IA Response to Consultation

HMT: UK Prospectus Regime review consultation

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 270 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.4 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 44% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive Summary

The IA welcomes this opportunity to input into HMT's Consultation on the UK Prospectus Regime.

The IA and its members have an ambition to re-energise public markets and create a savings and investment ecosystem which delivers for end savers and is attractive to both companies and global investors. We seek to widen UK and international businesses' access to long-term pools of capital and maintain robust standards that will help deliver long-term returns to our clients and their beneficiaries, including retail and pension savers. By channelling savings through capital markets, the investment management industry is a key source of funding for the UK economy, providing financing to a wide range of companies.

In response to Lord Hill's Call for Evidence - Listings Review the IA outlined our belief that the prospectus requirements should be subject to a wholesale review, with a particular focus on improving the efficiency of the capital raising process for both issuers and investors. We stated that a review should look to streamline the prospectus requirements to focus on providing investors with the information they need to make long-term investment decisions, as the current approach is too focused on managing liability.

We therefore welcomed the recommendations in the Listings Review Report to conduct a fundamental review of the prospectus regime. We agree with HMT that the FCA should be given new rule making responsibilities and granted new discretions to embed the practical elements of the prospectus regime into its rulebook. The FCA, as the UK's securities regulator is the correct body to set the content of prospectus requirements, to ensure that they are consistent with the interests of the market and its participants, improving the quality of information in prospectuses for investors while removing duplicative requirements that are unnecessarily burdensome for issuers.

We would like to signal our support for the differentiated approach proposed for primary and further issuances; ensuring that prospectuses reflect the information needs of investors necessitates such an approach.

We would like to stress two outstanding issues which we believe merit further consideration by HMT when it implements the proposals, and by the FCA when it becomes empowered to make rules:

- Protection of Pre-emption rights – Pre-emption rights are a key strength of the UK's securities markets. The protection of minority shareholders from the dilutive effects of large non-pre-emptive capital raises provides investors with the confidence to invest their capital through the UK's listed markets. A weakening of these rights will undermine confidence in markets, adversely impacting on the ability to attract the capital of both domestic and overseas investors to the UK's equity markets. The current requirements in the regulations for companies to produce a prospectus when they issue 20% or more of their issued share capital in the preceding 12-month period provides a natural barrier against non-pre-emptive issuances above 20%. HMT and the FCA should consider the practical implications that the reform has on pre-emption rights.

- Forward Looking Information – Reducing the liability applicable to forward looking information may not, in itself, result in a meaningful increase in forward looking disclosures within prospectuses. Forward-looking information gives investors a greater ability to assess a company's future strategy and ability to generate long-term returns. They can also contribute to greater market integrity through reducing information asymmetries leading to more accurate asset pricing. We ask that HMT and the FCA consider further actions to encourage forward-looking disclosures and increase the decision usefulness of prospectuses.

Questions

1. Do you agree with our overall approach to reforming the UK prospectus regime?

Yes. The IA and our members agree with the overall approach.

There is an important distinction between the differing information needs of investors for prospectuses prepared for an admission of securities to a regulated market, and those prepared for a public offering. We agree that these two instances should be treated differently in prospectus regulation.

We also support HMT's overall approach to grant the FCA with new rule making responsibilities on admissions to trading on regulated markets and enabling the FCA to incorporate the new prospectus regime into its handbook. Prospectuses are an integral part of the smooth operation of the securities market. Any reforms to the prospectus regime needs to consider the integrity and competitiveness of the UK's market and will require an extensive and robust consultation process, with market participants. We agree that the FCA, as the UK's securities regulator and therefore the body with the most relevant institutional knowledge, is the correct body to lead the more detailed elements of the reform of the UK prospectus regime through consultation with the market. Embedding the new prospectus regime into the FCA rulebook will afford the regime far greater flexibility than retaining it in statute; enabling regular updates to ensure it is reflective of current market practice and the interests of the wider market.

We therefore support HMT's proposals to retain in statute only the elements of regulations where it is strictly necessary, and to grant the FCA the powers to create the rules that will replace the Prospectus Regulation.

We do however note that alongside these new responsibilities and discretions the FCA will need to make a consistent effort to ensure that shareholder protections remain an integral part of the capital raising process in the UK. Chief amongst these efforts should be the protection of pre-emption rights.

Pre-emption rights are a cornerstone and major strength of the UK capital raising system. They represent one of the most fundamental shareholder rights and disapplying them for larger capital raises poses a considerable threat to investors and the interests of their clients and beneficiaries, including retail and pension savers, whose savings they manage. Any weakening of pre-emption rights will therefore significantly undermine confidence in UK equity markets.

