UK Listing Regime – Developments Over the Last 12 Months

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Contents

Introduction

In early 2017, the UK Financial Conduct Authority ("**FCA**") consulted on proposals to reform and enhance the UK primary markets. The FCA looked at a wide span of issues, ranging from a consideration of the effectiveness of the structure of the UK primary markets to specific technical amendments and guidance.

The FCA has now finalised much of its review and on 26 October 2017 published the following Policy Statements, containing amendments to the Listing Rules and Conduct of Business Sourcebook and new and amended Technical Notes:

- **Policy Statement 17/23** – to reform the availability of information during a UK IPO process, with effect from **1 July 2018**; and
- **Policy Statement 17/22** – to enhance and clarify a number of aspects of the Listing Rules, with effect from **1 January 2018**.

At the same time the FCA concluded in **Feedback Statement 17/3** that further work and consultation is merited on its broader inquiry into the effectiveness of the UK primary markets, including the positioning of the standard versus the premium listing segment.

In addition, in August 2017 the FCA published its **18th edition of Primary Markets Bulletin** which announced new and proposed changes to its **Knowledge Base**, including proposed new guidance for sponsors on their obligations under the Listing Rules.

Davis Polk

Reforming the Availability of Information in the UK IPO Process

Background

In March 2017, the FCA released a consultation paper (CP17/5) relating to the provision of information to research analysts and the timing of the publication of research during the UK IPO process. Following on from this consultation, Policy Statement 17/23 ("**PS17/23**") introduces, with effect from **1 July 2018**, substantial changes to the rules in the FCA's Conduct of Business Sourcebook ("**COBS**").

Broadly, the new rules seek to:

- restore the centrality of an approved prospectus or registration document in the investment decision-making and price-discovery process;
- create the necessary conditions for unconnected research to be produced more frequently during the IPO process; and
- enhance standards for investment banks to manage conflicts of interest in the production and distribution of connected research.

The new rules seek to restore the centrality of an approved prospectus or registration document in the investment decision-making and price-discovery process.

Form of prospectus

It is expected that COBS 11A will result in issuers using tri-partite prospectuses, comprising

- an approved registration document containing the core information about the issuer, which will be published prior to the release of the ITF and publication of analyst research; and
- an approved securities note and summary, published either at the start or after the conclusion of the management roadshow.

Availability of Analyst Research in the IPO Process

In PS17/23, the FCA noted that a prospectus, which should act as the key source of information on the issuer, is usually made available to market participants late in a typical UK IPO process. Two practical effects of the late provision of the prospectus are that: (i) prospective investors arguably do not have sufficient time to examine fully the prospectus in order for it to play its proper role in informing investment decisions and price discovery, and (ii) too much emphasis is instead placed on connected research, which is typically disseminated at or around the time of the issuer's intention to float ("**ITF**") announcement.

Appended to PS17/23 is the text of the new COBS rules relating to the dissemination of research as part of the UK IPO process ("**COBS 11A**"), which will have a significant impact on the typical UK IPO timetable.

Impact on UK IPO Timetable

Pursuant to COBS 11A, the timing of the publication of connected research will depend upon when an issuer provides unconnected analysts with access to the issuer's management. If issuers allow unconnected analysts access to management alongside connected analysts, analysts will be permitted to publish research one day after the publication of the approved prospectus or registration document. Otherwise, analysts will not be permitted to publish their research until at least seven days after the

publication of the approved prospectus or registration document. The seven-day period between the publication of the prospectus or registration document and the dissemination of research is intended to "level the playing field" between connected and unconnected analysts by providing unconnected analysts with the opportunity to produce research that can be disseminated at the same time as the connected research. In this period, a range of unconnected analysts will have to be provided with access to management of the issuer and to see information that connected analysts received to enable them to produce their research.

A practical consequence of the new COBS 11A rules is that, if syndicate banks decided to retain a customary IPO timetable (which typically entails a two-week window allocated to investor education, as per *fig 1* below), this could increase the length of the public portion of a typical UK IPO and therefore create additional execution risk.

