives. These are summarised below.

A. MAINTAIN AND ENHANCE THE PRE-EMPTION RIGHTS REGIME

The SCRR recognises that pre-emption rights, which restrict companies' ability to issue shares without shareholder approval, are a key feature of the UK's capital markets and UK company law. It recommends that pre-emption rights are preserved as an important aspect of UK shareholder protection and makes the following recommendations aimed at enhancing the pre-emption regime:

1. Put the Pre-emption Group ("**PEG**"), whose Statement of Principles sets market standards as to when shareholders should vote in favour of disapplying pre-emption rights, on a more formal and transparent footing. Timetable: immediately.

2. Require companies to publish on a template form, maintained by PEG, specified details of all non-pre-emptive issuances (such as placings) carried out, including the use of proceeds, discount, allocation policy, consideration given to retail investors and gross and net proceeds and PEG to maintain a publicly searchable database of such information. Timetable: immediately.

B. INCREASE THE FLEXBILITY FOR COMPANIES TO CARRY OUT SMALLER AND CERTAIN OTHER CAPITAL RAISINGS QUICKLY AND CHEAPLY

The SCRR also recognises that the shareholder protection afforded by pre-emption rights should not act as a barrier to smaller capital raisings, or capital raisings justified by an issuer's circumstances. It therefore recommends that PEG relaxes its Statement of Principles to:

3. Allow annual disapplication of pre-emption rights for placings of up to 20% of share capital, comprising 10% for any purpose with a further 10% available for an acquisition or specified capital investment (increased respectively from 5% and 5% currently). Timetable: immediately.

4. Allow capital intensive companies, with shareholder approval, to disapply pre-emption rights in excess of 20% of share capital each year or for a longer period than 12 months (potentially for up to five years, which is the maximum period permitted under the UK Companies Act). The practical limit on funds raised in this way is ultimately expected to be 75% of share capital per annum (the proposed new threshold for when a prospectus would be required – see Recommendation 8 below). Subject to disclosure in their IPO offer documentation, newly listed companies should be able to hardwire such authorities at IPO. Timetable: immediately.

In respect of cash box placings, which are used by UK companies in certain circumstances to raise capital without a shareholder resolution disapplying pre-emption rights, the SCRR recommends that the PEG Statement of Principles is revised to:

5. Permit cash box placings only up to the amount of the annual pre-emption disapplication granted at the company's last AGM. This addresses the fact that a practical limitation on their use would be removed by the proposal to raise the threshold for when a prospectus is needed from 20% to 75% of share capital. Timetable: immediately.

C. INVOLVE RETAIL INVESTORS IN NON-PRE-EMPTIVE CAPITAL RAISINGS

The SCRR makes the following recommendations to increase retail investors' participation in non-pre-emptive offers:

6. Companies should give due consideration to retail investors' interests and how to include retail investors in non-pre-emptive offers as fully as possible – e.g., via technology-driven solutions or by making a follow-on offer, after the non-pre-emptive offer has closed, to shareholders who were not invited to participate in the non-pre-emptive offer. Although the SCRR does not mandate a single fundraising structure for retail investors, it recommends that the PEG Statement of Principles is updated to include guidance on the use of follow-on offers. Timetable: immediately.

7. Shorten the minimum period for which an IPO prospectus must be made available in a retail offer from six to three working days before the end of the offer. The SCRR considers that the six-working-day requirement to keep open a retail offer following publication of the prospectus currently disincentivises the inclusion of retail investors because the IPO is exposed to general market volatility for a longer period than in an institutional-only IPO, which can be closed as soon as sufficient demand has been received. Shortening this period may make IPOs with a retail component more attractive than at present. Timetable: near-term.

