Hermes Investment
Management Limited
1 Portsoken Street
London E1 8HZ
United Kingdom

Tel: +44 (0)20 7702 0888
Fax: +44 (0)20 7680 9452

www.hermes-investment.com

Primary Markets Policy
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS
cp17-21@fca.org.uk

13 October 2017

Dear Sirs,

Proposal to create a new premium listing category for sovereign controlled companies

Hermes Investment Management is an asset manager with a difference. With £30.1 billion in assets under management we focus on holistic returns – outcomes for our clients that go far beyond the financial and consider the impact our decisions have on society, the environment and the wider world. Its stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on £310.7 billion[1] on behalf of over 40 international institutional investors.

Executive summary

The UK's reputation for high standards has been well earned, should be proudly guarded and seen as an asset. For this reason we oppose the proposed creation of a new premium listing category for sovereign controlled companies.

While the listing of sovereign-controlled companies in London would be attractive from a short-term commercial perspective, in particular for the stock exchange, investment bankers, lawyers and other advisors in the City, it is questionable whether their listing is beneficial to the underlying savers whose money will ultimately be invested in such companies. We believe that protecting the reputation and the value of a primary London listing, which can mean a lower cost of capital, should be at the top of the regulator's agenda when considering amendments to the Listing Rules.

It is our fundamental belief that the financial system and specifically the regulatory framework should operate in the interests of ultimate owners - the underlying savers. From the perspective of the ultimate owner, for example a UK pension saver, they are primarily concerned for the long-term return from their investments in companies around the world which is facilitated by adequate shareholder rights, investor protection and management accountability, as opposed to the short-term profits generated by a successful IPO and the subsequent profits from secondary trading that may accrue to the stock exchange and other market participants. Those markets that offer strong protections for investors should be best suited to attracting long-term orientated companies and providers of capital.

Yours sincerely,

Will Pomroy, Manager, Responsibility
Hermes Investment Management

[1] Assets under management and under advice correct as at 30 June 2017

OVERVIEW OF THE PROPOSED NEW PREMIUM LISTING CATEGORY

Question 1. Do you agree with the overall proposal outlined in this paper of creating a premium listing category for sovereign controlled companies?

No, we do not see the merit in creating a new category of premium listed companies for sovereign controlled companies and indeed are concerned that doing so would risk the UK's well-earned reputation for market integrity as a result of high standards of governance.

As we argued in response to the FCA's previous discussion paper (DP17/2 'Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape') the UK's existing listing regime already provides companies with a range of listing options and has proved effective in attracting a sizable number of international companies.

As an investor we value and are reassured by the high barriers to entry to obtain a premium listing. The investor protections offered and conveyed by the badge of a having a premium UK listing are well understood and influence our assessment of such companies vis-à-vis those listed in other markets.

Existing investor protection rules pertaining to controlling shareholders and oversight of related party transactions do not of course change the fact that a company is controlled by, in this case, a national government who will ultimately prevail. However, the transparency and checks and balances they provide are nonetheless important. Those rules that are now under re-consideration were only introduced in 2014 following the high profile governance failures at resource companies ENRC and Bumi Resources. It is difficult to argue that rules that are deemed useful in the context of privately controlled companies should not also apply to sovereign controlled companies, for example, when they buy or sell businesses from other state owned companies. Together, the protections granted to minority shareholders in relation to related party disclosures and the controlling shareholder agreement helps ensure that a company is run with all investors in mind.

At least some government owned companies will be as unpredictable as privately owned companies and the UK market's reputation can be all too easily damaged. Protecting the reputation and the value of a primary London listing, which can mean a lower cost of capital, should be on top of the regulator's agenda when considering amendments to the listing rules.

For these reasons, it is difficult to be supportive of diluting the protection the primary listing rules provide across the premium category, not least where a standard listing is already available to a sovereign controlled company.

Question 2. Do you agree that the changes proposed are best effected through the addition of a new listing category?

As outlined above, we do not believe there is a need for the new listing category and consider that the creation of such a category may mean risks to the reputation and the value of primary listings that are impossible to estimate today.

We do agree that sovereign-controlled companies are very different to ordinary commercial companies. That is not to say however, that they are necessarily always safer investments. While a government is often well aligned with the interests of a long-term investor, there is also often a large divergence of interest between the government and minority shareholders. While national governments can have a positive influence on how companies are run, they often find themselves in a complex situation as expectations for the state to deliver on political agendas are high. In the worst case scenario, state ownership can lead to the wrong kind of influence or even corruption.

As recognised by the OECD, in the case of state-owned entities, "it is important that the state doesn't abuse its role as a dominant shareholder….abuse can occur through inappropriate related party transactions, biased business decisions or changes in the capital structure favouring controlling shareholders." More pertinently still, the OECD guidelines go on to suggest that: "in situations where there may be a conflict between the interest of the state and those of minority shareholders, such as related party transactions, the involvement of minority shareholders in the approval process of such transactions should be considered."

This risk profile is one that is well understood by investors and is typically factored into valuations. There is little case that we can see that their difference merits adjustments to the requirements of the UK premium listing regime. To do so would risk confusion and implicitly suggest a judgement about the risk characteristics of an investment in such a company.

If there is deemed to be a real need for a new listing category for sovereign-controlled companies then we would urge the FRC to consider doing so outside of the "premium label." It should be very clear that this new segment is different from the existing premium segment and as such does not come with the same level of investor protections – it cannot be "premium" with sub-premium standards.

