Council of Institutional Investors®
The voice of corporate governance

June 28, 2023

Primary Markets Policy Team
Financial Conduct Authority
12 Endeavour Square London
E20 1JN

Via electronic submission: cp23-10@fca.org.uk

Re: CP23/10: Primary Markets Effectiveness Review: Feedback to DP22/2 and proposed equity listing rule reforms.

Dear Sirs/Madams:

I write on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of US public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants. Our associate members include non-US asset owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management.[1]

CII members have significant capital invested in UK-listed companies, and we share a commitment to healthy public capital markets around the world and strong corporate governance. We respect the FCA's efforts to facilitate UK competitiveness for global listings, and we acknowledge the intensity of regional pressures on regulators around the world to extend listing requirements to their most accommodative limits. Our relationship with Railpen since 2022 as co-founders of the Investor Coalition for Equal Votes (ICEV) underscores our interest in the UK market.

While CII does not object to a migration to a single-segment listing regime in principle, we are concerned by potential unnecessary reductions in investor protections made in connection with such a transition.[2] This letter addresses the potential rollbacks of greatest concern to CII.

[1] For more information about the Council of Institutional Investors (CII), including its board and members, please visit CII's website at http://www.cii.org.
[2] We communicated a similar theme in our response to Discussion Paper DP22/2. DP 22/2: Primary Markets Effectiveness Review: Feedback to the discussion of the purpose of the listing regime and further discussion, https://www.fca.org.uk/publication/discussion/dp22-2.pdf. CII response letter available at https://www.cii.org/files/issues_and_advocacy/correspondence/2022/07-28-22%20FCA%20comment%20letter%20final.pdf.

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Dual-Class Share Structures (DCSS)

We acknowledge the UK's extensive history of prohibiting unequal voting rights within Premium segment until December 2021. Equity structures with "enhanced voting rights" distort alignment between ownership and control for the purpose of ensuring that board members, and the managers they ostensibly oversee, serve at the pleasure of unaccountable founders, presenting performance risk to long-term shareholders. That is fundamentally why CII's membership-approved policies oppose unequal voting rights and support reasonable, time-based sunset provisions for DCSS.[3]

As an investor organization, we are disappointed that the FCA has recently gravitated toward generally accommodating DCSS in perpetuity for companies listed on the single segment, notwithstanding indication in May 2022 that it intended to "maintain the high levels of transparency, corporate governance and shareholder protections that characterize the UK listing regime."[4] At the time, the FCA appeared to be contemplating a less extreme position, under which listed companies could choose equal voting upon IPO or DCSS for up to five years, in concert with several ancillary safeguards for public shareholders. CII supported that approach in 2022 and we continue to support it. **We respectfully urge the FCA to adopt a mandatory five-year sunset requirement for DCSS across the single segment, as a reasonable balance between promoting capital formation and protecting investors**.

Research has shown that the negative effects of ownership-vote misalignment increase over time.[5] Time-based sunset provisions help mitigate this risk and provide certainty to the market about the company's path to accountable governance.

CII has observed over the last six years that although DCSS structures have risen among newly public US companies (as of 2022, approximately one in five), time-based sunset provisions are trending toward greater acceptance among companies choosing DCSS.[6] Adoption by the FCA of a reasonable time-based limit on unequal voting would be consistent with the private ordering trend away from indefinite DCSS.

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[3] CII Corporate Governance Policies, available at https://www.cii.org/corp_gov_policies, and CII Statement on Investor Expectations for Newly Public Companies, available at https://www.cii.org/policies_other_issues#newly_public_companies.

[4] Discussion Paper DP22//2, available at https://www.fca.org.uk/publication/discussion/dp22-2.pdf

[5] See, e.g., Martijn Cremers, Beni Lauterbach and Anete Pajuste, The Life-Cycle of Dual Class Firm Valuation (June 30, 2022). European Corporate Governance Institute (ECGI) - Finance Working Paper No. 550/2018, available at https://www.ecgi.global/sites/default/files/working_papers/documents/duallifecyclefinal.pdf. See also, Lucian Bebchuk and Kobi Kastiel, "The Untenable Case for Perpetual Dual-Class Stock," 103 Va. L. Rev. 585-631 (June 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2954630.

