The FCA’s new Listing Regime
An overview of the key changes and impacts of the final rules in PS14/8

INTRODUCTION

On 2 October 2012, the FCA's predecessor launched a consultation (CP12/25) on “Enhancing the effectiveness of the Listing Regime”, largely in response to market pressure to improve protections for minority shareholders in premium-listed issuers with controlling shareholders. Our client publication of October 2012 summarised the original proposals – click here

The FCA’s response to that consultation (CP13/15) was published on 5 November 2013. This recommended the adoption of most of the original proposals, and proposed further consultation on additional changes to the Listing Rules regarding related party transactions and the cancellation of premium listings. Our client publication of November 2013 analysed the results of the original consultation and the FCA’s further proposals – click here

On 16 May 2014 the FCA published its response (PS14/8) to that consultation, and its changes to the Listing Rules came into force on the same day (subject to some transitional provisions discussed below). The FCA adopted the majority of the changes which it had proposed last November. However, PS14/8 also provides unusually comprehensive responses by the FCA to various concerns raised during its consultation, and provides some helpful guidance regarding the FCA's thinking.

IMPACT FOR ALL PREMIUM-LISTED APPLICANTS AND ISSUERS

Independence and control of business
Previously any new applicant for, or issuer with, a premium listing was obliged to carry on an independent business as its main activity from admission. As proposed in CP13/15, new guidance to the rules now sets out what may be taken into account in determining whether the independence test is met. This new guidance was summarised in our client publication on CP13/15.

As proposed in CP13/15, the FCA has removed the former requirements that a premium-listed issuer controls the majority of its assets, and that a new applicant has done so for at least the past 3 years. The previous rule was not always easy to interpret and apply in practice, and its removal is a positive step.

Voting on issues related to premium listings
As proposed in CP13/15, the new rules permit only holders of premium-listed shares to vote on matters for which the Listing Rules require a premium-listed issuer to obtain shareholder approval. The best-known examples are the requirements to obtain shareholder approval of class 1 transactions and related party transactions.

The FCA may modify the operation of this rule in "exceptional circumstances", for example to accommodate the operation of voting rights attaching to preference shares which are in arrears.

Timeline for implementation: new applicants

New applicants for a premium listing must comply with the new voting requirements from the time of admission.

Timeline for implementation: existing issuers

Existing premium-listed issuers need only comply with the new voting requirements from 17 May 2016.
Some existing premium-listed issuers have other classes of non-premium-listed shares in issue which entitle the holders to attend and vote at general meetings (for example, legacy preference shares). These issuers need to consider whether adjustments should be made to the rights of the relevant shares to reflect the new voting requirements. This will presumably require the issuer to either obtain the necessary approvals to amend the rights of the non-premium-listed shares, or alternatively to obtain approval from the holders of premium-listed shares to transfer to a standard listing. However, it is not clear what incentive the holders of non-premium-listed shares have to agree to their voting rights being reduced in this way. If the issuer is unable to obtain the relevant approvals by 17 May 2016, then its premium listing could potentially be at risk, but this may not necessarily trouble the holders of its non-premium-listed shares. In such a situation, the FCA may come under some pressure from holders of premium-listed shares to grant a dispensation from this rule.

Listing principles

Monitoring persons with interests in shares

The Listing Principles require all premium-listed issuers to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable them to comply with their obligations under the rules. Following the introduction of new rules for applicants and issuers with a “controlling shareholder” (discussed below), the FCA expressed the view in PS14/8 that directors are not permitted by their duties to be wilfully blind to the existence of a controlling shareholder. The FCA expects that an issuer’s systems and controls would be capable of allowing reasonable efforts to be undertaken to identify any controlling shareholders. The FCA also said that, where an issuer knows of a controlling shareholder, it would expect the issuer to undertake all necessary steps to identify persons who may be “acting in concert” with them.

