Candor

Feedback on: FCA CP23/31 Listing Regime Reform Proposal

Candor Partners' response to the FCA's CP 23/31 document is designed to address the themes that were set out by Nikhil Rathi and Sarah Pritchard's Forward. The Market Effectiveness proposals aim to make our listing market more attractive to new issuers as well as improving the environment for our current crop of issuers. We have highlighted some fundamental problems our issuers face by looking through the very narrow lens of the execution phase of share buybacks on the open market.

In the last 2 years, around 50% of FTSE 350 companies have repurchased a little over £100bn worth of their own shares. In this period, new issuers have raised just over £2.5bn. We evidence that there is substantial value loss during the execution phase of share buybacks, directly impacting investors' overall returns.

We propose making some minor changes to the environment for buyback execution, and some of the products that are used to implemented them. We believe these proposals will help to make our UK market match fit for the current team of issuers on the pitch and as well as make the UK more attractive to new issuers over the longer term.

We think that the following areas will benefit from review and simple changes:

1. **Governance Oversight of the Execution Phase of Buybacks**
2. **Buyback Execution Products and their Fee Structures**
3. **The Publication of Issuer's "Transactions in Own Shares" Notifications**
4. **MAR Buyback Safe Harbours**

We give context as to why the narrow field of the execution of share buybacks deserves some attention, and address each of these topics in a little more detail in this letter's appendix.

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Overview

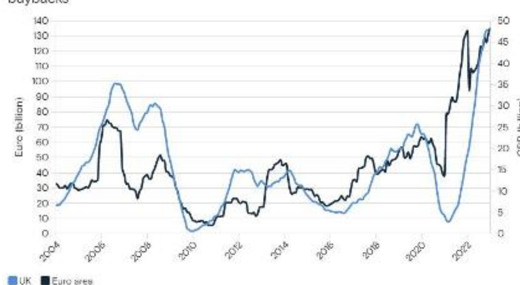
Share buybacks have been growing in popularity both globally and in the UK. In the UK this theme is likely to continue as boards look to address the much talked about valuation discount our issuers trade at relative to their global peers. It has been reported that [43% of UK issuers] executed share buybacks >1% of outstanding shares in '22, spending upwards of £50bn in and a further £55bn in '23. This pace has recently been increasing both globally and domestically as shown in Fig. 1.

Fig. 1.

Chart 616: % Global stocks buying back shares
Globally, 29% of stocks are buying back their shares

Source : BofA Global Quantitative Strategy, MSCI, Exshare

The pace of buybacks is higher than in the last 20 years
Rolling annual summation in local currency for UK (RHS) and Euro Area (LHS) buybacks



Source: Haver Analytics, Goldman Sachs Research (data as of January 18, 2023)

Goldman Sachs

Although a great deal of attention has been focused on the decision process for share buybacks, very little attention has been directed at how these decisions get implemented. Analysis, using issuers regulatory disclosures, provides evidence that there can be a significant value leakage in this phase. Any value leakage lost in the execution phase of a buyback has a direct drag on investor returns, which compounds over time. Simple improvements made in the UK will make our market relatively more attractive to both issuers and investors.

One of many examples is that of Royal Mail's '22 share buyback, that has been referenced by both the FT's Brooke Masters and the Sunday Times by Oliver Shah. In this case Royal Mail paid a fee of approximately 8.5% (£15.8m) to implement a buyback. A high fee, in and of itself, is not necessarily a problem, as fee's many be linked to other services. However, we draw attention to the overall process and highlight the mis-management of risks and incentives that have created conflicts. At times, the value leaks and fees are eyewatering.

Issuers and Investors are the two most important constituents for our public capital markets. The market's infrastructure and the rest of the financial

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service industry sit at where our issuers and investors interface. Their services help facilitate the flow of risk and capital between issuers and investors. Because of the scale of share buybacks, we use this opportunity to draw attention to problems that effect investors returns, and which are hidden behind information barriers.

Whilst attracting new issuers to our markets should remain a core focus, in ’23, buybacks were approximately 55 times larger by value than primary share issuance in the UK. Share buybacks are currently some of the single largest capital allocation decisions that boards are approving for UK listed companies. Some of the FTSE 350’s finance departments tell us that over the last 7 or 8 years approx. 60 to 70% of share buybacks have been executed using products like those that were used to implement Royal Mail’s 2022 buyback.