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The FCA notes in PS17/23, however, that issuers may employ certain structural techniques to alleviate such additional risk, including: (i) a reduction of the investor education phase of the IPO process, (ii) conducting additional meetings with investors at an early stage of the transaction process (i.e. further "pilot fishing" and "early look" meetings), (iii) not distributing connected research and (iv) not providing analysts with management access (although it is difficult to see how proposals (iii) or (iv) would be of benefit to market participants, given that the effect of each would be to deprive market participants of otherwise useful sources of information and analysis).

Fig. 1 below sets out an indicative UK IPO timetable under the current and new regimes, illustrating the changes to both the timetable and form of prospectus:

Indicative UK IPO Timetable			
	Current regime	New Regime	
		Option 1	Option 2
Week 2 – 4	"Early look" presentation to potential investors		
Week 4 – 8	First draft of the prospectus submitted to the UKLA for review	First draft of "registration document" submitted to the UKLA for review	
Week 6 – 10	Presentation to "connected" analysts	Presentation to "connected" **and** "unconnected" analysts	Presentation to "connected" analysts
At least **seven** days before connected research is published			"Registration document" approved by the UKLA and made available to all investors
At least **one** day before connected research is published		"Registration document" approved by the UKLA and made available to all investors	Presentation to "unconnected" analysts
Week 10 - 14	Intention to float announcement and publication of "connected" analyst research	Intention to float announcement and earliest publication date for "connected" and "unconnected" analyst research	
Maximum of two weeks following ITF	Investor education and price discovery		
Week 12 - 16	Publication of pathfinder prospectus and price guidance	Publication of "securities note and summary" in final form or pathfinder securities note and summary with separate price guidance	
Two weeks following publication of pathfinder/ securities note	Management roadshow		
Week 14 – 18	Pricing and publication of prospectus	Pricing and publication of pricing notification or final securities note and summary	

Fig. 1

Selection and Treatment of Unconnected Analysts

With respect to a syndicate bank's selection of unconnected analysts to involve in the IPO process, the relevant obligation will be to consider a range of unconnected analysts that, in the syndicate banks' reasonable opinion *"has a reasonable prospect of enabling potential investors to undertake a better-informed assessment of the present or future value of the relevant securities based on a more diverse set of substantiated opinions"*. Syndicate banks will be required to maintain records of the process for assessing the appropriate "range" of unconnected analysts, the staff involved in forming such opinion, and the syndicate bank's consideration of the number and expertise of the unconnected analysts included in the "range".

In order to guide syndicate banks through this process, it is envisaged that the FCA will work with trade associations representing producers of unconnected research to develop industry guidelines. It is then proposed that these trade associations will provide their members with the opportunity to sign up to these guidelines, with those that do so becoming eligible to be offered management access on any UK IPO.

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Syndicate banks should note that where unconnected analysts are not provided with access to communications with the issuer at the same time as connected analysts, a written record of all information provided by the issuer to both connected and unconnected analysts must be maintained and retained for a period of five years. The record may be used by syndicate banks to demonstrate that connected and unconnected analysts received the same information.

In addition, COBS 11A states that any restrictions placed on unconnected analysts as a condition to management access must not unreasonably prevent, limit or discourage those unconnected analysts from producing and disseminating research. A restriction will be considered "unreasonable" if it prevents an unconnected analyst from producing and disseminating research in circumstances in which the relevant syndicate bank is itself able to produce and disseminate research. Syndicate banks will be required to retain a written record of all such restrictions placed on unconnected analysts for a period of five years.

Timing of Adoption

The new COBS 11A rules will apply from 1 July 2018. The FCA has confirmed that this means that the rules would only apply if all of the key events governed by the new rules (for example, analyst presentations, the publication of a prospectus or registration document and the release of connected research) take place after this date.

Multilateral Trading Facilities

Following feedback from market participants, the FCA has decided not to extend COBS 11A to IPOs on multilateral trading facilities (for example, AIM).

