Council of Institutional Investors®
The voice of corporate governance

July 28, 2022

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

Via electronic submission

Re: DP 22/2: Primary Markets Effectiveness Review: Feedback to the discussion of the purpose of the listing regime and further discussion

Dear Sirs/Madams:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of U.S. 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-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[1] CII members have significant capital invested in the U.K., and we share a commitment to healthy public capital markets around the world and strong corporate governance.

This letter responds to Discussion Paper DP22/2.[2] As a general matter we support a transition to a single segment regime with strong investor protections and high standards of corporate governance. We appreciate the efforts of the Financial Conduct Authority (FCA) to carry out this significant undertaking.

Dual class share structures (DCSS)

CII strongly supports the proposed limitations on DCSS for the single segment regime. Our primary concern with DCSS is the principal-agent risk that is exacerbated for investors when equity structures skew the alignment of ownership and voting rights. Fundamentally, CII believes that when a company goes to the capital markets to raise money from the public, equity investors with the same residual claims should have equal protections and rights, including the right to vote in proportion to the size of their holdings.

As a long-time advocate for alignment between equity and voting power, CII is pleased to have recently joined Railpen in co-founding the Investor Coalition for Equal Votes (ICEV). CII is a

[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] 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.

co-signatory to a letter submitted by that group in response to DP22/2, outlining in more detail why this important investor protection is appropriate for the single segment regime.[3] We agree with the ICEV that "Capital structures providing disproportionate voting rights to founders and other insiders cause long-term performance risk by foreclosing companies' ability to make necessary leadership changes in response to sustained underperformance. Boards cannot carry out their fundamental oversight purpose if capital structures are designed specifically to render founders, their favored board members, and their favored managers unaccountable to the holders of a majority of outstanding shares."

As the next-best alternative to immediate equal voting upon entry to the public markets, time-based sunsets mitigate long-term investor risks of DCSS. Time-based sunsets are gaining in prevalence among U.S. initial public offerings tracked by CII. Our analysis found that the proportion of DCSS companies utilizing a time-based sunset provision increased from 26% in 2017 to 51% in 2021.[4] We strongly support the five-year limit outlined in the discussion paper, and have no objection to buttressing this approach with additional constraints on super-voting rights during that five-year period. These include a 20:1 ratio cap, high-vote holder eligibility requirements, and parameters on the types of proposals eligible for super-voting rights.

Financial eligibility criteria

DP22/2 indicates consideration of removing financial eligibility requirements from listing standards under a single segment regime. These requirements include:

- Three-year representative revenue earning track record
- Three years of audited historical financial information that represents at least 75% of the issuer's business
- A 'clean' or unqualified working capital statement

The discussion paper notes that the "intent is not to reduce standards but instead allow investors to consider the characteristics of each issuer on an individual basis." We respectfully urge the FCA to focus on the practical consequences for long-term, broadly diversified public equity investors. We share particular concern with three potential consequences of doing away with these requirements: an increase in speculative companies entering the public markets; greater volatility in public equity as an asset class; and higher research and trading costs for investors with varying practical ability to individually analyze thousands of companies. Amendments to listing standards that nudge market behavior toward active stock picking present new risks and costs to the market that may not be in the interest of broadly diversified, long-term public equity investors.

The discussion paper contrasts the contemplated elimination of financial eligibility requirements with financial eligibility requirements under the Nasdaq Global Select Market, which offers four alternatives based on earnings, capitalization with cash flow, capitalization with revenue and assets with equity. We caution that removing baseline financial eligibility requirements

[3] Investor Coalition for Equal Votes letter (July 28, 2022) available at https://www.cii.org/files/issues_and_advocacy/correspondence/2022/28-07-22%20ICEV%20FCA%20letter.pdf.
[4] https://www.cii.org/dualclass_stock

altogether would not just concede to global "race to the bottom" pressures, but would amplify them.

The discussion paper observes that "the requirements around consistent growth and revenue generation were last reviewed at the time of the dot-com bubble," and that those requirements were considered "important at that time." Baseline listing standards for business viability are valuable to investors, particularly for those who are navigating market downturns. We ask whether this moment is the appropriate time, if there is such a time, for accelerating the entry of pre-revenue businesses into the hands of public equity investors.

Clarifying the voluntary nature of certain eligibility criteria

The discussion paper puts forward eligibility criteria for the single segment under two sets of "continuing obligations" for listed companies: one mandatory and the other "supplementary," i.e. left to listed companies' discretion. Migration to a single segment regime is an opportunity to consider whether the term "supplementary continuing obligation" makes clear the wholly voluntary nature of disclosures and practices in this category. We suggest the single segment consider referring to this category of eligibility criteria as "optional disclosures and practices," in lieu of the contemplated terminology, which may unintentionally convey a level of investor protection that differs from what a given listed company actually discloses and practices.

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Thank you for considering the views of the Council of Institutional Investors. Please do not hesitate to contact me at glenn@cii.org with any questions.

Sincerely,

Glenn Davis

Glenn Davis
Deputy Director