Why does this matter?

On the surface, the execution of a buyback is very simple, it is just a case of buying some shares. However, when the magnitude of these transactions is considered, a certain degree of complexity arises. In addition, due to their size any inefficiencies in a buyback’s execution can have a significant impact on investors returns, which compound over time. There are several share buybacks in the market right now which are well over £1bn. This makes buybacks some of the single largest equity transactions currently in the market.

Asset management and hedge funds have fully staffed professional trading desks. These desks protect investors by focusing on managing the risks and complexities that arise when executing equity transactions. This involves navigating various conflicts of interests on behalf of their investors. The market is full of participants who try to extract value from investors order flow, including their own brokers.

Issuers and their staff are not generally equity execution specialists. When considering share buybacks and their implementation, issuers frequently receive advice from an array of highly skilled professionals with expertise in corporate finance, market abuse rules, contract law, competitive pricing processes, tax implication etc. This group of professionals frequently engage indirectly with the exotic options desks of investment of banks for pricing and structuring negotiations for execution products. To be candid, issuers and their advisers do not stand a chance.

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The asymmetry of knowledge and information on buyback execution products is enormous. In financial services, opportunities thrive in opacity. For share buybacks this opacity is maintained because most of the relevant data and documentation remains behind information barriers forever, preventing proper scrutiny.

The market is ruthless, it will extract value from those that are unprotected. Issuers and their advisers have a limited understanding of the scale of the problems at play. Equity execution is not their area of expertise, so they have no frame of reference for equity execution quality, nor how to measure the outcomes. This is dangerous. Contrast these arrangements with the expertise of our investors professional trading desks, then consider the scale of share buybacks in the market. Not only do we suggest that there are problems, but we have evidenced them with hard data.

If we strive to make our capital markets match fit, then we need to root out these sorts of issues. This is for both rational economic reasons, as well as for maintaining the required trust for our capital markets to function.
For further details please see Appendix below.

Yours faithfully

Michael Seigne
Founder
Candor Partners Limited

Candor Partners is an independent consultancy focused on helping issuers get better outcomes when transacting in their own shares. We have recently been very focused on the execution phase of share buybacks, where we have found several significant concerns. In 2023 we published 9 papers, including “The Great Deception”. The Financial Times, Sunday Times and Wall Street Journal all referenced and quoted our work. Harvard Law School, Columbia Law School, and The Chartered Governance Institute UK & Ireland published our papers on share buyback related governance topics. For a more complete overview of our work please see our LinkedIn posts, SSRN and the research and press section of our website.

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Appendix

We suggest there are four topics that would benefit from further review.

1) Governance

We suggest the governance topic is looked at from two different perspectives, the issuer board, and investors.

Boards Perspective
There are three core topics within the general heading of buyback execution governance for the board to consider:

a) **We believe that the execution phase of share buybacks should always have a purchase price limit (or valuation discount/premium limit) of some form to protect against wealth transfer from the holding shareholders.**

The general governance topics surrounding the decision to do share buybacks are well understood. However, these risks, and their associated mitigations do not always get carried dome from the board approval process to the buyback implementation phase.

By way of explaining first lets considers price limits. To do so we will borrow from Mr Warren Buffet's many explanations. Imagine that a company has 3 shares in issue, one owned by Mr Buffett, one by you, and one by me. The intrinsic or business value of this company is simply £3,000 of cash held in a bank, or £1,000 per share. The company elects to do a share buyback, and I choose to sell my share. The transaction price for the share buyback determines if there is a wealth transfer between the holding shareholders and the seller. If the price paid by the company to buy my share is £800, then value transfers to the holding shareholders, however if the transaction price is £1,200, then value transfers to the selling shareholder. This wealth transfer effect of buybacks is well understood and is addressed to some degree in the FCA's Listing Rules (LR) 12.

We acknowledge that knowing what the specific price limit should be is hard, as it requires estimating the business value or intrinsic value of the company. However, just because this is hard, it does not mean that it can be avoided. The board cannot just absolve itself of this responsibility due to difficulty. If it is

too hard, then the capital can be deployed via other means, or returned to shareholders via a special dividend. A share buyback being executed without a limit price is akin to the board being asked to approve a large acquisition without any ability to express price or value constraints at all.

