Brunel Pension Partnership's Response to CP23/10: Primary Markets Effectiveness review

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About Brunel Pension Partnership Limited (Brunel)

Brunel is one of eight UK Local Government Pension Scheme pools, bringing together £35 billion of investments of ten funds.

Brunel is a designated investment manager for the pooled LGPS' funds in the southwest of England. Our 10 clients are our shareholders, and our scope is limited to providing investment solutions in the listed and private market space for our clients to manage the long-term pension liabilities of their members. We are captured in our capacity as investment manager (portfolio management) however, given our relationship with our clients we have a unique position in the market to '*traditional*' asset managers.

We are therefore framing our response with reference to the unique relationship with our clients, in which we build products and reporting together, of which incorporating climate and sustainability risks and opportunities are central to our strategies including effective stewardship of our client's assets. We do however have a view to the wider financial services industry.

Executive Summary

Brunel are supportive of the overarching objectives the FCA are trying to reach with the proposals in the consultation. We believe that the UK should produce a listing environment which promotes transparency, market confidence, diversity and international competitiveness of the companies within the UK listed equity markets and with other international regimes.

Brunel, however, raise strong reservations about several of the current proposals the FCA have outlined to achieve these goals. We believe FCA have overemphasised the role of listing regulations in contributing to a decline in the number of UK listed companies and investment from UK based investors. In addition, we find that sufficient evidence has not been provided to support the claims that the proposed changes will address these issues.

The current consultation has been launched soon after the implementation of DP 22/2, and we do not believe that enough time has passed to review the impact of these changes, notably the 5 year sunset clause on enhanced voting rights. We also note that feedback to previous consultations which demonstrate concerns regarding key proposals have not been thoroughly addressed, and it is unclear how such feedback has been integrated into this consultation.

Our major reservations relate to the following:

The FCA's proposed approach to dual class share structures for the single ESCC category.

We do not agree with the FCA's proposed approach to dual-class share structures (DCSS). We also note with concern that some of the existing safeguards such as the limitations on enhanced voting rights have been rolled back without a strong rationale. We believe that the proposed changes will restrict shareholder influence and undermine the ability of asset owners, managers and shareholders more broadly to steward their capital. This will in turn impact the risk profile of the UK listed equity investments and jeopardise returns for (often retail) clients or pension scheme members.

The FCA's proposed approach to significant transactions for the single ESCC category.

Brunel strongly disagree with the FCA's approach to significant transactions. The removal of prior approval for significant transactions eliminates adequate protections for shareholders, and potentially exposes them to loss of value in the short and medium term. We, therefore, strongly advocate that the mandatory vote be maintained.

The FCA's approach to related party transactions (RPTs) for the single ESCC category.

Brunel strongly disagree with the FCA's proposal on related party transactions. Mandatory shareholder vote on related party transactions is an essential mechanism for investors to retain agency in the assets they own and/or manage. The removal of these requirements will significantly erode protections for asset owners and managers, leading to the UK listing environment becoming less attractive for investors who are unable to maintain sufficient influence.

We believe the current proposals will lead to lax governance standards, heighten risk and lead to a concentration of market influence resulting in lesser investor appetite for UK listed equities. Brunel would be supportive of expanding the Corporate Governance Code to all listed companies. We highlight however that such a proposal does not go far enough to alleviate the risks associated with weakening voting rights, and dual class share proposals.

We believe these measures would undermine the FCA's objective to "*protect and enhance the integrity of the UK financial system*", in conjunction with the objectives of the FCA in fostering a financial services sector which supports positive sustainable change and achieves the UK's Net-Zero objectives.

As stated, Brunel believes that the intended objectives of the proposed reform are important. However, our response outlines the view that the proposals could undermine the underlying objectives that they are seeking to achieve.

We are strongly supportive of the FCA's approach in consulting with firms in the financial services market, and would encourage continued dialogue with the FCA on this matter, as with all of our consultation responses.

If this would prove useful, please contact: Faith Ward, Chief Responsible Investment Officer or Vaishnavi Ravishankar, Head of Stewardship.

The following will break down Brunel's responses to individual questions in the consultation, starting with question 51, as this sets the framework by which our remaining answers build from, and clearly underwrites the FCA's policy decision-making in this area.

Question 51: What do you consider to be the most important factors in deciding where to list (for example, regulation, valuations, depth of capital markets, comparable peers, investor / analyst expertise, taxation, director remuneration requirements, indexation, location of main operations). Please rank your factors in order of importance.

