CP23/10 Primary Markets Effectiveness Review: proposed equity listing rule reforms

Nest's response

About us

Nest was established in 2010 as part of the auto enrolment programme to help people save for retirement. Unlike any other pension scheme in the UK, Nest has a legal obligation to accept any employer that wishes to use us to discharge their auto enrolment obligations. Over one million employers have signed up to use Nest.

Over the last decade, Nest has grown to be one of the largest pension schemes in the UK, with more than £30bn in assets under management. We are operating at scale as a high-quality, low-cost pension scheme helping over 12 million members save for their retirement. Many are low to moderate earners who may be saving into a pension for the first time.

Nest is built around the needs and behaviours of our members, from our approach to responsible investment to our focus on customer service. We now occupy a place in the market as a major Master Trust, helping to drive up standards and best practice across the industry. Nest has great potential for delivering pensions to mass market consumers for many years to come, leveraging our scale to deliver value through the combination of low costs, our market leading investment strategy and modernised services all overseen by strong trustee governance.

Our response

We welcome the opportunity to respond to this consultation paper issued by the Financial Conduct Authority (FCA). Although we support the FCA's intention to ensure the UK continues to be attractive to high-growth companies, we believe that several of the proposals will be counter-productive in supporting the development of high-quality, deep and liquid capital markets.

Strong shareholder and voting rights are vital for the effective stewardship required to achieve good outcomes for our members. We believe that several proposals significantly diminish shareholders' rights in the UK, making it harder to hold management accountable and increasing the risk to both institutional and retail investors of investing in UK-listed companies. We are specifically concerned about the proposed approach to dual class share structures (DCSS), the removal of specific financial information eligibility requirements and the removal of shareholder votes relating to significant and related party transactions. We have not seen compelling evidence that these proposed equity listing rule reforms are likely to have the desired consequence of making the UK a more attractive market to list and reverse the decline in the number of IPOs. On the contrary, we believe it may actually prove counterproductive, by discouraging institutional investors with strong stewardship principles to invest in UK-listed companies. A suggestion for an alternative solution would be to take advantage of the UK markets' unique selling point, which is centred around strong corporate governance standards.

Implementing an attractive regulatory regime can further encourage listing in the UK market. Pushing the UK to be at the forefront of emerging themes that companies can take advantage of will help the UK's listing objectives, an example of these emerging themes is AI regulation and development.

While we have no objections to the creation of a single ESCC category, we would strongly urge the FCA to align this more closely with the current eligibility requirements for the premium segment. We believe that this will be crucial to protect the UK's reputation as a high-quality market and not result in the lowest common denominator of standards which would be out of step with recent regulatory developments to increase disclosure for example climate change reporting and diversity targets.

Below we have set out our responses to the specific consultation questions that are relevant to Nest. We would of course be delighted to participate in any further discussions with the FCA on this topic.

Q1: Do you agree with the proposal to remove specific financial information eligibility requirements for a single ESCC category? If not, please explain why and any alternative preferred approach.

We are comfortable with the proposal to create a new single listing category, but we disagree with the proposal to remove specific financial information eligibility requirements for a single ESCC category as it increases risk for both institutional and retail investors. We recognise investors should be aware of the financial risks of companies they invest in, and financial risk assessment is part of investor due diligence. While we note that the FCA acknowledges there may be a greater risk of listed companies defaulting as a result of less stringent financial information being required, such as a clean working capital statement, we disagree with the assessment that this will be offset by the potential benefits of more investment opportunities in listed companies. Many institutional investors can get exposure to companies early on in their life cycle through private equity and would therefore not necessarily miss out on investing in companies if they choose to remain private. Crucially, this asset class is generally limited to classified investors who undertake their own due diligence. To protect the interests of retail investors, we would prefer that the new single category inherits the financial eligibility rules of the current premium segment.

Q2: Do you agree with a proposal to explore a modified approach to the independence of business and control of business provisions for a single ECSS category, with a view to enhancing flexibility, alongside ensuring clear categories for funds and other investment vehicles?

We broadly agree with the proposal to explore a modified approach to the independence of business and control of business provisions in order to enhance flexibility. However, it will be essential to have a balance between flexibility and regulatory clarity when considering such proposals. Any changes should be carefully analysed to avoid confusion and offer clear categories for different types of issuers. Choosing the approach which most clearly outlines and states the risks seems most sensible, even if that requires a greater level of disclosure.

