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FCA PROPOSES RADICAL OVERHAUL OF THE UK LISTING REGIME

BACKGROUND

The FCA has today published a consultation paper (CP23/10) on its proposed reforms to the UK listing regime for commercial companies which, if implemented, will be the most radical overhaul of the listing regime in a generation.

Most notably, the consultation paper proposes:

- A single listing segment to replace the current distinction between premium and standard listed companies; and
- A more disclosure-based approach, allowing investors to decide whether they wish to invest in and/or continue to support listed companies, removing some of the prescriptive eligibility criteria and corporate governance protections requiring mandatory shareholder approval for certain transactions.

Many elements of the premium listing regime promoting good corporate governance and shareholder engagement have been in place since the early 1980s and have only been subject to minor revisions over time. After an extensive market consultation, the FCA has concluded that it does not appear the incremental investor protection provided by some aspects of the premium listing regime, particularly when compared with other international capital markets, is attributed meaningful value by investors or essential to ensure the proper functioning of the market. Noting that UK institutional investors are willing to deploy significant capital in markets where these protections do not exist, the FCA is proposing to rebalance the UK regime with a view to improving the competitiveness of the UK equity market by creating a more attractive and compelling option for companies considering listing in the UK.

The new regime is intended to strike the balance between providing the highest standards of transparency, corporate governance and shareholder engagement whilst promoting broader access to listing for a wider range of companies. The proposed regime would allow investors to form their own judgment in making investment decisions based on issuers' disclosures. The removal of certain requirements in favour of a more disclosure-based regime will empower investors to conduct their own decision-making over the suitability of a listed company to meet their investment needs based on a company's disclosure and issuers will have greater flexibility to agree where additional shareholder engagement is appropriate.

Key issues

- Single listing segment to replace the existing distinction between premium and standard listing segments
- Removal of certain eligibility criteria with greater focus on disclosure and transparency e.g., no need for a three-year representative track record, no need for a "clean" working capital statement, more permissive approach to dual share class structures
- Removal of compulsory shareholder votes and shareholder circulars for significant transactions and related party transactions
- Modified rules on need for a relationship agreement with a controlling shareholder
- Greater onus on investors to carry out due diligence before investing and on shareholders to secure sufficient engagement with companies on key transactions

Next steps

- The closing date for the consultation is 28 June 2023
- The FCA will then publish a further consultation and draft rules in Q3 2023
- The FCA will progress on an accelerated basis
- Substantial progress targeted by end of Q4 2023

WHAT DOES THIS MEAN IN PRACTICE?

IPO eligibility requirements

Single listing segment

It is proposed that the existing distinction between premium and standard listing which has been in place for nearly 20 years be replaced with a single listing segment for commercial companies wanting to list their equity shares. This means that a commercial company looking to IPO will no longer have to choose between listing segments as there will be a single listing segment and set of eligibility criteria.

The FCA proposes to remove certain eligibility criteria which currently apply to a premium listing and instead rely on disclosure to allow investors to make an informed decision whether or not they wish to invest in a company. In particular, it is proposed that the following changes be made to the existing requirements applicable to a premium listing:

- No need for an issuer to have a three-year representative financial and revenue earning track record;
- No need for an issuer to have at least three years' of audited historical financial information that represents at least 75% of the issuer's business;
- No need to retain the various exemptions for the historical financial information for companies is various specialist sectors as these concessions will no longer be needed;
- No need for an issuer to give a "clean" or "unqualified" working capital statement;
- Greater flexibility to put in place dual class share structures; and
- Requirement for a relationship agreement with a controlling shareholder to become a "comply or explain" regime.

IPO eligibility

- No need for a three-year representative track record
- No need for a "clean" working capital statement
- More permissive approach to dual class share structures
- Comply or explain regime for relationship agreements with controlling shareholders

Financial track record

The removal of eligibility requirements in relation to an issuer's three-year track record of audited financial information will provide greater flexibility to allow companies to list:

- which have been established relatively recently;
- which are still at a pre- or early revenue stage;
- whose growth trajectory is such that their historic financial statements might not be representative of the current business (such as high growth biotech companies or innovative companies in other sectors); or
- which have undertaken significant M&A in the three financial year period prior to listing.

