UK Proposes PISCES—the Private Intermittent Securities and Capital Exchange System. Should the EU Look to Emulate it?

Dr Michael Huertas[*]

EU law; Financial markets; Private companies; Share exchanges

Abstract

This article assesses the UK's PISCES proposal, what it offers the UK, what that means for the EU as well as whether the EU co-legislators can, post-Brexit, perhaps look to emulate for something suitable and workable for the EU that is still looking to complete the Capital Markets Union (CMU).

Introducing PISCES

Coinciding with the UK Chancellor's announcements during the 2024 Budget, the UK's HM Treasury (HMT), on 6 March 2024, published a consultation on the government's proposal for a new "Private Intermittent Securities and Capital Exchange System" (PISCES). HMT describes its vision for PISCES as "a new innovative market system" that would allow private (unlisted) companies (HMT refers these to as "participant companies") to scale and grow and equally "boost the pipeline of future initial public offerings" (IPOs) in the UK.[1] This follows on from extensive HMT and other UK government-led efforts to enhance the future of the UK's capital markets.[2] PISCES is part of the measures first set out in the 2022 package known as the "Edinburgh Reforms" in efforts to boost the UK's position as a global financial centre.

HMT's public consultation was set to close on 17 April 2024.[3] Further consultations might follow as PISCES moves from proposal to more legislative and practical implementation. Expected PISCES stakeholders including prospective participant companies, investors and market operators (PISCES operators) as well as regulated intermediaries (brokers, investment banks, etc), professional service companies and trade associations, will likely be interested in this proposal. Various PISCES operators (provided they meet the pre-requisites) can establish a PISCES offering. A PISCES offering operates on an intermediated model (i.e. where member firms trade directly on PISCES, acting as intermediaries for the end investor). That being said, PISCES offerings and operating models may differ in design and scope of participant companies by PISCES operator and HMT notes that:

> "In theory, a PISCES operator might wish to operate a non-intermediated model, with the end investor interacting directly with the operator. An application under this model may require additional safeguards to be put in place by the operator."[4]

Regardless of operating model of each PISCES operator, the PISCES offering, as a concept, aims to provide liquidity, transparency and efficiency to private markets, while allowing participant companies to retain control over their disclosures and investor base. HMT's PISCES proposal allows PISCES operators to offer a secondary market with intermittent trading windows, facilitating the trading of existing shares of participant companies only, and will *not* enable capital raising through the issuance of new shares or the trading of other securities of such participant companies. Instead, PISCES focuses on making it easier for shareholders in unlisted (i.e. participant) companies to realise gains in their investments by connecting them more efficiently with investors wishing to back such participant companies coming together in a multilateral yet centralised operated system offered by PISCES operators.

Without such centralised connectivity, willing buyers and sellers must individually come together through various means (including message boards and/or brokers or even certain crowdfunding platforms facilitating transactions in private shares and/or other (interests in or to) private capital market instruments). This may cause barriers to price discovery and efficiency in transaction execution. Moreover, under the UK's (as well as the EU's) current legal framework there is no current possibility whereby securities can be admitted to trading on a multilateral system on an intermittent basis, with market abuse, transparency and disclosure arrangement applying only during intermittent windows. PISCES proposes (rather elegantly) to change that.

[*] Dr Michael Huertas, LLM, MBA, is a partner with PwC Legal in Frankfurt, the Financial Services Legal Leader for the Global Legal Network and the Financial Services Legal Leader for Europe. He is a Solicitor-Advocate (England and Wales), Solicitor (Ireland), a Solicitor (Northern Ireland) and a German Rechtsanwalt. His professional practice focuses on emerging regulatory issues in the Banking Union and Capital Markets Union. The usual disclaimer applies. The views expressed here are purely personal and need not reflect those of PwC nor PwC Legal. The author would welcome dialogue on any of the issues raised herein or in relation to his research interests. Michael can be reached via: *https://www.linkedin.com/in/michael-huertas-157a788*.