Conflicts of Interest in the Production of Connected Research

It is noted in PS17/23 that conflicts between the interests of syndicate banks and the issuer may arise during the IPO process and, most notably, it is suggested that there is potential for connected analysts to face internal and external pressure to produce research which shows the issuer in a favourable light.

To address this, the FCA has supplemented its existing COBS 12 guidance, which currently sets out a general principle that an analyst should not become involved in activities which might compromise its objectivity. In particular, the new guidance confirms that the FCA will consider interaction between an analyst and the issuer's management, shareholders or corporate advisers, before a bank has accepted a mandate to carry out underwriting or placing services for the issuer and the bank's position in the syndicate has been confirmed in writing by the issuer, to be "participating in pitches for new business", being an example of an activity which might compromise an analyst's objectivity as cited in existing COBS 12.

The FCA has clarified that the new COBS 12 guidance will not prevent analysts from engaging in legitimate interactions before formal pitching efforts begin, including having ordinary course discussions with issuers to form a view on sector trends and inform their coverage of existing listed companies or discussions with prospective issuers that are contemplating an IPO which already have other securities admitted to trading. Instead, the relevant obligation will be triggered when the analyst becomes aware or may have reason to believe that the syndicate bank is conducting pitches for equity capital markets work.

The new COBS 12 guidance will not prevent analysts from engaging in legitimate interactions before formal pitching efforts begin, including having ordinary course discussions with issuers.

Further, the FCA has confirmed that the new COBS 12 guidance is not applicable to non-independent research and, provided that such research is clearly labelled as a marketing communication, producers of non-independent research are not prohibited from attending pitches for new business to manage a securities offering.

The new COBS 12 guidance will apply from 1 July 2018. It would however be prudent for analysts to act in accordance with the guidance before then.

Compliance with the Market Abuse Regulation during an IPO Process

The FCA consulted on how persons handling information during an IPO process identify whether such information constitutes inside information for

the purposes of the Market Abuse Regulation (Regulation (EU) No 596/2014) ("**MAR**"). In particular, the FCA sought views on whether analyst presentations constitute inside information and, if so, how applicable MAR obligations were being discharged with respect to such inside information.

In PS17/23, the FCA stresses that it is not possible to make a blanket pronouncement about whether information contained in analysts' presentations will constitute inside information for the purposes of MAR, however, it notes that where MAR is applicable prior to the application for admission to trading of the issuer's securities (for example, if the issuer already has listed securities falling under MAR's ambit) the issuer and its advisers should carefully consider whether information contained in marketing materials (and the fact that the issuer is contemplating an offering of securities) triggers obligations under MAR, in particular strategic and forward-looking information on the issuer.

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Listing Rule Enhancements

Background

Prompted by observations that market participants have experienced difficulties in interpreting the current drafting of certain of the Listing Rules, and from market feedback that enhancements could be made to the regulatory framework, the FCA consulted on a number of changes to improve and clarify aspects of the rules in **Consultation Paper 17/4**. Our **client memorandum** discussed the key issues raised by Consultation Paper 17/4.

Consultation on the proposed changes closed in May 2017, with respondents generally supportive of the FCA's proposals. Accordingly, the FCA has now finalised amendments to the Listing Rules and Technical Notes in Policy Statement 17/22 ("**PS17/22**").

The new rules will come into effect on **1 January 2018**. Any company seeking admission of its equity shares to the premium listing segment of the FCA's Official List after that time will need to prepare any submission regarding its eligibility on the basis of the new requirements.

Clarifications to Eligibility Requirements

The FCA has reordered and amended certain provisions of Chapter 6 of the Listing Rules to simplify and clarify the existing eligibility requirements for premium listed companies. The clarifications are to:

- split the existing independence rules in LR 6.1.4R (which require a company applying to the premium listing segment to have an independent business and to have certain arrangements in place if it has a controlling shareholder) into three distinct provisions to set out more clearly what an applicant must demonstrate to meet the criteria;
- state explicitly in LR 6.2.4R that additional financial information (which may be required where there have been acquisitions during the three-year track record period) needs to be audited;
- clarify for the purposes of LR 6.3.1R, in relation to the three-year financial track record, that only a company that has been generating revenues in its declared line of business for the past three financial years can demonstrate that it is eligible for a premium listing; and
- remove references from the Listing Rules to the FCA's ability to waive the requirement for financial information and a track record (LR 6.1.13G to LR 6.1.15G) or the requirement for a clean 12-

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month working capital statement at the point of listing (LR 6.1.17G and LR 6.1.18G), as in practice the FCA does not waive these requirements and wants to remove any implication to the contrary.

