What's gone wrong with rights issues?

RPC's response to the UK Secondary Capital Raising Review Call for Evidence

November 2021

ADVISORY | DISPUTES | REGULATORY | TRANSACTIONS

Dear Chair

At RPC, we are excited about the future of the UK's capital markets. In the first half of 2021, there were 49 IPOs on the London Stock Exchange, over half of which were tech and consumer internet businesses. This followed an outstanding year for secondary issuances in 2020 when companies raised over £30 billion by turning to the UK equity markets to shore up their balance sheets in the face of the pandemic, as well as to fund growth and innovation.

But the UK must not rest on its laurels. If London wants to maintain its position as a leading global financial centre, we need strong public markets. We have been greatly encouraged by the recommendations of the UK Listing Review which we believe will bring about important changes and make it easier for technology and other high growth businesses to IPO and grow on the London Stock Exchange.

The Secondary Capital Raising Review has a key role to play in ensuring that UK public markets continue to meet the needs of issuers and investors, both by taking forward the unfinished business of the Rights Issue Review Group and by looking at how technology can improve secondary offer processes and make them more accessible to retail shareholders.

We have made seven proposals which we believe would materially improve UK rights issues and other secondary offers, leading to shorter timetables, reduced costs for issuers and increased participation by retail shareholders:

- Reduce the minimum rights issue offer period to one week.
- Remove the requirement for the FCA to review prospectuses for rights issues.
- Significantly reduce the content requirements for prospectuses in relation to rights issues.
- Increase use of technology to make it easier for retail investors to participate in rights issues.
- Adopt a two-tranche rights issue structure similar to the Australian AREO (or RAPIDS) model.
- Enable issuers to open up placings to a larger proportion of their retail shareholders, using platforms such as PrimaryBid, by removing the EUR 8 million threshold on such offers.
- Allow private companies to make public offers to raise additional capital (such as offers to customers and other crowdfunding structures) without a prospectus through the use of authorised firms to ensure such offers include appropriate investor protections.

We describe each of these suggestions in detail below.

We are grateful for the opportunity to contribute to this important work and would be delighted to discuss our proposals with you.

Karen Hendy
Partner
karen.hendy@rpc.co.uk

Connor Cahalane
Partner
connor.cahalane@rpc.co.uk

1. Can and should the overall duration and cost of the existing UK rights issue process be reduced? In what ways?

Reducing the minimum offer period to one week

The minimum offer period for rights issues under the Listing Rules is 10 business days.[1] Prior to 2009, the minimum offer period was 21 clear days. This was reduced to the current 10 business day period following the recommendation of the Rights Issue Review Group.

Statutory pre-emption rights applicable to all companies were first introduced in the UK in 1980, giving effect to the Second Company Law Directive (albeit there were pre-emption rights in default 'Table A' articles since at least the mid-1800s). The Directive provided that shareholders must be given at least 14 days to exercise their rights. Therefore, the reduction from 21 days to 14 days only brought the UK into line with the offer period contemplated in 1970s European legislation – a time when fax machines were still a new technology. With investors now able to access information using a wide range of technology, whether direct from issuers or through their brokers, we believe it is time to revisit whether this minimum offer period could be reduced to the "ideal period" of one week.

As can be seen in the timetables below (Fig. 1 Illustrative timetables for UK rights issues), the offer period of 10 business days is the minimum timeframe in which a UK rights issue can be undertaken. In practice, issuers may need to call a general meeting to increase the directors' authority to allot shares and disapply pre-emption rights. This can extend the minimum timetable to 33 calendar days.

The Rights Issue Review Group suggested that a one week offer period would be the ideal period for a rights issue. However, the Review Group identified certain challenges due to features of the market, such as the need for private client managers to advise clients and obtain funds, as well as complex holding chains within institutional investors, that would need to be overcome before a rights issue offer period of one week could work in practice.