Price cap logic should always be embedded into the associated buyback's execution strategy. This is especially true within a subset of execution products that we discuss in greater detail later, ones we call "problem products". These products are guaranteed execution products that reference a certain benchmark[1], which is commonly used for share buybacks.

There is no available data for products sold in the UK and EU that have price caps or similar price protection mechanisms. However, there are two relevant factors which suggest that a high proportion do not have price caps.

First, when a broker provides a product that guarantees that the programme will complete, then the inclusion of a price cap increases the costs for the broker. The pricing for these products is typically expressed as a discount to a benchmark. When the discounts are reduced, or they become a premium, the products are less attractive to the issuers. E.g. the broker may show a price that guarantees the buyback will complete at 50bps below a benchmark (50bps discount). With a price cap included this discount might reduce to say 10bps or even turn into a 30bps premium.

Second, we can evidence the lack of price caps by pointing to similar execution products used in the US market, where there is some limited data. These products are called ASR's (Accelerated Share Repurchase), and research shows that 68% of ASR's do not have price caps or collars.

Large share buybacks executed within confined timeframes, which also must be completed by the broker, can increase risk of pushing share prices up. Boards need need to have a mechanism in place throughout execution to protect the holding shareholder against value shifting to the sellers, especially given these heightened risks.

[1] Author's Note: The benchmark referred to is the arithmetic average of the daily VWAP (Volume-Weighted Average Price) over the execution period. This benchmark was critically evaluated and referred to as the "Bogus Benchmark" in Seigne and Osterrieder's study (2023, July 3) the Great Deception: A Comprehensive Study of Execution Strategies in Corporate Share Buy-Backs. Available at SSRN: https://ssrn.com/abstract=4499366.

b) Execution Strategy and c) related Broker Fee Structure

Using our simple 3 share company, lets clarify a mechanical aspect of buybacks. When the company buys back one share and cancels it, the remaining two shareholders ownership each increases to 50%. Alternatively, if the purchased share was prorated across the holding shareholders, each shareholder would own 1.5 shares or the same 50% of a 3-share company. The point being, that when a company buys back shares to cancel them, they are effectively buying those shares on behalf of the holding shareholders.

An aspect of the governance process needs to therefore look through the lens of the holding shareholders interest during the execution phase, and in so doing, consider the risks and costs from their perspective.

Within EU No 596/2014 article 5 paragraph 1 gives an issuer exemption from market abuse provided the sole purpose of a buyback is to **reduce the capital of the issuer**.

Logically, it follows that the optimal outcome, when an issuer is trying to reduce its share capital, is to attempt to buy a greater number of shares. The more shares purchased the larger the reduction in the issuer's capital. The best practices for attempting to buy as many shares as possible, with a pre-defined amount of money, are very well established in the investment management industry.

These best practices include the use of "pre trade" analysis, which quantifies the expected transactions costs as well as expected risks to implement the buyback programme under different execution assumptions. Post trade analysis afterwards evaluates the effectiveness of the execution and its quality.

Issuers might benefit from a risk based "pre trade", and a full post trade analysis carried out by an independent party. Would this help to understand the realised costs and improve the execution practices going forward?

From a governance perspective both the selling and holding shareholders need to be treated fairly. In the situations covered in this letter, the issuer is a company whose shares trade on the public markets. A selling shareholder can therefore choose to sell using the market at any time, regardless of whether

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there is a buyback in progress or not. They have control over setting their own price limits, timing, quantity of shares, execution strategy, or not selling at all. The main governance responsibility that the company has to the selling shareholder relates to ensuring that all the relevant buyback information is disclosed appropriately.

The holding shareholder on the other hand has no control over how, when and if a buyback gets executed at all. If the issuer enters a contract with the broker, then these contracts, the underlying execution strategy, associated execution fee structure and most other relevant details are kept on the private side of information barriers, for good reasons. The governance process of the company is therefore the only party who, through their fiduciary duties, can act to protect the interests of the holding shareholder. This process needs to align the issuers buyback objectives with interests of the holding's shareholder through an execution strategy that accounts for risks and associated costs appropriately.

Governance from the Investors Perspective

As the FCA continues to move the UK increasingly towards a disclosure-based process, it follows that "ESG" will continue to be a large theme for Investors. Albeit one that itself is under growing scrutiny. The recent regulatory and market focus on "E" and "S" have dominated investors' attention. We can speak first hand, that it is very hard to get the ESG and stewardship teams, or the broader investor industry groups, to pay attention to the problems being highlighted in this letter. However, given the magnitude of value being transacted by issuers in share buybacks, hopefully that will change with greater understanding of the topic.