[1] See HMT, "Private Intermittent Securities and Capital Exchange System (PISCES)" (6 March 2024), *https://www.gov.uk/government/consultations/private-intermittent-securities-and-capital-exchange-systems-pisces-consultation*; and *https://assets.publishing.service.gov.uk/media/65e6f39e7bc329020bb8c279/Consultation___Private_Intermittent_Securities_and_Capital_Exchange_System.pdf*.

[2] See, e.g. the parliamentary debate from 30 January 2024 as reported in *Hansard*, *https://hansard.parliament.uk/Commons/2024-01-30/debates/3BC4268A-8F71-4B24-A64A-F8507D6A1CEF/FutureOfUKCapitalMarkets*.

[3] Which for those following the western zodiac, falls under the star sign of Aries.

[4] See Table 3.A of "PISCES Operating Model" on p.19 of the HMT consultation.

PISCES is set to be developed using a financial market infrastructure (FMI) sandbox, which in itself is an innovative regulatory development that the EU and other global jurisdictions have followed in fashion, albeit in differing degrees of design and indeed success. The FMI sandbox allows the UK government to temporarily modify or not apply provisions (whether in full or in part) of the existing legislative framework, to support market operators to trial new or developing FMI technology or practices. The FMI sandbox environment will allow the UK government to check that the detailed regulatory requirements for PISCES are calibrated correctly, before the regime may be made permanent. The UK government intends to use the powers granted by the Financial Services and Markets Act 2023 (FSMA 2023) to put PISCES in place, setting it up first as an FMI sandbox, prior to PISCES graduating to any permanent regime that may be put in place. As the HMT consultation notes, "a successor permanent regime may have differences to the sandbox regime".[5]

The UK government will also confer functions to the Financial Conduct Authority (FCA) to support the implementation and supervision of the FMI sandbox arrangements. The FCA also intends to consult on the process for admission and approval to the FMI sandbox for participant companies as well as regulated firms along with the FCA rules that will apply to firms in the sandbox before it is established at the end of 2024.

Once built and in operation, PISCES will have its own standalone regulatory requirements, which will draw on the obligations that apply to trading venues (as opposed to a mere message board). These regulatory requirements will be adapted, whether in full or in part, through modifications and disapplications, to reflect the periodic nature of trading and the specific risks posed by the model. PISCES will accommodate "trading windows" at defined intervals, such as monthly or quarterly, providing investors with opportunities to trade the respectively eligible shares.

In furtherance of the above, disclosure requirements specific to PISCES will only apply shortly before and after each trading window and there will be no requirement for information to be disclosed to the public. Instead, information must only be made available to investors that may trade during the window.

Moreover, there will also be a (modified) market abuse regime for PISCES, which will be tailored to the intermittent nature of trading and the specific risks posed by the model. This PISCES-specific market abuse regime will apply to shares admitted to trading on PISCES but not to related (UK designated) financial instruments and will only apply from when an eligible company's disclosures are made available to investors prior to the trading window opening to the end of the trading event.

What does PISCES propose to offer UK stakeholders?

By offering liquidity, assisting shareholders—including staff shareholders—in realising their gains, and giving businesses the chance to streamline their shareholder base, HMT anticipates that participation in PISCES will help participant companies expand and thrive. Investors in participant companies could benefit from increased efficiency and transparency compared to private markets, as well as improved access to interesting growth companies.

Under the HMT consultation, it is made clear (para.2.15) that HMT expects that "the shares admitted to trading on PISCES will have a different risk profile to publicly traded shares. For example, the intermittent nature of the liquidity events means that there will be fewer opportunities for investors to reduce or dispose of their investments through PISCES, though investors could potentially arrange a bilateral transaction off-market". Accordingly, at para.2.16, HMT notes that "It may be appropriate therefore that only institutional and professional investors, such as pension funds or private equity firms, should be able to buy shares on PISCES in the first instance. This would likely include any person who can meet the definitions of eligible counterparty or professional client in the Markets in Financial Instruments Directive (MiFID)", i.e. as MiFID is retained or "on-shored" in the UK. The HMT also states in its consultation that PISCES may, however, be extended to cover:

> "… certain categories of retail investors may be able to buy shares through PISCES, including any of the following categories: (i) *Self-certified sophisticated investors*: in line with the definition in the Financial Promotion Order, this would include a person who has recently invested more than once in unlisted companies; has been a current member of a network of business angels for at least six months; has recently worked in the private equity sector or in the provision of SME finance, or; has recently been the director of a company with a specified level of turnover. (ii) *High-net worth investors*: this includes any person (other than in one of the categories referred to above) who meets the requirements in Articles 48, 49 or 51 of the Financial Promotion Order (respectively, certified high net individuals; high net worth companies and unincorporated associations; and associations of high net worth or sophisticated investors). (iii) *Employees of a company participating on PISCES*: in addition to the above, the government is also considering whether to allow employees to buy shares of their companies on PISCES, as well as being able to sell shares where they are existing shareholders (see paragraph 2.17 [of the HMT consultation]). Unlike general retail investors, employees would be

[5] See para.2.15 of the HMT consultation.

> expected to have a greater awareness and understanding of investing in their company by virtue of their employment. PISCES could potentially support companies to manage employee share schemes which involve the transfer of existing shares. The sale of the shares in question would need to be consistent with the terms of any employee share scheme that is in place. How this would work practically could depend on whether the PISCES operator is operating an intermediated model or a non-intermediated model. A PISCES operator or a regulated intermediary would need to assess the eligibility of an employee as a potential investor before processing their order. As set out in Chapter 4 [of the HMT consultation], the government does not propose to modify legislation to permit share buybacks on PISCES, so companies would not be permitted to undertake a buyback on PISCES for the purpose of buying shares on behalf of their employees."

Nevertheless, by enhancing the communication channel between private enterprises and the UK public markets, HMT hopes that PISCES will help pave the way for participant companies to prosper and grow thus increasing the volume of upcoming IPOs in the country. PISCES is therefore supposed to support the UK government's overarching extensive and continuous reforms aimed at promoting the UK's capital market, by improving the interface between private companies and UK public markets and complementing the UK government's wide-ranging and ongoing reforms to boost the UK as a listing destination and its attractiveness compared to other jurisdictions/alternatives.

Ultimately, HMT expects that PISCES will support companies to scale up and grow, providing liquidity, helping shareholders, including employee shareholders, to realise their gains, and providing an opportunity to companies to rationalise their shareholder base. Investors may gain better access to exciting companies while also benefiting from greater transparency and efficiency than available in private markets. Participant companies using PISCES may also find it easier to raise capital privately outside of this platform by connecting them to a wider group of potential investors. In turn, this means that when these companies decide to publicly trade and issue new securities as part of an IPO, this may represent less of a regulatory step and there will be greater confidence in their valuation.

Financial services firms that wish to operate PISCES (referred to as "PISCES operators") under the FMI sandbox will need to apply to the FCA for permission to do so. Such firms will only be eligible to apply where they have the appropriate permissions for the relevant regulated activity involved or where they are exempt. Any legislation that is disapplied or modified for use in the FMI sandbox will only apply to such sandbox participants and to the activity of trading of shares on PISCES.

Chapter 3 of the HMT consultation sets out the foundational objectives of the regulatory principles that apply to PISCES operators drawn along the lines for a "proportionate regulatory framework that mitigates against the unique risks presented by the model and affords protection to investors while still considering the commercial needs of a private company". These objectives include that the future framework:

- Take a proportionate approach to protecting against investor detriment;
- Consider the unique needs of participant companies looking to trade shares on PISCES when setting regulations relating to the disclosure of information;
- Set equivalent regulatory standards for all PISCES operators, regardless of whether they are authorised firms with an "arranging deals in investments" permission or have Regulated Investment Exchange (RIE) status; and
- Ensure that PISCES platforms maintain the key features of a "marketplace", allowing RIEs and authorised firms to leverage existing systems and regulatory standards.

Can non-UK stakeholders participate on PISCES?

PISCES will be open to those participant companies that are UK-based and/or overseas private or public limited companies (PLCs) whose shares are *not* admitted to trading on a public market in the UK or abroad, subject to the admission criteria set by the PISCES operators. PISCES operators will require authorisation in the UK and ability to access the FMI sandbox. As discussed above, PISCES will also restrict the categories of investors that can trade on the platform, excluding (for the time being) most retail investors and requiring intermediaries to assess the eligibility of potential investors. Conceptually, it may be possible for investors who are not ordinarily resident in the UK to access PISCES operators and participant companies.