D. REDUCE REGULATORY INVOLVEMENT IN FUNDRAISINGS

The implementation of the proposals of the UK Prospectus Regime Review would empower the UK Financial Conduct Authority ("**FCA**") to determine when a prospectus is required and its contents and whether the FCA will continue to approve prospectuses. With a view to simplifying the pre-launch period for secondary fundraisings (in particularly the process for approval of prospectuses by the FCA), the SCRR recommends that the FCA should use its discretion anticipated as a result of implementation of the UK Prospectus Regime Review to:

8. Raise the threshold for requiring a prospectus in connection with the admission to trading of shares issued in a secondary fundraising from 20% to 75% of share capital. The UK Prospectus Regime Review has proposed that a prospectus should no longer be required in connection with the making of an offer of securities to the public but only in connection with the admission of securities to trading; together, the reforms proposed by the UK Prospectus Regime Review and the SCRR would mean that up to 75% of share capital could be raised without a prospectus. Timetable: near-term.

9. Remove the need for issuers to appoint a sponsor for secondary fundraisings. Timetable: near-term.

10. Reconsider its approach to working capital statements included in prospectuses and shareholder circulars so as to allow "clean" working capital statements to be accompanied by disclosure of the underlying assumptions made by the company and to revise its approach to

the "importance of vote" language, which is required in circulars for refinancing or reconstructions to explain the impact on the company if the transaction does not go ahead, as disclosure should instead focus on the rationale for the quantum of the fundraising and the use of proceeds. Timetable: near-term.

11. Address the overlap between working capital diligence exercises needed for prospectuses and circulars and annual report disclosures that cover similar ground (i.e., currently going concern statements and viability statements or, when introduced by new legislation as proposed in the UK Government's Restoring Trust in Audit and Corporate Governance consultation response, resilience statements). Timetable: near-term.

E. MAKE EXISTING FUNDRAISING STRUCTURES QUICKER AND CHEAPER

The SCRR notes that UK listed companies typically only use rights issues or open offers when seeking to raise a significant amount of capital. The SCRR hopes that "a reduction in time and cost may enable boards to conclude that a pre-emptive offer along these lines is a more viable alternative to a placing than at present". In addition to the recommendations targeted at the pre-launch period (see Section D above), the SCRR aims to improve the functioning of the post-launch period for pre-emptive offers by making recommendations to:

12. Reduce the minimum offer period for rights issues and open offers from ten to seven business days. Timetable: near-term.

13. Delegate to the relevant UK Government minister the authority to reduce the minimum notice period for shareholder meetings, other than AGMs, from 14 to seven clear days (so that companies can obtain shareholder approval more quickly if they are seeking to issue shares or disapply pre-emption rights in excess of the standing authorities granted at their previous AGM). Timetable: medium-term.

14. Allow companies to seek annual allotment authorities of up to two-thirds of their issued share capital for all forms of pre-emptive offers (including open offers and follow-on offers), not only rights issues as at present. Timetable: near-term.

15. Align the statutory pre-emption provisions in the UK Companies Act regarding, e.g., exclusions of certain overseas shareholders, fractional entitlements and offers of new shares to holders of contractual rights to new shares (such as convertible bonds, warrants and preference shares) with current practices for disapplication of statutory pre-emption rights by shareholder resolution so as to give companies using the statutory route greater flexibility. Timetable: near-/ medium-term.

16. Reform the UK Listing Rules to provide the ability to attach excess application mechanics to rights issues. This would allow existing shareholders to apply to take up shares not taken up by other shareholders and may therefore help to avoid the requirement to place a "rump" of

shares at the end of a rights issue process (and therefore also the problem addressed in Recommendation 17). Timetable: near-term.

17. Reconcile the desire for non-duplicative, streamlined offer documentation with non-UK securities law requirements that have historically required a full prospectus to be published if the "rump" not taken up by shareholders needs to be placed overseas (e.g., under Rule 144A in the US). To streamline disclosure at the time of an offer, it is proposed that companies should be able voluntarily to enhance their annual report disclosures so as to meet non-UK securities law standards (e.g., by including US-style risk factors) and then to incorporate those enhanced disclosures into the offer documentation by reference. Timetable: near-/ medium-term.