Shareholders can ask issuers more questions, such as...

How do you measure the execution quality of your share buyback?
Is the execution quality independently verified?
How much does it cost, are the fee's performance related?
Do you have execution price limits?
What is the execution strategy goals and performance benchmarks?
And so on....

The foundation of this process already exists as large asset managers are very familiar with the correct sets of questions to ask that relate to execution quality. These investors undergo similar scrutiny from the likes of pension

consultants and end asset owners. These investors also perform more detailed scrutiny of their own brokers best execution processes.

UK current position vs other global competitive markets

UK is currently in line with others for both the issuers boards and investors governances' processes, however the UK has a distinct advantage in that some of our disclosed data is more granular that that of Australia and the US. More on data disclosures later in appendix.

Suggested solution to differentiate UK-

i) Encourage/require board level education to enable informed challenges along the lines of these articles published by CGI UK and Columbia Law School.

ii) Encourage the trading desks of asset managers to engage in the evaluation of their portfolio companies buyback execution strategies and achieved quality.

2) Execution Products and their Fee Structures

Share buybacks can be implemented in many ways. In this letter, we are only focused on Open Market Repurchase (OMR) processes (i.e. excluding Tender Offers, Dutch Auctions etc). Within OMR's there are a variety of different solutions, we will focus on some packaged products designed specifically to help issuer execute buybacks.

Buying shares on listed exchanges, whether for investors or corporates, have similar execution challenges. Our bankers appear to prefer to sell our issuers products designed and priced by our exotic options desks. Why is this, and why are they a completely different set of products to those our investors use to solve for essentially the same set of challenges and risks?

Matt Levine, a Bloomberg journalist, and an ex-banker who sold buyback execution products to issuers in the US recently wrote....

Matt Levine, Bloomberg: Money Stuff 08/23/2023

PEOPLE ARE WORRIED ABOUT SHARE BUYBACKS

When I was an investment banker, ages ago, part of my job was to pitch stock buybacks to companies. Part of this pitch involved comparing buybacks to dividends, the other way that companies commonly return cash to shareholders. For *me*, the advantage of buybacks was obvious: A buyback requires hiring a bank and paying it a commission,[12] so I could make money from buybacks but not from dividends. The *pitch* did not highlight that.

[12] Actually ideally it would involve a derivative product like an accelerated stock buyback, rather than just paying $0.01 per share of commissions, but in any case a buyback involves some economics to a bank or broker.

Charlie Munger also famously said "...show me the incentive, and I'll show you the outcome..."

We are calling for more scrutiny of a particular set of buyback execution products. It is worth examining the brokers incentives, to see how they align with those of the holding shareholders. We are referring to have a variety of products with names such as "VWAP-minus" and "VWAP-discount", and a related derivative product specific to the US, called ASRs. We collectively call these the "problem products".

One common feature of these products is an unusual benchmark, that we have nicknamed the "bogus benchmark" in our white papers and research. We think that Mr Munger would have been most interested in examining the interaction between this unusual benchmark, the brokers fee / PnL (profit and loss) and the issuers outcomes.

It is unusual for brokers to be rewarded via a variable fee structure when executing institutional client's equity orders for a variety of reasons that we will not go into here. The idea behind incentivising the broker with a fee that escalates with the improving quality of execution is appealing. For this structure to work, the benchmark against which the quality of the execution is measured is critical.

If this "bogus benchmark" does not measure execution quality, then products that are designed to outperform it are at risk of having problems. Which brings us to this quote "What gets measured gets managed- even when it is pointless to measure and manage it, and even if it harms the purpose of the organisation to do so"[2].

The optimal outcome, specific to the execution of a buyback, is for an issuer is to maximise the number of shares purchased in a risk responsible manner. When we look for alignment of interests, we therefore need to ask the question does the brokers fee positively correlate with increasing the number of shares purchased by the product?

The underlying execution strategy for a buyback will likely vary depending on the objectives of the issuer. For example, a share buyback can be viewed through many lenses such as an investment in the issuers own cheap stock, a

[2] The conclusion from R F Ridgway's 1956 paper on *Dysfunctional Consequences of Performance Measurements*, summarised by journalist Simon Caulkin.