All premium-listed issuers should satisfy themselves that their systems and controls are adequate for this purpose. It is general practice for issuers to monitor their shareholder register and announcements by major holders of voting rights. However, this process may need to become more regular and rigorous, and better-documented. The definition of a controlling shareholder is not limited to persons who are registered shareholders, and concert parties are broadly defined. As a result, issuers may need to make more regular use of their powers under section 793 of the Companies Act 2006 to require information from persons whom they reasonably believe are interested in their shares.

Premium listing principles

As proposed in CP13/15, two additional Premium Listing Principles now apply to premium-listed issuers, as follows:

- all shares in a premium-listed share class must carry an equal number of votes on any shareholder vote; and
- the aggregate voting rights of different premium-listed share classes should be broadly proportionate to their relative interests in the company’s equity (taking into account the commercial rationale for the differences in the rights and the extent of dispersion and relative liquidity of the classes).

There is no transitional period for existing premium-listed issuers to comply with these new principles.

The new “broadly proportionate” requirement may potentially be an issue for some premium-listed investment companies which have multiple classes of premium-listed shares with different voting rights. However, as discussed in our client publication on CP12/25, where differential voting rights simply reflect different share classes tracking different pools of assets, or being denominated in different currencies, this should comply with the “broadly proportionate” requirement. In PS14/8, the FCA stated that the purpose of this new principle is to prevent artificial structures involving multiple classes with different voting powers, which are designed to allow a small group of shareholders to exercise control. However, the FCA acknowledges that different share classes may also be used for other purposes, e.g. closed-ended
investment funds use them to meet the differing investment needs of investors.

**Smaller related party transactions**
As proposed in CP13/15, premium-listed issuers are now required to announce any smaller related party transactions (i.e. 0.25% to 5% on the percentage ratios), but are no longer required to report each transaction in their annual report or to inform the FCA in advance.

**Free float**
As proposed in CP13/15, the FCA has added guidance setting out some additional factors which it may take into account when considering whether to lower the 25% EEA free float threshold for premium-listed issuers, namely the number and nature of public shareholders and whether the market value of shares in public hands exceeds £100 million. Any request for a modification would have to be supported by evidence to satisfy the FCA that the market would continue to operate properly, and the FCA previously noted in CP12/25 that it will only grant a waiver for an EEA free float below 20% in exceptional circumstances.

As proposed in CP13/15, the free float calculation now excludes shares which are locked up for more than 180 calendar days. In PS14/8 the FCA confirmed that this applies where the lock-up was originally granted for a period longer than 180 days, not only where the unexpired term of the lock-up is greater than 180 days.

Previously, “free float” shares and depositary receipts did not include any 5% or greater interest held by persons in the same group or acting in concert. Under the new rules, shares held by investment managers in the same group are no longer combined for these purposes, provided that investment decisions are made independently.

**Notification obligations**
As proposed in CP13/15, all premium-listed issuers are now obliged to notify the FCA of any of the following:

- failure to carry on an independent business as its main activity;
- failure to meet the free float requirement; or
- failure to ensure that only premium-listed shares may vote on matters for which the Listing Rules require a premium-listed issuer to obtain shareholder approval.

**IMPACT FOR PREMIUM-LISTED APPLICANTS AND ISSUERS WITH CONTROLLING SHAREHOLDERS**
The majority of CP13/15’s proposed changes to ensure that a premium-listed issuer with a controlling shareholder can act independently are being introduced.

**Controlling shareholders**

*New definition of controlling shareholder*

As proposed in CP13/15, the new definition of “controlling shareholder” essentially captures persons who, with their concert parties, control at least 30% of the votes of the relevant issuer.

“Control” of voting rights is not defined in the Listing Rules. However, in PS14/8, the FCA said that this will include situations where the shares are held on a person’s behalf by a nominee or through a company over which the person has de facto control (i.e. control of more than 50%, traced through a chain of controlled companies if necessary).