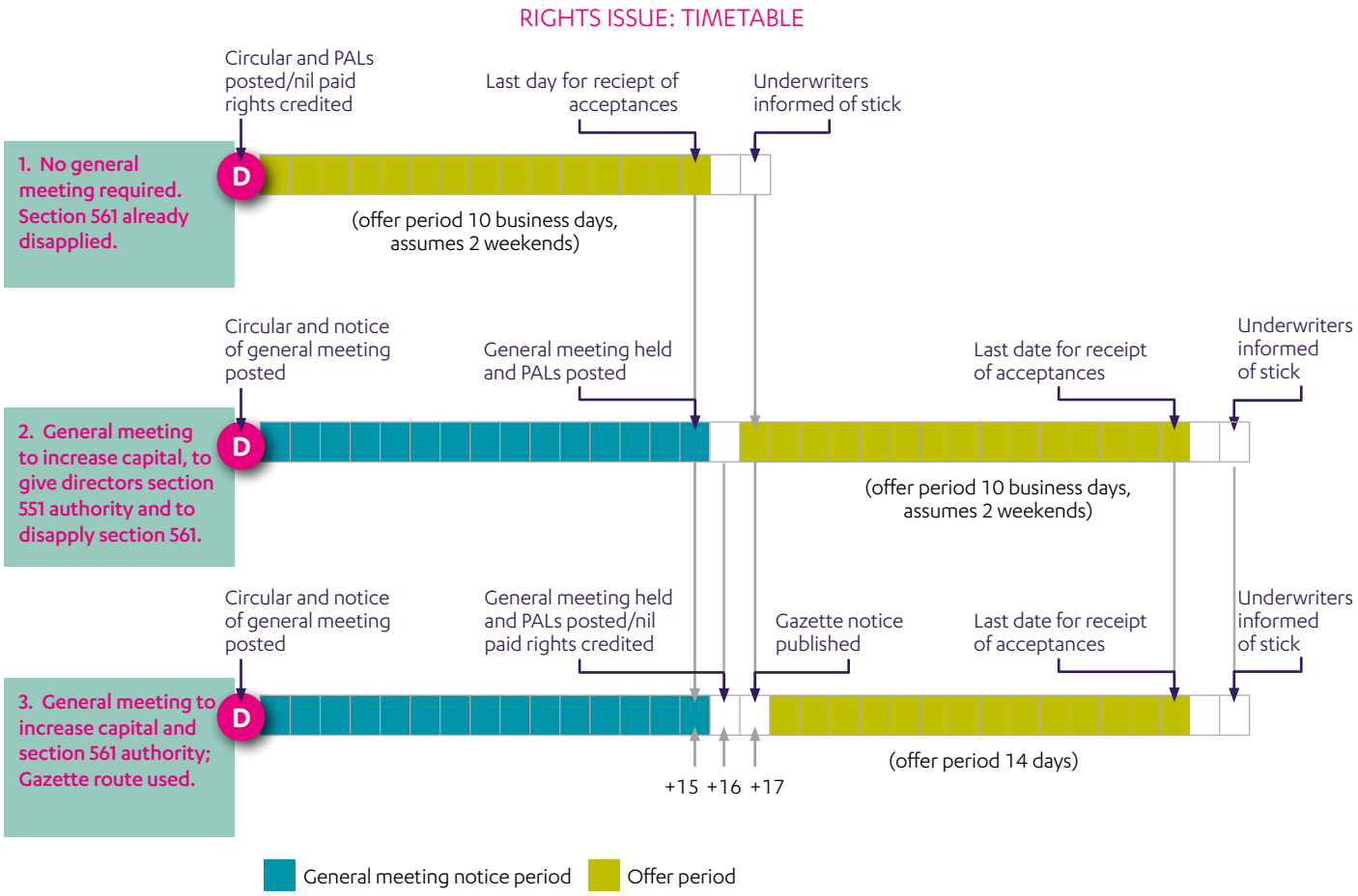

Fig. 1: Illustrative timetables for UK rights issues.

In the light of developments in technology since 2008, we suggest a further reduction should now be made to the offer period. The Rights Issue Review Group noted at the time, "[t]he practice of rights issues lasting for three weeks [the old 21 day period] dated from a period of far less sophisticated communication options – with hand and post delivery the only feasible options ... The emerging presumption now is that an acceptable proportion of shareholders should be contactable at most times and in most places...".[2] If that were true in 2008, prior to the mass adoption of mobile technologies, it is all the more relevant today.

Remove the requirement for the FCA to review prospectuses for rights issues

In our experience, the time needed by issuers to prepare for a rights issue, in particular having a detailed prospectus approved by the FCA, adds significantly to the time that it takes for UK issuers to launch a rights issue. Although the FCA is typically able to review the first submission of a rights issue prospectus in five working days, and three working days for subsequent submissions, in practice the need for the FCA to review and approve the prospectus can add at least two weeks to a rights issue timetable.