To help market participants interpret the eligibility requirements, the FCA has released new Technical Notes UKLA/TN/102.1 (financial information and track record requirements) and UKLA/TN/103.1 (business independence), which are appended to PS17/22 and will apply from 1 January 2018.

Concessionary Route to Premium Listing for Property Companies

Ordinarily, commercial companies that apply for a premium listing are required to demonstrate a three-year revenue-earning track record in order to be eligible. The Listing Rules currently exempt certain sectors from this requirement (the so-called "concessionary routes" to premium listing), namely, scientific research based companies and mineral companies, in recognition that a three-year revenue-earning track record may say very little about the value of these types of companies.

Consistent with this policy, the FCA will now introduce an additional concessionary route in LR 6.12 for certain property companies, where a property valuation report will be considered in place of a financial track record. The two subcategories of property companies that will have the benefit of this concession are:

- companies that have been established for fewer than three years, but predominantly hold mature, let assets that generate revenue; and
- property companies that develop assets, and have done so for three years, but focus on long-term projects that may only be revenue-generating after many years, if not decades.

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The existing concessionary routes will continue to be available for scientific research based companies and mineral companies, for which the FCA's updated guidance in Technical Notes UKLA/TN/422.3 and UKLA/TN/427.1 will apply from 1 January 2018.

Disregarding Anomalous Profits Test Results in Class Tests

When classifying transactions for the purposes of LR 10, issuers may approach the FCA if they believe that the class tests, when prepared in accordance with the rules in LR 10 Annex 1, produce an anomalous result or are inappropriate given the company's activities. The FCA may agree either that adjusted figures can be used in a class test or that appropriate substitute tests can be used.

The FCA's own experience, as well as market feedback, indicates that there is often a real question whether the profits test result alone is an accurate representation of the size of the transaction.

Accordingly, the FCA has made two changes in its approach to the profits test to permit premium listed issuers, without consulting the FCA in advance, to:

- disregard a profits test result of 25% or more when all the other applicable class test results are below 5% and the result is anomalous. This will mean the transaction is treated as unclassified and therefore not subject to a shareholder vote; and
- make certain adjustments – for a limited number of genuine one-off costs and historic financing costs – to the profit figures used in their profits test if the result was 25% or more, and this result was anomalous.

Premium listed issuers may disregard a profits test result of 25% or more when all the other applicable class test results are below 5% and the result is anomalous. This will mean the transaction is treated as unclassified and therefore not subject to a shareholder vote.

Issuers will continue to be subject to the requirement to obtain a sponsor's guidance under LR 8.2.2R when proposing to enter into transactions that could amount to a class 1 transaction, for which sponsors will need to apply their judgement to the case in hand to consider whether it would be appropriate to regard a profits test result as anomalous.

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Some respondents to the FCA's consultation suggested the FCA should extend its policy further (for example, to move a class 2 transaction to unclassified in a similar manner), and to provide additional guidance on what is meant by "anomalous"; however, the FCA did not deem it appropriate to make additional changes or guidance at this time. This means that listed companies are still under an obligation to disclose a class 2 transaction (or consult with the FCA) in accordance with LR 10.4 where the profits test result is between 5% and 25% and all of the other class test results are below 5%. In addition, as there was no consensus among respondents regarding how the calculation of profits test could be enhanced, the FCA will not make any changes on this aspect of the rules at this time.

As proposed in the consultation, the FCA will also amend LR 10 Annex 1 to take account of the guidance already set out in Technical Note UKLA/TN/302.1, to clarify that the figures used in class tests must be adjusted for transactions completed during the financial period to which the figures relate (in addition to the existing requirement to adjust for

transactions, such as acquisitions and disposals, entered into by either the issuer or the target after the year-end).