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capital restructuring, as a "dividend", an ownership consolidation etc. Similarly, a buyback might be a "one off" capital allocation or planned to be part on an ongoing process of many buybacks to return excess capital to shareholders over time, maybe alongside a dividend scheme. It is not likely that any single execution product and strategy are going to be optimal for each of these different objectives.

Given that there can be different objectives, the important topic for this section of our letter, is to highlight that these "problem products" are not suitable for any legitimate share buyback objective.

How can we state this?

There is plenty of academic research on various equity execution strategies, execution quality, total transaction costs, impact costs, pre-trade cost models, execution benchmarks etc. The industries current best practices in this field are largely built on the work of Almgren and Chriss from the early 2000's. Their model considers factors such as market impact, risk aversion and the timing/rate of trading to optimise the execution process. This work underpins the best practice used for effectively managing large trades, and should include share buybacks.

Conversely there is very limited academic work that focuses on the specific niche of share buyback execution strategies and the various related products. This has been highlighted in Prof Osterrieder and Seigne's literature review of the topic. Having said that, one of the few examples of relevant research is Prof Guéant et al's work, including papers relating to aspects of the above-mentioned Accelerated Share Repurchase (ASR) products. Their research is focused on the pricing and optimal hedging strategies from the brokers perspective rather than that the issuers. Nevertheless, their work highlights that ASRs use the same "bogus benchmark" as the other problem products we have mentioned above.[3]

The combination of the "Fee" Structure and Benchmark

These problem products can differ in many ways, we therefore need to generalise. However this "bogus benchmark" forms the basis of what is

[3] For details of the benchmark in question search for "Forward Price" in the General Terms section of the US regulatory disclosures of a document called Exhibit 10.1. These are "boiler plate" disclosure documents required to be published relating to ASR's... examples: General Motors Company, Rambus Inc., American Egal Outfitters, Inc., Twitter, Inc (pre Elon!)

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effectively a forward price agreement. The forward price forms part of the contracted mechanism to calculate the number of shares, or the price of the shares that the broker guarantees. This guarantee is either delivered direct or indirectly via a "fee" arrangement. This fee arrangement flies close to the wind in terms of looking like it acts as a mechanism to affect a price or share quantity adjustment. The "fee" in question is "payable to or by *the broker* under terms of the agreement". When a broker pays an issuer a "fee" whilst the broker also provides the execution service to buy shares, then the true purpose of this "fee" is questionable. The UK the Companies Act says that "where a limited company purchases its own shares the shares must be paid for on purchase". Does this fee structure create a process that in effect can act like a pricing adjustment?

We have not done a wide study of buybacks, however in Europe we wrote a case study on an ING share buyback last year. ING confirmed to us that they used one of these "problem products" to implement the programme we studied. The broker's execution underperformed the agreement with ING and the broker owed performance to the issuer. If you read the related press announcement ING specifically says that "in total 104.41% of the announced program....was purchased. The purchases exceeding 100% due to the performance arrangements, including the average price per share....". ING goes on to say the effect of the performance arrangement was to change the average share price of the programme for ING from €12.66 down to €12.36. We are not lawyers, but a performance mechanism type "fee" whose purpose looks like it can enable price adjustments could be skating on thin ice.

