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PLSA Consultation response: Primary Markets Effectiveness Review: Feedback to CP23/10 and detailed proposals for listing rules reforms

We welcome the opportunity to respond to Consultation Paper CP23/31 - Primary Markets Effectiveness Review: Feedback to CP23/10 and detailed proposals for listing rules reforms and we thank the FCA for the opportunities to engage throughout this consultation period. Engagement with senior officials at the FCA has provided important insight into how these proposed reforms form one part of the wider approach to securing greater inward investment into the UK.

The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

We appreciate that the underlying objective of these proposals is to improve the UK's competitiveness and attractiveness globally by encouraging and increasing investment into UK growth. However, we wish to take this opportunity to remind the FCA that this intention must be balanced with consumer protection considerations and fundamentally, protecting consumers from bad conduct must be at the centre of any proposals. Our members still have significant concerns on a couple of key issues that we believe would not be in the best interests of savers and which we still are not convinced have been considered sufficiently in the policy debate:

1. Removal of sunset clauses on Dual Class Share Structures.
2. Removal of votes for significant and related party transactions.

These concerns have been present throughout the development of these proposals and we have, on a number of occasions, made the point that we do not believe the measures being proposed by the FCA will have the desired effect. This response will reiterate these concerns and propose what we see as viable alternative options.

In our response, we have taken the approach of grouping some questions so that our response is considered by certain key themes. Where we have done so, we have set out which questions we have grouped together.

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Question 1

Question: Based on our overall proposals for commercial companies, and taking into account the broader UK regulatory, legal and corporate governance environment, do you believe that we have struck the right balance in designing a proposed regime that enables the conditions for a stronger, more effective and competitive listed market with appropriate measures in place to support market integrity and investor protection. If not, what changes should be made?

Answer:

We do not believe that, as proposed, the measures put forward by the FCA strike the right balance. We are concerned that far too much weighting has been put on the views of sell side respondents. There seems to be a misconception that the buy-side will retain significant leverage over the sell side, despite these proposals, and we simply do not think that will be the case.

Our members do not disagree with the principle of a single listings regime and accept that simplification could be beneficial in attracting inward investment into the UK. The concern we have is that the changes being proposed to Dual Class Share Structures (DCSS), and the removal of votes on related and significant party transactions, will move the UK too far away from the high standards set by the current premium listing regime. We would like to take this opportunity to highlight again the July report published by the Investor Coalition for Equal Votes,[1] which most strikingly identifies that not only do Dual Class Share Structures fundamentally damage shareholders' rights but also that any potential financial advantages of dual class share structures for companies, if they exist, tend to recede quite rapidly over a short period of time.[2] We have not seen any evidence contrary to this to show that the changes proposed to dual class share structures, as well as significant and related party transactions, will encourage companies to list in the UK or increase M&A activity. We would call on the FCA to publish evidence if any is available.

By ushering in a system that is closer to the current standard listing system, there is no guarantee of effective corporate governance and we simply do not have confidence that a disclosure-based regime, which relies on the engagement and good practise of companies, is sufficient.

Question 6

Question: Do you agree with our proposals for allowing DCSS for companies listing shares in the commercial companies category and our

[1] ICEV (2024), 'Undermining the Shareholder Voice', https://cdn-suk-railpencom-live-001.azureedge.net/media/media/55reei4u/icev-report-2023-undermining-the-shareholder-voice.pdf

[2] Bebchuk, L. and Kastiel, K. (2017), 'The Untenable Case for Perpetual Dual-Class Stock', Virginia Law Review, Vol. 103 (4), pp. 585-631, https://virginialawreview.org/articles/untenable-case-perpetual-dual-class-stock/

approach to matters on which enhanced voting rights can be used? If you disagree, please explain or suggest alternative approaches?

Answer:

We do not agree with the proposed direction of travel in relation to DCSS.

We have heard the arguments outlining that DCSS can play a role in materially stimulating the IPO pipeline by incentivising founders to list in the UK, but we have not seen the evidence to support that the current approach is the most significant stumbling block preventing UK listings.