F. INCREASE THE RANGE OF PRE-EMPTIVE FUNDRAISING STRUCTURES FOR COMPANIES

The SCRR also examined foreign fundraising structures that observe the principles of pre-emption whilst providing the speed and flexibility of a placing. The SCRR notes that aspects of Australian law and practice are attractive and recommends that certain key features should be implemented in the UK by proposing to:

18. Adopt features of certain Australian accelerated fundraising structures in the UK capital markets. In particular, for secondary issues involving a public offer that would not require a prospectus (e.g., because less than 75% of share capital would be raised assuming the UK Prospectus Review and SCRR proposals are implemented), a shorter form offer document setting out the terms of the offer should be accompanied by a "cleansing notice" confirming to the market that the company is in full compliance with its market disclosure obligations and is not delaying inside information (or, if it is delaying inside information, the announcement would disclose that information). The SCRR envisages that the "cleansing notice" will help to streamline disclosure. Timetable: near-/ medium-term.

19. Amend the provisions of the UK Companies Act which give UK public limited companies a legal mechanism to serve notices on persons requiring them to disclose their interests in the company's shares to additionally require persons receiving such notices to disclose the identity of the ultimate investment decision maker or beneficial owner of shares as well as their contact details. The SCRR considers that this will help companies more quickly identify and contact their institutional and retail investors, potentially facilitating Australian style accelerated fundraisings. The SCRR notes that many institutional investors do not trip the 3% ownership threshold that triggers a requirement to disclose direct or indirect shareholdings under the UK's Disclosure Guidance and Transparency Rules. Timetable: near-/ medium-term.

20. Market participants should agree and make publicly available standard form terms and conditions for use on secondary fundraisings, to remove the need to agree bespoke terms with institutional investors at the time of a transaction. The SCRR cites as an example the Australian Master ECM Terms which provide, e.g., standard form warranties, foreign jurisdiction representations and allocation forms. Timetable: near-term.

G. START AN AMBITIOUS "DRIVE TO DIGITISATION"

The SCRR also identifies as sources of inefficiencies both the chain of intermediaries between a company and the beneficial owners of shares held in uncertificated form (i.e., via CREST) and the continuation of paper based shareholdings. It therefore recommends that the UK Government should:

21. Prioritise the move to a system where all shareholders, both institutional and retail, hold their shares in fully digitised form, by establishing a Digitisation TaskForce with an independent chair and a statement of principles for reform. Timetable: near-term.

NEXT STEPS

The SCRR's recommendations are addressed to various stakeholders, namely HM Treasury, the Department for Business, Energy and Industrial Strategy, the FCA, PEG, the Investment Association (which sets market standards as to when shareholders will vote in favour of granting directors authority to allot shares) and the Financial Reporting Council (which regulates auditors and reporting accountants and also acts as the secretariat to PEG). Their involvement will be necessary to implement the recommendations. In a speech on July 19, 2022, the Chancellor of the Exchequer accepted all the recommendations made by the SCRR to the UK Government. The FCA and PEG have also published statements of support for taking forward the recommendations (see here and here).

The proposed timetable for implementing the recommendations ranges from immediately to the near- and medium-term, depending on the recommendation in question. The SCRR notes, in particular, that PEG expects shortly to publish an updated version of its Statement of Principles, alongside revised template resolutions for the disapplication of pre-emption rights reflecting the SCRR's recommendations. These may therefore be available for some companies to use at their next AGMs (many of which will be in spring 2023). In respect of Recommendation 21, the UK Government has appointed Sir Douglas Flint to chair the Digitisation Taskforce and has published its terms of reference (see here). Otherwise, implementation of certain of the recommendations will require the UK Parliament to pass new legislation and therefore their timeframe is not certain.

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