“Acting in concert” is not defined in the Listing Rules. However, in CP13/15 the FCA indicated that issuers should base their assessment on whether two (or more) entities are acting together to control the exercise of 30% or more of the votes on all or substantially all matters at general meetings of the company. In PS14/8, the FCA said that it will ask the company or its advisers to set out their own analysis of whether parties are acting in concert, including details of any view taken by the Takeover Panel. The FCA stated that they “think it is unlikely in practice that our conclusions on who is acting in concert would be substantially different to any that the Takeover Panel might reach.” However, the lack of a definition in the Listing Rules could give rise to some uncertainty. Even the relatively detailed Takeover Code definition is often the subject of discussion and some debate between issuers and the Takeover Panel.
The definition of “controlling shareholder” has the effect that any concert parties of a controlling shareholder will themselves be “controlling shareholders” for the purposes of the new rules.

When applying the 30% test to a possible “controlling shareholder”, CP13/15 had proposed aggregating not only votes controlled by concert parties, but also all votes controlled by the shareholder’s “associates”. However, the FCA ultimately dropped “associates” from its proposal, accepting that this would cast the net too wide.

Relationship agreements
Under the new rules, premium-listed issuers with a controlling shareholder must have a relationship agreement in place, subject to certain transitional provisions.

Mandatory provisions
The relationship agreement must include the following mandatory provisions, which are essentially as proposed in CP13/15:

(1) transactions and arrangements with the controlling shareholder (and/or any of its associates) will be conducted at arm’s length and on normal commercial terms;

(2) neither the controlling shareholder nor any of its associates will take any action that would have the effect of preventing the issuer from complying with its obligations under the Listing Rules; and

(3) neither the controlling shareholder nor any of its associates will propose or procure the proposal of a shareholder resolution which is intended or appears to be intended to circumvent the proper application of the Listing Rules.

Some responses to CP13/15 queried whether these provisions should be extended to “associates”, given that a shareholder may not always control its associates. However, the FCA rejected these submissions as unrealistic.

The issuer will be obliged to comply with these mandatory provisions at all times, and to notify the FCA of any breach by it or (in certain circumstances) a controlling shareholder (see “notification obligations” below).

It is helpful that the list of mandatory provisions is focussed and short. Traditionally, relationship agreements have tended to cover a wider range of matters. Controlling shareholders will now have a stronger basis on which to seek a more focussed agreement, addressing the matters covered by the new rules.

Regarding mandatory provision (1) above, in PS14/8 the FCA said that whether a transaction is on more favourable terms depends on whether it may benefit a controlling shareholder or its associates. The FCA went on to say that the mandatory provisions address the nature of the entire relationship with the controlling shareholder, and aim to prevent an “inappropriate relationship” from developing. Accordingly, the FCA proposes to leave the issuer’s directors to assess particular transactions, taking all aspects into account, and would not see transactions on more favourable terms as automatically offending this principle. This is helpful, given mandatory provision (1) does not include a materiality test which would otherwise exclude a single, small transaction.

The FCA stated in PS14/8 that mandatory provision (1) is not intended to require a review a past agreements and transactions entered into with a controlling shareholder or its associates. This provision will only apply to future transactions, meaning transactions occurring after the issuer acquires a controlling shareholder (curiously, not only those occurring after the relationship agreement is signed). For these purposes, the FCA considers that a transaction occurs when the issuer loses discretion as to whether to proceed with it. Comments made elsewhere in PS14/8 also suggest that, if an issuer had a 30%+ shareholder for some time prior to 16 May 2014, the issuer only acquired a “controlling shareholder” (as defined) on that date, when the new definition took effect.

Regarding mandatory provisions (2) and (3) above, our client publication on CP13/15 suggested that additional FCA guidance would be beneficial. For example, if the controlling shareholder proposes a general meeting resolution for the issuer to pay a
dividend, or to change strategy, might that prevent the issuer from complying with its obligation under the Listing Rules to carry on an “independent business”?