For a recently established business, the reason why three years of historical financial information is not available is readily explainable (and indeed the disclosure requirements under the Prospectus Regulation Rules only require the inclusion in a prospectus of three years of audited financial information or such shorter period that the issuer has been in operation). However, for an applicant that has undertaken material M&A in the recent past, careful consideration will need to be given to the level of financial and non-financial disclosure given in respect of acquired businesses to ensure that full value is

attributed to the recently acquired business in the absence of historical financial information. In addition, whilst the eligibility requirement has been removed, there remains the disclosure requirement to include *pro forma* financial information if a "significant gross change" has occurred to the business in the period since the commencement of the last completed financial year, as well as the need to satisfy the disclosure requirements applicable to issuers with complex financial histories and the requirement to include the necessary information to allow an investor to make an informed assessment of, amongst other things, the assets and liabilities, financial position, profits and losses and prospects of the issuer. For issuers contemplating offering their shares to US qualified institutional buyers in reliance on Rule 144A of the US Securities Act of 1933, as amended, consideration will also be needed of the requirements for additional financial disclosures arising under Regulation S-X.

Given the degree of overlap between the requirements for historical financial information in the eligibility requirements for listing and the disclosure requirements under the Prospectus Regulation Rules, the FCA has indicated that as part of its broader review of the prospectus regime, it will consider whether changes need to be made to the disclosure requirements as they relate to historical financial information.

Working capital statement

In relation to the working capital statement (i.e. that the issuer has sufficient working capital for at least the 12 month period from the date of the prospectus), the removal of the requirement to have a "clean" or "unqualified" working capital statement will bring the new single listing segment into line with the position that applied for standard listed companies. In practice, this will provide greater flexibility to issuers whose business model is such that they are capital hungry and require further funding in the short term, with such applicants likely needing to include greater disclosure to explain their historical, current and future business model to persuade investors of the merits of the issuer's business. The FCA notes that there are examples of standard listed companies where issuers have listed despite having a qualified working capital statement and that during the pandemic substantial equity was raised by listed companies when there was significant uncertainty around the financial outlook.

In the case of an applicant which is unable to give a "clean" or "unqualified" working capital statement in respect of the forthcoming 12 month period (i.e. it will need to raise more capital in the short term to fund its working capital needs), it is likely that the auditors would require material uncertainty disclosures to be included in the financial statements in relation to the going concern statement. In addition, as well as an explanation of the capital hungry nature of the business model, disclosure would need to be included if the source of and likelihood of being able to access the additional funding required to meet the applicant's working capital needs and the steps that would be taken, and the consequences if they were not, if the issuer were unable to raise this additional funding. In reality, this would likely need to be included in a prominent risk factor to put potential investors on notice of the potential risks associated with the issuer's business model and working capital needs.

As can be seen, the proposed approach to the eligibility requirements for the new single listing segment will likely result in a greater due diligence by investors on the applicant's business model and capital needs, as well as the

Historical financial information

- No need for a three-year representative track record
- No need for financial information to represent at least 75% of the business
- Still need to include financial information for the three years if the issuer has been in operation
- Still need to include pro forma financial information if a "significant gross change" has occurred
- For US offerings, need to comply with Regulation S-X

applicant's disclosure to provide investors with the necessary information to make an informed investment decision.

Dual share class structures

Feedback to the FCA's discussion paper DP22/2 indicated that some viewed the ability to list a company with a dual share class structure under the premium listing regime as being too restrictive. Under the current premium listing regime, these structures are only permitted where the enhanced voting rights can be used in limited circumstances i.e., the removal of the holder as a director or after a change in control of the company. In addition, dual share class structures are only permitted if they contain a sunset clause meaning that the enhanced voting rights expire within five years.

In moving to a single listing segment, unless a more relaxed approach is adopted, this would remove the ability for issuers with dual share class structures that did not meet these requirements to list in London. To address the risk that the existing requirements might be too restrictive and act as a deterrent to listing in London in the absence of an alternative listing segment, the FCA is proposing to introduce more flexibility under the new single listing segment as follows:

- enhanced voting rights can be exercised on any shareholder vote (except issuing new shares at a discount of greater than 10%) not just removal of the holder as a director or after a change of control;
- extension of the sunset period from five years to ten years;
- greater restrictions on transfer – i.e., automatic conversion of the shares with enhanced voting rights to ordinary shares upon the holder ceasing to be a director (currently transfers of enhanced voting rights shares are permitted to the beneficiaries of a director's estate); and
- removing the limitations on voting ratio or weighting limits i.e., the FCA is proposing to remove the 20x limitation on the enhancement of the voting rights and leave it to the market to negotiate a suitable level.

