
# SHARE CAPITAL MANAGEMENT GUIDELINES

FEBRUARY 2023

## 1. Introduction

These guidelines set out the expectations of Investment Association members where companies seek shareholder authorisation for the general allotment of new shares and any disapplication of pre-emption rights.

They have been reviewed following the Report of the Secondary Capital Raising Review which was published in July 2022. The Review, led by Mark Austin, provided recommendations on improving further capital raising processes for publicly traded companies in the UK. The review included a recommendation for the Investment Association to update these guidelines:

> *"Recommendation 14 - Companies should continue to be able to seek annual allotment and pre-emption rights disapplication authorities from their shareholders of up to two thirds of their issued share capital, but with the authority extending not just to rights issues as is currently the case but to all forms of fully pre-emptive offers made on the basis of the updated pre-emption provisions set out in Recommendation 15 below, and any follow-on offer as described in Recommendation 6."*

Having consulted IA members, the UK Shareholders' Association and ShareSoc we have updated these guidelines to reflect the recommendation. We will continue to keep these guidelines under review as market and regulatory approaches develop, including the recommendation on the definition of pre-emption rights in the Companies Act 2006, referred to in recommendation 15 of the Secondary Capital Raising Review.

Whilst we have amended the guidance to incorporate all fully pre-emptive offers and to not only refer to fully pre-emptive rights issues, IA members expect companies to explain why they have chosen their capital raising structure and why it is appropriate for the company and its shareholders. Some retail shareholders have highlighted that rights issues continue to be their preferred method of fully pre-emptive capital raising as the Secondary Capital Raising Review highlights:

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*"A rights issue is seen as the 'gold standard' of investor protection as it has two key features: it provides shareholders with a 'tradeable' right to subscribe for shares that they can either use or sell, and it provides the possibility of monetary compensation for the dilution suffered by shareholders that take no part in the offer."*

We have also updated our guidelines to support the new Pre-emption Group Statement of Principles which allows annual authorities of up to 20% of the issued share capital and an additional 4% for a follow-on offer. Finally, the guidelines recognise that capital hungry companies may have reason for raising larger amounts of equity capital.

These guidelines set out the expectations of The Investment Association's members as institutional investors on various aspects of share capital management. They apply to companies whose shares are admitted to the premium segment of the Official List of the UK Listing Authority.

Companies whose shares are admitted to the standard segment of the Official List, to trading on AIM, or to the High Growth Segment of the London Stock Exchange's Main Market, are encouraged to adopt these guidelines.

# 2. Directors' Power to Allot Shares

## 2.1 SECTION 551 – GENERAL POWER TO ALLOT

Members will regard as routine an authority to allot up to two-thirds of the existing issued share capital. Any amount in excess of one-third of existing issued shares should be applied to fully pre-emptive offers only.

This routine authority is acceptable as appropriate protections against shareholder dilution are provided both by pre-emption rights and the requirement that shareholders of premium listed companies in the UK have a vote on all major transactions – under Listing Rule 10.5, a listed company must, in relation to a Class 1 transaction send an explanatory circular to its shareholders and obtain their prior approval in a general meeting for the transaction/ensure that any agreement effecting the transaction is conditional on that approval being obtained.

The authority should be approved by ordinary resolution and be for the period until the next Annual General Meeting.

In calculating existing issued share capital, any shares held in Treasury should be excluded.

## 2.2 SECTION 570 – GENERAL POWER TO DISAPPLY PRE-EMPTION RIGHTS

The terms of a special resolution to disapply pre-emption rights should comply with the provisions of the Pre-Emption Group's current Statement of Principles.

The Investment Association notes that the Pre-Emption Group has provided template resolutions for the disapplication of pre-emption rights. The template provides for two separate resolutions, which relate to:

a) the disapplication of pre-emption rights on up to ten per cent of the issued share capital to be used on an unrestricted basis; and

b) the disapplication of pre-emption rights for an additional ten per cent in cases when boards consider the use to be for the purposes of an acquisition or specified capital investment in accordance with the Statement of Principles, and

c) a follow-on offer to existing holders of securities not allocated shares under an issue made under either a) or b) above.

Investment Association members are supportive of the template resolutions and, save with respect to capital hungry companies seeking a disapplication of pre-emption rights in accordance with the Statement of Principles, expect any company seeking a disapplication of pre-emption rights up to 24% of the issued share capital to follow the template resolutions in so far as applicable. The disapplication of pre-emption rights over lesser amounts may be appropriate for some companies.

Where a company is seeking authorities against the Pre-emption Group's template resolutions, IA members expect that companies will confirm in their Notice of Meeting that they will follow the shareholder protections and approach to follow on offers as set out in paragraph one and paragraph three of Part 2B, respectively, of the Statement of Principles.

Investment Association members have asked the Institutional Voting Information Service (IVIS), the IA's voting research service, to Red Top companies that:

a) seek a routine disapplication of pre-emption rights in excess of 24% of the issued share capital allowed for by the Statement of Principles; or

b) seek a disapplication of pre-emption rights up to 24% that does not:

I. follow the template resolutions;

II. confirm that it will follow the shareholder protections in Part 2B of the Statement of Principles; and

III. confirm that it will follow the expected features of a follow-on offer as set out in paragraph 3 of Part 2B of the Statement of Principles.

