

Innovate Finance response to FCA CP21/21 Primary Markets Effectiveness Review

Introduction

Innovate Finance is the independent not-for-profit industry body representing the UK's global FinTech community. Our mission is to accelerate the UK's leading role in the financial services sector by directly supporting the next generation of technology-led innovators to create a more transparent, inclusive and democratic financial services sector for all.

Innovate Finance has over 250 members, spanning seed-stage startups, fast growing scaleups, and established "unicorns". A small number of these firms have listed and many will be planning to list in the future.

Innovate Finance and its members welcome the FCA's work to explore changes to the listings regime and its overarching aim to make London a more attractive venue for listing. As stated in The Kalifa Review of UK FinTech (published in February 2021), for which Innovate Finance served as co-secretariat, more than a third of privately funded UK FinTechs expect to undertake an IPO within the next five years and are therefore considering their listing destinations.

Innovate Finance believes IPO reforms are a core component of a broader strategy to help maintain and develop the UK's position as one of the world's leading FinTech hubs. Seeing UK FinTech companies list on the London Stock Exchange will be one important measure of success, but there is also the opportunity to attract European FinTech companies to list in London.

As co-secretariat to the Kalifa Review of UK FinTech, Innovate Finance is particularly pleased to see the FCA consult on two of the key recommendations focusing on improving the listing environment in the UK, namely dual class shares and a reduction in the minimum free float requirement.

The Kalifa Review specifically recommended:

- Reduce free float requirements on the Premium segment from 25% to 10%, for a limited time post-IPO; or put in place a minimum threshold.
- Enhanced governance rights: A golden share or dual class share structures.

We commend the FCA on issuing proposals which wholeheartedly adopt the spirit and the specifics of the Kalifa Review recommendations.

Innovate Finance spoke to over 20 FinTech companies to inform its response to the consultation. At one end, some of these companies are relatively early in their growth journey. At the other, some are actively planning to IPO in the next 12 to 24 months. Others are beginning to think about how they will approach an exit within a longer timeframe. It is worth adding that many of the companies Innovate Finance spoke to are founder-led, making the dual class share structure proposals particularly relevant.

It is worth noting that within the conversations Innovate Finance had with its members about this consultation, it is clear that listing on the premium segment of the London Stock Exchange is not the only route that FinTech companies are considering for going public. FinTech companies are clearly weighing up the relative merits of a direct listing, or listing on the high growth segment, or even listing via a SPAC. This underlines the fact that there is not necessarily a common view among FinTech companies on the best option for an IPO and so there is considerable interest in what changes in the listings rules the FCA will ultimately implement.

Innovate Finance looks forward to working with the FCA on the next steps that follow this consultation process and will welcome the opportunity to discuss the views of the FinTech sector on listings rules further.

Q18. Do you agree with our rationale for introducing DCSS to the premium listing segment? Is there any additional evidence that we should consider?

Innovate Finance agrees with the FCA's rationale for introducing dual-class share structure (DCSS) to the premium listing segment.

Many FinTech companies are led by founders who are "mission driven", in other words they have created a company to solve a specific problem in the financial services industry, or because they want to fix a particular market failure or address a societal need. By their nature, the typical mission of a FinTech founder takes many years to complete. The introduction of DCSS will help FinTech founders continue their mission and support long-term strategic goals beyond an IPO event. The FinTech companies Innovate Finance spoke to specifically referenced the importance of the founder being able to continue to deliver the company's growth according to their own vision and founding purpose. DCSS is an important tool in so far as it reduces the risk of a loss of control that could come if a company was taken over shortly after going public. Many FinTech founders have a powerful vision they want to bring to life; DCSS is a way of helping them complete their mission after an IPO. DCSS can protect newly listed companies from falling prey to takeover, especially if they experience an initial reduced valuation shortly after listing.

More generally, the companies Innovate Finance spoke to agreed that the introduction of DCSS will have the effect of bringing more innovative, tech-driven firms to IPO in London. The prospect of more diverse issuers coming to market and becoming public companies is undeniably a good thing for UK public markets.

Innovate Finance agrees with the FCA's reasoning for why it is beneficial from a corporate governance perspective for companies to list on the premium segment. During Innovate Finance's discussions with FinTech companies on this point, many raised the question of what the impact of DCSS would be on investors and investor protection. FinTech companies stressed the strength of the London Stock Exchange's corporate governance requirements and the fact this bolsters London's reputation as a highly respected market. Innovate Finance members agree that DCSS will be beneficial for FinTech companies, and by making this an option for the premium segment only it will help allay concerns that DCSS might erode the seriousness with which the LSE takes investor protection and corporate governance.

Q20. Do you consider that a five year sunset period for DCSS in the premium listing segment is the correct length to protect companies from unwanted takeovers? Please provide evidence for your answer.