Helpfully, in PS14/8 the FCA addressed this point and confirmed that “we strongly support shareholder engagement and it is not our intention to prevent a controlling shareholder from legitimately disagreeing with the company”. The FCA did not see its proposals as preventing shareholders from exercising their rights as shareholders. Rather, the FCA stated that it seeks to prevent influence being exercised improperly and in a way that is unfairly detrimental to minority shareholders. The FCA stated that in practice its response would “depend on the totality of the controlling shareholder’s interactions with the issuer”. While this provides useful comfort, the precise scope of these provisions will to some extent need to be worked out in practice.

Signatories

Where a premium-listed issuer has more than one controlling shareholder, it need not enter into a relationship agreement with all of its controlling shareholders provided that (a) the signing shareholder agrees to procure compliance by a named non-signing shareholder and its associates, and (b) the issuer reasonably considers, in light of its understanding of the relationship between the relevant shareholders, that compliance can be so procured.

No requirement for shareholder approval under Listing Rule 11

In PS14/8, the FCA confirmed that entering into, or amending, a relationship agreement with a controlling shareholder in order to comply with the new rules would not constitute a related party transaction under the Listing Rules.

Annual report disclosures

Essentially as proposed in CP13/15, a premium-listed issuer with a controlling shareholder must include in its annual report a confirmation by its board that a relationship agreement has been entered into and, so far as the issuer is aware, controlling shareholders and their associates have complied with its mandatory provisions during the relevant accounting period. Alternatively, the report must state the reasons for the failure or breach, and that the FCA has been notified. If any independent director cannot support a clean statement of compliance, then the report must record this fact.

Sanctions for non-compliance

As proposed in CP13/15, enhanced oversight measures apply to any premium-listed issuer with a controlling shareholder:

- which does not have a relationship agreement in place;
- which breaches a mandatory provision of such an agreement, or becomes aware of such a breach by a controlling shareholder or its associates; or
- where an independent director does not agree with the board’s assessment of whether the above requirements have been complied with.

Under these measures, all transactions between the controlling shareholder and the issuer will become subject to the pre-approval of independent (i.e. non-controlling) shareholders, until the issuer’s board is able to make a unanimous statement of compliance in its annual report. As mentioned in our client publication on CP13/15, there will be no automatic exemptions for small transactions or ordinary course activity, although the FCA could grant a waiver at its discretion. In PS14/8, the FCA stated that the enhanced oversight regime is not intended to prohibit ordinary course transactions. The FCA would expect to discuss upfront and agree with the affected issuer what types of transactions could continue to be treated as ordinary course.

Consultation responses expressed some concerns regarding the potentially long and arbitrary duration of enhanced oversight measures (i.e. until the next annual report). In PS14/8, the FCA stated that it would keep the duration of these measures under
review, and may change its approach later if this seems appropriate. Likewise, at this stage it was not willing to provide guidance regarding the “exceptional” circumstances in which it may grant dispensations from the enhanced oversight regime.

**Timeline for implementation: new applicants**

New applicants for a premium listing with a controlling shareholder must enter into a compliant relationship agreement prior to admission.

**Timeline for implementation: existing issuers**

Existing premium-listed issuers with a controlling shareholder as at 16 May 2014 must enter into a compliant relationship agreement on or before 16 November 2014.

Transitional relief also applies where a person becomes a controlling shareholder in a premium-listed issuer after 16 May 2014. Such an issuer will have 6 months in which to enter into a compliant relationship agreement.

**Election of independent directors**

All premium-listed issuers with a controlling shareholder must put in place a new election procedure for independent directors, subject to certain transitional provisions.

**Election procedure for independent directors**

Premium-listed issuers with a controlling shareholder must follow a new election procedure for their independent directors (as defined in the UK Corporate Governance Code). The election or re-election of independent directors must be approved by both the shareholders as a whole and by the independent (i.e. non-controlling) holders of premium-listed shares alone. The FCA confirmed in PS14/8 that this requirement can be satisfied through a single vote on a single resolution, so long as it is passed by both constituencies. If either constituency does not vote in favour, but the issuer still wishes to proceed with the appointment, then a further resolution with the same effect must be proposed and tabled at a shareholder meeting to be held at least 90 days but not more than 120 days after the original vote. This resolution only needs to be passed by a simple majority of shareholders as a whole.