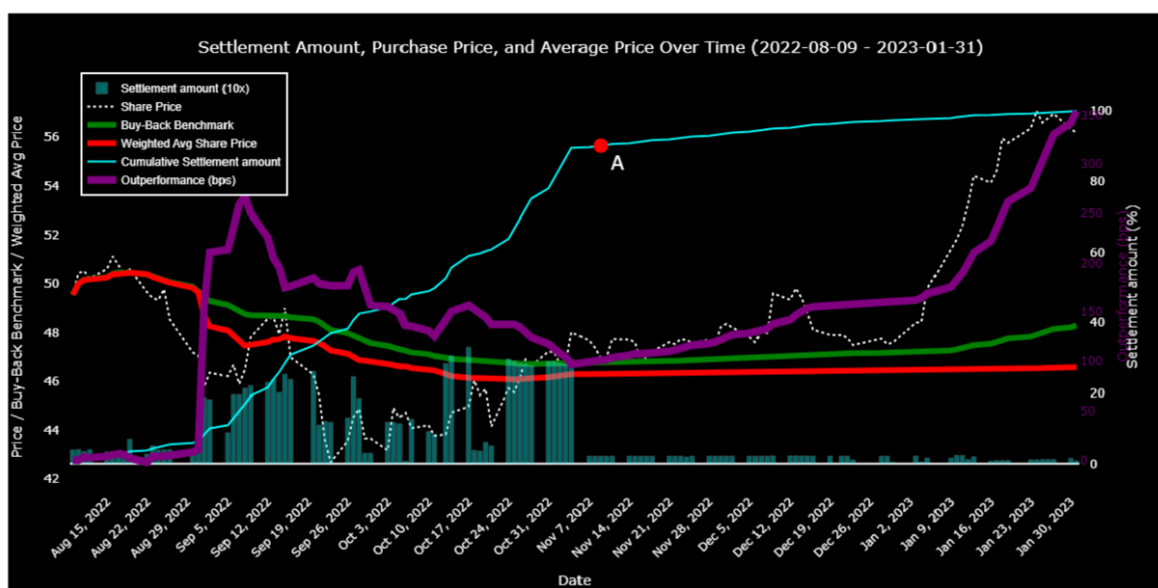
Some of the core problems within these benchmark and fee arrangements are that they can lead to issues around: mis-management of the value at risk (VaR) in the buyback, variation to the benchmark setting period, ex-dividend mis-treatment, relationship to execution quality, conflicting incentives for the broker etc.

This letter is not the right format for too much detail, however, just to put some UK market wide numbers on just one part of this topic. We estimate that the cumulative mis-management of VaR at the start of all the buyback programmes last year was approximately £12.6bn[4]. The cost of this mis-managed risk was borne by our holding shareholders.

[4] Assuming 20% of the £55bn share buybacks implement by UK issuers in 2023 were executed using these problem products.

Similarly on the conflicting broker incentives, the design of these products makes it possible for the issuer to receive an incrementally worse outcome at the same time as the "outperformance" improves. The broker is incentivised by trying to maximise the outperformance, and hence their fee/PnL. This can be proven using public data in many cases, such as the one below.

An example of the brokers incentive misalignment
Fig. 2



Apologies as Fig. 2 is a very busy chart. The data is taken from the disclosures of a UK FTSE 100 companies' buyback which completed last year. Focus on three lines, the brokers weighted average purchase price of shares from the market (red), the benchmark[5] (green) and the outperformance (purple). The outperformance is the difference between the red and green lines.

The broker guarantees the issuer an average share purchase price for the programme that is derived from the benchmark (green). On the chart there is a Point A (9th Nov) marking that the programme is 90% complete by value spent. At this point the broker has used 62 of the 117 (53%) allowed number of trading days agreed complete the programme. The broker has control over when to end the programme within a window. This control gives the broker a choice of when to end the benchmark calculation period.

[5] The benchmark calculation is an approximation, using the daily purchase price of the shares instead of the daily VWAP.

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In the chart, the brokers incentive is to make the purple outperformance number the highest it can be. At point A 90% of the value of the programme is already spent, meaning the purchase price for the broker has already largely been determined. The broker has a degree over when to end the benchmark pricing period, as once they complete the programme, the benchmark is set. Their decision on when to end the programme depend in large part on whether the benchmark price is raising or not. If the share price on any given day is below the benchmark, then when that day's price is added to the benchmark, its value will reduce. If the share price is above the benchmark, then when that day's price is added the benchmark will increase.

In this example, from Point A until the last trading day, the broker had 10% of the value left to spend, but they had 47% of the allowable time left. The share price remained above the benchmark for the entire period. The broker ran the programme to the last allowable day, by spending small values each day, remaining flexible to complete should the share price fall.

From point A until the end of the program the brokers weighted average purchase price for shares increased by 60bps, while they slowly spent the last 10%. They spent on average about £800k a day, as the benchmark price increased in price. In this period, the benchmark's price rose by 325bps.

The result of this is the outperformance increased from about 100bps to about 350bps, as the benchmark price rose faster that the change in the brokers average purchase price. The broker gets paid more as the outperformance increases. The outperformance rose by 250% (from approx. 100bp to 350bps). The issuer received a price based on the benchmark, which went up by a little over 3% (from approx. £46.8 to £48.3) in this same period.

Clearly the incentive for the broker is not aligned with the interests of the issuer when the share price they will receive gets worse at the same time as the fee the broker will receive improves. The brokers fee for this programme was approx. 2.7%.

