SECONDARY CAPITAL RAISING REVIEW
TECHNICAL ELEMENTS OF CAPITAL RAISING

INDUSTRY UPDATE

The recent review of secondary capital raising in the UK ('the Austin Report'), authored by Mark Austin, makes several important recommendations to continue progress in modernising UK capital markets, as communicated to issuers on 9 August. This update focuses on several aspects of the Austin Report's recommendations in relation to modernising capital raisings, simplifying how companies raise funds as well as enhancing retail investor participation.

The Austin Report's recommendations were swiftly endorsed in full by the Chancellor, so we anticipate that over the course of the remainder of this Parliament, bodies such as the Financial Conduct Authority (FCA), the Department for Business Enterprise and Industrial Strategy (BEIS) and the Pre-Emption Group (PEG) will be advancing the work to implement the recommendations. We anticipate that this work will have to be done in consort with the work of the Digitisation Taskforce or at least be mindful of their work to ensure implementation of the secondary capital raising recommendations are fit for the future.

Some of the recommendations to improve fundraising in the UK market will require improvements to the way in which investors who hold their shares via an intermediary can be identified and communicated with, as well as the speed with which they can engage with issuers and their agent(s). These are matters that we discussed in our previous publication in response to the Austin report, most notably the formation of the Digitisation Taskforce to address digitisation of all shareholdings. It could therefore be considered likely that there will be interaction between the work undertaken on digitisation and the plans for implementation of the recommendations on capital raising and consequently, the precise future shape of any changes is not yet entirely clear. We will continue to communicate with you as the details emerge.

The recommendations consider various changes to the rules on pre-emption rights and the use of said rights in capital raisings. This update will focus on those recommendations where our expertise and experience will provide insight as the authorities progress to implementation.

RAISE FUNDS QUICKLY & CHEAPLY

At the height of the Covid pandemic, the government temporarily permitted companies to issue new shares up to 20% of their issued capital without having to make the offer available to shareholders generally, as required under the right of pre-emption. This was a temporary increase from the pre-existing level of 10%. According to

the Austin Report this worked well, and it is recommended that the 20% authority is made permanent. PEG, who provide guidance in this area, are being called on to update their Statement of Principles.

The recommendation is that this authority should be limited by the same additional requirements as were in place during the pandemic, together with several new requirements. This would mean that:

- An issuance of up to 10% of new share capital should be available for any purpose; and
- A further 10% can be raised if it is to be used for an acquisition or a specified capital investment.

Under the proposals, where companies avail themselves of the option to issue between 10 and 20% new share capital, they would be required to report publicly after a placing is completed, using a standard template issued by PEG within a week of it completing.

The Austin Report also calls for the PEG Statement of Principles to be updated to restrict the use of 'cash box' structures to circumvent pre-emption rights, which in theory can be used by a listed company to issue shares without having regard to the pre-emption rights of its existing shareholders up to any amount.

THE INVOLVEMENT OF ALL

A key component of the Austin Report is the inclusion and participation of retail investors in capital raising events. This retail investor participation is seen as important in enhancing the operation of the UK market, both for issuers and individuals.

The report recommends that issuers should involve all retail investors in future capital raisings. This is a significant shift in position to the current environment where issuers tend to consider the most appropriate, effective, and efficient method of raising capital for their circumstances, without necessarily having any obligation to ensure that participation is open to everyone with an economic interest in the company.

While there are many references to retail investors within the report, the implementation of the associated recommendations will need to consider both directly registered investors (i.e., shareholders) and intermediated retail investors ("beneficial owners").

Currently, issuers have no efficient mechanisms to effectively engage their beneficial owner population for this purpose, nor do they have any legal obligation to engage or pass or make available rights directly to them. Beneficial owners are currently solely reliant on the intermediary chain and the service terms and conditions of their chosen intermediary to pass on communications and facilitate participation rights. The recommendations within the Report could fundamentally challenge these existing frameworks and the work of the Digitisation Taskforce will be a key input into how this will take shape.

As noted in our previous paper, related decisions regarding any extension of intermediary obligations, to complement any new responsibility to be placed directly on issuers, will need to be considered by the digitisation taskforce.

While at present dematerialisation in the UK requires shares to be deposited into CREST accounts, which are predominantly intermediated nominee accounts, this is not the only feasible approach. For example, there are long-established, proven international examples of secure, efficient dematerialised shareholding systems that continue to allow securities to be administered outside of the settlement system, such as those found in Australia or the USA. These markets embed the investor choice model – direct registration or holding via a nominee – that is currently central to the UK shareholding structure.
We would urge the Taskforce to consider international experience in effective delivery of digital solutions for shareholdings and will contribute our own deep experience in global markets to the discussion.

