Recommendations for UK Secondary Capital Raising Reform Published

August 4, 2022

On 19 July 2022, a review of the United Kingdom's secondary capital raising regime (the "SCRR") was published, setting out a number of recommendations to reform and update the regime. The SCRR was launched as a result of the recommendations contained in Lord Hill's UK Listing Review, published on 3 March 2021.

The objectives of the SCRR are to make the regulatory regime more flexible and efficient and cheaper, while increasing participation by retail investors in secondary capital raisings.

Below, we summarise the SCRR's key recommendations.

Maintain and Enhance the Pre-Emption Rights Regime. Given that the principle of pre-emption is an important protection for shareholders in UK companies, the SCRR acknowledges that the maintenance of the pre-emption rights regime should remain part of the framework of secondary issuances. In keeping the pre-emption regime, it recommends that the Pre-Emption Group (the "PEG"), a group consisting of representatives of issuers and investment and corporate finance practitioners setting guidelines for pre-emptive offerings, be put on a more formal and transparent footing. This would include the introduction, amongst other things, of a revised terms of reference, a dedicated website with a searchable database of pre-emption regime information and the publication by the PEG of an annual report on the operation of the pre-emption regime.

Increase the Flexibility for Companies to Carry out Smaller Fundraisings. During the Covid-19 pandemic, the PEG temporarily relaxed its guidelines to permit publicly traded companies to issue up to 20% of their issued share capital without pre-emption rights applying. In light of the success of the temporary relaxation, the SCRR recommends that the 20% threshold be kept on a permanent basis (up from the current 10%), subject to companies satisfying the following conditions (which are similar to the conditions introduced with the temporary relaxation in 2020) when issuing additional capital:

- an explanation of the background to and reasons for the fundraising and the proposed use of proceeds should be provided;

- to the extent reasonably practicable and permitted by law, a consultation with a representative sample of the company's key shareholders should be undertaken;

- the issuance should be made on a "soft" pre-emptive basis, and the shares should be allocated based on the current shareholder base to the extent possible; and

- company management should be involved in the allocation process.

In addition, the SCRR recommends the introduction of two additional conditions, namely:

- due consideration should be given in all placings to the involvement of retail investors and other existing investors; and

- up to 10% of the issuance proceeds should be available for use for any purpose with up to a further 10% being permitted for only an acquisition or a specified capital investment announced contemporaneously with the issuance or which has taken place in the previous 12 months.

In line with the current regime, the 10% + 10% pre-emption authorities would be subject to prior shareholders' approval at the company's annual general meeting on an annual basis.

Immediately after the placing, companies should report to the market on how the placing was carried out using a template to be issued by the PEG to confirm the satisfaction of the conditions described above, as well as disclose the discount to market price at which the shares were issued and the gross proceeds and net proceeds (i.e., net of all fees) raised in connection with the placing. Such reports would have to be kept publicly available on the PEG's proposed publicly searchable database and summarised in the company's next annual report.

In addition, given the tendency for companies to use cash box structures to issue new shares for non-cash consideration and, therefore, to avoid the application of pre-emption rights when raising capital, the SCRR recommends that cash box structures should only be used to increase distributable reserves and capped at the amount of the pre-emption authority granted by shareholders at the company's most recent annual general meeting.

Increasing the threshold before pre-emption rights apply from 10% to 20% is likely to be welcomed by issuers and markets and will provide issuers with significant additional flexibility.

Involve Retail Investors in All Capital Raisings. The SCRR recommends that companies should give due consideration to the interests of retail investors in all capital raisings. Companies should have flexibility to decide how best to achieve the involvement of retail investors, depending on the circumstances of the fundraising and the nature of their shareholder register.

The SCRR notes that companies can make use of current market solutions and technology platforms that allow for a separate retail offer following on from the institutional offer. Should companies do so, they should ensure that the follow-on retail offer is limited to 20% of the size of the placing with a cap of £30,000 per investor. This amount would be in addition to the up to 20% pre-emption disapplication authority. Any such offer to retail investors should be on the same terms and conditions as the institutional offering and be open for five business days.

Reduce Regulatory Involvement in Larger Fundraisings. Under the current UK prospectus regime, a company with shares listed on the Main Market of the London Stock Exchange plc (the "LSE") is required to publish a prospectus when it admits additional shares of the same class to trading on the same market where such additional shares represent at least 20% of the number of shares already admitted to trading on the Main Market of the LSE. In the SCRR's view, prospectuses prepared for such secondary offerings are often duplicative of the issuer's existing market disclosure and therefore are ultimately not needed by investors; the SCRR, therefore, recommends raising the threshold before a prospectus must be published from 20% to 75% of the existing issued share capital for an admission of shares to trading. It is expected that this would supplement HM Treasury's reforms to the UK prospectus regime, which are designed to significantly shorten the pre-launch preparation time and cost for issuers.

