RPMI

Via email: cp21-21@fca.org.uk

Date: 13 September 2021

Dear Sir/Madam,

RPMI RAILPEN RESPONSE TO THE FCA REQUEST FOR VIEWS ON THE HILL REVIEW ON PRIMARY MARKETS EFFECTIVENESS.

About Railpen

RPMI Railpen (Railpen) is the investment manager for the railways pension schemes, and is responsible for managing c. £32 billion of assets on behalf of 350,000 members. Railpen is authorised and regulated by the Financial Conduct Authority (FCA). The Trustee's mission is to pay the pensions of its 350,000 members securely, affordably and sustainably.

The Trustee, and its subsidiary Railpen, undertake responsibilities attributed to asset owners and asset managers, and we have answered the issues raised in the Call for Evidence in a way that reflects the breadth of our responsibilities. Unlike many UK Defined Benefit (DB) schemes, the railways pension schemes include many open DB sections, which means that the Trustee expects to be paying the pension of an eighteen-year-old who is their first job today out to 2100 and beyond. We therefore continue to allocate an appropriate proportion of our assets under management to growth assets such as equities.

Introduction

We support the government's intention through its Hill and Kalifa Reviews to enhance the UK's attractiveness as a global financial centre. The UK's financial services sector is a world leader, and we recognise that the proposed reforms are driven by the desire to ensure the UK remains a competitive and dynamic market in the wake of Brexit.

We also acknowledge the government's recognition that the UK "needs to maintain the highest global standards" on corporate governance and the FCA's commitment to doing so. We believe that key to the UK's success as a financial services sector is the historically robust and well-regarded regulatory system that supports high standards of corporate governance and includes strong protections for minority shareholders.

This response builds upon our previous response to the Hill Review. In that response, we highlighted that "any move to allow dual-class voting structures would be detrimental to the kind of effective stewardship by institutional investors which the government has been laudably keen to encourage through [recent] initiatives." And that doing so would "in turn damage the global reputation of the UK as a market where investors enjoy structured protections and ownership rights."

Our response to the Hill Review cited the significant body of evidence demonstrating that any potential advantages of dual-class share structures tend to recede after a few years and that controlling owners have perverse incentives to retain dual-class share structures (DCSS) even when these become inefficient over time.[1] We still firmly believe that the optimal approach would be not to allow DCSS at all. However, our response also proposed a series of corporate governance safeguards – particularly the introduction of a mandatory sunset clause for unequal voting rights – which we believed would help minimise the negative impact of DCSS. We welcome the fact that many of these proposed safeguards have been taken up and therefore cautiously support most of the FCA's proposals in this regard.

Because of our ongoing concern, our following response focuses on DCSS, but we also offer comments on other areas of the FCA's proposed approach.

Our Response to the FCA Consultation

Dual Class Share Structures (DCSS)

Our support for the proposed changes to allow DCSS is offered on the basis that high corporate governance standards are not compromised.

The interests of retail investors are unfairly penalised since DCSS provide the owners (typically founders or corporates) of certain share classes with superior voting rights, giving them voting control over a company that is disproportionate to their equity shareholding. This 'gap' between ownership of a company and control skews the incentive structure towards the founder or entrepreneur (who in recent years has usually been the beneficiary of share classes with superior voting rights) while diluting market discipline, i.e. the influence and positive challenge of other shareholders.

We express our support for the suggested corporate governance safeguards, in line with what we proposed in our Hill Review response, including:

1. Maximum five-year "sunset" provisions, after which the weighted voting rights fall away for the company's shares admitted to a premium listing. We think that a 'hard-stop' maximum of 5 years would be sufficient given that many issuers are coming to the market at a later point in their lifecycle and are usually large and established by the time they list on an exchange.

2. Requirements that the weighted voting shares are held only by directors and that weighted voting applies only to votes on the removal of founders from the board and blocking a change of control.

However, should we go forward with the adoption of DCSS, we would suggest a maximum weighted voting ratio for dual class shares of 10:1 and not as high as the 20:1 limit proposed. We believe this would protect the rights of minority shareholders better. For example, if the ratio was set at 10:1 the holder could control 50% of the voting power with 9.1% of the shares. Whereas if it was set at 20:1, the holder could control 50% of the voting power with 4.8% of the shares.

It is also worth noting that the 10:1 limit is currently in practice in Singapore and Hong Kong.

Free Float Requirements

[1] Bebchuk and Kastiel (2017): The Untenable Case for Perpetual Dual-Class Stock

We believe that the current free float requirement is calibrated at around the right level at 25%. We think that any less would give too much influence to controlling shareholders and dilute the potential capacity for influence by minority shareholders in a way that would be detrimental to long-term corporate success, as per our views on DCSS structures above. There is also evidence to demonstrate that the increase in minimum UK FTSE free float requirements in 2011, from 15% to 25%, positively impacted stock liquidity.

We are disappointed that the reduction in free float is still going ahead and that it is a missed opportunity not to increase to 30% as "30% could be a powerful signal of the government's commitment to supporting shareholders to act as engaged stewards of their assets and further enhance the UK's attractiveness to global investors."

We note that if HM Treasury proceeds with reducing the number of shares an issuer is required to have in public hands (i.e. free float) from 25% to 10%, as part of the eligibility criteria set out in the Listing Rules, they need to ensure they have appropriate safeguards to ensure minority investors do not get squeezed out or forced to sell.

Our concern is that there needs to be sufficient liquid shares for investors like Railpen to be able to build a position in a company in a timely manner.

We would also question whether a greater threshold is required for companies with a DCSS.

Minimum Market Capitalisation (MMC)

We support increasing the minimum market capitalisation (MMC) threshold for both the premium and standard listing segments for shares in companies other than funds from £700,000 to £50 million, giving investors like Railpen greater trust, confidence and clarity about the types of company with securities admitted to different markets.

SPACs

Although it is outside the scope of this Consultation, we would welcome any greater guidance on SPACs beyond just suspending shares from trading when a potential acquisition is announced. Investors like Railpen need disclosure of information on proposed acquisitions, shareholder votes on acquisitions and redemption rights and that this is in line with other jurisdictions.

Measuring Success

We have noted that the measures of success referenced in the FCA consultation only look at success from the perspective of companies/corporates. In addition to this, we recommend early and explicit consideration of how well the changes are working for investors, like ourselves, including in their role as stewards and across all the changes proposed in the Review.

This should give us an indication of whether there has been an increase in investor choice.

Conclusion

The UK is an attractive place to invest, largely because of its investor-friendly approach, with a robust regulatory regime which includes strong protection for minority shareholder rights. We do not believe that the UK economy or its financial services sector are best served in the long-term by seeking to dilute these protections in a "race to the bottom".

In a world where the benefits of long-term, responsible investment are becoming increasingly clear, and where the current UK government has committed to supporting institutional investors to act as engaged and long-term stewards of their assets, it does not make sense to change the regulations in a way which fundamentally diminishes the impact of the key tools we require to do so.

We hope that the views we present here have been helpful. We would welcome the opportunity to continue the conversation – please do get in touch if this would be of interest.

Yours faithfully,

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