Q3: Do you have views on what rule or guidance changes may be helpful, and whether certain disclosures could also be enhanced to support investors and market integrity, or any alternative approaches we should consider?

Whilst we are comfortable with the creation of a single segment if it raises standards for all UK listed companies, we would also be comfortable with maintaining the current regime with an alternative segment (in addition to the premium segment) to accommodate issuers who are unable to meet the high standards required in the premium listing segment. We support the idea of rebranding the standard listing segment to make it more attractive to high growth and innovative companies. These issuers could be granted a grace period to work towards meeting eligibility requirements regarding revenue track record and developing appropriate governance structures. The flexibility and less rigorous requirements of an alternative listing segment could be particularly attractive for international issuers. However, we would remain uncomfortable with some of the proposals even in an alternative segment, including dual class share structures and voting on RPTs. We note the feedback from issuers in the consultation paper that the current regime can be confusing, but we believe that this could be addressed through further guidance and does not necessarily require a merging of the two segments.

Q4: Do you agree with our proposed approach to dual class share structures for the single ESCC category and the proposed parameters? If you disagree, please explain why and provide any alternative proposals.

We strongly disagree with the proposed approach to dual class share structures (DCSS) and its parameters. DCSS restrict the rights of shareholders by giving the directors of companies unequal voting rights. In our experience, this makes it difficult to hold management accountable on important issues. The proposition to allow enhanced voting rights to be exercised on all matters and at all times seems excessive. We do not believe the FCA's proposals of a 10-year time-related sunset provision are sufficient to safeguard the rights of minority investors. Our strong preference would be to prohibit DCSS in a single segment. If proposals to introduce DCSS go ahead, we would urge the FCA to maintain the DCSS framework of the current premium segment, including the 5-year sunset period and weighting cap.

Q5: Do you agree with our proposed approach to the controlling shareholder regime for a single ESCC category? Do you have any views on the suitability of alternative approaches to the one proposed?

We disagree with the proposed approach to the controlling shareholder regime for a single ESCC category that issuers could "opt in to". The approach does not effectively address the risk that the interests of minority shareholders are overridden by controlling shareholders, especially in conjunction with the proposal to stop requiring a shareholder vote to approve related party transactions (RPT). The FCA notes that the current regime was introduced for the premium category in response to concerns raised by investors. We have seen no evidence that the regime introduced in 2014 has not delivered its objectives, or that the risk to the interests of minority shareholders has substantially decreased since then. We would therefore urge the FCA to maintain the current regime in the premium segment for the single ESCC category.

Q6: Do you agree that our proposals as regards controlling shareholders align with our need to act, as far as is reasonably possible, in a way which is compatible with our strategic objective of ensuring markets work well and advances our market integrity and consumer protection objectives? If you don't agree, how do you believe these should be balanced differently?

We disagree that the proposals are compatible with the FCA's strategic objective on consumer protection by significantly reducing the rights of minority shareholders to participate in the governance of the companies they own. A comply or explain approach does not seem comprehensive enough and shareholders should continue to be able to vote to approve related party transactions. We believe that litigation, as highlighted by the FCA, is a more complex and costly alternative to the relatively simple approach of a shareholder vote.

Q7: Do you agree with the proposed approach to significant transactions for a single ESCC category? If not, please explain why and any alternative proposals.

We disagree and propose that shareholder approval be mandatory for all significant transactions. We believe shareholders rights should not be restricted and having a vote on significant transactions is important to protect the rights of minority investors. It is crucial that investors have the ability to scrutinise corporate transactions. By removing this right, we fear there may be an increase in the number of poor-quality transactions that could negatively impact shareholder value. We believe keeping the requirement to make Class 2 announcements at the current Class 2 threshold of 5% allows for good transparency. A company should be required under ESCC rules to announce significant transactions that would fall below the current Class 1 thresholds.

Q8: Do you consider that additional disclosure could be considered to further support transparency to shareholders on significant transactions and, if so, what (e.g., considering current circulars)?

As highlighted in the previous response we disagree with the proposals to remove the requirement for shareholder approval for Class 1 transactions and do not believe that additional disclosures will be sufficient to protect the rights of minority shareholders.

Q9: Should we consider further mechanisms prior to a significant transaction being formally completed (for example, a mandatory period of delay between exchange and completion) to support shareholder engagement with listed commercial company equity issuers in place of shareholder approval? What should those mechanisms be and why?