The current prospectus regime plays an important function in re-enforcing pre-emption rights through exempting from public offer rules, further issuances of securities below 20% of issued share capital. Companies must produce a prospectus when they issue 20% or more of their issued share capital in a preceding 12-month period. This 20% threshold provides a natural barrier for any issuers intending on conducting non-pre-emptive issuances of greater than 20% of issued share capital. It therefore protects existing shareholders from excessive dilution through non-pre-emptive capital raises, or from losses where the raise is conducted at a significant discount. It is important to note that market practice in the UK is for investors not to consider supporting non-pre-emptive issuances of greater than 10%. Both HMT and the FCA should be aware of this role that the current Prospectus regime has in upholding pre-emption rights and should ensure that the reformed regime retains pre-emption rights which are such a vital part of the UK equity markets.

The reform of the prospectus regime also offers an opportunity to address an issue that is detrimental to pre-emption rights in the UK. The current regime and the way it is implemented has resulted in a pre-emptive capital raising process that is unduly time consuming and costly for companies. Through requiring a full prospectus to be produced for pre-emptive issuances, companies are unable to raise significant capital at speed and may not have sufficient time to prepare, gain approval, and publish a prospectus ahead of a pre-emptive capital raising. The current regulations therefore incentivises companies to raise capital on a non-pre-emptive basis through accelerated book-build.

This became particularly evident through the COVID-19 pandemic when companies sought to strengthen their balance sheets through raising capital. The majority of these companies chose to do so through non-pre-emptive cash boxes, as they were uncertain if they would be able to raise capital quickly enough through a pre-emptive capital raising given the requirement to publish a prospectus ahead of the offering. Whilst most large shareholders received their pro-rata entitlement through these non-pre-emptive structures not all shareholders will have received their pre-emptive entitlement. This was detrimental to minority investors who did not participate in those capital raises who had their shareholdings diluted.

In recognition of this, we are supportive of the proposals to exclude offers to existing shareholders (rights-offers) from public offering rules, and the removal of requirements for a prospectus to be produced for pre-emptive raises. This will remove a key barrier for issuers who wish to do the right thing by raising capital on a pre-emptive basis, thereby protecting their shareholders from dilution.

Finally, we are also supportive of creating an exemption from Section 85(1) of FSMA for companies with (or applying to have) securities admitted to trading on stock markets. Securities that are already freely trading do so in a highly regulated market where they are

subject to a number of ongoing disclosure requirements, they are therefore well known to their investors and the wider market. The prospectus produced by such companies for further issuances contain large amounts of duplicated publicly available information, and so have little additional value for investors. Requiring that this information is repeated in the prospectus for secondary issues not only increases the time and costs burden for issuers, but makes them increasingly long and may even detract from important new or offer-specific information.

2. **Do you agree with the key objectives that we are seeking to achieve?**

Removing the disincentives that currently exist for companies to issue securities to a wider group of investors is imperative to creating a savings and investment ecosystem that delivers for both companies and savers. The IA would like to stress the importance that any attempts to facilitate wider participation in capital markets will need to respect the principles of pre-emption and should also explore the balance of retail investor protection with restrictions for retail investors to participate in the equity raising process. Provided these two concerns are kept in mind we agree with Objective 1.

The review of the UK prospectus regime should focus on improving the efficiency and cost-effectiveness of the infrastructure that supports capital raising and the approach to documentation and regulation. It should streamline the prospectus requirements to focus on providing investors with information to make long-term investment decisions, as the current approach is too focused on managing liability. We therefore welcome Objectives 2, and 3.

In relation to objective 4, we agree that prospectus regulations should be sufficiently agile to reflect changing market practices, and this will contribute to the long-term success of UK capital markets. Embedding the new prospectus regime into the FCA rulebook will afford the regime far greater flexibility than retaining it in statute. An agile prospectus regime supported by a dynamic engagement process with sound governance, will create the foundations for a regulatory approach that is responsive to the needs of the market. Consequently, we agree with the overall approach to grant the FCA greater rule making responsibilities.

3. **Do you have any views on the underlying purpose of a prospectus when seeking admission to a regulated market?**

We agree with HMT's proposed statement of purpose. However, we would like to note that this should be understood as a very general statement of purpose.

The information within a prospectus needs to be complete enough to allow investors to make an assessment as to the long-term prospects of a company. This requires that there is information on the current financial health and stability of the company that allows a prospective investor to comprehensively understand the business today. Just as important, there needs to be sufficient disclosures to inform an investor as to the company's future and how it intends on creating value for its investors over the long-term. The reform to the UK prospectus regime must ensure that prospectuses present a fair, balanced and understandable assessment of the company's current position as well as its long-term prospects.