We believe the requirement for the FCA to review and approve rights issue prospectuses should be removed. The FCA's process of reviewing draft prospectuses for compliance with the Prospectus Regulation Rules is inefficient for issuers, the FCA and the market overall. For issuers, it materially adds to the time taken to launch a rights issue. The FCA has a relatively short window to review and comment on the document, which can put strain on its resources. The FCA does not conduct any verification or due diligence on the issuer or the prospectus, it is simply checking that the issuer has met the content requirements of the Prospectus Regulation Rules. Overall, the benefits to the market of the FCA's review do not, in our view, outweigh the additional burden and time constraints that it places on both issuers and the FCA.

There are two alternatives to the FCA review process. For issuers listed on the Premium Segment of the Official List, the issuer's sponsor could be required to confirm to the FCA that the issuer has met the content requirements of the Prospectus Regulation Rules. This could be similar to the role taken by nominated advisors in relation to admission documents for the AIM Market. Sponsors are already required to provide certain confirmations to the FCA in relation to rights issues. Although the issuer would still need to factor into the rights issue timetable a review by the sponsor, as the sponsor and its advisors are usually closely involved in drafting the prospectus, this is likely to be quicker than a review by the FCA.

However, we have concerns that requiring a sponsor to provide the FCA with confirmations on the contents of a rights issue prospectus could end up simply transferring the timetable for the review from the FCA to the sponsor. Sponsor firms would also likely be concerned that having a formal role in reviewing the prospectus could potentially lead to increased exposure to liability for the contents of the prospectus. For this reason, we favour an approach that would not require the sponsor to confirm formally to the FCA that all of the content requirements of the Prospectus Regulation Rules have been met as it is ultimately for the issuer to take responsibility for the contents of the prospectus.

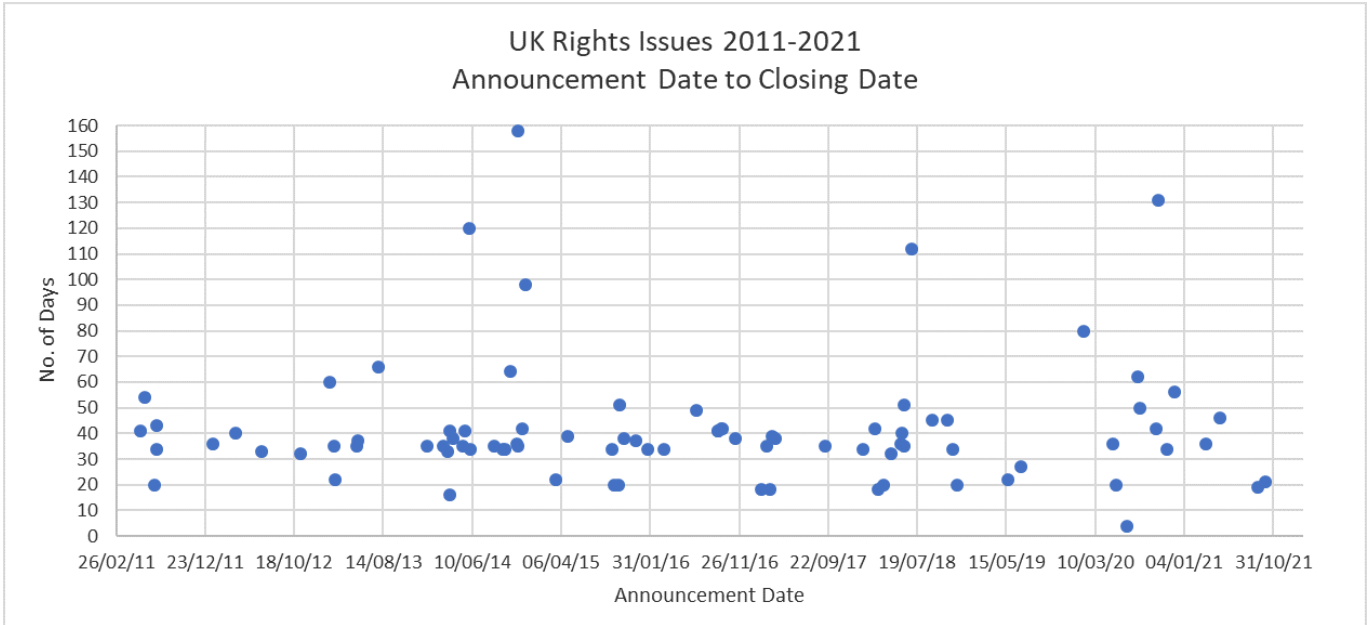

Fig. 2: Offer period for UK Main Market rights issues 2011 to 2021. Source: Practical Law What's Market.

