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March 18, 2024

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

Re: Primary Markets Effectiveness Review: Feedback to CP23/31 and detailed proposals for Listing Rules reforms

Dear Sir/Madam,

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

EOS is a leading stewardship service provider advising on $1.4 trillion as at 31 December 2023. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance issues. We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society.

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

We recognise that there has been significant engagement and feedback to the FCA's consultation on the proposed reform of the Listing Rules. We are grateful for the continued opportunity to comment on the proposed changes. Indeed, we recognise that there is significant momentum and desire for a re-evaluation of several foundational features of the UK's corporate governance structure. We believe that all stakeholders involved have a genuine desire to create a system which boosts competitiveness and dynamism, while maintaining the rigorous standards which have become a hallmark of the UK market. We are therefore disappointed to see that the proposed Listing Rules take into account very little of the feedback raised by ourselves and other stakeholders as part of the process.

Significant transactions

On the proposed new regime for significant transactions, we remain of the opinion that the proposed amendments represent a material reduction in shareholder protection. At their core, we believe these votes give shareholders the opportunity to properly assess and approve transactions at a company which may have a material impact on the business and its potential delivery on its strategy. Shareholders should rightly trust the elected board and management to develop and execute on company strategy – however, this trust is something which should be validated by allowing shareholders to have sufficient oversight over significant company developments.

In light of this, the decision to remove compulsory shareholder votes to approve significant party transactions and related part transactions is not something we are supportive of. In the FCA's recent Final Notice regarding the collapse of NMC Health, undisclosed related-party transactions are referenced as an important factor in the FCA's decision to censure the firm. Paragraph 2.13 references *'Related Party transactions which should have been included in the figures reported to the market but were not'*, while paragraph 2.14 finds that the company committed breaches of EU Market Abuse Regulation '*by publishing false or misleading information about its debt position within its March and August Statements and 2018 Annual Report and by failing to declare Related Party transactions therein'*. The market abuse conducted by NMC Health was well disguised, and the presence of a shareholder vote would not have guaranteed a better outcome for the company - indeed, the related-party transactions referenced did not meet the threshold required for a shareholder vote. However, removing the presence of a shareholder vote on any such transactions potentially allows for a wider range of such activity to go unchecked by shareholders, thereby increasing the risk of corporate malfeasance – a risk that we believe is largely unnecessary, with limited upside.

It is interesting to note the divergence in approval for the proposed changes. Paragraph 6.19 of CP23/31 notes that *'Premium listed companies, most legal advisors and a sponsor firm, the sell-side trade bodies and UK market operators by contrast agreed with our CP23/10 proposals and the underlying rationale'*, while paragraph 6.26 notes that *'UK buy-side firms and pension schemes reiterated their strong preference to have a vote on significant transactions under new rules, even if circular content requirements were reduced and sponsor or FCA involvement in approving a circular were no longer required'*. As buy-side participants, it is disappointing to see that the proposed changes do not appear to have taken our concerns into account.

Eligibility criteria for listing companies

We welcome the decision to introduce additional eligibility requirements for shell companies and special purpose acquisition companies (SPACs) as part of the rules on categorisation. Clarity around the time limit for reverse takeovers and the regulation around ringfencing investor capital is a positive development. The relative decline in usage of such vehicles may limit the impact of these changes partially, but we are supportive of their intent.

The changes in eligibility criteria for commercial companies are likely to have far greater impact, and we maintain our previously articulated position on these changes. Specifically, we remain concerned that the removal of requirements relating to historical financial information (HFI), revenue earning track record and working capital requirements could lead to an overall lowering of the quality of company listings. The rationale expressed by some respondents for removing some of these requirements, as set out in paragraph 4.7 of CP23/31, is that *'this will allow high growth companies to list at an earlier stage'*. We would counter that if the current requirements were a sufficient disincentive to listing for a company, then that company is unlikely to be a good fit for a public listing. A three-year track record is considered by many investors as a basic indicator of confidence before considering a significant level of investment.

As we have previously expressed, 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 note that, as outlined in paragraph 4.7 of CP23/31, some respondents indicated that *'their support for removing these requirements was dependent upon retaining HFI requirements and the necessary information test in the context of a prospectus'*. We understand that this may be a potential compromise, if properly enacted. However, we consider that the role of an investment prospectus is to provide investors with information on what differentiates the proposed business and makes it a compelling investment proposition, whereas the role of the regulator is to set minimum comparable standards for potential companies which must be met before they can reach investors and the broader market. As such, we believe it is the role of the regulator to set and monitor these market standards, rather than transferring that responsibility onto those preparing the prospectus.

Dual class shares

As we explained in our last response, 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. As such, we believe there may well be circumstances where a dual class share structure provides the right environment for the creation of long-term, sustainable wealth creation for stakeholders.

In our previous response, we cited examples of family-owned enterprises in France, such as LVMH SE, which have delivered excellent returns for a broad base of stakeholders over many years operating with a concentrated ownership allocated to family members. We stated that 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 robust shareholder protections in place to ensure that alignment between all types of shareholders is strong.

We are pleased that the new Listing Rules would ensure that enhanced voting rights can only be exercised by the original holder, and also that no further weighted voting rights can be issued following listing (as outlined in paragraphs 5.37-5.39 of CP23/31). However we are disappointed that the FCA has chosen to remove many of the other protections which we had previously advocated for, such as the time-based sunset clause provision and the existing 20:1 voting rights cap. FCA feedback highlights that *'There were strong views particularly from buy-side respondents that encouraging more permissive DCSS models could be detrimental to investors' ability to engage with an issuer's management and may reduce company value in the long term'* (paragraph 5.26). We would concur with this feedback – much of our work relies on constructive engagement with portfolio companies, which we have historically found to be more challenging at companies with concentrated dual class ownership. Allowing for more of these structures with less protection risks hindering the ability of the broader shareholder class to properly hold a company to account.

We recognise that the current dialogue around the UK market is driven by a genuine desire to ensure the attractiveness of the market, and as investors we have a vested interest in ensuring that the listing environment strikes the right balance between competitiveness and protection. The US market is often used as a comparative market, due to the listing activity currently taking place. It is worth noting,

however, that over the course of time, even the US market is suffering from a decline in listed companies. In 2000, approximately 6,900 companies were listed on the Nasdaq index. By 2018, this number had fallen to approximately 4,400, and today the number stands at roughly 3,600.[1] Every market is suffering from a downturn in listings, which we believe points to broader systemic issues and therefore a need for a broader consideration of factors when attempting to improve the market environment.

Paragraph 6.18 notes that some stakeholders are concerned that the proposed changes to the Listing Rules *'denoted a 'race to the bottom' in regulatory standards and may reduce investor confidence, and that UK regulation should, in principle, preserve higher standards supporting investors'*. We would echo that view, particularly the UK market's role in aiming for the highest standards to support investors. The proposed changes to significant elements of the Listing Rules regime may not provide the dynamism that the market requires – rather, we are of the opinion that such an approach potentially damages one of the market's genuine strengths.

Thank you for your consideration.

Respectfully,

Richard Adeniyi-Jones

Engagement

EOS at Federated Hermes

[1] Nasdaq Stock Market | Statista.com