The definition and content of a prospectus should be consistent with this.

4. **Do you agree the FCA should have discretion to set rules on when a further issue prospectus is required?**

Yes. Investors have different information needs from prospectuses prepared in connection with a primary issuance and those prepared in connection with a further issue, this difference should be reflected in the revised approach to the rules governing the content and timings of prospectuses.

There is a clear and established need for a prospectus when an issuer is seeking admission to a regulated market and is making its first public offering of securities. However, following admission to a regulated market, an issuer is subject to a number of ongoing disclosure obligations rules. These obligations ensure that an issuer informs the market of any developments which are material to its value. Provided that investors have the confidence that the publicly available information is correct and 'up-to-date' the market will be fully informed.

Prospectuses for further issuances often duplicate a substantial portion of this publicly available information. This adds extra cost and time to what is already a complex capital raising process, without providing further decision useful information.

We therefore agree that a full prospectus is not required in all instances where securities are admitted to Regulated Markets and support the proposal to give the FCA discretion to set rules when a further issue prospectus is required.

However, whilst the need for a prospectus in the case of a further issuance is not universal, there are occasions when a prospectus (or similar offering document) will be necessary. Some form of prospectus should always be required for transformational capital raises which would significantly change the capital structure of a company. The FCA, when exercising its discretion, should seek to minimise the time and cost burden placed on companies through the capital raising process, while ensuring the latest public information on a company's performance and risks is not out of date.

Finally, as we outlined in response to question 1, the removal of requirements for prospectuses for further issuances will also remove a barrier that protects minority shareholders from dilution caused by non-pre-emptive capital raises over 20% of the issued share capital. This may have detrimental impacts on pre-emption rights with the UK. We believe that a weakening of these rights would not only put the savings of investors at risk of dilution but will also adversely impact on the attractiveness of UK equity markets for investors. We therefore strongly encourage both HMT and the FCA to consider how the new prospectus regime can support and uphold pre-emption rights and any adverse impact on pre-emption rights might be minimised or mitigated.

5. **Do you agree the Government should grant the FCA sufficient discretion to be able to recognise prospectuses prepared in accordance with overseas regulation in connection with a secondary listing in the UK?**

Yes. The UK's regulated markets are an international security market where secondary listings are, and should remain, an established feature. We agree that the FCA should be granted sufficient discretion to be able to recognise overseas prospectuses for the purposes of a secondary listing in the UK. This will allow the FCA to remove a significant barrier to overseas companies obtaining a secondary listing, and may lead to an increase in secondary listings, giving UK investors access to a broader range of companies.

Where the company's primarily listing is on a foreign regulated market with equally high standards in relation to the preparation and content of prospectuses, we believe that the FCA should have sufficient discretion to recognise an overseas prospectus. However, this

discretion should only be applied where the overseas prospectus meets the same minimum standards relating to prospectus preparation and content as UK listed issuers.

We therefore expect this discretion to be used with caution to ensure that it does not lead to any 'relaxation' in the standards as it relates to quality of information provided, or shareholder protections. This is particularly relevant where the issuer's primary listing is on a market with less stringent requirements.

The FCA will also have to consider if it can ensure that a Company with a Secondary Listing is subject to the continuing obligations with regards to disclosure.

Finally, the FCA will have to be satisfied that securities regulator in the issuers primary market has enforcement mechanisms that are equivalent to the FCA's and be satisfied those investors who purchase securities through the secondary listing have sufficient recourse. The FCA will also have to provide clarity on UK recourse to compensation where there is misleading or untrue information within the prospectus which leads to shareholder losses.

6. **Do you agree with our approach to the 'necessary information test'?**

In principle we approve of an approach which allows the FCA to set out different standards of preparation and content for further issuances compared to primary issuances. However, we are concerned that the relevant regulations for issuers will sit across at least three separate documents (Article 6 of Prospectus Regulations, Supplementary Guidance, and the FCA handbook) and so may prove to be unnecessarily complex.

We encourage HMT and the FCA to work to make the regulations regarding the preparation of prospectuses as simple and transparent as possible with the goal of reducing complexity for issuers. Key to this will be ensuring that there is consistency across regulations contained within statue and those within the FCA rulebook.

7. **Do you agree the FCA should have discretion to set out rules on the review and approval of prospectuses?**

We agree that, below the level required to establish a statutory standard of preparation, the FCA should be the body to stipulate rules on prospectus content.