Significantly reduce the content requirements for prospectuses in relation to rights issues

In 1991, the average length for listing particulars for a rights issue was just 30 pages.[3] For the 12-month period ended 31 December 2020, this had increased to an average of 274 pages for rights issue prospectuses.[4]

While disclosure requirements, and investors' insistence on more information from companies, has increased significantly over the past 30 years, there has been a recognition that the level of disclosure required for rights issues should not be as extensive as for an IPO or admission to listing. Secondary issuers are subject to the ongoing disclosure requirements which ensure that the market, including shareholders and other investors who may participate in an offer, should have all material information on the issuer in order to make an investment decision.

While the UK Prospectus Regulation allows issuers undertaking a rights issue to prepare a simplified prospectus with fewer disclosure requirements than a full prospectus, issuers still need to include a large amount of information which is already available to the market.[5] This followed the recommendation of the Rights Issue Review Group for the adoption of a short form prospectus for rights issues. Despite the "proportionate disclosure regime" for rights issue prospectuses introduced in changes to the Prospectus Directive in 2012, and the simplified prospectus regime now in effect since 2019 under the Prospectus Regulation, the level of disclosures in, and the average page number of, rights issue prospectuses has not reduced (See Fig 3: No. of pages for UK Main Market rights issue prospectuses 2011 – 2021). While a number of issuers have conducted rights issues using a simplified prospectus, these documents were not materially shorter than a full rights issue prospectus. In fact, the seven simplified prospectuses published in relation to UK rights issues during 2020 and 2021 had an average of 324 pages.

The UK Listing Review highlighted the need for differentiation in the level of disclosure required for secondary offers such as rights issues and for new applications for listing. We agree with this and propose that the FCA should reduce the content requirements for prospectuses for rights issues in line with the suggestions of the Rights Issue Review Group.[6]

