Capital Markets Alert

Skadden

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The Secondary Capital Raising Review: Capitalising on the Drive for Regulatory Reform

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Introduction

On 19 July 2022, the U.K. Secondary Capital Raising Review (the Review) published its report (the Report), making significant recommendations to improve the efficiency of secondary capital raising by companies listed on the London Stock Exchange. The Report, which is expected to precipitate significant regulatory and legislative change, is the latest development in the myriad reforms to the U.K. capital markets regime — new rules governing U.K. SPACs, reforms to the rules around free-float and dual-class share structures, and proposals to combine premium and standard listing segments — following Lord Hill's Listing Review last year.

Below are key recommendations and proposals contained in the Report. While His Majesty's Treasury and the Financial Conduct Authority (FCA) have welcomed the findings of the Review, and the Pre-Emption Group (PEG) has begun implementing the proposals, there is no definitive timing as to when new rules or legislation will be brought forward to fully implement the Report's recommendations. The recommendations also mark a significant divergence from the existing EU-based rules that have governed U.K. capital markets law and regulations for decades. It remains to be seen whether, if implemented, these reforms will result in further decoupling between the U.K. and European capital markets.

While the Report's recommendations are encouraging, it is currently unclear how quickly the U.K. government and regulators are able to implement these reforms. Given the fluidity of the U.K. capital markets regime, it is also uncertain how these recommendations will dovetail with the other outstanding and ongoing capital markets-related consultations and reviews.

Key Themes and Recommendations of the Report

1. Easing Pre-Emption Requirements

The Report makes the following proposals to the existing regime surrounding pre-emption rights:

- amending the PEG Statement of Principles to enable companies to seek an annual authority to disapply pre-emption rights up to 20% of an issuer's share capital, which would be comprised of (i) up to 10% available for any purpose at the board's discretion and (ii) up to 10% to raise proceeds in connection with acquisitions or specified capital investments. This would effectively mean the temporary relaxation of pre-emption limits brought in during the COVID-19 pandemic would become permanent. The PEG took up

this proposal and amended the PEG Statement of Principles in November 2022 on the basis that the market reacted positively to the temporary relaxation on pre-emption limits during the COVID-19 pandemic;

- imposing conditions on non-pre-emptive offers, such as stakeholder engagement prior to an announcement of such an offer to the extent possible, consideration of retail investor participation and application of informal "soft pre-emption" so that the newly issued shares are allocated to investors in a way that replicates the existing shareholdings (see "Increasing Retail Participation" below). The amendments made to the PEG Statement of Principles in November 2022 make clear that these conditions are applicable when a company proposes to disapply pre-emption rights in an offering;
- supporting higher disapplication of pre-emption authorities for "capital hungry companies" (*i.e.*, high-growth companies such as technology companies) up to 75% on a case-by-case basis. This dovetails with another Report recommendation that the admission to trading exemption from the requirement to produce a prospectus be raised to 75% of existing share capital from the existing 20% upper limit (see "Relaxing Disclosure Requirements" below). The amendments made to the PEG Statement of Principles in November 2022 indicate that "capital hungry companies" may seek a pre-emption limit beyond the 20% limit and in excess of the current 15-month time limit as long as the purpose of such higher disapplication of pre-emption rights is disclosed when shareholder approval is sought. The amended PEG Statement of Principles does not reference an upper limit for such "capital hungry companies"; and
- placing the PEG on a more formal and transparent (albeit still non-statutory) footing, which would include a revised governance structure, dedicated website, revised appointment process, membership review and annual reporting. This proposal has not yet been actioned.

Pre-Emption Reporting. For issuers raising capital using the relaxed pre-emption authorities mentioned above, the Report recommends enhanced and standard post-transaction disclosure using a template form produced by the PEG and published via an RNS announcement. This standardised form would require disclosure of:

- the allocation policy used for the fundraising;
- the consideration given to the impact of the offer on retail investors;
- gross and net proceeds; and
- the discount to the market price at which the shares were offered.

The requirement for pre-emption reporting was implemented by the amendments made to the PEG Statement of Principles in November 2022. Companies issuing shares pursuant to a general disapplication of pre-emption rights are required to make a transaction report via an RNS announcement in line with the above requirements within one week of the completion of the share issuance. The transaction report should also be submitted to PEG for inclusion in its database. This new requirement demonstrates that companies' abilities to take advantage of the higher limits on disapplication of pre-emption rights will be balanced by new disclosure obligations in respect of non-pre-emptive offerings.

Cash Box Structures. The Report also recommends amending the PEG Statement of Principles to include a limit on the use of cash box structures so that they are only used, as under existing guidance, up to the amount of non-pre-emptive disapplication authority approved by the issuer's shareholders at the most recent annual general meeting. The Report acknowledges that cash box structures will remain an important route for listed companies because of the resulting increase in distributable reserves arising from a placing using a cash box structure.

2. Increasing Retail Participation

A key focus of Lord Hill's Listing Review was to improve retail investors' access to capital raises. The existing U.K. financial promotions regime makes it difficult for issuers to enable retail investors to participate in a secondary offering in a timely manner, notwithstanding the increasing use of new online platforms that have enabled more securities offerings to be available to them.