**Possible amendments to articles of association**

Premium-listed issuers with a controlling shareholder will need to ensure that their constitution (articles of association) allows for the new voting procedure.

The new voting procedure requires that an ordinary resolution is passed as usual, in accordance with company law and the issuer’s articles of association. In addition, the resolution will be subject to an additional requirement under the new rules, namely that a majority of independent shareholders vote in favour. This requirement will be explained in the circular.

As indicated in our client publication on CP13/15, we believe that it should not generally be necessary for this additional requirement to be written into (or expressly referred to in) the issuer’s articles of association. In particular, the articles need not expressly provide for approval by the independent shareholders, just as company articles do not currently expressly provide for the possibility of obtaining a resolution of independent shareholders (only) to approve a related party transaction under Listing Rule 11, or a “whitewash” resolution under the Takeover Code. In PS14/8, the FCA took the same view, stating that premium-listed issuers are not obliged to amend their articles of association provided the articles do not prohibit such elections from taking place.

**Timeline for implementation: new applicants**

New applicants for premium listing with a controlling shareholder must follow the new election procedure, and ensure that their articles of association allow for this, with effect from admission.

**Timeline for implementation: existing issuers**

Existing premium-listed issuers with a controlling shareholder must introduce the new election procedure for independent directors at their next AGM
for which notice is given on or after 16 August 2014. That is, more than 3 months after the person became a “controlling shareholder” (as defined), which in this case happened when the new definition took effect on 16 May 2014.

Transitional relief also applies where a person becomes a controlling shareholder in a premium-listed issuer after 16 May 2014. Such an issuer must introduce the new election procedure for independent directors (and amend its articles of association, if necessary) at its next AGM for which notice is given more than 3 months after it acquired a controlling shareholder.

**Additional content requirement for shareholder circulars**

As proposed in CP13/15, where a premium-listed issuer with a controlling shareholder puts the election or re-election of an independent director to its shareholders, the circular must detail any existing or previous relationship or agreement the proposed director has or had with the issuer, its directors, the controlling shareholder or any of its associates. The circular must also describe why the issuer considers that the director will be effective, how it has determined that the proposed director is independent and the process for the selection of that director.

These additional requirements will not come into force until 17 August 2014.

If a person becomes a controlling shareholder in a premium-listed issuer on or after 17 August 2014, then a circular sent out within the following 3 months need not comply with the above content requirements.

**Independent shareholder approval**

Premium-listed issuers with a controlling shareholder must now have certain matters (the cancellation of a premium listing, a transfer of equity shares from a premium listing to a standard listing, or (as discussed above) the election of an independent director) approved not only by the shareholders as a whole, but also by the independent (i.e. non-controlling) holders of premium-listed shares alone.

**Notification obligations**

In addition to the notification requirements which apply to all premium-listed issuers, those with a controlling shareholder must also notify the FCA of any of the following:

- failure to have a relationship agreement in place with controlling shareholders;
- failure to follow (or have articles of association which allow) the required election procedure for independent directors;
- failure to comply with the independent shareholder approval requirements;
- failure by the issuer to comply with the mandatory provisions in a relationship agreement; or
- the issuer becomes aware that a controlling shareholder or its associates have not complied with a mandatory provision in a relationship agreement, or a provision obliging a controlling shareholder to procure compliance by a non-signing controlling shareholder and its associates.