Similar to our response to question 9, we do not believe that a delay mechanism or other measures to facilitate engagement would be sufficient to protect the rights of minority shareholders.

Q10: Should the sponsor's advisory role in assessing whether a potentially significant transaction meets the proposed disclosure threshold be mandatory or optional, and what are your reasons? Do you agree with our proposal that sponsors have more discretion to modify the class tests, including substituting the tests with alternative measures, without seeking formal FCA agreement to the modifications? If you disagree, please provide your reasons and alternative proposals.

It should be mandatory to obtain a sponsor for an advisory role. We would suggest keeping in place the current process for sponsors to obtain a formal FCA agreement. The process for appropriate modifications to the class tests should be disclosed and transparent. The role of a sponsor will become increasingly valuable to companies and it is important proper practice and oversight of this process is conducted.

Q11: Should we consider expanding the sponsor's role further on any aspects of significant transactions?

The current role of the sponsor seems satisfactory and should not be overly complicated.

Q12: Do you agree with the proposed approach to RPTs for a single ESCC category, which is based on a mandatory announcement at and above the 5% threshold, supported by the 'fair and reasonable' assurance model which includes the sponsor's confirmation as described above? If not, please explain why and any alternative proposals in the context of a single ESCC category.

We disagree with removing a mandatory independent shareholder approval of RPTs at or above the 5% threshold, or for RPTs involving a controlling shareholder. This limits shareholder rights and may have a negative impact on shareholder value and lead to potentially abusive behaviour by controlling shareholders. As the FCA notes, the transactions happen so infrequently it should not be overly burdensome on the issuer. The FCA suggests this may be because "there is a significant portion of firms who regard the inclusion of a requirement for shareholder approval in general meeting in current RPT rules as such a significant burden that they simply do not pursue consideration of a UK listing in the first place as a consequence." However, it doesn't present any evidence or consider an alternative rationale that the mandatory shareholder vote discourages companies from engaging in related party transaction that are unlikely to be approved by shareholders. We do agree with the mandatory announcement of RPTs at and above the 5% threshold, to inform shareholders. We believe companies should be made aware of what is considered best practice and what strong disclosure and transparency looks like. Best practice would always encourage greater disclosure of information to shareholders.

Q13: Do you consider that additional disclosure requirements could be considered to further support transparency to shareholders on RPTs, and should we consider requiring certain mechanisms prior to a deal being completed (for example, a mandatory period of delay between exchange and completion) to support shareholder engagement with listed companies to replace the requirement for independent shareholder approval?

As highlighted in the previous response we disagree with the proposals to remove the requirement for shareholder approval of RPTs. We don't see shareholder approval of RPTs as a barrier to companies wishing to list on the premium segment and would unnecessarily weaken shareholder scrutiny and rights as we see no upside from removing this. We don't believe that additional disclosures or delay mechanisms will be sufficient to protect the rights of minority shareholders or reduce risk to investors.

Q14: Should it be mandatory for a listed company in the single ESCC category to obtain guidance from a sponsor on the application of the LR, DTR and MAR whenever it is proposing to enter into a related party transaction (irrespective of the size of the transaction), or should it be at the company's discretion?

Obtaining a sponsor in relation to acquiring guidance on the application of LR when it is proposing to enter into a RPT remains a good idea and should be mandatory. The sponsor ensures that the issuer is operating in line with the listing rules and helps companies avoid confusion. However, there is potential for conflicts of interest and therefore we reiterate the importance of keeping the mandatory shareholder vote for RPT.

Q15: Should it be mandatory for the sponsor to consult with the FCA and agree any modifications to the class tests and classification of a proposed RPT, or should the sponsor have more discretion? Please explain your reasons.

It should remain mandatory for the sponsor to consult with the FCA and disclose information related to the modification of class tests. This allows for greater oversight of listed company transactions and ensures best practice is being followed.

Q16: Are there any broader, alternative mechanisms that existing shareholders or prospective investors would want to see in place of, or made use of, in order to strengthen shareholder protection in relation to RPTs in the event that these changes are made to our LR? If so, would these be matters for inclusion in our LR or are they found, for example, in legislation or market practice?

We believe that there is no substitute for the mandatory shareholder vote on RPTs and that it should be a matter for inclusion in the LR. Additionally, it may be useful to have a list of non-mandatory company best practices, specifically related to trying to strengthen shareholder engagement with RPT's and improving shareholder rights.