As mentioned in response to question 1, it is important to distinguish between an issuer coming to market with an initial public offering and an issuer that is already listed and is conducting a secondary offer. Granting the FCA powers to modify the content requirements for secondary issuances will allow it to ensure that prospectus requirements are reflective of the information needs of investors. Reducing the amount of information required in the secondary offer by allowing issuers to incorporate by reference allows the prospectus to focus on the salient terms of the offer.

At the moment, prospectuses are unduly long and contain too many generic or boiler plate statements in relation to risk factors that do not aid investor understanding. The FCA should be able to address this issue and ensure that prospectuses remain presented in a way that is usable for both institutional and retail investors. Allowing the FCA to specify the component parts of the prospectus in addition to the detail of the content will allow it to remove any duplicative or superfluous requirements, thereby reducing the burdens placed on issuers. Not only will this benefit issuers, but it could provide benefit to investors and the operation of the market.

Many investors feel that prospectuses, particularly those for an IPO, are not publicised with sufficient time ahead of the IPO. This negatively impacts on the ability of investors to include prospectus disclosures in their investment modelling and decision making and so impacts on their view of price formation, it also means that investors do not have enough time to sufficiently prepare for management meetings. Reducing the content demands should enable issuers to publish prospectuses earlier in the IPO process. With regards to base prospectuses, investors are similarly concerned about the lack of time they have to assess the disclosures within a prospectus due to their late publication.

8. **Do you have any comments on what ancillary powers the FCA will need in order to ensure admissions of securities to Regulated Markets function smoothly?**

N/A

9. **Do you agree with our proposed change to the prospectus liability regime for forward looking information?**

Yes. The current statutory liability standards which apply to the prospectus has effectively ensured that there are no forward-looking disclosures in a prospectus. We believe that this situation is not consistent with the purpose of a prospectus to provide potential investors with the information they need to make an investment decision in a security.

When deciding to invest in a company, investors need to assess the company's future strategy and the likelihood that this will generate long-term returns. Robust forward-looking disclosures inform this assessment and gives confidence to investors about the company's strategy and financial resilience. The IA encourage regulators to ensure that investors have access to better forward-looking disclosures across the entirety of corporate reporting, including through prospectuses, periodic reporting such as the Annual Report, and through RNS announcements.

The quantity and quality of forward-looking information included in annual reports and RNS announcements is not currently delivering all the required information that investors wish for when making investment decisions. However, we recognise that the statutory approach taken to the liability that applies to disclosures in these elements of corporate reporting is far more conducive to the disclosure of forward-looking information than the approach taken to prospectuses.

We therefore agree that the 'recklessness liability standard' should apply to forward-looking information in prospectuses. This should facilitate greater disclosure of forward-looking information, allowing investors access to decision-useful information, leading to more accurate asset valuations, and reducing information asymmetries. Reducing the liability standard will be an important first-step in encouraging greater disclosure of forward looking-information, but it should not be the only step. We encourage HMT and the FCA to consider what further actions might be taken to encourage companies to make more forward-looking disclosures both within the prospectus and wider corporate reporting.

We also note that the FCA's CP21/21: Primary Market Effectiveness Review includes a discussion on track record requirements and that the FCA may consider waivers to the existing rules on track record.

Were there to be greater disclosure of forward-looking information from companies seeking admission to regulated markets, the FCA would be able consider track record

requirements in tandem with forward-looking information. Provided that the forward-looking disclosures are robust enough to give confidence to investors about the company's strategy and financial resilience and that the totality of disclosures can be sufficient to support informed investment decision making, the FCA could consider providing greater flexibilities on its track record requirements for admission to the premium segment.

HMT should therefore facilitate greater disclosure of forward-looking disclosures through a reduction in the applied liability standard, as this will improve the quality of information available to investors. In addition, this is also a pre-requisite to an FCA conducting a review of the track-record requirements which act as a significant barrier to entry for some companies who seek admission to regulated markets.

10. Do you think that our proposed changes strike the right balance between ensuring that investors have the best possible information, and investor protection?

We welcome the additional warnings that HMT proposes. Where disclosures within the prospectus are subject to a lower standard of liability it should be clearly identified. This will ensure that all investors, and particularly retail investors, are aware of the reduced standard of liability but also that there are far greater levels of uncertainty that apply. Clearly signalling which disclosures in the prospectus have a lower liability standard attached is an appropriate approach and strikes the correct balance.

However, as set out in response to question 9, we are concerned that this change alone may not result in any discernible improvements in the disclosures made within prospectuses. The IA therefore, encourage regulators to consider if there are any other steps which they might take to greater encourage and facilitate the disclosure of forward-looking information by issuers.

