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Insights

THE BIG IPO DEBATE

THE AMERICAN DREAM OR ENGLAND'S GREEN AND PLEASANT LAND?

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In what will undoubtedly be seized upon by the financial press as another blow to UK equity capital markets, Arm Holdings Limited, the Cambridge-headquartered chip designer which was once courted by Prime Minister Rishi Sunak for a London listing, has now announced that it has opted to IPO on Nasdaq. Arm's decision to list stateside comes off the back of WE Soda's abandoning of its plans to float in London in June, at which time its CEO suggested that, were the company to renew its efforts to IPO, New York seemed "a credible alternative". Many commentators have argued that stories such as these evidence the decline of UK capital markets and a relentless wind directing evermore IPOs across the Atlantic.

As an international law firm with a significant presence on both sides of the pond, we at BCLP are often asked about the comparative advantages and disadvantages of a Main Market listing in the UK as against a US listing on either the NYSE or Nasdaq. We have therefore sought to address this question in this article, whilst also looking at the proposed reforms within the UK and whether these reforms will offer the UK a new competitive edge.

As a health warning, this article will not seek to address any of the questions around valuations or liquidity and their respective disparities on either side of the Atlantic - we will rather focus on the merits of the respective listing regimes and legal environments.

ELIGIBILITY CRITERIA

Following Britain's exit from the European Union, the UK's listing regime was identified by Rishi Sunak, then Chancellor, as a key area for reform to strengthen the UK's position as a leading global financial centre. This focus on reforming the listing regime resulted in the publication of Lord Hill's 2021 Listing Review, which brought about changes to the eligibility criteria for listing on UK regulated markets, such as the Main Market. These included a decrease in the free float requirement from 25% to 10%[1]and the minimum market capitalisation being raised from £700,000 to £30 million.[2] This 10% free float figure compares with NYSE and Nasdaq[3]free float requirements which are instead based on a stipulated minimum number of shares (1,100,000 in respect of the

NYSE[4]and 1,000,000 in respect of Nasdaq[5]) being held by a specific number of shareholders who are not directors, officers or persons who hold (directly or indirectly) more than 10% of the issued share capital of the company (400 shareholders of 100+ shares in respect of the NYSE[6] and 300 shareholders of 100+ shares for Nasdaq, of which, Nasdaq requires at least 50% of such shareholders hold freely tradeable shares[7]). In terms of market capitalisation, the Main Market's aforementioned £30 million minimum compares with minimum market capitalisations of US$40 million[8]and US$50 million[9]on the NYSE and Nasdaq respectively. In addition, an issuer must have a closing price of at least US$4.00 on the NYSE[10]and US$2.00 on Nasdaq[11]. These eligibility requirements are, quite evidently, more prescriptive in the US and require securities in US-listed companies to be far more widely held following the IPO.

At the time of Lord Hill's 2021 review, there was a market perception that one of the reasons for an increasing number of founder-led technology companies opting for the US over the UK was the ability for founders to take advantage of "poison pill" style dual-class share structures to protect themselves from unwanted activists or bidders. As a result, changes were made as part of the reforms to allow dual-class share structures on the Main Market's premium list. These FCA changes were, however, both prescriptive in nature and relatively limited in scope, allowing directors of a company to hold a separate class of shares, which, following a change of control, would provide additional voting rights on any vote - disincentivising potential bidders as they would be unable to take full control. The latest proposed reforms to this area now go further than the current rules and are more permissive in nature, adopting a disclosure-based approach to dual-class share structures.

A fundamental aspect of the eligibility criteria for the premium segment of the Main Market has historically been the requirement to show that 75% of the business is supported by a revenue earning track record for the last 3-year period.[12]This has often been considered a limiting factor in encouraging high-growth or acquisitive companies to join the Main Market's premium list due to the difficulties of listing with a complex financial history. Nasdaq, on the other hand, which is often regarded as the preferred destination for high-growth companies, has a financial eligibility criteria which is based on net tangible assets. The net tangible assets requirements are lower (US$2m)[13]if the issuer has been in continuous operation for at least three years, or higher (US$5m) if it has been in operation for a shorter period. This being said, there is an alternative to using a net tangible assets metric – provided that the issuer has had an average revenue of at least US$6m for the last three years.[14] If an issuer is seeking to rely on the Net Income Standard for Nasdaq eligibility, however, it must also have a net income from continuing operations of at least US$750,000 in the most recently completed fiscal year or in two of the three most recently completed fiscal years, but this allows for a lesser minimum market capitalisation.[15]

Following the implementation of the new single segment regime in the UK, it is proposed that specific financial eligibility requirements will be removed from the Main Market, making the eligibility requirements easier to navigate.

The above comparison of listing criteria is not intended to be comprehensive and further additional specific eligibility requirements will apply on each of the Main Market, NYSE and Nasdaq. However, it is clear from the points raised above that the eligibility requirements in relation to financial track record and dual-class share structures are currently less advantageous in the UK than those in the US, particularly those found on Nasdaq. Nevertheless, with amendments proposed to the FCA's Listing Rules as a result of the move to a single segment, before long, this is expected to be no longer the case.