We would cite developments in some important global markets that paint an interesting picture. Regional surveys conducted by the Asian Corporate Governance Association (ACGA),[3] presented in their report '*A new order,*' set out the biggest shift in global markets rankings for 20 years. Japan has surged with policymakers ramping up corporate governance reforms and actively attempting to boost shareholder value.[4] This is proving enormously attractive to likeminded investors, and research by PwC[5] further highlights how Japan is re-emerging with the country re-entering the global top 10 for follow-ons. Interestingly, both the ACGA report and PWC research highlight how Hong Kong continues to see a decline in IPO issuances. This is despite Hong Kong rolling back on corporate governance protections in recent years (including on DCSS). These examples demonstrate that diluting corporate governance standards does not guarantee growth and actually could inhibit it. This supports our view that the approach proposed by the FCA is not the way to achieve the intended outcomes.

We have significant concerns that the FCA has not included any time-related sunset requirement to limit the ability to exercise enhanced voting rights. This would mean that shareholders and prospective shareholders would need to rely on their ability to engage companies and take decisions on whether to invest based on their risk appetite. Members have continually made the point that without a sunset clause, there is no guarantee companies will engage. If they do, it will have a significant impact on escalation processes which are likely to be much more costly for schemes and companies. In the long-term, this only seems likely to further reduce the willingness of companies to engage and we do not accept that this is a good outcome.

We are concerned by the FCA rationale which seems to suggest that pension schemes continue to maintain control and influence through their ability to divest if they are not satisfied with a company's governance standards, or that schemes can rule out investing in the first place where companies are known to have poor governance

[3] ACGA (2023), 'A New Order', https://www.acga-asia.org/pdf/cg-watch-2023-overview-report

[4] Joseph Lee and Mizuki Suma (2023), 'The Future of Japanese Corporate Governance: Participation, Sustainability, and Technology, Oxford Business Law Blog, https://blogs.law.ox.ac.uk/oblb/blog-post/2023/01/future-japanese-corporate-governance-participation-sustainability-and

[5] PwC (2024), 'Global IPO Watch 2023 and outlook for 2024', https://www.pwccn.com/en/audit-assurance/publication/global-ipo-watch-jan2024.pdf

processes. Strong governance requirements are one of the reasons that our members choose to invest in the UK, and were this to weaken, other markets may appear more attractive. Whilst it is the case that they can divest, it is clearly at odds with the message of the FCA and Government who are seeking to incentivise growth. If everyone divests if they are not satisfied, then not only will it work against the growth agenda, but it is unlikely to lead to any change at the company level, because the ability to engage is taken away.

There are further challenges for pension schemes who have passive investments in indexed strategies. A survey from The Investment Association[6] outlined how indexed strategies make up 37% of pension scheme assets - a significant proportion of total assets. These assets will be managed through a fund and so to divest would require engagement with the asset manager and it is likely this would incur a significant cost. With a thought back to member interests, this approach cannot be seen as a good thing for scheme beneficiaries who ultimately would lose out, as costs would likely follow through to them. We note that Railpen have engaged with the six largest index providers, who have indicated that they could create a bespoke index to address the issue of investors concerned about corporate governance standards, but clearly this would be more costly with yet further cost implications on member outcomes.

Our position, and that of our members, is clear. We favour maintaining the current sunset clause (five years) and maintaining the 20:1 maximum voting ratio. The five-year limit was an evidenced-based decision by the FCA, and this is discussed in the FCA's statement in PS21-22, stating that "this number is also consistent with the various academic research highlighted in the consultation." We are sympathetic to the FCA's concerns that negotiating a suitable figure for a sunset clause provision is difficult, but we feel strongly that some form of guard rail mechanism to protect those on the buy-side is vital. We therefore propose a couple of alternatives:

1. Given our strong support for a sunset clause, we propose its inclusion. As we have made clear, our preference would be for a requirement to review every five (in line with FCA evidence) to seven years, but at least every 10 years. Whilst this timeframe would still be sub-optimal for our members, we hope it could go some way to striking a balance between views on either side of the argument.
2. A variation on this measure would be to include some form of review clause that would mandate a continuation vote. This could be triggered at a predetermined date after the IPO, and we would suggest no more than 10 years after the IPO.
    a. We would want to see a continuation vote giving shareholders the opportunity to vote on removing superior voting rights and converting them into ordinary shares or retaining the DCSS arrangements for a set, pre-determined number of years.
    b. We also suggest prohibiting enhanced voting rights from applying to the continuation vote. This would be in keeping with current proposed