TECHNOLOGY & DIGITISATION

Clearly, technology has the potential to deliver better support for retail investor participation, either in connection with event communications or through the provision of digital platforms so that investors can quickly and efficiently exercise their rights to participate. These opportunities can be made available today for registered shareholders, although there are structural considerations which will have to be addressed for beneficial owners, including:

- what ownership data is made available,
- who has the associated obligations to make rights available (will it be the issuer, or the intermediary?) and
- who pays for these solutions?

Case Study

In a 2020 Rights Issue undertaken by a FTSE100 issuer, 42% of the 48,000 applications received were on provisional allotment letters with cheques attached in payment, while 53% of the applications were received through an online application and payment portal and the remaining 5% were received through CREST. Such statistics evidence the potential value of digital channels where they are made available.

We are aware that some existing platform providers, within the intermediary community, are currently facilitating participation of retail investors in placings (although we understand that such platforms do not typically validate whether participants are current investors in the security). While this is a step in the right direction, directly registered retail investors are normally excluded from placings, yet it is clear from the Report that the inclusion of all retail investors in secondary capital raisings is paramount from a government policy perspective. Issuers and their advisors may have to consider the impacts of including an expanded audience within their placings, including the cost implications and how easily such participation can be supported.

For investors holding directly on an Issuer's share register, digital channels to facilitate retail investor participation have become much more common in secondary capital raisings, such as Rights Issues & Open Offers. One size doesn't always fit all issuers, so often the application process used for corporate actions by investors has been determined on a case-by-case basis, taking into consideration the time available, the number of shareholders, investor demographics, complexity of solution and additional cost to the issuer.

The overarching challenge comes in finding solutions that are fit for all types of investors, whether directly registered shareholders or those investors holding through an intermediary chain.

Consideration for how and when additional data including such things as e-mail addresses or key ownership information is obtained for each category of investor will be critical to any new capital raising solutions.

To date this has been problematic and infringed on issuers and their agents being able to support everything from electronic communications, identity verification and participation in corporate actions. When considering any future solutions, due consideration must be given for the two distinct audiences. For instance, capturing additional information for directly registered shareholders should be done at the point of investment, while for beneficial holders this should be built into any ownership disclosures.

Additionally, it will be necessary to ensure that any solutions or technology platforms designed to increase participation are suitable, efficient, and cost effective for a wide range of issuers and investors.

We will be working closely with issuers and the market to help inform the FRC and PEG as they plan to address these points in the coming months. These enhancements to existing obligations need to be balanced with the wider work looking at digitisation. As with many of the recommendations made throughout the Report, achieving the best result means that some work must be done in tandem and with consideration and thought to the work of others.

ELECTRONIC PAYMENTS

There are also several elements of the Austin Report that recommend the use of electronic payments, both to increase participation and accelerate the ability to raise capital. It is already common to include electronic payment channels for shareholders to use when participating in a capital raising, but a balance must be struck between ensuring speed but not unduly excluding those who may not be in a position or who are not comfortable to use technology to make or receive payments. Issuers will need to balance the needs and timescale of the capital raising with the ability to have retail investors participate in an effective and cost-efficient manner, potentially using a range of payment mechanisms, to maximise participation (a key goal of the report) and not unduly disenfranchise investors.

In our experience, permitting electronic payments offers significant benefits both to the issuer and the investor in ensuring quick acceptance of an offer, especially for those investors who may not be based in the UK. However, electronic payments systems are not ubiquitous.

When considering electronic payment methods used by retail investors, the impact of payment card fees or other participation charges on both the issuer and their investors need to be considered. Often this can be a barrier to adopting electronic solutions, but this may not be the only barrier. The digital channel itself may come with adoption and usage costs, leaving market participants to consider how best to adapt their existing solutions and services to meet a future digital need. It's unlikely that we'll see a big bang approach to the use of electronic payment mechanisms and therefore authorities will need to consider how to evolve solutions to support the longer-term goal while in the short term still being able to accommodate non-electronic mechanisms.

At Computershare we have worked hard over many years to facilitate more efficient payment mechanisms, e.g., in the collection of bank mandates on shareholdings and the removal of cheques in their entirety (something we refer to as 'Mandatory Direct Credit') for a range of clients. We also facilitate custodians/brokers receiving payments through the CREST system and encourage issuers to make this functionality available. Some of these mechanisms have their limitations, however, we continue to strongly push for their wider adoption because of the benefit they can have in delivering efficiencies for both issuers and investors.