Suspensions of Listing for Reverse Takeovers

The Listing Rules provide that a suspension of listing may be necessary when a reverse takeover becomes public, as it is presumed that there is insufficient information available regarding the proposed transaction which prevents proper price formation occurring in the acquiring company's securities. However, market feedback suggested that a presumption of insufficient information and the resulting suspension is not necessary to ensure an orderly functioning market, and indeed a suspension can have a serious adverse impact on investors and issuers.

The FCA agrees and accordingly it will no longer make these presumptions, instead assuming that proper price formation can occur on the basis of a listed company's disclosure obligations under the MAR.

Practically, this means that issuers will no longer need to approach the FCA ahead of announcing a reverse takeover to discuss the requirement for a suspension. However, the FCA may still suspend a listing if it considers that the issuer is unable to accurately assess its financial position and inform the market accordingly (LR 5.1.2G(3)) or there is insufficient information in the market about a proposed transaction (LR 5.1.2G(4)). As a result, sponsors and issuers will still need to consider carefully what level of disclosure is required when announcing a reverse takeover, particularly having regard to the existing level of public information concerning the target.

Issuers will no longer need to approach the FCA ahead of announcing a reverse takeover to discuss the requirement for a suspension.

Sponsors and issuers will still need to consider carefully what level of disclosure is required when announcing a reverse takeover, particularly having regard to the existing level of public information concerning the target.

The exception to this is the case of shell companies, where the FCA will continue its existing approach and presume the need for a suspension. A new Technical Note (UKLA/TN/420.2) will also replace the FCA's existing guidance for shell companies. The FCA will also give consideration to whether the rules should require shell companies to obtain prior shareholder approval as a condition of any acquisition, in response to a suggestion made during consultation.

Ongoing Review of the Primary Markets

Background

In parallel with its review of the Listing Rules, and building on its groundwork from stakeholder engagement during 2016, the FCA released **Discussion Paper 17/2** ("**DP17/2**") to prompt a broad debate about the effectiveness of the UK primary markets landscape. Our **client memorandum** earlier this year discussed the key topics canvassed in DP17/2, namely:

- the appropriateness of the boundary between the standard and premium listing categories;
- the effectiveness of the current regime in supporting early stage science and technology companies; and
- measures to support greater retail participation in debt markets.

The FCA has now released Feedback Statement 17/3 ("**FS17/3**") which concludes that it is prudent and necessary to have further stakeholder engagement before any final policy decisions can be taken. The areas that the FCA proposes to consider further are discussed below.

Positioning of Standard v Premium Listing

The FCA comments that the current listing regime gives companies that want to list in the United Kingdom a binary choice between largely EU directive minimum requirements in the standard listing segment, and a more demanding set of requirements based around UK corporate governance traditions in the premium segment. It notes that some companies may be unable to meet all the premium listing requirements, but are willing and able to meet others.

In addition, the FCA notes that, rightly or wrongly, there is a perception in some quarters of the market that the standard listing segment suffers from a lack of clear identity.

> The FCA will continue its review and encourage further debate among stakeholders in the months ahead with a view to generating a consensus on what, if any, enhancements to the standard listing regime (and, to a lesser extent, the premium segment) may be desirable.

Against this backdrop, the FCA sought feedback on what could be improved. The feedback was varied, with no clear consensus identified. The key themes that can be discerned from the feedback are that:

- UK capital markets are seen to be world-leading and high standards sit at the heart of their success;
- the majority of respondents do not consider there to be a need to change the premium listing requirements, though some thought minor enhancements may be useful;

- views on the standard listing segment were more divergent – it is seen to offer choice, but not necessarily the right choice. A number of respondents confirmed there were public relations issues associated with the standard label, and doubt has been expressed over the benefits of a standard listing compared with a listing on AIM; and
- some respondents perceived gaps in the current offering; however others considered that too many categories or labels would be harmful as it would lead to confusion and possible fragmentation of the market.