11. Which option for addressing companies admitted to MTFs do you favour and why?

We favour option 2. We agree that AIM listed companies should be exempted from section 85(1) for the same reasons as outlined above in response to question 1. It is also important that companies seeking admission to AIM provide investors with access to quality information that supports well-informed decision making, of which forward-looking disclosures are an important part.

A further benefit of Option 2 is that it is consistent with *Objective 1: 'To facilitate wider participation in the ownership of public companies'*. Due to the current approach taken to MTFs, admission documents prepared for an IPO in accordance with AIM (whose rules are supervised by the FCA) are not considered to be prospectuses. Consequently, the current prospectus regime, effectively prohibits wider participation in AIM IPO's since ordinary retail investors are not classified as Qualified Investors. Recognising AIM admission documents as prospectuses will allow the participation of retail investors in an AIM IPO.

12. Do you agree there should be a new exemption from the public offer rules for offers directed at existing holders of a company's securities?

Yes, the IA agree that offers directed at existing holders of securities should be exempt from the public offer rules.

Recent experience through the COVID-19 pandemic had demonstrated that the rights issue process has become unduly costly and slow for issuers, with prospectus requirements being a major source of both barriers. As a consequence, when companies needed to raise additional capital to strengthen their balance sheets following the effects the covid-19

outbreak, they had to rely on flexibilities from investors to use non-pre-emptive 'accelerated book-builds'.

However, this is not a permanent solution. Pre-emption rights are amongst the most essential protections for minority shareholders and they are widely acknowledged as a great strength of raising equity capital in the UK. Under current market-practice, investors value being consulted ahead of all non-pre-emptive placings above 5% to solicit their opinion and support, and issuers appreciate the 10% flexibility in terms of speed and cost. The process overall ensures that any non-pre-emptive transaction is well received and priced favourably.

There is therefore a need to address barriers that dis-incentivise rights issues and ensure that companies who need to raise capital, especially over 10% of their issued share capital, with urgency are able to do so on a pre-emptive basis.

We therefore agree with an exemption from public offer rules for offers directed at existing holders of securities. Whilst investors want to have sufficient information to make informed investing decisions, existing holders of securities will already be familiar with the issuer, and a full prospectus does not add much. In the context of a rights issue the cost and time burden of prospectus disclosure requirements is disproportionate with the marginal value of the disclosures within.

The series of capital raises through the pandemic has shown that investors have been willing to support companies through a capital raising with only the publication of a trading update. Where companies do need to raise capital through a rights issue, members have been clear that the most important disclosure is not a full prospectus but rather the working capital statement. This gives confidence that the company will have a sustainable approach to capital management under different scenarios and secures the longevity of the capital raise.

We agree with the addition of an exemption from public offering rules for issuances for offers directed at existing holders of a company's securities. However, we expect the FCA to introduce rules governing the required disclosures in connection with a rights issue, once it is given the relevant powers.

13. Do you agree we should retain the 150 person threshold for public offers of securities and the 'qualified investors' exemption? Do you have any comments on whether they operate effectively?

The IA agrees that several of the proposals would provide enough flexibility for issuers, and facilitate wider participations in offerings of securities, including:

- Exemptions from Section 85(1) for issuers with securities already trading on regulated markets and MTFs;
- Recognition of AIM admission documents as prospectuses; and
- Exemption from Public Offering Rules for offers to existing securities holders

With regards to the efficient operation of the 150-person threshold, this does not apply to the intermediary firms but rather on a 'look-through' basis. This requires that each intermediary consults with all other participating intermediary firms and ascertain the total number of 'non-qualified' investors which it wishes to engage. This is a very challenging and costly coordination issue, which intermediaries rarely, if ever undertake.

14. Does the exemption for employees, former employees, directors and ex-directors work effectively?

N/A.

15. Which option for accommodating the right of private companies to offer securities to the public do you favour?

Our members, as qualified investors, are more likely to invest in the securities of private markets through direct investment or a wholesale offering of securities. However, we would like to stress that private companies offer a very different investment prospect to companies that are publicly listed and have very different risk profiles. If HMT pursues expanding the participation of retail investors in private companies it should ensure the regulation can offer suitable protections for retail investors.

16. **Which of the options above do you prefer? (Please state reasons)**

N/A

17. Do you have any further thoughts or considerations over how a new deference mechanism (Option 2) should operate?

N/A

18. Do you agree there should be no mechanism to allow public offerings of securities by overseas unlisted companies? (Please state reasons)

N/A