There are multiple other noteworthy issues with these products, which can be seen in this case. For example, this company announced a 37.8p dividend on the 9th of Aug, prior to the contracted start date of the programme. The share price went ex-div on the 1st Sept. The calculation of the benchmark does not adjust for the share price going ex-dividend. This means that the jump in outperformance, from sub 10bp, to above 180bps over the few days after the

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1st Sept is in part just the mechanical effect of the share price going ex-dividend. The standard method for treatment for other forward pricing agreements in the rest of finance is to adjust for dividends going ex.
From the issuer's perspective, they don't pay a dividend on shares they have bought and hold in treasury. To the company, the share price of a cum-div share is the whole dividend cheaper, than a share bought at the same market price when the share price is ex-div. However, in through these products, the broker is incentivised to spend relatively more money right after the share goes ex-div at higher adjusted share prices, than right before it.

Execution costs

Equity execution is an expense for all investors, just as it is for issuers when they buy back their own shares. Research from the Man Institute estimate the trading impact of buybacks in the US to be approx. 300bps per annum. Yet there is a whole community of our issuers, bankers, advisors, lawyers, and accountants that have been led to believe these products guarantee a positive outcome. This is a false comfort, as it gives a sense that the execution cost is zero, and the fee is paid out of some sense of a better outcome for the issuer and their shareholders due to a superior execution performance. We are told that these products are sold as "win-win", the broker only wins when the issuer wins. They sound too good to be true because they are just that.

The impact of the inefficiency of share buyback executions compounds over time, meaning the effect of a poorly executed share buyback 10 years ago, continues to drag on the holding shareholders returns today. As an example of this, we estimate that shareholders of Apple Inc's have lost $6bn of capital gain due to this compounding effect over a 10 year period to 2022 (pg 18 The Great Deception).

Why? If the buybacks had been executed more efficiently, a greater number of shares would have been purchased. The holding shareholders at that time should have therefore owned a greater portion of the company. In addition to owning more of the company, their future portion of any dividend stream would have also increased.

Alternative Solutions to the current Structured Execution Products

These problem products do have some very good operational qualities. Benefits such as allowing the issuer to implement their buyback over extended

periods of time, including when the issuer is “inside”. And issuers being able to transfer the daily trading decisions and related market abuse rule concerns to their brokers.

There is no reason that some of these positive qualities cannot be retained inside similar products, which have suitable execution strategies and fee structures, while removing the problematic components.

The choice of a suitable execution strategy will depend on several core factors, including those that are driving the decision to do a share buyback. The choice of the right strategy for the issuer’s situation is one that should be made with appropriate pre-trade risk and cost estimates in conjunction with the adequate input of trading expertise.

We hope that we have made clear that these “problem products” are not suitable for their stated purpose, which links back to the governance oversight already mentioned.

UK current position vs other global competitive markets

It is likely that the UK issuers use of “problem products” is higher than the US, and in line with the EU. There are no league tables and market share data to verify this. Anecdotal feedback from market participants suggest that UK and EU issuers choose “problem products” 60 to 70% of the time, Candor Partners thinks this might well be overstated. In the US there is data that 10% by value of share buybacks are executed using ASRs, and anecdotal feedback from the market that suggest that other “problem products” are less prevalent than ASR’s.

Suggested solution to differentiate the UK- enforce existing Consumer Duty rules to ensure that share buyback execution products are suitable for the issuer’s requirements.

3) Timeliness of the notification of purchases (RNS Transaction in Own Shares notices)

Very large share transactions are vulnerable to front running and other value extraction techniques used by other market participants. There is a balance to

be found when disclosing share buyback information. The company is the ultimate “insider”, it seems right that they have higher levels of disclosures for buybacks than for other investors buying the same shares. The disclosures laws have to find the balance between informing the market in general and protecting the various interests of shareholders in the company. Before we discuss finding this balance anymore, lets run a thought experiment.

Imagine if Berkshire Hathaway was required to notify the market of their intentions to buy a £1bn stake in a UK listed company prior to making any purchases. The company in question’s shares have an average daily turnover of say £100m.

Now imagine if, on any day that they did make a purchase, they had to notify the market of how many shares, and at what price they made those purchases, prior to the market open the next trading day.