The SCRR also recommends that companies should not generally need to appoint sponsors for secondary fundraisings unless, for example, the secondary fundraising is linked to a material acquisition.

In addition, following the Financial Conduct Authority's (the "FCA") recent proposal to make the approach to working capital statements in IPOs more flexible and based on a disclosure-based approach, the SCRR recommends that the FCA should extend such proposals to secondary raisings. The key disclosure should be around the rationale for the amount of funds being raised and the use of the proceeds. The SCRR notes that the current approach in relation to "importance of vote" language can lead to unnecessarily

hypothetical outcomes, which are often artificial and can put fundraisings and the continued viability of companies at risk.

Make Existing Fundraising Structures Quicker and Cheaper. The SCRR proposes reducing the offer period for rights issues and open offers from 10 business days to seven business days. In addition, for shareholders' meetings that are not annual general meetings, the minimum notice period is proposed to be reduced from 14 clear days to seven clear days.

In the context of offerings to U.S. institutional investors and other non-UK shareholders, the issuer's financial advisers typically require the provision of appropriate legal and accounting comfort for U.S. securities laws purposes. Under the current structure of the UK secondary offering regime, this requires the issuer to publish a full prospectus to provide the level of disclosure required for such comfort to be given. To permit companies to undertake pre-emptive offers quickly and cheaply, the SCRR recommends permitting issuers to opt in to an enhanced continuous disclosure regime, rather than being required to publish a full prospectus, by way of more detailed disclosures in the issuer's annual report in areas including risk factors, the business overview and the operating and financial review. It is intended that these additional disclosure requirements would be less onerous and duplicative than the current regime. These disclosures would be subject to the same liability standard as other market disclosures.

The proposed streamlined disclosure regime in secondary offerings could raise some issues in connection with the provision of a customary legal comfort for U.S. securities law purposes to the underwriting banks, but the SCRR proposal assumes that a shorter, non-duplicative offer document, together with adequate public disclosures and an efficient due diligence process, would be sufficient for law firms to provide the necessary legal comfort for U.S. securities law purposes to the underwriting banks. The SCRR notes that an alternative could be for a supplemental offer disclosure to be published in an extended press release at the time of the offer.

Possible Additional Features of Pre-Emptive Fundraising Structures for Companies. The SCRR notes the different types of accelerated fundraising structures used in Australia, including AREOs, ANREOs, PAITREOs and SAREOs. Whilst such structures cannot be readily implemented in the United Kingdom because of the differences between the UK and Australian regimes, the principles that they follow (speed and the observance of pre-emption rights) are sound, and some of their features can be replicated in the United Kingdom.

One example given by the SCRR is the Australian concept of a "cleansing notice". This is an announcement by a company at the time of a fundraising that confirms that it is

fully compliant with its market disclosure obligations, and it is not delaying the disclosure of any inside information. The SCRR notes that a cleansing notice could be adopted in the United Kingdom in the context of secondary issues where the public offer does not require a prospectus. Other features from the Australian regime that could be adopted include shorter offer documents that do not duplicate existing market disclosures (as discussed above), the use of market-standard terms and conditions with institutional investors and splitting shareholder registers to identify institutional and non-institutional investors more readily.

Start an Ambitious "Drive to Digitisation". The SCRR notes that its recommendations to make fundraising structures quicker and cheaper will be realised even more effectively if a digitised shareholding system is developed. The SCRR therefore advocates eradicating paper share certificates and introducing a digital system to ensure rights attaching to shares flow to end-investors quickly and such investors can exercise those rights efficiently. Companies should have greater transparency real-time over the ownership of their shares and investment decision-makers.

The SCRR recommends that such changes should be coordinated and driven by a new digitisation taskforce. The Digitisation Taskforce was launched on the day that the SCRR was published and is chaired by Sir Douglas Flint.

Comment. The recommendations contained in the SCRR are ambitious, and whilst some of the recommendations can be enacted fairly quickly, some recommendations will require legislation or broader policy development. If the recommendations are adopted, the United Kingdom would substantially streamline its current secondary market regime, as well as making it cheaper and more efficient. Coupled with the FCA's ongoing Primary Markets Effectiveness Review, this could help make London a more attractive venue for global companies to list their shares.

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Please do not hesitate to contact us with any questions.

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