The current PISCES proposal will be of interest to UK and international non-financial sector firms and market participants, as it could provide them with an alternative or complementary route to access liquidity and investment opportunities in the private market segment. However, the proposal may also pose some challenges and risks, such as the potential for market abuse, the adequacy of investor protection, the quality and availability of information, and the operational and legal complexities of the PISCES model. Therefore, the UK government has invited views and feedback from the relevant stakeholders on the proposal and its implications. Notably, PISCES differs from international comparable peers, such as the US and the closest conceptual cousin, the "pink sheets".

The US term "pink sheets"[6] refers to a quotation system that displays the prices and volumes of over-the-counter (OTC) securities, such as those of private companies, that are not listed or traded on a regulated exchange. The "pink sheets" are not a trading venue themselves, but rather a platform that connects brokers and dealers who execute trades bilaterally on an OTC basis. The "pink sheets" are subject to minimal regulatory oversight and disclosure requirements and the securities traded on them are often considered speculative and illiquid. Furthermore, in the US, NASDAQ Private Market has facilitated the trading of private company shares since 2013.

In contrast to the US, the PISCES proposal envisages a multilateral system that operates as a secondary market, facilitating the trading of existing shares of private companies and PLCs whose shares are not admitted to trading on a public market in the UK or abroad. The PISCES proposal also envisages a bespoke regulatory framework that will apply to the PISCES operators, the participant companies and the investors, as well as a market abuse regime that will cover the PISCES trading windows. The PISCES proposal also aims to provide greater transparency and efficiency than available in private markets, while still considering the commercial needs of private companies.

What's the EU to do?

The EU already seeks to offer a number of capital markets-based financing alternatives for those that qualify, using the EU's terminology, as small to medium-sized enterprises (SMEs). This includes alleviations from certain requirements from the EU's Prospectus Regulation, EU legislative facilitated measures in traditional capital markets legislation to create "SME growth markets" (itself an idea partly inspired by the UK) as well as access to the world's largest single market for crowdfunding per the EU's Crowdfunding Regulation as well as for (interests in) tokenised securities (including previously unlisted or tokenised crowdfunding interests) in the form of the EU's Markets in Crypto-Assets Regulation (MiCAR). Some of these existing alternatives have performed well, others (so far at least) less so. Both EU crowdfunding platforms facilitating transactions in private unlisted company shares and/or tokenisation of such unlisted shares or other securities have gathered interest, and in certain EU Member States increased market share, but these do not operate (as of yet) with sufficient cross-border capability nor around a centralised market that is plugged into the public market infrastructure as is proposed with PISCES.

The EU, as part of its Capital Markets Union (CMU) priorities, continues to try to champion SMEs and their access to growth capital and greater liquidity across multiple types of trading venues. EU co-legislators as well as financial services policymakers will probably want to review the PISCES proposal along with respective feedback to the HMT and FCA consultations as and when this is published prior to taking any own policymaking actions (if at all). Ultimately, the EU will not want to delay too long if it is indeed proposing to emulate some aspects of PISCES to champion CMU and its (meaningful) delivery. For EU non-financial sector firms and market participants more broadly, the UK's proposals for PISCES may present both opportunities and challenges. Some of these are political and some of these are more practical.

On the one hand, EU companies that meet the (forthcoming) criteria for PISCES may be able to access a new source of liquidity and exposure to UK investors (as opposed to EU markets), while EU investors may be able to diversify their portfolios and invest in innovative and high-growth UK companies. On the other hand, EU companies and investors may face regulatory barriers or costs in participating on PISCES, such as compliance with UK rules, taxation or currency risks. Moreover, EU companies and investors may have concerns about the level of investor protection, market integrity or disclosure standards on PISCES, compared to the EU's regulatory framework for public and private markets. The UK policymakers, however, have full rulemaking flexibility to redress some of those shortcomings if need be if indeed PISCES also aims to play a role in attracting firms that otherwise would be EU orientated to come to the UK.