[6] The Investment Association (2023), 'Investment Management in the UK 2022-2023', https://www.theia.org/sites/default/files/2023-10/Investment%20Management%20in%20the%20UK%202022-2023_0.pdf

limitations. Instead, a continuation vote could require a majority of not less than 75%, if it is passed by not less than 75% of the votes cast by those shareholders entitled to vote.

We believe implementing either of these proposals would be an encouraging move that would not impact the UK's efforts to open capital markets, but would ensure that investors retain their ability to bring about change that could benefit a listed company's long-term performance.

Questions 7, 8 & 15

Question 7: Do you agree with our proposed approach towards a significant transactions regime for the commercial companies category? Please provide any alternative views.

Question 8: Do you agree with our proposed enhanced disclosures regime for significant transactions? If you disagree, what changes do you consider we should make and why?

Question 15: Do you agree with our proposed approach towards a related party transactions regime for the commercial companies category and the specific disclosure proposals for notifications? Please provide any alternative views as relevant.

Answer:

Our asset owner members place a strong emphasis on exhibiting good stewardship and responsible investment practises. They remain very concerned with the proposed approach of the FCA, which focuses solely on pursuing a disclosure-based regime in relation to significant and related party transactions, instead of shareholder votes which runs counter to these objectives. The FCA itself has previously noted in its 2019 paper the clear link between meaningful, well-targeted stewardship and financial performance.[7]

The view from the FCA seems to be that shareholder votes are not highly valued and rarely drive negative responses. However, it is clear to us that their presence alone is a highly effective deterrent that drives good corporate governance. Our members are clear that shareholder votes are a vital investor protection. Votes provide them the opportunity to make their views known on important and relevant transactions.

Academic evidence suggests that acquirers subject to shareholder voting are more likely to engage with their investors and provide essential disclosures during the transaction period. This in turn leads to better outcomes for both managers and investors, as well as stronger post-merger performance.[8] This further illustrates how

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[7] FCA (2019), 'Building a regulatory framework for effective stewardship', https://www.fca.org.uk/publication/discussion/dp19-01.pdf

[8] Tan Do, Beatriz Garcia Osma, Anna Toldrà-Simats and Fengzhi Zhu (2023), 'Shareholder Voting and Disclosure in M&As', ECGI https://www.ecgi.global/sites/default/files/working_papers/documents/shareholdervotinganddisclosureinmas.pdf

the value of shareholder votes, and the increased requirements and expectations on disclosures that accompany them, can be a benefit to successful M&A activity and not a hindrance. We would also highlight that academic research suggests that robust shareholder protections help to increase stock market capitalisation, trading, and turnover.[9]

Simply requiring disclosures, without any accompanying mechanisms for investors to act pre-emptively on a transaction they are unhappy with, fails to provide an appropriate level of protection. We are concerned at the knock-on effect that the removal of shareholder votes will have:

1. A disclosure-based regime will put more responsibility on investors to do due diligence themselves. This will quickly ramp up costs both for investors and listed companies, which runs counter to value for money initiatives elsewhere.
2. We remain unconvinced by the FCA expectation that, as good practice, investee companies will offer shareholder votes. That is not guaranteed, and we do not think it is very likely, given there does not seem to be any real incentive for companies to engage with stakeholders without a requirement to do so.