The FCA proposes to retain the existing limitation under the premium listing requirements that enhanced voting rights shares can be held only by directors of the company.

The greater flexibility proposed to be allowed under dual share class structures, in particular the ability to use the enhanced voting rights on almost any shareholder vote, will need to be considered in the context of other key minority investor protections under the Listing Rules, such as resolutions for the election of independent directors and the cancellation of listing.

Dual share class structures

- Expansion of scope to (almost) any shareholder vote
- Sunset provision extended from 5 to 10 years
- No limitation on voting ratio or weighting
- Can only be held by a director

Controlling shareholders and relationship agreements

As a consequence of the FCA's proposal to remove the requirement for a shareholder vote for certain related party transactions, including where the related party is a controlling shareholder, the FCA has also questioned the effectiveness of requiring a controlling shareholder to enter into a relationship agreement with a premium listed company.

Whilst the formal requirement to have a legally binding relationship agreement was enshrined in the Listing Rules in 2014 (following several high-profile cases where overseas based UK listed issuers had controlling shareholders), it had been market practice to have in place a relationship agreement for many years prior to that time.

Controlling shareholders and relationship agreements

- No longer a mandatory requirement
- To be replaced with a "comply or explain" regime
- Risk factors in prospectus and annual report

The FCA is proposing to reframe the requirement for a controlling shareholder agreement (i.e. a relationship agreement) under a "comply or explain" regime whereby if an issuer did not put in place such an agreement, it would require specific disclosures and a discussion of the risks arising from having a controlling shareholder in the prospectus and annual financial report. Again it has been market practice to include risk factor disclosure relating to the risks arising from having a controlling shareholder for many years, irrespective of whether a legally binding relationship agreement was in place or not.

In effect, the FCA's proposal is to put the onus on to shareholders to satisfy themselves that the nature of the relationship between the company and its controlling shareholder is within the parameters of their risk appetite and hence it is likely that there would be a greater interrogation of management and focus on due diligence by investors about this relationship.

REFORM OF THE CONTINUING OBLIGATIONS REGIME FOR LISTED COMPANIES

Dropped – the voluntary opt-in to supplementary continuing obligations

In a key departure from the position set out in its Discussion Paper DP22/2 in May 2022, having taken soundings from key stakeholders and market participants, the FCA has decided to simplify the continuing obligations regime under the new single listing segment by dropping this ability to opt-in to an additional set of supplementary continuing obligations. In addition, the FCA has decided to make significant changes to the significant transactions regime, as well as the requirements in relation to related party transactions.

In its Discussion Paper DP22/2 the FCA had proposed that issuers under the single listing segment would be subject to a set of mandatory continuing obligations and, should they so wish, they could also opt-in to an additional set of supplementary continuing obligations having taken into account feedback from shareholders. Any such opt-in would only have been permitted in respect of all the supplementary continuing obligations rather than being to pick and choose which ones to comply with. Feedback from various market participants indicated that this opt-in was overly complicated, restrictive (i.e., any opt-in had to be on an all or nothing basis) and unlikely to be taken up by many premium listed companies. As such, the FCA has decided to drop the concept of the opt-in, thereby leaving it to individual companies and their shareholders to determine whether any additional corporate governance measures should be put in place.

The resulting FCA proposal is a radical departure from the continuing obligations regime which has been in place in London for more than a generation and will provide greater flexibility to listed companies and their shareholders to agree the circumstances in which a listed company needs to seek approvals from its shareholders.

Continuing obligations

- No voluntary opt-in to supplementary continuing obligations
- No need for shareholder vote or shareholder circular on Class 1 (unless it is a reverse takeover….)
- No need for shareholder vote or shareholder circular on RPT (unless it is a reverse takeover….)

Significant transaction regime

Under the current Listing Rules, premium listed companies are required, depending on the size of transaction undertaken, to make an announcement to the market including certain specified information and seek the prior approval of shareholders before consummating the transaction. The thresholds triggering these requirements, and the basis for calculating the

various tests to classify the size of a transaction, have remained largely the same for many years.

