Hermes Equity Ownership Services Limited
150 Cheapside, London EC2V 6ET
United Kingdom

+44 (0)20 7702 0888 Phone
+44 (0)20 7702 9452 Fax
www.FederatedHermes.com

June 15, 2023

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

Re: Feedback on the proposed rule changes to create a single listing category for shares in commercial companies.

Dear Sir/Madam,

EOS at Federated Hermes welcomes the opportunity to provide our comments on the Primary Markets Effectiveness review.

EOS at Federated Hermes is a leading stewardship service provider advising on $1.3 trillion as at 31 March 2023. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on governance, business strategy and purpose including relevant environmental and social issues. We believe this is essential to build a global financial system that delivers sustainable wealth creation: improved risk adjusted long-term returns for investors including through better, more sustainable outcomes for society and the environment.

The views expressed in this communication are those of EOS at Federated Hermes and do not necessarily represent the views of all clients. Our response to this consultation is explicitly supported by Lothian Pension Fund (UK).

Overview

The Primary Market Effectiveness consultation comes at an opportune time for UK market participants. Comprehensive conversations are taking place across a broad range of stakeholders, all of whom are heavily invested in improving and maintaining the competitiveness of the UK market for companies, investors and the wider financial market. We appreciate the opportunity to provide feedback on the proposed reforms.

We believe that public markets exist to provide an environment in which companies, guided by beneficial corporate governance requirements and robust protection of shareholder rights, gain access to capital which allows them to grow and deliver long-term, sustainable wealth creation. Balancing capital access with a strong focus on protecting shareholder rights will thus attract the right combination of companies and investors to create a deep pool of liquid capital. In our view, standards for listing requirements should not be lowered and companies should not pursue a public listing solely for the sake of listing. Doing this promotes a 'race to the bottom' ideology, and devalues the benefits to investors of companies listing and trading publicly.

When a company lists on a main market, there are multiple factors which we consider to be important. One of these is the protection of minority interests. Stakeholders of all sizes must be properly accounted for as part of the listing process, in order to ensure company behaviours are aligned with a broad range of interests. Similarly, we would expect to see the implementation of authentically good governance practices, rather than the adoption of a formulaic 'tick box' approach that does not match the company's context. These priorities should be matched by a business environment which allows for a company to invest and grow profits in a sustainable manner, coupled with an engagement approach that allows constructive dialogue with stakeholders to achieve better performance.

There are several elements of the proposed consultation which we would like to address as part of our response.

Related-Party Transactions

On the proposal to amend the thresholds and tests for related-party transactions (RPTs), we note the rationale outlined by some market participants in paragraph 5.31 of CP 23/10 that *"there is a significant portion of firms who regard the inclusion of a requirement for shareholder approval in general meeting in current RPT rules as such a significant burden that they simply do not pursue consideration of a UK listing in the first place as a consequence"*. This argument does not seem compelling, as the logistical hurdles involved in setting up a general meeting do not appear to be regularly inhibiting companies from conducting extraordinary business, such as seeking additional capital allocation authorities or conducting M&A activity. The provision of additional proposals as part of an annual general meeting relating to RPT activity does not appear to have inhibited their activity where these authorities have been sought – indeed, paragraph 5.30 remarks that *"such shareholder votes are relatively infrequent, and usually result in approval"*, and the FCA's own evidence remarks that there were 19 instances of shareholder approval being required during the period 2017-2022.

More broadly, the downside potential for *"unintended consequences",* as described in paragraph 5.31, which may arise as a result of relaxing the existing RPT rules, is significant. Shareholder oversight and approval of RPTs conducted by companies they are invested in plays an important role in effective stewardship. Such approvals give investors the opportunity to analyse potentially meaningful corporate actions and, crucially, the ability to properly express their consent or disapproval of the activity being undertaken. An inability to intervene in RPT activity which is not in shareholder interests would hamper the ability for shareholders to conduct effective stewardship, which in turn could lead to destruction of shareholder value and long-term company prospects. Paragraph 5.39 refers to *"the disciplining effect on a listed company's behaviour due to the possibility of a vote"*, a factor which we consider to be important in maintaining good corporate behaviours. We would appreciate seeing any evidence or case studies whereby a company chose to list in an alternative market as a direct consequence of RPT rules.