Q17: Do you agree with the proposed approach to cancellation of listing for the single ESCC category, and do you have any views on other possible changes to the existing cancellation process?

We agree that retaining the requirement for a shareholder vote to cancel listings of shares in the single ESCC category, including the 75% majority requirement is best practice and in the best interests of minority shareholders. We don't propose any other changes to the process.

Q18: Do you think that the notice period proposed for the single ESCC category for de-listing should be extended (taking the approach of other jurisdictions) and if so to what? What would the benefits be?

Increasing the notice period proposed for the single ESCC category for de-listing is not of major concern in comparison to other proposals, however the longer the notice of intended cancellation, the more time shareholders have to evaluate their positions. The notice period should definitely not be shortened.

Q19: Do you consider the policy for cancellation of listing by the FCA after a long suspension should be revisited? If so, how?

In such circumstances we would suggest that companies who have had their listing cancelled by the FCA for over 6 months should be required to reapply for listing.

Q20: Do you agree with retaining shareholder approval provisions on discounted share issuance and on share buy-backs, as currently required by the premium LR, as part of a single ESCC category, or would these be problematic for certain issuers?

We agree with retaining shareholder approval provisions on discounted share issuance and on share buy-backs as currently required by the premium LR. This does not seem like it would be overly burdensome for issuers and in addition provides shareholders with greater clarity and rights over the capital structure of the company. This seems to be best practice globally in similar developed markets.

Q21: Do you agree with our proposed approach to reporting against the UK Corporate Governance Code for companies listed in the single ESCC category, and are there any other mechanisms the FCA could consider to promote corporate governance standards?

We agree with the proposed approach to reporting against the UK Corporate Governance Code for companies in the single ESCC Category. We think it provides listed companies with a set of standards to follow and report on, which are quite extensive and should be mandatory for all listed companies in the UK. This will give confidence to investors that companies listed in the UK are acting 'responsibly' in regards to best practice around corporate governance issues.

We do not consider this proposal to counter-balance the proposed reduction in investor protections and investors' ability to act as good stewards. Corporate governance and stewardship go hand-in-hand.

Q22: Do you have any views on the proposed application of reporting requirements under LR 9.8 (i.e., premium LR requirements) as the basis for the single ESCC category?

We agree with the proposed application of reporting requirements including TCFD reporting and disclosure requirements on diversity and inclusion alongside the Corporate Governance Code. In addition, maintaining other annual reporting requirements in LR 9.8 is reasonable, to allow for good disclosure and transparency and expect that further reporting requirements, such as the forthcoming ISSB standards, should be introduced in a similar way

Q23: Do you agree with our proposed changes to the LR principles? If not, please explain why and provide details of any alternative suggested approach.

Yes, we agree.

Q25: Do you agree with our proposed changes to strengthen co-operation and information gathering provisions as outlined in this section? If not, please explain why and any alternative suggested approach to addressing the issue identified.

We agree with the proposed changes as they look to strengthen co-operation, increase disclosure and reduce investment risk through greater transparency by listed companies. It's encouraging that an applicant must confirm as part of the application process their ability to comply with the applicable listing rules obligations and transparency and disclosure obligations more generally.

Q26: In relation to our proposal to ask issuers to provide contact details of their key persons, do you think this should include details of the CEO, CFO and COO? Do you have any other suggestions as to other key roles that we should consider? Also, are there circumstances where it would be appropriate for an issuer to nominate a third party (such as an FCA authorised advisor), as a key person and, if so, why?

It should include the CEO, CFO and COO, as well as key members of the board of directors (Chair, lead independent director etc).

Q31: Do you have any concerns that sponsors will be able to demonstrate continued competence under our proposed approach? What matters should the FCA take into account when assessing sponsor competence?

We have no specific comments on sponsor competence in light of our previous comments on the importance of maintaining the requirements of the current premium category to protect the interests of minority shareholders. We believe it is important that the FCA make the requirements for a sponsor transparent and fair across the board. Allowing for assessment to be performed on a case-by-case basis can lead to inefficiencies and unfair judgement.

Q32: We welcome views on proposed restructure of the listing regime set out above. In particular, do you agree with our preliminary proposals for dealing with issuers that are not issuers of equity share in commercial companies?

The preliminary proposals for dealing with issuers that are not issuers of equity shares in commercial companies seem adequate. The inclusion of sovereign-controlled companies in the ESCC category is another important reason it is crucial to have the requirements of the premium segment applied, to impose proper oversight and accountability.