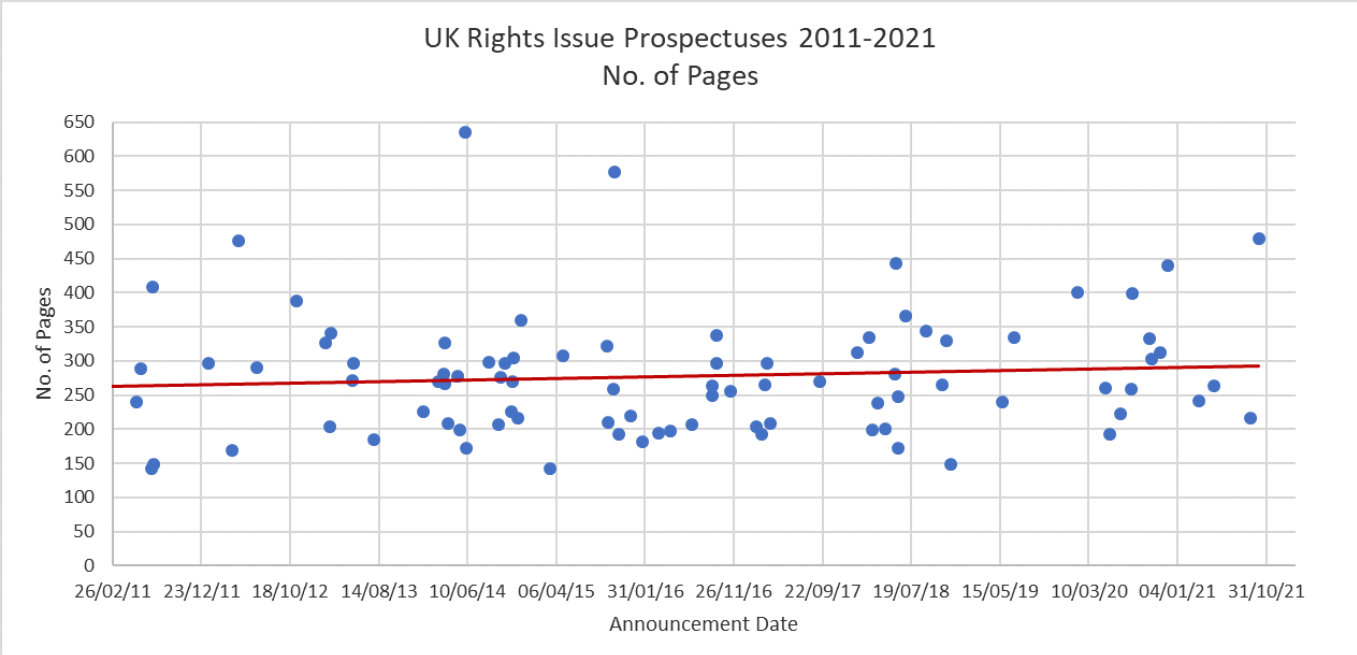

Fig. 3: No. of pages in prospectuses for UK Main Market rights issues, 2011 to 2021. Red line denotes linear average. Source: Practical Law What's Market.

2. Should new technology be used in the process to ensure that shareholders receive relevant information in a timely fashion and are able to exercise their rights and, if so, how?

Over the past 10 years, the average acceptance rate for rights issues by issuers on the Main Market of the London Stock Exchange was approximately 93%.[7] The high rate of participation can be explained by the tendency for issuers to price rights issues at a deep discount to the market price, making it attractive for shareholders to exercise their rights.

While these high take up rates indicate that overall shareholders are receiving information from issuers in time to exercise their rights, there are studies from other markets which point to lower levels of participation by retail shareholders in rights issues.[8] We believe this is also likely to be the case for UK rights issues and that the high take up rates are explained by the fact that many of the larger companies by market capitalisation traded on the London Stock Exchange have a significantly greater proportion of institutional investors over retail shareholders.

We note the growing use by issuers of PrimaryBid's platform to enable retail shareholders to participate in placings offered by way of an accelerated bookbuild. This platform enables retail investors to use PrimaryBid's website or mobile app to subscribe for shares in a retail offer that is separate from, but runs in parallel to, an institutional placing. The retail offer closes at the same time that the institutional bookbuilding process completes. Payment for shares is made through PrimaryBid's website or mobile app and then settled through the investor's broker. PrimaryBid's platform has also been used on IPOs and for open offers.

We support the recommendation of the UK Listing Review that changes should be made to make secondary offers more efficient and to improve retail investor participation and we believe the use of technology has an important role to play in this. We believe platforms such as PrimaryBid will play a key role in bringing technological advances to UK secondary offers and facilitating greater participation by retail shareholders.