No need for prior shareholder approval…unless it is a reverse takeover

Under the new single listing segment, the FCA is proposing to raise the threshold which triggers the requirement for seeking prior shareholder approval from 25% to 100%. The increase in the threshold, in effect, means that only a transaction which would result in such a fundamental change to the business that it would constitute a "reverse takeover" (i.e., the results of any of the class tests exceeds 100%) would require the prior approval of shareholders. Transactions which exceeded the 25% threshold but were below the 100% threshold would only be required to be announced to the market. This is a significant departure from the long-held practice of requiring prior shareholder approval if a transaction were to exceed a 25% threshold and, indeed, will mean that if adopted the rules applicable to AIM listed companies would be more restrictive than those on the new listing segment. AIM listed companies are currently required to seek prior shareholder approval in respect of any disposal which, when aggregated with any other disposals over the previous 12 month period, would exceed 75% of any of the class tests.

Not only will the relaxation of the need to seek prior shareholder approval remove a significant administrative burden, it will also mean that listed companies are no longer at a competitive disadvantage when participating in an auction process in relation to an acquisition in competition with private company bidders or overseas listed companies which are not required to obtain shareholder approval. The proposed changes to the significant transaction regime to remove the need for prior shareholder approval for all but the largest of M&A transactions will also align the UK listing regime with many of its main peers across Europe.

Other proposed changes to the significant transaction regime

The FCA is also proposing:

- to amend the requirement to obtain guidance from a sponsor in certain circumstances such that this is only required where there is any doubt about the correct application of the Listing Rules and the company's obligations;
- to preserve the requirement to make a Class 2 announcement at the time of entering into a transaction but only at the current Class 1 threshold of 25% rather than at the current Class 2 5% threshold meaning that the inclusion of historical financial information, pro forma financial information or a working capital statement will not be mandatory requirements (but an issuer will still need to ensure it is disclosing any inside information and complying with its MAR obligations);
- not to require the sponsor to "sign off" on, or for the FCA to pre-approve, such an announcement in relation to a transaction exceeding the Class 1 25% threshold; and
- not to require a sponsor to make a declaration to the FCA in connection with a Class 1 transaction.

The FCA is also proposing to change the basis for calculating the various thresholds which apply under the significant transaction regime – in particular:

- removing the profits test (given it frequently produces anomalous results); and
- allowing sponsors more discretion to apply appropriate modifications to the class tests without having to submit a request to the FCA.

Related party transaction regime

The FCA is also seeking to make a radical departure in relation to the related party transaction regime by removing the long-established requirement to obtain prior approval of the independent shareholders in respect of related party transactions which exceed a 5% threshold. In effect, this will more closely align the requirements for related party transactions under the Listing Rules with those that currently apply to both premium and standard listed issuers under the Disclosure and Transparency Rules by virtue of article 9c of the EU Shareholder Rights Directive II (as onshored into UK legislation). An important distinction will still remain between these two regimes, however, as under the Listing Rules it is proposed to retain the requirement for a listed company to appoint a sponsor to advise on whether the terms of the related party transaction are fair and reasonable.

In particular, the FCA proposes to:

- remove the requirement for a prior approval by independent shareholders of related party transactions which exceed the 5% threshold;
- remove the requirement for a related party transaction involving a controlling shareholder which is below the 5% threshold to be approved by independent shareholders;
- remove the modified requirements for smaller related party transactions above 0.25% and below 5%;
- retain the requirement for sponsor confirmation that the terms are fair and reasonable; and
- retain the requirement for companies to seek the guidance of a sponsor in connection with any related party transaction in order to assess the application of the Listing Rules.

Which other matters requiring shareholder approval will remain in place?

- ***Cancellation of listing*** - given the significant impact de-listing has on the transparency and liquidity available to shareholders, and the risk a larger shareholder may exploit their position to take a company private to the detriment of other shareholders, the FCA proposes retaining the requirement for a shareholder vote to cancel listings of shares in the single listing segment.
- ***Reverse takeovers*** – despite the proposed changes to the significant transactions regime, the FCA is proposing to retain the requirement for shareholder approval for transactions which exceed the 100% threshold and hence are classified as being a reverse takeover.
- ***Companies in financial difficulty*** – where a premium listed company in financial difficulty proposes to undertake a transaction it may, depending

on the circumstances, need to seek prior shareholder approval, send a circular to shareholders which includes a working capital statement, appoint a sponsor and have the circular pre-approved by the FCA. The FCA has reserved its position on whether these requirements will be retained or revised and will set out its proposals in due course.

- **Other matters** – the FCA is proposing to retain the requirement for prior shareholder approval in certain other situations e.g., the issuance of shares at more than a 10% discount, share buybacks which currently require shareholder approval in certain circumstances etc.

