Candor

Mr Nikhil Rathi
Chief Executive
Financial Conduct Authority
12 Endeavour Square
London
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Candor Partners Limited
6th Jan 2025

Dear Mr Rathi,

Subject: Enhancing the Competitiveness of the UK's Equity Capital Markets

I am writing in relation to Sir Keir Starmer and The Hon Rachel Reeves MP recent calling for 5 concrete ideas by mid-Jan. I hope this letter will be received with the intention that it is offered.

The UK listed market trades a valuation discount to its global peers, especially the US. The consequence of this widening discount is widespread, and it is stiffing growth. If the FCA can help to narrow this discount, then we should be able to help retain more UK listed companies and improve the narrative. This improved narrative will help the UK attractive more IPO's, as owners are unlikely to choose to issue shares in the UK whilst they perceive they are selling at a relative discount.

There are some very simple actions that the FCA can take which will help the market to narrow this discount. However, first a quick look at one of the causes of this discount.

Part of the purpose of a listed equity capital market is to efficiently transfer capital (money) from investors to issuers when they require it. And then to enable the return of this capital to investors when it is no longer required. If share prices of listed companies trade at large valuation discounts then it may make sense for companies to return more of their capital via share buybacks, which in turn should help narrow this discount quicker.

We can observe part of this behaviour in the UK as the popularity of buybacks and the proportion of capital returned via buybacks has indeed increased from 20% to around 50% over the last 10 years or so. The total value spent on buybacks has also increased from around £15bn to around £55bn each year. The Uk's valuation discount on the other hand, has also increased from 10% to over 40% in this same time frame.

There have been many reasons proposed for this valuation discount increasing, however it is very troubling when also looked at in the light of the dramatic increase in share buybacks. The combination of these two factors suggests that something might not be functioning correctly in the UK market as we know that efficiently executed share buybacks help to narrow valuation discounts when used and implement correctly.

Key Areas of Concern and Proposals for Improvement

1. **Reducing the Friction in Share Buybacks**

In the UK, share buybacks cost issuers approximately 6–8% of capital returned, compared to 3% in the US. This disparity results in an estimated £2.5bn annual loss in investor returns, which compounds to £35bn over a decade. I propose a buyback safe harbour review to include:

- **Disclosure Rules for Buybacks**: Align UK disclosure requirements with US practices by introducing quarterly delayed disclosures of buyback trading activities, rather than immediately prior and daily updates. This would reduce price increases before and while issuers purchase shares, allowing them to buy back shares more effectively. See FT OpEd on topic.

2. **Interpretation of Article 5**

The current interpretation of Article 5 of Regulation (EU) 596/214 allows for execution strategies that may conflict with shareholder interests with broker incentives (see FT letter). It is recommended that to benefit from safe harbour the:

- The FCA clarifies that any buyback execution strategy must aim to maximise the number of shares repurchased when claiming clause 2 (a).

3. **Updating Conditions of Trading**

The rules for market abuse and insider trading exemptions were mostly drafted in 2005, prior to MiFID I and subsequently changes in market structure. I propose that issuers should be allowed to source liquidity on the same terms as investors when implementing on-market buybacks. Currently issuers are restricted to source liquidity from the lit continuous market only and limit daily volumes to 25%. To achieve this, I propose:

- Replacing existing prescriptive conditions of trading with principles-based regulations to provide issuers with greater flexibility to access liquidity.

- To include the access of modern block trading venues, helping reduce risk more efficiently and limit information leakage, which will reduce intermediaries' ability to exploit issuers buyback executions.

Anticipated Benefits of Proposed Changes

Adopting these reforms would enhance the UK's capital markets by:

- Lowering transaction costs for issuers and increasing returns for long-term investors.

- Strengthening the market's appeal to both domestic and international investors, encouraging higher participation from UK pension funds.

- Improving alignment with global best practices while maintaining robust regulatory oversight.

These measures would reinforce the UK's position as a leader in financial services innovation and corporate governance, supporting the government's vision for dynamic capital markets that facilitate efficient capital allocation and attract high-quality IPOs.

I trust these proposals will be considered as part of your ongoing process. I am keen to discuss any aspect of this submission further and collaborate to enhance the UK's competitive edge in the global financial landscape.

Yours sincerely,

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