[6] CII analysis found that among US initial offerings, the proportion of DCSS companies utilizing time-based sunset provisions rose from 26% in 2017 to 43% in 2022. For more information, please see https://www.cii.org/dualclass https://www.cii.org/files/publications/dual-class/2022%20Dual%20Class%20Report.pdf.

Financial eligibility criteria

Financial eligibility requirements can serve a valuable market function by helping to ensure baseline quality of public equity. There is room for debate over how to integrate financial criteria into listing requirements; history of revenue, cash flows, earnings, shareholder equity, audited financials and 'clean' audits have a potential role, whether applied in combination or separately, broadly or tailored to industry. Recalibration of eligibility requirements can address specific areas of stated FCA priority, such as the attraction of biotech companies. Instead, the FCA proposes to replace financial eligibility requirements with disclosure. Blunt reductions in listing standards may have spillover effects for indices seeking to capture the investable universe, which in turn could nudge investors toward more costly alternatives, such as custom index services or active stock picking.

Accommodations for Special Purpose Acquisition Companies (SPACs)

While we understand *prima facie* why a special category of equity shares is warranted for shell companies including SPACs, we believe extending FCA accommodations for SPACs calls for a careful review of the *extent* of conflicts and risk SPACs pose, and whether greater accommodation for this complex and costly path for public market entry is fit for purpose. Recent history paints a grim picture of overly optimistic financial projections, value-destroying governance arrangements and weaknesses in accounting practices.[7] We also note the proportion of US IPO proceeds derived from SPACs has cratered from its peak of 59% in 2022 to 23% thus far in 2023.[8]

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[7] The example of Lordstown Motors illustrates the consequences of markets accommodating capital raising models that amplify dubious projections and de-emphasize performance history. With no history of revenue, Lordstown thrust itself into the public equity markets in 2020 through a de-SPAC merger, only a year after having been created. In connection with tapping public investors' capital, the SPAC published Lordstown estimates that by 2024, it would annually produce over 100,000 vehicles and over $5 billion in revenue. See p. 102 of DiamondPeak Holdings 2020 annual meeting proxy statement at https://www.sec.gov/Archives/edgar/data/1759546/000110465920113421/tm2029038-7_defm14a.htm. Public investors bid up market capitalization to a peak of over $5 billion on Feb. 11, 2021. Reality caught up to the hype, but not before the evaporation of billions in public investors' savings. On June 27, 2023, the Wall Street Journal reported that Lordstown had filed for chapter 11 bankruptcy. See https://www.wsj.com/articles/lordstown-motors-bankruptcy-sues-foxconn-5c7a0f46.

For a discussion of accounting weaknesses of companies going public via SPAC merger, see Dec. 6, 2022 Financial Times, "Spacs confess to accounting weaknesses as year-end audits loom," available at https://www.ft.com/content/58ed6ba3-780a-41d1-a970-c1376ea4abdd. See also In the Matter of Marcum LLP Respondent, Exchange Act Release No. 97773; Acct. & Auditing Enforcement Release No. 4423 (June 21, 2023), available at https://www.sec.gov/litigation/admin/2023/34-97773.pdf.

SPAC sponsors routinely allocate Founder Shares to the same "independent" directors who are charged with reviewing deal quality negotiated by the sponsor. These allocations generally become worthless if a transaction is not consummated within a specified time, and not surprisingly, focus can turn quickly to simply getting a deal done. The de-SPAC shareholder vote does not carry the governance benefits understood in the context of traditional acquisition votes. See Michael Klausner, Michael Ohlrogge, Emily Ruan. "A Sober Look at SPACS", Yale Journal on Regulation, 2022, Vol. 39, Issue 1, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3720919.
[8] See https://www.spacanalytics.com/.

Clarifying the voluntary nature of certain eligibility criteria

CP23/10 proposes eligibility criteria for the single segment under two sets of "continuing obligations" for listed companies: one mandatory and the other "supplementary," i.e., voluntary. The term "supplementary continuing obligation" may not effectively communicate the voluntary nature of this second category of criteria. Referring to this category as "optional disclosures and practices" or similarly straightforward terminology would likely reduce market confusion.

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Thank you for considering the views of the Council of Institutional Investors.

Sincerely,

Glenn Davis
Deputy Director