The FCA will continue its review and encourage further debate among stakeholders in the months ahead with a view to generating a consensus on what, if any, enhancements to the standard listing regime (and, to a lesser extent, the premium segment) may be desirable.

Sovereign Controlled Companies Category?

The FCA released **Consultation Paper 17/21** ("**CP17/21**") in July 2017, canvassing views on a new listing segment for issuers that are controlled by sovereign countries. Our review of CP17/21 can be found **here**.

The consultation period for CP17/21 closed on 13 October 2017 and the FCA will now decide whether to proceed with the sovereign controlled premium listing category after its consideration of the responses, in conjunction with its broader review of the positioning of standard and premium listing discussed above.

The FCA will now decide whether to proceed with the sovereign controlled premium listing category after its consideration of the responses, in conjunction with its broader review of the positioning of standard and premium listing.

Supporting Science and Technology Companies

In DP17/2 the FCA explored the effectiveness of UK primary equity markets in providing 'scale-up' capital and 'patient' capital, in particular in the context of supporting the growth of science and technology companies. The FCA asked what, if any, improvements could be made in the regulatory framework to facilitate this type of investment.

The feedback highlighted potential constraints on the availability of capital for early stage companies in the United Kingdom, predominantly market factors. In particular, respondents noted that the fairly binary success-or-failure outcome associated with an investment in these types of companies may be outside the risk appetite or investment mandate of many investors, and suggestions were made that market factors tended to favour the United States as a listing destination.

Respondents also pointed to both market and regulatory factors discouraging so-called 'patient' capital (investment based upon long-term considerations). Broadly, there was a suggestion that market regulation,

focused on facilitating secondary market trading, may promote short-termism and deter issuers with long-term needs from accessing capital markets (for example, listed companies' continuous and periodic disclosure obligations and the requirement for regular valuation requirements).

Clearly, many of the concerns raised are unconnected to the regulation of capital markets. However, insofar as points related to the regulatory framework, the FCA has undertaken to consider what steps can and should reasonably be taken, in further consultation with stakeholders.

Retail Access to Debt Markets

The FCA sought feedback on what steps could be taken to facilitate retail access to straightforward debt instruments issued by established corporates, particularly in an environment in which issuers can already raise finance relatively easily. At its core, the issue is whether corporates would issue retail tranches alongside their wholesale bonds if this did not involve additional regulatory requirements.

There was a general consensus among respondents that where issuers have a well-established track record, are of sufficient size, and are under an obligation to provide regular information to the market (for example, because they already have listed securities), standard bond programme documentation would be adequate disclosure for retail investors.

With this in mind, the FCA will continue to consider the case for identifying circumstances in which standard bond documentation should in principle be enough to meet prospectus requirements. This will of course need to have regard to the wider regulatory framework, including the EU Prospectus Regulation (which has relatively recently been reviewed with changes coming into effect in July 2019) as well as the product governance requirements of PRIIPS and MiFID II.

No Reform for Wholesale Bond Markets

The FCA also consulted on the possibility of creating a listed wholesale bond multilateral trading facility ("**MTF**"). Respondents considered that, given the launch of a new debt MTF (the International Securities Market) by the London Stock Exchange earlier in 2017, further action from the FCA to facilitate a listing segment for a new wholesale bond MTF is unnecessary.

Based on this feedback, no further action will be taken on this proposal.

Standard Listing for ETFs

In DP17/2 the FCA proposed that there is limited rationale for premium listing of exchange-traded funds and that a standard listing may be more appropriate.

Respondents generally agreed with this proposal and accordingly, the FCA will now prepare rules for consultation to facilitate the standard listing of ETFs and discontinue premium listing of these companies.

Proposed New Guidance for Sponsors

Sponsor Regime

The sponsor regime applies to companies seeking to admit shares, or with shares already admitted, to the premium listing segment. Broadly, a sponsor's duties include:

- assessing the eligibility of a company for listing;
- providing guidance as to the application of the Listing Rules in connection with, amongst other things:
  - the initial listing;
  - further issues of shares;
  - related party transactions;
  - class transactions;
  - certain circulars produced in respect of share buybacks, refinancing or reconstructions;
- guiding directors in understanding and meeting their responsibilities under the Listing Rules, the Disclosure Requirements and the Transparency Rules; and
- acting as the channel for communications between the premium listed companies and the FCA.

