

General authorities to issue shares without preemptive rights

(UK & Ireland)

Background and Overview

The Pre-Emption Group, a UK body which includes representatives of companies and investors, had long-standing guidelines which recommended that a general authority to disapply pre-emption rights should be limited to no more than 5 percent of the issued share capital. This limit has been observed by most UK companies when seeking approval for a disapplication authority at their AGM.

In March 2015, the Pre-Emption Group issued revised guidelines. The revised guidelines now permit companies to seek shareholder approval for an extra 5 percent disapplication in addition to the standard 5 percent, provided that the additional 5 percent is used only in connection with either an acquisition or a specified capital investment. A “specified capital investment” is defined as “one or more specific capital investment related uses for the proceeds of an issuance of equity securities, in respect of which sufficient information regarding the effect of the transaction on the listed company, the assets the subject of the transaction and (where appropriate) the profits attributable to them is made available to shareholders to enable them to reach an assessment of the potential return.” Among others, the key UK investor trade bodies (the Investment Association and the Pensions and Lifetime Savings Association (previously known as the National Association of Pension Funds)) have endorsed the new guidelines.

Following the issue of the revised guidelines, a significant number of UK companies (as many as 45 percent of FTSE All Share companies holding AGMs between July and September 2015) have sought general authorities to disapply pre-emption rights up to 10 percent of the issued share capital, with the commitment that the additional 5 percent above the usual 5 percent will only be used as set out in the guidelines. These authorities have received widespread support, with no evidence of any specific concerns raised by investors in terms of the voting outcomes for these resolutions.

Key Changes Under Consideration

The proposed change is for the ISS UK and Ireland policy to be updated to reflect the change in acceptable practice, clarifying that a general authority to issue shares with a disapplication of pre-emption rights of up to 10 percent of the issued share capital is acceptable, provided that the extra 5 percent above the first 5 percent is to be used only for the purposes of an acquisition or a specified capital investment. The policy will also clarify that a company which receives approval for an authority of this nature but subsequently abuses the authority during the year (for example, by issuing shares without preemptive rights up to 10 percent for purposes other than set out in the revised guidelines) may receive a negative recommendation on the authority at the following AGM.

Intent and Impact

This proposal reflects the updated Pre-Emption Group principles and what has over the course of 2015 become routine market practice. As noted above, many companies have sought approval for a 10 percent authority since the revised guidelines were published. The ISS approach for these authorities has been to recommend support, while flagging the proposals for shareholder attention. The formal adoption of the guidelines within the ISS policy is therefore a codification of recent practice since the Pre-Emption Group principles were issued, and can be expected to have limited impact on the level of support for these general authorities at AGMs.

What is unknown at this stage is how companies will use the extra flexibility in practice. The first evidence of concern raised occurred in September 2015, when Glencore was strongly criticised by the Investment Association and the NAPF for renegeing on its commitment to only use the 10 percent authority approved at its May AGM in connection with an acquisition or specified capital investment. Glencore instead decided to use the full 10 percent authority to raise funds to strengthen its balance sheet.

Request for Comment

1. Do you agree that changing the ISS UK and Ireland policy to reflect the new Pre-Emption Group guidelines is appropriate?
2. If a company is perceived to abuse the extra flexibility it has been granted through these extended authorities, what voting response do you consider is appropriate and should be adopted (for example, votes against directors) in addition to the potential for a vote against the relevant share issuance authority at the following AGM?