Innovate Finance members think that the five year sunset period for DCSS in the premium listing segment is the correct length to protect companies from unwanted takeovers.

The prevailing view from Innovate Finance members is that five years is a suitable length of time to allow a company to grow and mature in the listed environment. A shorter time frame of three

years, for example, was not considered to be long enough to give a company headroom to adjust to being a public company and would therefore leave it vulnerable to unwanted takeovers. The FinTech companies Innovate Finance spoke to saw the value of gaining protection from takeover if for whatever reason a company's valuation was significantly reduced after IPO. The overall aim of shielding newish companies who are inexperienced in public markets was welcomed by FinTech companies.

A longer time frame could raise questions about London's reputation for investor protection.

Innovate Finance and its members believe that the five year sunset period for DCSS is a good trade-off between the right of a founder to maintain control compared to the rights of other shareholders.

Q21. Do you consider that the mechanism proposed will be effective in providing a deterrent to unwanted takeovers? Please give reasons for your answer and any possible alternatives.

Innovate Finance considers that the DCSS proposal should allow companies to allocate and structure their shares in such a way that upon IPO there is adequate protection against a hostile takeover bid within the predefined period. However, Innovate Finance does think that the FCA's proposals need to be carefully designed to ensure there are no "loopholes" that could be used to enact a successful hostile takeover, as this could have significant negative repercussions for existing listed businesses, and act as a deterrent for businesses seeking an IPO.

Q22. Do you agree with the proposed controls around DCSS in the premium listing segment? Are there any additional controls that would make the regime more effective?

Innovate Finance members agree with the proposed controls around DCSS in the premium listing segment.

Innovate Finance members thought the controls mapped out are important in striking a balance between making London more competitive in attracting IPOs through DCSS and maintaining the "gold standard" London has for investor protection and good corporate governance.

More generally, the view from FinTechs is that it will be important to communicate the fact that the DCSS reform will not make the rules in London the same as in the United States, where it could be argued that founders have too much control compared to investors.

Innovate Finance members therefore believe that the proposals and controls for DCSS are a good tradeoff between the right of a founder to maintain control compared to the rights of other shareholders.

Q23. Do you agree with our proposal to raise the minimum market capitalisation for companies seeking to list under standard and premium listing to £50m? If not, please state your reasons and indicate what alternative threshold may be more appropriate along with any supporting evidence. We also welcome views on whether we should consider setting out conditions under which we might modify the proposed rule on the new threshold, and if so what criteria stakeholders think we could usefully consider.

Innovate Finance members agree with this proposal. This comes with the caveat that the proposed change is highly likely to be only a niche area of concern for FinTech companies. A FinTech company is very unlikely to IPO with a market value of less than £50m and the vast majority of FinTech companies would not be considering a listing until they are valued in excess of £50m.

Q25. Do you agree with our proposal to reduce free float to 10% and to remove current guidance on modifications? Please give your reasons.

Innovate Finance members agree with the FCA's proposal to reduce free float 10% and to remove current guidance on modifications.

The FinTech companies Innovate Finance spoke to about this question voiced their support in general for this proposal. The prevailing view was that it might encourage companies to list on the premium segment rather than the high growth segment, where the free float is 10%.

Drawing on previous industry conversations, the FinTech investors (both institutional and smaller) that were involved in the discussions that led to the recommendation in the Kalifa Review to reduce the free float to 10% were happy to support this move. This is an important consideration for FinTech companies themselves, who said that they were content to agree to this proposal provided it would not cause significant concern among the investor community.

On a related point, FinTech companies agreed that one of the main reasons to list on the premium segment is to be included in the FTSE UK Index Series. As a result this might be more of a determining factor when companies are deciding whether to list on the premium segment as opposed to the high growth segment than the free float requirement.

Q26. Do you agree with our proposal to leave track record requirements as they are now, based on our assessment that this would only affect a small number of stakeholders? If you disagree, please provide further evidence or examples of the wider impact this has on prospective listing applicants and proposed amendments.

Innovate Finance and its members agree with the FCA's proposal to leave track record requirements as they are now.

In general, the FinTech companies Innovate Finance spoke to on this matter agreed with the thrust of the FCA's position of maintaining a high bar for financial statements. This was particularly the case with acquisitions, where it is recognised that it can be difficult to understand a group's accounts without previous statements. FinTech companies report this does bring significant hurdles but they understand and appreciate the FCA's desire to insist on such standards, since it is fundamental for ensuring the quality of companies that list on the premium segment.

In Innovate Finance's discussion with FinTech companies, an open question was raised about how high value businesses that have relatively low revenues might find the track record requirements. It is becoming more commonplace for fast growing tech companies to attract large valuations with an expectation of rapid "hockey stick" revenue and profitability growth. The FinTech companies Innovate Finance spoke to did not voice a particular opinion on this question, but will be very interested to see how such tech companies are impacted.