Audited Accounts Requirements

Concerning the proposed changes to audited accounts for companies, we do not agree with some of the feedback articulated in CP 23/10, and therefore do not consider it sufficient justification for changing the current requirements. For example, we disagree with the claim in paragraph 8 of Annex 2 that *"Information that is 3 years old including that on acquisitions is too out-of-date to have any value to investors"*. Historical information is important to investors when identifying potential targets for investment, particularly for nascent or pre-IPO companies, as it allows investors to build a bigger picture of past performance and provides more information for analysis. A three-year track record is considered by many investors as a basic indicator of confidence before considering a significant level of investment. By removing the requirement for the provision of this information, investors will have less resources available when making decisions that could have significant impact on both portfolio performance and effective capital allocation to firms who require it.

Investors require confidence when investing in early-stage companies, which we believe is built up over time and using a mosaic of information sources. Company disclosures form an important piece of this process. The ability to chart business development trends, analyse capital expenditure/investment decisions and see regulated disclosures helps early stage gain greater confidence, especially when such information is available for an extensive period of time. A requirement for sufficient historical information also serves as a protection for investors against fraudulent behaviour – disclosure of historical financial statements can aid investors in discovering suspicious patterns of behaviour ahead of time and help avert potentially disastrous scenarios.

We do not believe that the associated effort and expense of compiling this historical information is a significant enough hurdle to prevent good quality companies from listing on the UK stock market – indeed, if they do hesitate due to the information required, we would question whether they are the sorts of companies that the UK regime would like to attract.

Dual-class share structures

Finally, we would like to discuss the attitude and potential implementation of dual-class share structures for UK listed companies. We believe that 'one share, one vote' is an important principle of good corporate governance, as the use of a single share class promotes strong alignment and representation of all shareholder interests. We also believe that company leadership should be primarily focused on long-term, sustainable value creation, which entails decision making that extends beyond short time horizons which some investors may be focused on.

The use of differentiated share structures has been implemented in multiple geographies around the world, with varying results. Family-owned enterprises in France, such as LVMH SE, have delivered excellent returns for a broad base of stakeholders over many years operating with a concentrated ownership allocated to family members. Since the introduction of dual-class voting shares at Moncler SpA, which came with strict ownership provisions and guidelines, the company has seen significant share price appreciation, while also being able to defend itself against potential takeover from entities with a shorter-term focus.

We consider that all companies should place stakeholders and long-term thinking at the heart of their decision making. In most cases, we believe that enshrining the principle of 'one share, one vote' helps facilitate this best, as it ensures that all types of shareholders have sufficient opportunity and rights to express their views. However, if the FCA was minded to allow the use of differentiated share classes to achieve a net positive for stakeholders, such as maintaining continuity with a founder-CEO or family ownership who are genuinely integral to the fortunes of a company, we would expect to see strong protections and provisions in place. We would also have to consider them to be genuinely exceptional cases.

Specifically, we would like to see the existing 20:1 voting rights cap maintained, as well as restricting transfer of shares except for particular circumstance (eg, death of the beneficial owner). Also, we would expect the sunset provision to remain in place, with a maximum limit of 10 years and a preference for a shorter time frame. In the event of a corporate transaction, we would expect that the shares revert back to standard shares (ie, without the benefit of a different share class). The presence of these provisions would not guarantee that we would accept a differentiated share class structure at a company – rather, they are a set of minimum expectations we would expect a company to adhere to if planning to implement this kind of structure.

As an investment firm, we are strong believers in the UK market, and are wholly aligned in ensuring that it offers an attractive and dynamic environment for businesses and shareholders. However, we are of the belief that the proposed reforms reduce UK standards of corporate governance, and the potential for negative consequences and reduction in shareholder protections exceeds the relative upside.

Thank you for your consideration.

Respectfully,

Richard Adeniyi-Jones
Engagement
EOS at Federated Hermes