**Cancellation of listing**

As proposed in CP13/15, a premium-listed issuer with a controlling shareholder will now be required to obtain a majority vote of independent shareholders to sanction the cancellation of its premium listing. As discussed in our client publication on CP13/15, in the context of a cancellation following a takeover, where an offeror is a controlling shareholder holding (with its concert parties) more than 50% of the shares in a premium-listed issuer at the outset of the offer, the offeror needs to obtain acceptances or acquire shares from independent shareholders holding a majority of votes held by independent shareholders as well as reaching the 75% acceptances threshold. However, this additional “majority of the minority” requirement falls away if the offeror obtains 80% of voting rights. In that case a cancellation of listing can proceed regardless, given the issuer will have a free float of 20% or less.
Overall impact on premium-listed issuers with controlling shareholders

In our client publication on CP13/15, we discussed the impact of these rule changes upon premium-listed issuers with a controlling shareholder in some detail. However, as a general theme, it is worth noting that many of the new rules impose process requirements, such as formal relationship agreements, a cooling-off period before a majority vote on independent directors, and various disclosure and notification requirements. Generally speaking, the new rules do not substantively curtail the voting and other rights of controlling shareholders under company law.

This is probably for the best. Both minority and majority shareholders may exercise their rights in a manner adverse to the interests of all shareholders. Giving the minority the benefit of an excessive number of super-majority requirements (effectively, veto rights) would provide them with disproportionate power. As it stands, the FCA’s rule changes should not be too onerous for issuers to implement, and will provide some additional protection to minority shareholders without excessively undermining the importance of preserving the rights of the majority.

IMPACT FOR STANDARD-LISTED ISSUERS

Listing principles

Premium-listed issuers have long been required to (a) take reasonable steps to establish and maintain adequate procedures, systems and controls to enable them to comply with their obligations, and (b) deal with the FCA in an open and cooperative manner. These two Listing Principles now also apply to issuers with only standard-listed securities (including debt and depositary receipts).

In its guidance on these Listing Principles, the FCA stresses the importance of ensuring that systems and controls are in place for the timely and accurate disclosure of information to the market. This includes systems and controls that enable issuers to properly identify information which requires disclosure under the Listing Rules or the Disclosure and Transparency Rules, and that such information is properly considered by the directors.

The FCA is quite focussed upon issuers’ obligations regarding systems and controls. In recent years it has cited this Listing Principle when fining several premium-listed issuers for breaches of the Listing Rules and Disclosure and Transparency Rules. As we mentioned in our client publication on CP12/25, issuers with only standard-listed securities may wish to review their existing procedures, systems and controls, to ensure that these are sufficiently robust and properly documented.

Free float

The 25% EEA free float threshold remains in place for issuers with only standard-listed shares or depositary receipts. However, as mentioned in our client publication on CP12/25, the FCA has previously indicated that it will take a more flexible approach in deciding whether to accept a free float of less than 25%. This change in approach will allow the admission of shares and depositary receipts with a very small percentage of free float in absolute terms, provided that there will still be sufficient liquidity. In assessing liquidity, the FCA proposes to have regard to the number, nature and diversity of holders post-admission. However, for issuers of standard-listed shares the FCA has expressly reserved the right to revoke any modification if in practice the market for the shares is not operating properly.

As proposed in CP13/15, the free float calculation now excludes shares or depositary receipts which are locked up for more than 180 calendar days. Also, shares and depositary receipts held by investment managers in the same group are no longer combined when determining which shares should be excluded from the “free float”, provided that investment decisions are made independently. These two changes were considered above, in the section discussing the impact upon premium-listed applicants and issuers.

CLOSED- AND OPEN-ENDED INVESTMENT FUNDS

Premium-listed closed- and open-ended investment funds are not subject to the new requirement to carry...
on an independent business. They will not be required to enter into a relationship agreement with any controlling shareholder or to introduce a new election procedure for independent directors (or make any of the associated disclosures or notifications).

Closed-ended investment funds are required to comply with the new requirements regarding voting on issues related to premium listings, but these requirements will not apply to open-ended investment funds.

Closed- and open-ended investment funds are required to comply with the two new Premium Listing Principles.

If you would like further information on any aspect of this paper or any advice relating to the new proposals, please contact:

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