PROSPECTUS AND LIABILITY

The preparation of a prospectus is central to any IPO, whether that be in the US or the UK, and the processes for the preparation of this document in both jurisdictions are largely consistent.

In the US, IPOs are registered with the SEC, with the requisite registration statement for this purpose requiring a prospectus containing various prescribed categories of financial and non-financial disclosures. In the UK, eligibility for admission to the Main Market is contingent upon a prospectus being published, which also includes financial and non-financial disclosures. In the US and the UK, the SEC and the FCA respectively will vet and comment on the prospectus.

The US and UK also have broadly equivalent liability regimes for false or misleading disclosures. In the UK, claims are generally made under sections 90 and 90A as well as Schedule 10A of the Financial Services and Markets Act 2000. These provisions allow for potential shareholder redress where a shareholder has suffered loss as a result of (a) untrue or misleading statements within, or omissions from, prospectuses or (b) misleading statements within, or dishonest omissions from, other published information, or as a result of a dishonest delay by the company in publishing information. Similarly, in the US, prospectus liability may occur when securities are sold pursuant to a registration statement containing material misstatements or omissions. Sections 11 and/or 12 of the US Securities Act and Rule 10b-5 of the Securities Exchange Act are the principal statutes and regulations that are invoked by investors in this context.

Reference is often made in US capital markets parlance to the requirement for a 10b-5 letter (also known as a negative assurance letter). Rule 10b-5 of the Securities Exchange Act is an anti-fraud rule, which makes it unlawful to issue materially misleading statements or omit material facts in connection with a sale or purchase of securities. Prospectuses utilised with a US IPO or a UK IPO involving an offering in the US will therefore often require that a 10b-5 letter is prepared by the issuer's and the underwriter's counsel which will generally state that, based on their participation in the offering, including conferences with the relevant representatives of the issuer, their accountants, underwriters and their counsel, nothing has come to the respective counsel's attention that the registration statement (which includes the prospectus) contains any untrue statements of material facts, or omits to state any material facts necessary in order to make the statements in the offering document, in the light of the circumstances under which they were made, not misleading. This letter helps to establish a due diligence defence for underwriters against potential claims for untrue or misleading statements within the prospectus. In support of a 10b-5 letter, respective counsel for the issuer and the underwriters will conduct additional due diligence to assist in confirming that there are no material misstatements or omissions in the offering documents. The issuer's auditors will also provide assurance through comfort letters in respect of the financial information contained in the prospectus as additional support for establishing the due diligence defence for the underwriters.

There are similarities between this process in the US and "verification" in the UK, a process undertaken by the issuer and its counsel which involves checking the statements in the prospectus to ensure that there is supporting evidence to substantiate all relevant statements within. This verification exercise provides the directors and the company with comfort that the prospectus contain no untrue or misleading statements. Similarly, reporting accountants in the UK will also provide comfort letters to the issuer and underwriters to support the financial information contained in the prospectus.

Yet although the nature of the liability regimes may be similar, the difference between the likelihood of being held accountable for an untrue or misleading statement or omission is stark. Although the UK appears to be increasingly embracing class action style lawsuits like those typical in the US (see associated article), for now, the number of securities litigation cases under section 90, section 90A and Schedule 10A FSMA is minimal. The recent 2022 HP/Autonomy case was, in fact, the first case under section 90A to reach trial in the courts of England and Wales. The parallel litigation situation across the Atlantic is strikingly different. In 2018, 431 federal securities class action filings were made in the US, of which 209 related to Rule 10b-5 of the Securities Exchange Act or sections 11 and/or 12 of the US Securities Act. The equivalent figures were lower in 2022 (205 new federal securities class action filings, of which 180 related to Rule 10b-5 of the Securities Exchange Act or section 11 and/or 12 of the US Securities Act[16]) but it is nevertheless clear that the chances of being sued for statements within a prospectus or other published information are far lower in the UK than they are stateside.

CONTINUING OBLIGATIONS FOR LISTED COMPANIES

The sponsor regime is a uniquely British concept, with similar listing agent regimes only existing in a few other jurisdictions, including Hong Kong SAR, Milan and Saudi Arabia. Therefore, the requirement for premium listed LSE companies to appoint a sponsor to advise them and their management on the interpretation of the FCA's Listing Rules and guide them through various scenarios requiring shareholder approval – for instance, substantial and related-party transactions - is not something that generally applies to companies listed in America. This current regime, however, which is often criticised for being particularly burdensome compared to other jurisdictions, may well be about to be reduced in its scope, as with the move to a single segment, the FCA is also considering the ambit of the sponsor regime and the transactions for which a sponsor is required.