In order to increase retail participation in secondary capital raisings, the Report proposes new rules modelled on the Australian rules: Permitting a follow-on offer to retail investors following a placing to institutional investors, subject to meeting the following requirements:

- participation of up to £30,000 per retail investor;
- a maximum of 20% of the shares offered in the institutional placing is made available under the follow-on offer;
- the follow-on offer is limited to shareholders on the register immediately prior to the announcement of the institutional placing (excluding any shareholder who has participated in the institutional placing);
- non-U.K. shareholders are excluded if compliance with the securities laws of other jurisdictions would be burdensome;
- the follow-on offer is made at a price equal to or less than the offer price in the placing; and
- the follow-on offer is open for a sufficient period in order to permit retail investors to make an investment decision.

The proposals to increase retail participation were implemented by the amendments made to the PEG Statement of Principles in November 2022. Companies are permitted to seek further authority to disapply pre-emption rights by up to 2% beyond the 20% limit in order to enable increased participation in offerings by retail investors by way of a follow-on offer.

3. Relaxing Disclosure Requirements

Another key theme in the Report, following Lord Hill's Listing Review, is reducing disclosure requirements and regulatory oversight when listed companies are raising new capital. The Report references the American concept of the "well-known seasoned issuer," where existing issuers are subject to a lighter disclosure regime for further fundraisings compared to new issuers.

The Report recommends an alternative to the existing universal registration document (URD), a shelf registration mechanism originally introduced to make the disclosure process less onerous for frequent issuers. URDs have not been commonly used in the U.K. because the burden of preparing and maintaining the document is generally seen as being disproportionate to the benefits obtained.

To address the above, the Report's recommendations include:

- increasing the threshold for when a prospectus is required in order to admit new shares to trading from 20% of existing share capital to 75%. This would give high-growth companies significantly more headroom before triggering the lengthy preparation and approval process involved in the publication of an FCA-approved prospectus when undertaking a secondary fundraising;
- an opt-in enhanced continuous disclosure regime relying on an existing issuer's latest annual report in order to reduce the amount of information required to be included in the offering document at the time of the secondary fundraising, especially when U.S. shareholders or investors are being targeted (see also "Dealing with Non-UK Shareholders and Investors" below); and
- the use of a cleansing notice mechanism, similar to that used in Australia, to confirm that the issuer is in full compliance with its disclosure obligations, and that all inside information has been disclosed to the market at the time of the secondary fundraising in accordance with the U.K. Market Abuse Regulation.

4. Timetable and Reducing Costs

In addition to reducing the disclosure requirements for secondary fundraisings, the Report makes recommendations to shorten the timeline and reduce overall costs and burdens for secondary offers:

- reducing the minimum notice period for shareholder meetings that are not annual general meetings from 14 clear days to seven;
- reducing offer periods from 10 business days to seven for both rights issues and open offers;
- removing the requirement to appoint a sponsor to act on the fundraising (unless a sponsor continues to be required to be appointed in connection with a significant transaction under the Listing Rules, which is also under review). This would remove the need for the lengthy and costly diligence exercise (including the accountants' comfort package) currently required by sponsors to allow them to give the necessary confirmations to the FCA;
- in lieu of requiring a clean working capital statement, adopting a more flexible approach regarding the working capital statement by bringing it in line with working capital disclosures required in annual reports, and permitting the inclusion of assumptions in the working capital statement; and
- clarifying that investment banks and financial advisors, acting in any capacity, are not liable for the issuer's offering documentation or any information incorporated by reference therein.

5. Making Rights Issues More Efficient

In respect of rights issues, the Report recommends that the U.K.'s Listing Rules should be amended to allow premium-listed issuers to incorporate an excess application facility into a rights issue without first having to obtain a waiver from the FCA. This would enable existing shareholders to apply for shares that are not taken up by other shareholders at the offer price. This can also help avoid the common requirement to sell a rump of shares at the end of the rights issue process.

The Report also recommends that statutory pre-emption rights in the U.K. Companies Act 2006 should be amended in order to permit the exclusion of non-U.K. shareholders, and to allow issuers more flexibility in aggregating and selling fractional entitlements. Both of these proposals would make the rights issue process quicker and easier from an administrative perspective.

6. Dealing with Non-UK Shareholders and Investors

Consistent with reducing disclosure requirements and shortening the secondary capital raisings timetable, in circumstances where an issuer has a material number of U.S. shareholders or wishes to target U.S. investors on a secondary fundraising, issuers typically spend a lot of time and resources preparing a U.S.-style prospectus in order to fully comply with U.S. securities laws.

In order to avoid preparing a compliant offering document each time an issuer undertakes a secondary fundraising targeting U.S. or other non-U.K. investors, the Report recommends allowing issuers the ability to "opt in" to an enhanced continuing disclosure regime combined with a shorter offering document, in which issuers would be able to rely on an existing annual reporting disclosure when making offers to U.S. or other non-U.K. investors.

In the case of U.S. investors, this would involve aligning the risk factors, business description and operating and financial review sections in the annual report with U.S. practice (*i.e.*, adopting Form 10-K or 20-F style disclosure for these sections) so that this information can be used and relied on during a secondary offering. There would be no need to duplicate this information in a newly prepared offering document.

Bringing in this enhanced continuous disclosure regime would also usher in a more efficient diligence process (*e.g.*, when 10b-5 letters and other U.S.-style comfort letters need to be issued in connection with a secondary offering) that would reduce the workload and shorten the timeline for a secondary offering involving U.S. or other non-U.K. investors.

7. Digitisation of Securities

The final recommendation in the Report pushes for full digitisation of securities issued by U.K. companies. This would require significant improvements to the existing system for intermediated securities and the elimination of paper certificates for publicly traded companies. This is a very ambitious recommendation that would require innovative and technological solutions, and would likely only occur in the medium term.

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