Single set of Listing Principles

As a consequence of creating a single listing segment to replace the premium and standard listing segments, the FCA is also proposing to create a single set of Listing Principles to replace the existing Listing Principles and the Premium Listing Principles.

With a single set of Listing Principles, the FCA recognises the need to make modifications or exceptions to address the differences between the various types of issuer and types of securities which could be listed (replacing the distinction which currently exists by virtue of a security being premium or standard listed). The FCA will provide more detail on the application of the combined set of principles and where modifications and exceptions would apply in their follow-up consultation on draft rules in due course.

WHAT IS HAPPENING TO THE SPONSOR REGIME?

The FCA is proposing to retain the sponsor regime for the new single listing segment, ensuring that new applicants and listed companies are supported and receive expert advice at the time of listing and subsequently at key points once the company is listed.

At the listing gateway the role of the sponsor would remain largely unchanged, except where the FCA is proposing to remove certain of the existing premium listing eligibility criteria. Once listed, the need to appoint a sponsor would be reduced. The FCA has recognised the concerns about the ability of sponsor firms to maintain the requisite skills, knowledge and expertise required to provide sponsor services if the circumstances in which a sponsor need be appointed post-listing are reduced. To address these concerns, the FCA has indicated that they may broaden the type of transactions which are considered to be evidence of having the requisite expertise, including advising companies which are admitted to AIM. It remains to be seen what impact this will have on the universe of firms willing and able to provide sponsor services.

The FCA proposes retaining the sponsor regime in connection with:

- the confirmation that the terms of a related party transaction are fair and reasonable; and
- any transfer between listing categories – although with the premium and standard listing segments for commercial companies being replaced with a single listing segment, this would only occur relatively infrequently in circumstances where a closed ended investment fund sought to change to become listed as a commercial company.

The FCA is continuing to consider the circumstances requiring the preparation of a prospectus for secondary issues, including the role of the sponsor.

WHAT ABOUT FTSE INCLUSION?

Historically one of the benefits of a company having a premium listing was the ability to be eligible for inclusion in FTSE's UK indices, resulting in additional demand for a company's shares by virtue of certain institutional investors with passive investment mandates being required to hold a position in companies included in the index. Whilst the FCA regulates benchmark providers, such as FTSE, the FCA do not play any role in setting the eligibility criteria for inclusion in the indices themselves. These eligibility criteria are determined by the benchmark provider, often following consultation with its users. As such, it is not directly within the FCA's powers to ensure that companies which are listed under the new single listing segment are eligible for inclusion in FTSE's UK indices.

The FCA has noted in the consultation paper that it will remain open to index providers to set higher or different standards than the FCA's Listing Rules should they wish to supplement the minimum standards required under the proposed reformed Listing Rules. Therefore, whilst the FCA has sought to maintain an open dialogue with FTSE and other index providers in developing the framework for a single listing segment, it remains to be seen whether FTSE will impose its own additional eligibility requirements which go above and beyond those set out in the Listing Rules for companies listed on the new single listing segment.

CLIFFORD CHANCE VIEW

Whilst there have been some piecemeal changes in recent years in an attempt to make listing in London more attractive, notably relaxing the minimum free float requirements and allowing certain dual share class structures to be eligible for premium listing, the proposed changes represent a significant overhaul of the UK listing regime, which has largely remained unchanged for nearly 20 years.

Whilst the historic division between premium and standard listings meant that issuers had an alternative listing segment if they were unable to meet the high standards required in the premium listing segment, in reality the standard listing segment was not generally viewed as being a success. The lack of eligibility for inclusion in FTSE's UK indices and the perceived "second-class status" associated with issuers who chose to list in the standard segment rather than the premium segment meant that many international businesses elected to list elsewhere in Europe if they were not eligible for a premium listing.

In re-casting the listing regime by creating a single listing segment, the FCA hopes to have come up with a solution to solve this issue. A critical element in whether this is viewed as being a success depends on FTSE's position and, in particular, whether companies listed under the single listing segment will be eligible for inclusion in FTSE's indices or whether FTSE will apply any additional eligibility criteria of its own.

More broadly, when combined with other regulatory reforms currently under discussion in relation to the circumstances in which a prospectus needs to be prepared, the options for listed companies to raise additional equity capital and how to encourage greater retail participation in the equity capital markets, this represents a significant attempt to re-boot and revitalise the UK equity capital markets.

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