Lord Hill, in his 2021 *Call for Evidence – UK Listings Review* – one of several consultations on the listings regime which preceded the FCA's latest paper – noted that "there is a range of factors that can make a jurisdiction an attractive place to list and do business. These might include (but are not limited to): the strengths of the wider business ecosystem; the visibility of public companies and IPOs; the presence of a pro-investment culture; the prestige associated with a market".[1]

UK Finance[2] noted that the top five factors considered by companies when they come to list are the following (in order):

- Access to a strong investor base
- Valuation and research coverage
- Liquidity
- Comparable companies
- Ease and cost of being publicly traded

It also noted that "governance matters" was a top issue for "large internationally focused UK companies" but not a top three priority for *any other kind* of company (including "small/high-growth US/US/European companies" i.e. exactly the kind that the government and FCA are keen to encourage to list and grow in the UK).[3]

Brunel ultimately believe that companies looking to list on UK exchanges want, including others: accurate and fair valuations, access to deep levels of liquidity and capital, a stable policy and regulatory environment.

The FCA acknowledge within the paper that "*regulation is not necessarily a key driver*" and that "*change to FCA regulation … will not on its own necessarily result in more listings in the UK*". Furthermore, the feedback to previous discussion and consultation papers show: "*limited support for single segment concept*", "*mixed (views) on removing the requirement for a clean working capital statement*", "*preference among key buy-side respondents to retain the two-segment approach*" and "*small minority suggesting more radical reform towards a disclosure-based approach instead of votes*"

This feedback indicates the potential risk of reducing the level of investment in UK listed equities, due to lack of clarity, governance inconsistencies and dilution of investor rights as a result of the proposals.

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[1] HM treasury, '*Call for Evidence – UK Listings Review*' (2021)
[2] *UK capital markets: Building on strong foundations* (2023).
[3] *UK capital markets: Building on strong foundations, (2023).*

Question 4: Do you agree with our proposed approach to dual class share structures for the single ESCC category and the proposed parameters? If you disagree, please explain why and provide any alternative proposals.

Brunel does not agree with the FCA's proposed approach to dual class share structures (DCSS). We are particularly concerned about the relaxation of safeguards and limitations on DCSS that could result in undermining investors' stewardship activities, and consequently their impact. We believe that this will in turn impact the risk profile of the UK listed equity investments and jeopardise returns for (often retail) clients or pension scheme members.

We also note that the proposals sit in direct conflict with a number of FCA and UK government initiatives which seek to strengthen investors stewardship efforts, including: FCA's Vote Reporting Group, and work on the ESG sourcebook, including Sustainable Disclosure Requirements (SDR) and finance for positive sustainable change discussion paper, the government's Taskforce on Pension Scheme Voting Implementation (TPSVI), HM treasury's published report from the Asset Management taskforce on Stewardship and the Financial Reporting Council's UK Stewardship Code 2020 and Corporate Governance code consultation.

We therefore, recommend that the sunset clause is maintained at 5-years and enhanced voting rights be limited to a very specific set of circumstances. Otherwise, executive directors may be less incentivised to take shareholder views on board.

Question 7. Do you agree with the proposed approach to significant transactions for a single ESCC category? If not, please explain why and any alternative proposals.

Brunel strongly opposes the FCA's proposed approach to significant transactions.

We believe the proposed disclosures alone will not be sufficient to provide adequate protection for shareholders. Without sufficient mechanisms for shareholders to exercise influence through a mandatory vote, companies may push ahead with transactions that could result in loss of value, given the lack of shareholder scrutiny. It could also be expected that companies will be lot less receptive to investor challenge on such transactions in the absence of complementary voting rights.

Question 12. Do you agree with the proposed approach to RPTs for a single ESCC category, which is based on a mandatory announcement at and above the 5% threshold, supported by the 'fair and reasonable' assurance model which includes the sponsor's confirmation as described above? If not, please explain why and any alternative proposals in the context of a single ESCC category.

Brunel strongly disagree with the proposal to remove voting rights of shareholders on related party transactions. It is crucial that shareholders are able to use voting for large transactions outside of normal company operations, as these forms of transactions can significantly change the economic, social, and environmental viability of an asset.

Removal of these voting rights could have significant negative consequences for investors – the absence of checks and balances could result in abuse of power and increased number of governance scandals.

We would challenge the specific point that RPTs are rare and are usually approved by investors. Current statistics that support this claim reflect the fact that transactions are unlikely to be put to shareholders for vote in anticipation of rejection. In fact, we believe it is likely that the number of RPTs which will be carried out will increase if shareholder voting requirements are removed, thereby raising the risk profile of investments, especially those in companies which are currently receiving the highest levels of engagement from investors on such transactions.

Question 21. Do you agree with our proposed approach to reporting against the UK Corporate Governance Code for companies listed in the single ESCC category, and are there any other mechanisms the FCA could consider to promote corporate governance standards?

Brunel would be supportive of expanding the Corporate Governance Code to all listed companies. We highlight however that such a proposal does not go far enough to alleviate the risks associated with weakening voting rights, and dual class share proposals.

Effective corporate governance reporting (including sustainability/climate reporting) is essential for investors to understand whether or not a company meets a specific investment strategy. The application of the 'comply or explain' approach to all listed companies however would not be sufficient to protect investors from dubious and risky transactions. The UK is renowned for its 'best-in-class' corporate governance standards, and the proposals around DCSS and significant and third-party transactions would likely erode this status.