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LSE Reforms May Succeed At Building On Bumper 2021

By **Marcus Young and William Morris** (February 3, 2022, 6:37 PM EST)

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If 2021 is anything to go by, the regime regulating the London Stock Exchange is a roaring success. Last year was a bumper year for initial public offerings on the LSE as companies and market participants rebounded following the initial shock caused by the onset of the COVID-19 pandemic in 2020.

The LSE has looked to capitalize on this increase in market activity with an overhaul of the listing rules in the U.K., chiefly the listing rules introduced by the Financial Conduct Authority in July, which also intended to attract special-purpose acquisition companies to the LSE.

In November, Hambro Perks Acquisition Company Ltd. became the first SPAC to list on the LSE under the new reforms. Hambro Perks has stated in its prospectus that its focus for a de-SPAC transaction will be on potential targets in the technology-enabled sector based in Europe.[1]

Hambro Perks was just one of the highlights of 2021. In total, 122 companies listed on the bourse, raising over £16.8 billion in equity capital, which is the most capital raised from IPOs on the exchange in a single year since 2007. This places it on top of the pile in Europe and the best globally, excluding stock exchanges in the U.S., China and Hong Kong.[2]

Encouragingly for the City, 39% of all capital raised by IPOs on the LSE was by technology or consumer internet companies, with a combined market capitalization of £31 billion at IPO.[3] This represents a substantial boon following the pricing difficulties experienced by Deliveroo in the first quarter, and subsequent fears that tech stocks would not be well-placed listing in London.

One significant highlight was Wise's IPO, which achieved two unprecedented accolades, being the largest listing on the LSE by a tech company by market capitalization — approximately £8.8 billion at close of trading on its first day — and the LSE's largest direct listing.[4]

There is hope that this momentum can be carried on into the new year, with further reforms maintaining that push.

Old Dog, New Tricks

As part of its response to the Hill Review and the Kalifa Review of UK FinTech, the FCA confirmed a series of amendments to its listing rules in order to increase the allure of listing in the U.K. The FCA seeks to balance this aim with protecting market transparency and integrity. The majority of these rules came into force on Dec. 3, 2021, with the remainder introduced on Jan. 10, 2022.

The changes to the listing rules are:

- A targeted form of dual-class share structure within the premium listing segment is now permitted;

- A reduced level of shares required to be in public hands — free float — at listing to 10% from the prior requirement of 25%;

- An increase in minimum market capitalization at listing to £30 million from £700,000; and

- Minor modernization to the listing rules, disclosure guidance and transparency rules and prospectus regulation rules.

Each of these amendments is considered in more detail below.

Targeted Form of Dual-Class Share Structure on Premium Listing Segment

A dual-class share structure is where a company has two or more classes of shares with different voting rights. These are typically utilized where founder shareholders are provided with greater control and voting rights, whereas other investors will have severely watered down voting rights.

In the past year, dual-class share structures have been utilized on the standard listing segment of the LSE by both Deliveroo and Wise in order for the founders to maintain control of the company while accessing public markets. Previously, their use had not been permitted on the premium listing segment. The FCA has now introduced a conditional five-year exception to this preexisting rule.

Issuers can now take advantage of the use of a dual-class share structure where the class of shares with weighted voting rights meets these criteria:

- There is a maximum weighted voting ratio of 20-to-1;

- The shares may only be held by directors of the company or beneficiaries of such a director's estate;

- The weighted voting rights are only available in two limited circumstances:

- A vote on the removal of the holder as a director; and

- Following a change of control, in relation to a vote on any matter — to operate as a strong deterrent to a takeover; and

- The share will convert to ordinary premium listed shares following a transfer to anyone other than a beneficiary of the director's estate.

The FCA has made no secret that these changes are aimed at meeting the needs of founder-led innovative growth companies, as it looks to compete with global exchanges with traditionally less stringent listing requirements. By doing so, it hopes to enable these companies to list on public markets at an earlier stage in their development.

Given the use of dual-class share structures on the standard listing segment, it would be little surprise to see a number of admissions utilizing this exception on the more prestigious premium-listing segment in the next 12 months.

Reduction in the Free Float Requirement

The FCA has reduced the threshold for free float at listing from 25% to 10%, and has removed guidance for applications to modify the rule where a lower percentage will be accepted in view of certain factors. The proposed aim of doing so is to provide issuers with greater flexibility in how to structure IPOs to suit their own needs.

The FCA conducted an analysis on the impact that such a reduction might have on liquidity, and has stated that it is comfortable that any concerns that liquidity would be substantially decreased are unfounded based on the available evidence. In support of its position, it cited the fact that average free floats at IPO are at levels much higher than the current 25% limit, and that it receives only a modest number of applications to modify the 25% free float threshold.

This change brings the LSE in line with other major exchanges in the U.S. and across Europe.

Increase of the Minimum Market Capitalization

Minimum market capitalization refers to the minimum permitted value of all the shares in issue of a company listed on a stock exchange. The FCA has increased the minimum market capitalization permitted from £700,000 to £30 million. This change has been made to address instances of high share-price volatility and suspected suspicious trading, which are predominantly observed with respect to companies with a market cap of below £30 million.

This amendment will apply to new listings only and will not be applied as a continuing obligation. The minimum market capitalization requirement for closed-end investment funds and open-end investment companies shall remain at £700,000.

In response to concerns raised in consultation, the FCA has introduced transitional provisions with respect to:

- Applicants that have made complete submissions for a listing eligibility review by no later than 4 p.m. on Dec. 2, 2021, to continue to be able to formally apply for listing based on an minimum market capitalization of £700,000 provided they do so within 18 months; and

- Shell companies, including SPACs, already listed on Dec. 3, 2021, to allow listing applications following an acquisition to be made based on a minimum market capitalization of £700,000. This is only available if complete submissions for an eligibility review for listing and prospectus review are made before Dec. 3, 2023.

The changes are intended to address issues with price volatility and suspicious trading activity commonly associated with companies that list with a low minimum market capitalization, and protect those companies that struggle to meet expectations when listing and have difficulties in complying with their ongoing regulatory obligations.

More of Same to Follow

The FCA has also provided an update in relation to the potential for future changes to the existing financial track record requirements for premium listed companies. Currently, the general rule is that a company applying for a listing must provide a revenue-generating financial track record for the three accounting periods prior to listing. Any changes would again be seen as a way to attract innovative high growth companies that have limited trading history to list in London.

Amendments could also pave the way to listing for companies with an acquisitive business model in the biotech, fintech and pharmaceutical sectors, as well as other companies following a roll up acquisitive strategy. It has stated that it will be conducting a further review into how any changes would be introduced and will provide further information this year.

The FCA's new rules and its stated intentions for this year show a continued appetite to provide the City with more allure as it faces off with competitors to attract a new wave of issuers to the LSE. Expect to see this continue as the FCA conducts an ongoing review of how best to make its rules more user-friendly. The challenge in implementing its goals will be to do so without having too great of a dilutive effect on standards.

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[1] https://www.londonstockexchange.com/discover/news-and-insights/london-stock-exchange-welcomes-hambro-perks-acquisition-company.

[2] https://www.lseg.com/resources/media-centre/press-releases/london-stock-exchange-raises-most-ipo-funding-2007-marking-strong-year-lseg-capital-markets.

[3] https://www.lseg.com/resources/media-centre/press-releases/london-stock-exchange-raises-most-ipo-funding-2007-marking-strong-year-lseg-capital-markets.

[4] https://www.ft.com/content/811dacb5-a2ed-4208-9b93-41522f3b032b.