Q45: Have we identified the areas where our proposals may impose additional costs on investors? If not, please explain the additional costs that we should consider in our CBA.

There are a number of areas where we believe FCA proposals will impose great costs to investors. The removal of the financial eligibility requirements will require investors to perform enhanced due diligence on less transparent companies. The proposals on RPTs and DCSS will remove important shareholder protections by not allowing investors to hold management to account, and could result in negative shareholder outcomes. Ultimately, we believe that this could lead investors to reduce their exposure to UK-listed companies and reverse the effects that the UK equity listing reform is trying to achieve. Overall, the proposal fails to recognise what creates healthy capital markets and what investors are looking for.

Q46: To assist us to quantify the costs of our proposals, please provide data or additional information to explain the additional costs to or other impacts on investors.

Deliveroo is a good case study that amplifies investors' concerns regarding the cost of proposals, such as the proposed approach to dual class share structures. For example, Deliveroo's shares dropped 26 per cent after their IPO, erasing almost £2bn from its opening £7.6bn market capitalisation. This plunge ultimately came from Deliveroo failing to win the backing of multiple investors due to its dual class share structure.[1] This should be a lesson learnt for the UK, investors take corporate governance and stewardship duties seriously and see dual class share structures as a major blockage to those responsibilities.

Another good example is the Eurasian Natural resources company (ENRC), which listed in the UK and FTSE 100 Index with a small free float. The flotation raised £1.4bn and ENRC was valued at £13bn after a few months, however eventually poor corporate governance was exposed and the valuation fell massively, leading the company to de-list. There were apparent disagreements involving board and management, allegations of corruption and a criminal investigation into fraud.[2]

Q48: Have we correctly identified the costs to parties in relation to indexation as a consequence or follow-on from our proposals? To assist us to quantify these costs or any other costs we should consider, please provide data or additional information to explain the additional costs or other impacts.

One potential outcome of these proposals is that some issuers currently with standard listings may become eligible for FTSE index inclusion. This could lead investors in index-tracking funds to invest in higher risk companies with weaker corporate governance provisions. The FCA should engage with FTSE Russell on the impacts of a single listing segment on its indexes. We see potential reputational risks for FTSE Russell and LSEG and investors would expect FTSE Russell to strengthen their inclusion criteria to protect them from exposure to poorer quality companies, leading to no change in the index composition but at a higher cost to index providers, which will likely be passed through to their customers. It would therefore be a sub-optimal outcome if there wasn't any consistency between the FCA premium listing reforms and FTSE Russell's own potential changes to its UK Series index inclusion criteria.

These proposals could also bring additional costs to investors in the form of additional resource needed for monitoring and stewardship.

Q49: Do you agree with the benefits of our proposals that we have identified above? If not, please explain why.

We agree with most of the benefits relating to some applicants and issuers, particularly in the short term. However, we believe the risks associated with creating those benefits through the proposed changes are too high and particularly the proposals to reduce the protections for minority shareholders which could ultimately lead to less investment in UK-listed companies. We believe that the depth of

[1] **https://news.sky.com/story/traders-go-cold-on-deliveroo-offer-as-shares-flop-on-market-debut-12261448**

[2] **https://www.ft.com/content/7b8716a6-0ef7-11e3-ae66-00144feabdc0**

capital markets, taxation and the location of main operations play a more important role than listing rules in the long term, so the proposed changes may have very little impact on increasing attractiveness of a UK listing and could in fact achieve the opposite. The cost cuts associated with the proposed changes are not considerably large, therefore companies considering listing in the UK are unlikely to be swayed.

In addition, as transparency and reporting continues to improve around the world, some of these proposals indicate a step in the wrong direction and are at odds with some of the FCA's own proposals in other areas, such as SDR. Companies are moving towards improving their own transparency on financial information, so introducing more relaxed proposals in this area are unlikely to encourage a company that listing in the UK is attractive and is incongruous with the direction the Government has taken on stewardship and reporting in the UK. We agree that the listing rules may be easier for investors to understand, however the benefit of these proposals is primarily for issuers and sponsors and not investors.

Q51: What do you consider to be the most important factors in deciding where to list (for example, regulation, valuations, depth of capital markets, comparable peers, investor / analyst expertise, taxation, director remuneration requirements, indexation, location of main operations). Please rank your factors in order of importance.

It largely depends on the type of company and investor. However, all the factors are important and likely considered by any company during listing.

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