Now imagine if they also had to show the exactly trading pattern throughout each trading day. Showing the number of shares, purchase price, venue, and exact time sequence for each print for the whole day.

The market would know of the pending buy order, almost live progresses updates daily, the overall trading strategy, and the intraday trading pattern with the exact start and end times, and their footprints on each venue. This amount of data is a market makers dream!

Each increased layer of disclosure has an additional expected cost to Berkshire Hathaway. At some point the investor might just consider the costs of entering and exiting investments in the UK to be too high for their expected returns.

If you substitute in Issuer, for Berkshire Hathaway in the above set of criteria, you get the disclosures requirements that our UK issuers follow for share buybacks. Remember the issuer is effectively buying shares for their holding shareholders, whose returns are ultimately reduced by any additional costs due to the issuer’s discloser requirements.

There are numerous studies on gaming (and anti-gaming), and the FCA are very aware of the concerns of investors regarding the behaviours of market makers, HFT, hedge funds and other actors. One related paper from the Oxford – Man Institute’s Stefan Zohren et al quantifies the cumulative impact costs of large

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orders that require many days consecutive days to implement. This study is without the addition cost of the daily trading activity details being disclosed.

We understand the value and importance of disclosures, but there is a balance to be found. The current timeliness of this highly sensitive trading information is likely to be negatively impacting the holding shareholders returns. Do we have this balance right?

We recommend that the UK look to the SEC's modernisation of share repurchase disclosure proposals made in May '23. These rules were ultimately overruled in a recent appeal process, so have not been enacted. However, we believe the SEC rules were well structured. They proposed daily trading activity details to be updated in the issuer's quarterly updates. There are clearly other factors relating to investors knowing the issuers outstanding share count, however other markets accommodate this whilst also having delays.

UK current position vs other global competitive markets

UK disclosures laws are T+1 daily activity with fully granular time and sales by venue for all child orders.
EU is similar level daily granular disclosure, released weekly at the start of the following week.
US require aggregated total shares and price per month disclosure delayed until following quarterly report. No daily trading activity disclosed at all.
Australia do not appear to require any granular post trading disclosure details.

Suggested solution to differentiate UK- maintain the current details of disclosure, with a substantial delay, suggest like the SEC's proposals in the US.

4) Safe Harbour rules relating to Market Abuse

Trading impact is a function of the size of the order and the participation rate of the execution of that order as a function of market volumes. As modelled by Almgren and Chriss. When access to liquidity increases, all else kept equal, the impact cost of trading reduces, and rate of risk reduction increases.

The current interpretation of our MAR rules for share buybacks limits issuers to trading only in the continuous phase of certain recognised investment exchanges. According to big xyt lit, this continuous lit market volume has

fallen to 37% of overall market volume across Europe. This means that our issuers, who are executing some of the largest equity orders in the market, are limited through our MAR rules to 25% of 37% of available liquidity. This means that issues access to liquidity is limited to less than 10% of what other investors can access when executing in the same shares.

On top of the costs of this liquidity access constraint, the quality of the allowed liquidity is the most "toxic" of all the available liquidity. The FCA's own Occasional Paper 60 evidenced and concluded that use of certain non-lit venue types improves execution quality. In a separate study big xyt showed that liquidity sourced from "lit markets" experience worse adverse selection, as evidenced here and here. It is also worth noting that market volume migrates between venues and venue types intraday and over time, including the opening and closing auctions.

We believe we should be giving issuers similar liquidity access and flexibility as investors have. For example, if "block" trading on contingent venues, and other similar liquidity sources falls within MAR for all other investors, then why is it not suitable to be included in MAR safe harbours for issuers?

We fully support the concept of Safe Harbour's for issuers when they transact in their own shares. We propose that the current safe harbour rules need to be updated and clarified for the market, so that issuers have the same or similar access to liquidity as all other investors.

UK current position vs other global competitive markets

UK is currently in line with the US and EU markets MAR safe harbour rules. In Australia there is no similar safe harbour under their insider dealing framework despite relatively stringent disclosure and price requirements for buyback programmes under the Corporations Act 2001 (Cth)[6]

Solution to differentiate UK- review the MAR safe harbour rules to enable issuers executing buybacks a similar ability to access and use available liquidity as other investors can.

[6] Capital Markets Law Journal march '23 Lance Ang "The regulation of share buybacks and insider dealing: a comparative analysis.

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