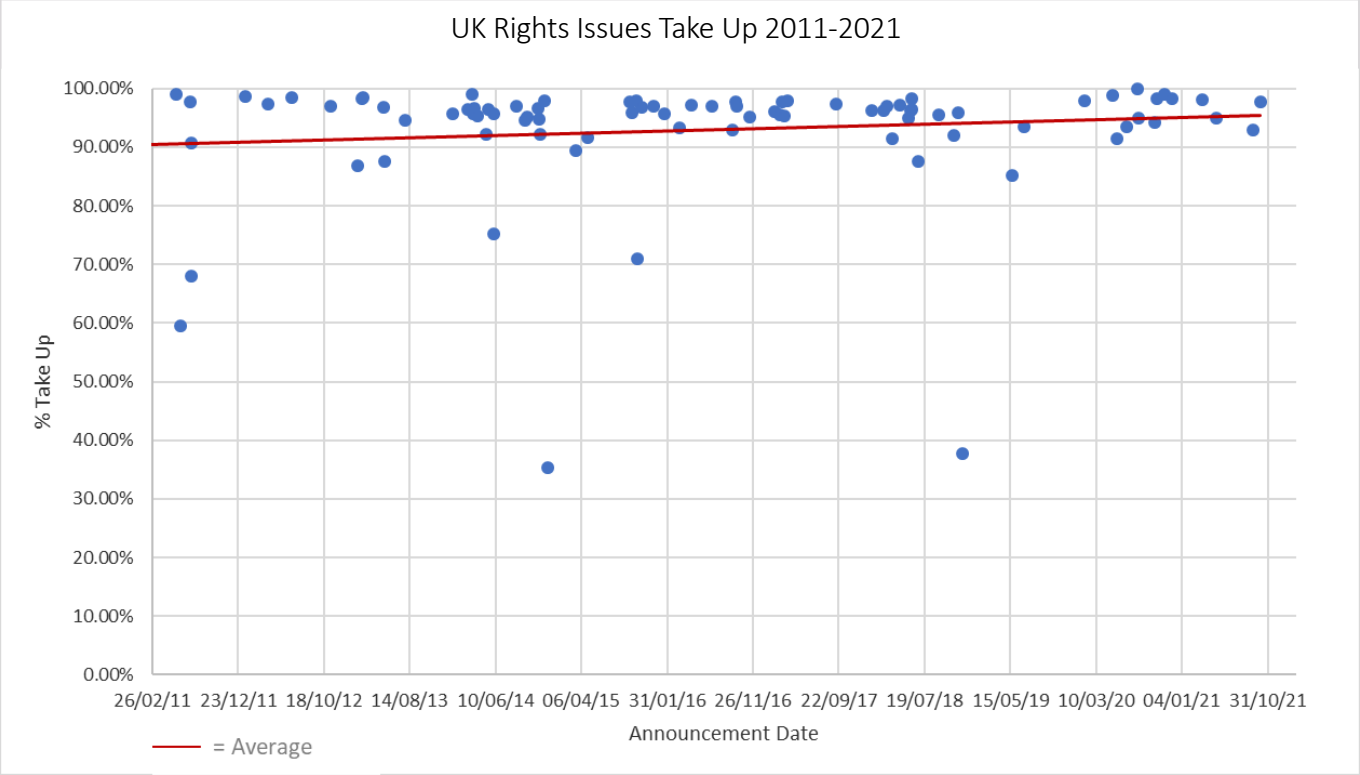

Fig. 4: Percentage of shareholders exercising rights in UK Main Market rights issues 2011 to 2021. Red line denotes linear average. Source: Practical Law What's Market.

3. Are there fund-raising models in other jurisdictions that should be considered for use in the UK? For example, the use of cleansing notices in lieu of prospectuses on secondary capital raisings in Australia and also the Australian ANREO, AREO (or RAPIDS), SAREO and PAITREO structures?

We believe that issuers would benefit from being able to use alternative fund-raising models to the traditional rights issue, such as accelerated pre-emptive offerings along the lines of the Australian AREO (or RAPIDS) model.

The AREO (or RAPIDS) structure splits the rights issue into two-tranches:

- a first tranche to institutional investors; and
- a second tranche to retail investors.

The institutional offer is carried out through an accelerated offer, which can be announced and closed in one or two business days. This is followed by a second retail offer open to all other shareholders conducted over a longer offer period (up to three weeks).

Giving issuers the option of using a similar structure for UK rights issues would bring a number of advantages:

- One week offer period: Adopting a split structure would facilitate shortening the rights issue offer period to the 'ideal' period of one week (see Question 1) for the institutional tranche and potentially even shorter to one to two business days.
- Faster access to funds: An accelerated institutional offer would enable issuers to receive the majority of the rights issue proceeds in a short space of time (on the basis that retail investors tend to make up a small proportion of the total percentage of the issued share capital).
- Reduced underwriting costs: Issuers could reduce underwriting fees on rights issues by choosing to underwrite only the institutional tranche. A shorter offer timetable should also contribute to overall lower underwriting costs.
- Reduced documentation: The institutional offer could be carried out on an undocumented basis following the Australian approach of using clearing notices in lieu of a prospectus, or alternatively with significantly reduced disclosure as suggested in our response to Question 2 above.
- Additional time for retail investors: Although technology allows retail shareholders to receive and respond to information on rights issues in a relatively short time period, by extending the retail offer over a longer period, issuers would provide more opportunities for retail investors to participate in rights issues. Splitting the offer into two tranches would also enable issuers to provide retail investors with specific information relevant to them and avoid the 'one size fits all' approach to documentation under the UK's current prospectus regime.

The Rights Issue Review Group identified a number of challenges that would need to be addressed to implement a similar structure for UK offers, in particular (i) the need to split the register by identifying which shareholders are retail vs. wholesale/institutional; (ii) whether it is practical for institutional investors to respond to a rights issue offer over one to two days; and (iii) the need to treat all shareholders equally.

Notwithstanding these challenges, we believe there would be clear benefits to UK issuers being able to choose a two-tranche offer structure as an option for UK rights issues.