TIME IS OF THE ESSENCE

The Austin Report calls on the government and the FCA to align legislation and the Listing Rules to allow issuers to use the same minimum offer period. Currently the Listing Rules indicate the period should be at least 10 business days, whereas Companies Act is at least 14 calendar days[1] or may be more. While aligning these two timeframes would make sense in terms of providing clarity for the market, in our experience most offers allow at least 10 business days for Rights Issues (*Open Offers tend to be longer and mirror notice periods for the associated general meeting*) to maximise participation of shareholders.

The Austin Report further discusses the potential to amend pre-emption provisions found within the Companies Act so that they are more in line with a rights issue or open offer which permits the disapplication of rights, in certain circumstances. Again, such action would ensure the market has clarity and may enable issuers to make decisions on the best capital raising structure to utilise for their individual requirements.

Despite the core aims of broader participation, the report also considers speed of execution against the possibility of share price volatility that may otherwise arise during an extended process. To aid the speed of participation, the report recommends that issuers should have the ability to exclude shareholders when they are based overseas

if the cost and burden of extending offers into those territories isn't appropriate. This could include, for example, excluding EU shareholders where to include them may require an EU compliant prospectus for a limited number of investors.

These recommendations are accompanied with further suggestions for legislation to be amended so that the Secretary of State can in future, without the need for Primary legislation, reduce shareholder meeting (not AGMs) notice periods to seven clear days. This would allow issuers to obtain shareholder consent to raise capital rapidly but would require issuers and all parties involved in a shareholder meeting, including investors, to react quickly. Technology to allow shareholders to be informed of the meeting, its resolutions and to lodge their voting instructions, will clearly be critical to achieving this accelerated timeline, otherwise issuers may not receive the necessary approvals to continue to raise the capital required.

When it comes to rights issues, the ability to allow existing shareholders to make excess applications is recommended and with existing open offers, excess entitlements don't automatically transfer with a market claim. The regulators will need to factor this into their work. Such solutions may potentially remove a significant cost for a company by reducing the need for an underwriter. Questions may be asked by some shareholders as to whether this would disenfranchise certain holders forcing them to lose out as they can't elect to sell their rights or be defaulted into receiving a payment for their lapsed rights, and with these recommendations they may no longer receive any lapsed rights compensation. While currently it isn't clear that this will occur and it will be for the FCA to make clear, our assumption at this point is that the implementation of these recommendations would remove existing rights.

There is clearly some detail to work through here as with any changes to the cashless take-up process, such as making it the default option for those shareholders who choose not to, or are unable to, take any action prior to the market deadline.

MORE CHOICE

This Austin Report also considers how more choice in fundraising structures could aid the market and it focuses on several accelerated structures seen in the Australian market that with potential adaptions, could be implemented in the UK. This is not the first time that such structures have been considered.

These structures could include:

- Accelerated Non-Renounceable Entitlement Offers (ANREOs)
- Accelerated Renounceable Offers (AREOs)
- Pro-rata Accelerated Institutional, Tradable Rights Offer (PAITREOs)
- Simultaneous Accelerated Renounceable Entitlement Offer (SAREOs)

The Austin Report considers the principles of these structures as a sound basis for further consideration here in the UK over the medium term but are not expected to form part of any initial review.

The use of an Australian style 'cleansing notice' in place of a prospectus is seen as a potentially suitable way to provide the market at large with comfort that an issuer is compliant with their obligations without unduly burdening the issuer with drafting a full prospectus. Such a notice, together with other existing publications, some of which are undertaken by the issuers, such as investor presentations, could also help streamline offers.

WHAT'S NEXT

The implementation of these recommendations is contingent on the government, regulators, and other parties coming together to determine appropriate solutions. The recommendations raise some fundamental issues that need to be thoroughly reviewed and debated. We will be working hard to keep you informed and to gauge your thoughts and feedback (especially on the overall cost benefit analysis of implementing these broad recommendations to streamline the capital raising process, while delivering on the digitisation efforts outlined in our first paper) as they progress, whether that is the form of consultations, discussion papers or working groups.

As experienced leading practitioners responsible for the administration of capital raising activities on behalf of our issuer clients, we can bring unique insights into some of the key challenges of delivering on the recommendations. We anticipate being closely involved, either directly or indirectly, in the relevant consultations and expect to be actively involved in any subsequent implementation of the report recommendations.

If you have any questions on the Austin report, the contents of this document or even wish to help inform our positions on anything you've read in this paper please contact John Britton or your dedicated Client Manager.

Look out for our next paper where we'll be look at the technical elements of those recommendations focused on secondary capital raising.

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