This thus raises the question as to whether the EU should or indeed must emulate a similar set-up as PISCES, whether as part of CMU or otherwise. If so, it would have to consider several factors, such as the existing regulatory framework for private markets, the demand and supply of private capital, the diversity and fragmentation of national markets and the potential impact on the EU's CMU project in delivering a pan-EU solution. This also raises the question that, as with the UK, where multiple PISCES operators can operate a PISCES-compliant offering, the EU, in aiming to harmonise capital markets across the EU-27, may need to take a more definitive set of criteria to concentrate trading activity with a more connective yet still competitive group of core EU-regulated operators to achieve a pan-EU marketplace.

The EU would have to fast-track any assessment (so as to swim ahead of PISCES) on the need and a scope for creating a platform for intermittent trading of private company shares, and whether such a platform would be compatible with the EU's objectives of enhancing the efficiency, transparency and integration of capital markets. Arguably, there are good grounds, notably given

[6] The name "pink sheet" originated from the practice of displaying price quotes for unlisted equities on pink-coloured sheets of paper. These securities, most of which are considered highly speculative, are now subject to increased regulation, including removal of "dark securities", restriction from broker-dealers and other market-makers from publishing quotations of OTC stocks that do not provide financial information to the public and to improve transparency and disclosure obligations more generally. In 2008, the pink sheets were officially rebranded as Pink OTC Markets, and in 2011, they were further renamed as OTC Markets Group. Nevertheless, the informal expression "pink sheets" continues to be commonly employed.

the breadth of SMEs that speak for such need, that have yet to venture into a listed environment on SME growth markets or otherwise.

The EU would also have to be quick to decide on the appropriate legal basis, governance structure and regulatory requirements for such a platform, and whether it would operate at the EU level or in the (lesser efficient) alternative, at the national level. The EU would have to consult with relevant stakeholders, such as national regulators, market operators, private companies, investors and intermediaries, to ensure that the platform would meet their needs and expectations and address any potential risks or challenges. That being said, the EU's approach to build its own FMI sandbox, something which it has demonstrated can be done, allows for hope that a credible concept that equally advances CMU's objectives could well be promising if not be on point equally in terms of timing.

It is likely that the European Securities and Markets Authority (ESMA) itself, amongst many responsibilities in its growing mandate, an oversight operator of the DLT pilot regime, would need to take front row in any facilitating and supervising any further FMI sandbox. A perhaps greater challenge is finding a suitable and memorable acronym—which may of course leave the realms of the zodiac and/or any pescatarian parables—that resonates with stakeholders across EU Member States. Some examples might include:

- EU-PRICES: "EU Private Regulated Intermediated Capital Exchange System" highlighting the regulated intermediated components of the system, along with the private capital exchange function;
- EU-PRIVEX: "European Union Private Investment and Exchange" a more concise acronym, focusing on the private investment and exchange nature of any such EU system; or
- EU-SPIRE: "EU Securities Private Investment and Regulated Exchange" suggesting inspiration and upward movement, fitting for a system designed to enhance the market for private (unlisted) securities.

Whatever the name, the detail of any design of the legislative regime will be the determining factor if and how EU stakeholders decide to (re-)act and what shape such regime would take and how it can help complete CMU.

Outlook

Whether PISCES will be a UK success written in the stars, which facilitates participant companies with access to streams of growth, allowing them to become big fish that can swim easier into the IPO-pond, remains to be seen. It is also possible that PISCES could become a red herring, in particular if the FMI sandbox and the FCA cause capital and liquidity to only yield small fry results.

For the EU, its co-legislators and the financial services regulatory policymakers championing CMU, the UK's innovative proposal should, however, not be viewed as "fishy". Instead, it marks a strong signal of increased competition that could drive welcome innovation in capital markets offerings in a post-Brexit world. Accordingly, PISCES perhaps offers a much-needed push for the EU, its co-legislators and financial services regulatory policymakers to evaluate, emulate and possibly expediate its own suitably tailored solution as part of completing (or at least meaningfully advancing) CMU, in particular in the intervening 10 years since that project first having been proposed.