4. Has the greater transparency around short selling that was introduced after the financial crisis benefited the rights issue process and is there more that can and should be done in this area?

We believe that the disclosure requirements in relation to short selling introduced in 2009 have helped to address concerns around short selling in relation to rights issues. A number of studies carried out following the financial crisis have found that, while increased disclosure of short selling has been welcome, an outright ban on short selling generally, and specifically in relation to rights issues (or other secondary equity offerings), would not be beneficial to markets as short selling restrictions have been found to reduce market quality (in terms of liquidity and pricing).[9]

For these reasons we do not support a ban or similar restrictions on short selling in relation to rights issues.

5. Are there any refinements that should be made to the undocumented secondary capital raising process in light of recent experiences during the Covid-19 pandemic?

The UK market has recently seen an increase in the number of issuers allowing retail investors to participate in institutional placing offers. This has been done using PrimaryBid's platform to conduct separate retail offers in a very short timeframe alongside the institutional placing. These retail offers have typically been capped at EUR 8 million (or lower) to allow the issuer to rely on an exemption from the requirement to publish a prospectus.[10]

We propose that there should be a separate exemption from the requirement to publish a prospectus to allow issuers to extend the ability to participate in a placing to all, or at least a proportion, of their shareholders and not be restricted to offers of EUR 8 million or lower. This would remain subject to the overall cap of 20% of a company's issued share capital for undocumented placings.[11] While we acknowledge that issuers may not always wish to open up placings to all of their shareholders due to the uncertainty around take up levels and the need to place any unsubscribed shares, it would be for issuers to decide on the size of any such offer on a case by case basis.

6. Are there any other recommendations or points made by the Rights Issue Review Group in 2008 that should be investigated further?

We believe further consideration should be given to the forward settlement and conditional instrument models proposed by the Rights Issue Review Group.[12] These structures would enable issuers to run rights issues during the general meeting notice period and significantly reduce the overall time period for rights issues where shareholder approval is required.

7. In what other ways should the secondary capital raising process in the UK be reformed?

The responses above all relate to proposed changes to rights issues and other secondary offers by public companies listed on the London Stock Exchange. However, we believe improvements should also be made to the secondary capital raising process for private companies.

Despite the changes in technology that have occurred in recent years and the widescale use of online platforms and mobile technologies for financial services, private companies have been reluctant to raise additional capital by offering their shares to the public, for example through offers to their customers and other crowdfunding structures. We believe this is in part due to the costs associated with preparing a detailed prospectus.

We believe the following changes should be made to the regulation of secondary capital raising by private companies:

- private companies should be permitted to make an offer to the public by registering the offer with an FCA authorised firm (for example, existing crowdfunding platforms or other financial services firms);
- the FCA authorised firm would need a specific permission under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) to operate a platform for the public offering of securities; and
- a specific set of requirements in relation to appropriate standards of disclosures and due diligence by the FCA authorised firm could ensure a high level of investor protection.

We are aware that HM Treasury is considering reforms along the lines described above as part of its consultation on the UK Prospectus Regime and we encourage the UK Secondary Capital Raising Review to contribute to this work, specifically in relation to secondary capital raising by private companies.[13]

1. Listing Rule 9.5.6R.
2. Chapter 6 of the Rights Issue Review Group Report (November 2008).
3. Source: Perfect Information, www.perfectinfo.com.
4. See Fig 3. Source: Practical Law What's Market.
5. Article 14 of the Prospectus Regulation.
6. See Chapter 2 of the Rights Issue Review Group Report (November 2008).
7. See Fig 4. Source: Practical Law What's Market.
8. Rights issues: Retail shareholders and their participation decisions, International Review of Finance, Volume 21, Issue 3 p. 917-944. This study found that the median participation rates for retail and institutional shareholders in rights offers in Australia was 60% and 94%, respectively.
9. Avgouleas, E. (2011). 'Short Sales Regulation in Seasoned Equity Offerings, What Are the Issues?'. In D. P., & A.R. (Eds.), Corporate Law and Finance in the UK and EU (pp. 117-138). Oxford University Press
10. Section 86(1)(e) Financial Services and Markets Act 2000.
11. Article 1(5)(a) Prospectus Regulation.
12. See Chapter 7 of the Rights Issue Review Group Report (November 2008).
13. See www.gov.uk/government/consultations/uk-prospectus-regime-a-consultation.

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