In terms of continuous disclosure, however, the existing regimes in the US and the UK are already broadly similar. In the US, the NYSE and Nasdaq generally require prompt disclosure of any material information that would reasonably be expected to affect the value of its securities or influence investors' decisions[17] and in the UK, the requirement is to disclose any inside information as soon as possible. When determining whether information is to be regarded as such "inside" information, a company should assess whether the information in question would be likely to be used by a reasonable investor as part of his or her investment decisions. This is a very similar test across markets.

Financial reporting requirements can also be an additional consideration when making the decision of where to list. In the UK, there is a uniform requirement for audited financial statements to be published on an annual basis, along with a condensed set of financial statements at the half year mark. This compares to the position in the US where a distinction is drawn between "domestic issuers" and "foreign private issuers". A foreign private issuer for such purposes is an entity incorporated or organised under the laws of a jurisdiction outside of the United States unless (a) more than 50% of its outstanding voting shares are directly or indirectly owned by US residents, and (b) any of (i) the majority of its executive officers or directors are US citizens or residents, (ii) more than 50% of its assets are located in the United States, or (iii) its business is administered principally in the US. Both domestic issuers and foreign private issuers are required to file audited financial statements with the SEC on an annual basis, but if you are a US domestic issuer, you must additionally undertake quarterly reporting on a condensed basis. If you are a foreign private issuer, quarterly reporting is not required but half yearly financial statements must be provided as of the end of an issuer's second quarter.

Another relevant consideration is corporate governance requirements. Again, however, these are broadly similar in the US and the UK, with requirements for, amongst other things, the majority of directors to be independent, the establishment of audit, compensation/remuneration and nomination committees, malus and clawback policies (or provisions to such effect in director service agreements) and board diversity being applicable for issuers on the premium segment of the Main Market as well as on Nasdaq. Foreign private issuers are, however, exempt from certain corporate governance requirements, provided that the issuer complies with applicable home country requirements instead.

Finally, a criticism that is often made about being listed in the UK is the approach to remuneration, and that executives in the UK generally do not receive equivalent compensation to executives in companies listed elsewhere (particularly the US). Cultural differences between the US and the UK may well have an impact on views on executive remuneration. Both countries require a shareholder vote on the matter, although the vote in the UK on an issuer's remuneration policies is binding, whilst in the US, the vote is advisory only and non-binding on the overall compensation of its CEO and other highly compensated executive officers. It should be noted, however, that the US does mandate binding shareholder approval for the adoption or material amendment of equity plans for non-foreign private issuers (which must instead comply with local law requirements).[18]

CONCLUSION

In response to the proposed reforms to the UK's listing regime, ten of the UK's largest pension schemes have warned the FCA that the reforms would damage "fundamental investor protections" and "diminish" the UK's reputation for robust investor protections and high corporate governance standards. The response to this position by other stakeholders and market participants has been strong, with a number of commentators pointing out that those same pension funds "will happily go and invest in overseas markets without holding them to the same standard of governance".

What is clear is that the US system does currently have some distinct advantages for many issuers (particularly founder-led high-growth companies), but the authors' view is that the proposed changes to the UK listing regime should help to redress this imbalance.

FOOTNOTES

[1] Listing Rule 6.14.2 (Main Market Premium Listing); Listing Rule 14.2.2 (Main Market Standard Listing).

[2] Listing Rule 2.2.7.

[3] References to Nasdaq listing standards discussed in this article are to those in relation to the Nasdaq Capital Market, which is the lowest of three listing tiers (the others are the Nasdaq Global Select Market and Nasdaq Global Market).

[4] Rule 102.01, NYSE Listed Company Manual.

[5] Nasdaq Rule 5505(a)(2).

[6] Rule 102.01, NYSE Listed Company Manual.

[7] Nasdaq Rule 5505(a)(3).

[8] Rule 102.01B, NYSE Listed Company Manual.

[9] Nasdaq Rule 5505(b)(2) – the minimum market cap requirement is based on the "Market Value of Listed Securities Standard". Other applicable standards, including the "Equity Standard" and "Net Income Standard", may also apply with no or reduced minimum market capitalisation requirements, but with alternative conditions.

[10] Rule 102.01B, NYSE Listed Company Manual.

[11] Nasdaq Rule 5505(a)(1)(B) - US$2 per share if the Company meets the requirements of the "Market Value of Listed Securities Standard," or US$3 per share if the Company meets the "Equity Standard" or "Net Income Standards".

[12] Listing Rule 6.2.1.

[13] Nasdaq Rule 5505(a)(1)(B).

[14] Nasdaq Rule 5505(a)(1)(B).

[15] Nasdaq Rule 5505(b)(3).

[16] Recent Trends in Securities Class Action Litigation: 2022 Full-Year Review – 24 January 2023 – NERA Economic Consulting, - pages 1, 2, 3 (Figure 2).

[17] Rule 202.05, NYSE Listed Company Manual and Nasdaq Rule 5250(b). Additionally, the SEC requires that certain events be disclosed on a Current Report on Form 8-K within four business days' of the occurrence of the event, subject to certain exceptions.

[18] Rule 303A.08, NYSE Listed Company Manual and Nasdaq Rule 5635(c).

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