The FCA is likely acutely aware that obtaining a premium listing is a pre-requisite for a company seeking index inclusion. It is our view that companies that aim for inclusion in indices, for example through a primary listing, should be required to adhere to the highest levels of investor protection. Providing protections and control rights to investors can effectively be regarded as a quid pro quo for their access to generally highly liquid and low cost pools of capitals. More specifically, if an issuance is going to result in forced buyers of the equity then those forced buyers should in turn be granted adequate rights. While the entry criteria for index inclusion is outside of the FCA's remit it should nonetheless be very cognisant of the implications of its decisions on all market participants.

CONTROL THRESHOLD

Question 3. Do you agree that the threshold for control should be set at 30%?

Yes, 30% is a well understood level for considering that de facto control has been reached and is thus already established in the listing rules as the threshold under which a shareholder is considered to be controlling, at which point they become subject to additional requirements including the relationship agreement and independent shareholder vote.

NATIONALITY ISSUES

Question 4. Do you agree that eligibility for the new category should not be restricted on grounds of national identity of the controlling shareholder? Do you agree that it should also not be restricted on grounds of country of incorporation of the company?

As explained previously we do not agree that a new listing category is warranted. If one is created which hopefully responds to the concerns we have expressed then we would agree that it should also not be restricted on grounds of country of incorporation.

PROTECTIONS FOR INVESTORS

Question 5. Do you agree that independent shareholder approval should be required for a transfer from an existing premium listing into the new category?

Yes. It is very important that independent shareholder approval should be required for an existing listed company to transfer from its existing premium listing into the new category.

MODIFIED RELATED PARTY RULES

Question 6. Do you agree that the sovereign controlling shareholder should not be considered a related party for the purposes of the Listing Rules?

No. As we have highlighted the OECD's Guidelines on Corporate Governance of State-Owned Enterprises acknowledges the potential abuse of related party transactions. While it is true that with a national government the risk of wealth transfer from the company and minority shareholders to related third parties and controlling shareholders is lower than it might be with respect to other parties a risk does remain and additionally minority investors benefit from the additional oversight into the workings of the company that they would not otherwise possess.

Critically, if a company is able to move assets between the State and the company with little to no disclosure or oversight from minority shareholders then investors are not able to have confidence in valuing the company, or be confident that the company is meeting other premium listing requirements to be carrying on as an independent business as its main activity as there will be concerns that it is being run in the interests of other stakeholders.

Question 7. Do you agree that MAR-mandated disclosures are sufficient to secure the necessary at-the-time transparency?

Whilst Market Abuse Regulation mandated disclosures will mitigate to some extent the removal of certain information requirements, they do not provide the same overall level of protection or oversight, it is for this reason that the additional requirements are in place.

NO CONTROLLING SHAREHOLDER RULES

Question 8. Do you agree that controlling shareholder provisions should not apply in respect of the sovereign controlling shareholder for companies listed in this category?

We do not agree that the recently created controlling shareholder provisions should be disapplied in respect of sovereign-controlled companies.

We acknowledge that the enhanced voting rights for independent shareholders in respect of the election of independent directors have to date proved to be of limited impact, after all the controlling shareholder's wishes will still prevail, in particular if they are inattentive to public perception. That said, we do believe that the double voting mechanism does provide for an important signalling effect. Given that the role of independent directors is more important still in the boardroom of a controlled company this signalling mechanism allows us to demonstrate our support or opposition to the actions of the Board's independent directors, in so doing this can help those same independent directors press their arguments around the board table and ensure that they are helping to ensure that the best interests of all investors are pursued.

The removal of the requirement for relationship agreement is perhaps more concerning. These agreements are important documents in setting out how the company and controlling shareholder will act, what rights are extended and how each party is expected to interact. In the case of a company and the state understanding these relationships are very important. As noted already, a state-owned company may have significant political pressures to manage and a government shareholder will likely have very different financial imperatives to minority investors and these imperatives can change dramatically over time, potentially with little or no notice to minority shareholders.

DEPOSITARY RECEIPTS

Question 9. Do you agree that DRs over equity shares should be eligible for this category?

No we strongly oppose the proposal that Depositary Receipts become eligible for this new category of listing.

In the first instance, DRs are presently only eligible for a standard, rather than a premium, listing in the UK. There appears to be no merit in creating an exemption to this practice solely for sovereign-controlled companies.

More broadly, we do not agree that DRs for any issuer should become eligible for a premium listing. We are particularly concerned that to do so, irrespective of any guarantees provided about the 'passing through' of voting rights, would provide a back-door for companies to obtain index inclusion without meeting other criteria such as free-float requirements.

Finally, we note that the existing structure has proven successful in attracting a good number of international companies to list their depositary receipts in London and in so doing allow investors to obtain exposure to a company with a primary issuance overseas.

Question 10. : Do you agree that full pass-through of voting and other rights on the basis described should be a requirement for eligibility of DRs for listing in the proposed category?

We agree that the full pass-through of voting and other rights is important, however, we do not agree with the proposal that DRs should eligible for premium listing in any form, whether in the existing segment or in any new segment. We would however, encourage the FCA to continue to explore how it may work with investment banks to ensure that those wishing to exercise the voting rights for their interest in a company held via DR can do so in an efficient manner.

OTHER CHANGES

Question 11. Do you agree with the proposed consequential changes to the Listing Rules and to the Fees manual set out in Appendix 1?

N/A