## 2.3 Capital Hungry Companies

The New Pre-emption Group Guidelines provide more flexibility in terms of the size and frequency of non-pre-emptive authorities for capital hungry companies.

> "Companies that need to raise larger amounts of capital more frequently ('capital hungry companies') may seek additional disapplication authority, for use whether or not in connection with an acquisition or specified capital investment, if the reason for exceeding the level set out above is specifically highlighted at the time at which the request for a general disapplication is made."

The Pre-Emption Group Statement of Principles are clear, "Companies seeking admission to the Official List of the Financial Conduct Authority that wish to be considered a 'capital hungry company' for these purposes and to make use of this approach should disclose that fact in their IPO prospectus."

IA members support this approach and IVIS would Amber Top the pre-emption authorities in excess of 24% of the issued share capital for companies who have disclosed at the time of their IPO in their prospectus that they are a capital hungry company.

# 3. Own Share Purchase

Institutional investors are supportive of companies' efforts to return surplus funds to shareholders and seek for companies to set out their proposed approach to returning capital to shareholders including how this is aligned with the company's long-term strategy and business model. This should be supplemented with details of any distributions made to shareholders during the year under review and any expectations for the current financial year. Dividend payments remain the preferred method for regular distributions to shareholders. However, the following guidelines are provided for companies who decide that share repurchases are in the best interests of their shareholders.

## 3.1 AUTHORITY TO REPURCHASE OWN SHARES

Companies should seek authority to purchase their own shares whether on market or off market by special resolution and not simply an ordinary resolution as is allowed by Sections 694 and 701 of the Companies Act 2006.

A general authority to purchase shares should be renewed annually.

Shareholders expect that a general authority for a company to purchase its own shares will be exercised only if it is in the best interests of shareholders generally and normally only if it would result in an increase in earnings per share or, in the case of property companies and investment trusts, if it would result in an increase in asset value per share for the remaining shareholders. Where this is not expected, the benefits should be explained clearly.

Companies should disclose in their next Annual Report the justification for any own share purchases made in the previous year, including an explanation of why this method of returning capital to shareholders was decided upon. In this context, companies should discuss the effect share buybacks have on earnings per share (EPS), total shareholder return (TSR) and net asset value (NAV) per share. EPS and TSR targets under both short and long term incentive schemes should take account of the effect of share buybacks. Market conditions should be carefully considered and an average price paid should be disclosed. The effect on the holdings of major shareholders might also merit discussion in the Annual Report.

## 3.2 AMOUNT

A general authority to purchase up to 10% of the existing issued Ordinary share capital is unlikely to cause concern.

The Institutional Voting Information Service (IVIS) will note a general authority to purchase more than 10% (but less than 15%) of the existing issued ordinary share capital. A repurchase of more than 15% is not permitted under the Listing Rules, unless carried out by a tender offer.

In calculating existing issued share capital, any shares held in Treasury should be excluded.

Whilst the Companies Act now allows companies to hold more than 10% of their shares in Treasury, the Investment Association's preference is for companies not to hold more than 10% in Treasury.

## 3.3 PRICE

Investment Association members consider as appropriate the requirement of the Listing Rules that (unless a tender offer is made to all shareholders) purchases of less than 15% of the issued share capital pursuant to a general authority should be at a price which does not exceed the higher of:

a) 5% above the average market value of the company's shares for the five business days before the purchase is made; and

b) the higher of the price of the last independent trade and the highest current independent bid on the market where the purchase is carried out.

Members discourage share buybacks that are done off-market unless there is transparency on terms and pricing.

### 3.4 DEALINGS BY COMPANIES IN DERIVATIVES OVER THEIR OWN SHARES

Investors are concerned about unusual structures and transactions that relate to returns of capital where there might be unusual risks.

a) The boards of companies contemplating returns of capital through contingent dealings in their own shares, or in derivatives referenced to their shares, should explain these clearly to shareholders and demonstrate the expected benefits to, and safeguards for, shareholders.

b) Prior authority for any such dealings should be sought and approved via a specific special resolution and the amount should be counted within the general authority limit.

c) Companies should report in due course on the effectiveness and benefits of any such dealings in their next Annual Report.

# 4. Scrip Dividends

Investment Association members are concerned about the dilutive effects of scrip dividend issues. Consequently, they normally prefer that shares offered in lieu of dividends are sourced from shares purchased in the market (Dividend Reinvestment Plans or "DRIPs"), rather than primary issuance.

However, in some circumstances, shareholders may be offered an option of taking newly issued shares in lieu of a dividend.

Any authority to offer a scrip dividend using new shares should be renewed at least every three years.

Shares to the value of the cash dividend forgone should be allocated at the average of the middle market quotations on the London Stock Exchange, as derived from the Daily Official List, for the five business days beginning on the ex-dividend date.

Arrangements whereby a scrip dividend offer is cancelled are only acceptable if a clear rationale and explanation to shareholders is provided.

# 5. Issuance of Shares by Investment Trusts

New shares should not be issued below net asset value (NAV).

Treasury shares should only be re-issued at a discount which is lower than the weighted average discount at which all shares held in Treasury have been repurchased.

Boards should always explain why they believe it is in the interest of shareholders to hold shares in Treasury for potential re-issue at a discount rather than to cancel them at the time of re-purchase.

IVIS will also red top pre-emption authorities greater than 20% of the issued share capital (excluding shares held in Treasury).

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