We acknowledge that our members do invest in companies in other jurisdictions that do not have the protection of shareholder votes on significant and related party transactions. But, in doing so, our members think incredibly carefully about their strategic asset allocation, and may choose to carry additional risk in some investments because of the security they have in others. Losing some of the protections from their AUM in UK investments will significantly alter the risk profile of AUM and will be a major challenge to manage. In addition, we know from the ICGN statement that it risks undermining investor confidence in UK assets.[10]

Therefore, we think it is vital that the challenges we have raised are addressed and propose a couple of options:

1. Do not proceed with the removal of shareholder votes on related party transactions.
2. Consider whether there is an option to include some form of requirement for UK listed company boards to engage shareholders on significant transactions, given the disclosure-based regime will not provide the transparency needed for continued trust in the UK's current reputation for high corporate governance standards. Any requirement to engage would need to encompass all shareholders, including the beneficial owners. We would be happy to work with the FCA on what this proposal may look like.

[9] Guillén, M. F., & Capron, L. (2016), 'State Capacity, Minority Shareholder Protections, and Stock Market Development', Administrative Science Quarterly, *61*(1), 125-160, https://journals.sagepub.com/doi/10.1177/0001839215601459

[10] ICGN (2024), 'Statement on High Standards of Corporate Governance and Investor Protections as Pre-requisites for UK Capital Market Competitiveness and Growth', https://www.icgn.org/icgn-statement-high-standards-corporate-governance-and-investor-protections-pre-requisites-uk

Question 57

Question: Do you hold any information or data that would allow assessing the costs and benefits considered (or those not considered) here? If so, please provide them to us.

Answer:

Quantification of potential due-diligence costs relating to the removal of shareholder votes on significant/related party transactions (and how this is likely to fall largely on asset managers):
As we have outlined elsewhere in our response, the FCA proposals to shift towards a disclosure-based regime will inevitably lead to an increase in pension scheme due diligence. This will drive up costs which again, as we have set out, runs counter to FCA value for money initiatives. On top of this, we have significant concern that costs will fall disproportionality on smaller schemes, who will need to work harder and dedicate more resource to achieving similar outcomes to their larger counterparts.

We are grateful to colleagues at Railpen who have provided an estimate of due diligence costs per action. We have significant concerns at these estimations and their potential to quickly ramp up to the detriment of scheme beneficiaries.

CP23/31 proposal	Estimated cost per company/action as noted
Dual class share structure (no sunset clause)	£44,000 over a five-year holding period (pre- and post- investment) *per company*
Significant transaction (no shareholder vote)	£10,000 per significant transaction (post-investment only) *per action*
Related Party Transaction (no shareholder vote)	£24,000 per related party transaction (pre- and post-investment) *per action*

Question 58

Question: Do you agree with our conclusion that the proposals don't significantly reduce the investment in UK listed companies compared to current levels, but might increase investment if larger number of companies list in the UK? We welcome comment, in particular, if supported with evidence on the likely impact on investment levels.

Answer:

We think it is too simplistic to assume that more listings alone will increase levels of investment. There are a couple of reasons which we believe demonstrate why this assumption is not automatically the case:

1. At the start of February, the ICGN issued a statement[11] on the importance of high standards of corporate governance (of which we, and a number of our members, were signatories). It is an important statement, since it reflects the concerns that a number of leading global investors have with the FCA's proposed direction of travel. The statement is clear that "the UK's reputation for high quality listing and governance standards and resultant overseas investor confidence is both a competitive advantage and a positive differentiator for the UK market in a global context". This suggests that the FCA proposals are not guaranteed to lead to increased investment from global investors, and could potentially lead to divestment.
2. Additionally, the FCA proposals, as drafted, are focused solely on attracting new listings. Our members are concerned that, even if the proposals do increase the number of UK listings, there is little being done to stem the flow of companies leaving the UK. If we want to encourage newly listed companies to stay in the UK and grow, we believe new measures would be needed, most likely in the form of a significant package of fiscal incentives. We are clear that we would want to be heavily involved in the development of such proposals.

Finally, it is vital that the FCA puts in place a clear monitoring system to measure the impact of the reforms to UK Listings rules. It will be important to understand both what the impact is on the number and quality of UK listings, but also what the impact is on the corporate governance landscape. We have yet to see clarity on this area and encourage the FCA to consider this further, and report back with more information.

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We thank the FCA for the opportunity to respond to this consultation and we urge further consideration of the issues we have raised in our response to shape the final UK Listings Rules. We would be happy to respond to any queries or provide further information.

Kind regards,

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[11] Ibid