Background

On 31 August 2017, the FCA published Primary Market Bulletin No. 18 ("**PMB18**"). PMB18 focuses mainly on proposed changes to the FCA's Knowledge Base – of particular note are the proposed Technical Notes relating to the provision of sponsor services.

Based on a review of the work conducted by sponsors to comply with certain Listing Rule obligations, the FCA published three draft Technical Notes (**UKLA/TN/718.1**, **UKLA/TN/719.1** and **UKLA/TN/720.1**) for consultation to help sponsors to fully understand the FCA's expectations for compliance with these obligations.

In addition, **UKLA/TN/708.3**, which relates to LR 8.4.2R(4) and sets outs the FCA's expectations of sponsors regarding financial position and prospects procedures, will be updated to align the language with the proposed new Technical Notes above, however the substantive guidance will not be changed.

Consultation closed in October 2017 and the FCA will now need to determine whether to finalise its proposed guidance.

Sponsors' Duty Regarding Directors of Listed Companies

LR 8.3.4R requires that where, in relation to a sponsor service, a sponsor gives any guidance or advice to a listed company or applicant on the application or interpretation of the Listing Rules or Disclosure Requirements and Transparency Rules (together, the "**Relevant Rules**"), the sponsor must take reasonable steps to satisfy itself that the director or directors of the listed company understand their responsibilities and obligations under the Relevant Rules.

> The sponsor must take reasonable steps to satisfy itself that the director or directors of the listed company understand their responsibilities and obligations under the Listing Rules and Disclosure Requirements and Transparency Rules. The proposed new Technical Note UKLA/TN/718.1 provides guidance on what the FCA will consider to be "reasonable steps" for the purposes of LR 8.3.4R.

The proposed new Technical Note UKLA/TN/718.1 provides guidance on what the FCA will consider to be "reasonable steps" for the purposes of LR 8.3.4R and indicates certain considerations that a sponsor should take to inform its decision, including:

- the type of sponsor service being provided. The FCA notes that the guidance required to be given in an IPO will typically be wider in scope than in the context of a class transaction;
- the nature of the listed company or applicant (for example, where the listed company operates in a specialist sector, is of an acquisitive nature or has multiple related parties); and

- the directors' level of understanding and their experience of complying with their responsibilities and obligations under the Relevant Rules.

In the event that a sponsor determines that there are gaps in the directors' understanding of the Relevant Rules, the sponsor will need to decide upon the most effective way of addressing these gaps. Examples given include:

- attending and participating at board meetings where presentations and memoranda are used to educate the directors on their responsibilities and obligations;
- discussing with directors examples of good practice and highlighting pitfalls by referring to FCA publications and guidance, as well as FCA Final Notices in relation to breaches of FCA rules by listed companies;
- working through illustrative scenarios with the directors to assist them in understanding the application of their responsibilities and obligations; and
- carrying out one-to-one training with a director if such director has limited knowledge or experience of the Relevant Rules.

Sponsors should also ensure that directors are provided with the opportunity to ask questions and, where it is apparent that further work is necessary, an appropriate follow-up should take place. Sponsors should also be mindful that the obligation to satisfy LR 8.3.4R will apply throughout the sponsor service from the time of any preparatory work until completion of the transaction.

Alternatively, where a sponsor comes to the view that there are no material gaps in the directors' understanding such that limited (or no) action is required on behalf of the sponsor, the FCA would expect the sponsor to be able to demonstrate how it came to this view (which may be based on previous experience with the individuals on the board). The FCA notes that simply relying on directors' questionnaires or comfort letters provided by the company or its lawyers, without an appropriate level of enquiry and challenge by the sponsor, is unlikely to be sufficient evidence to demonstrate that a sponsor has taken reasonable steps. Furthermore, a sponsor (in conjunction with its legal advisers) should review third-party materials to be presented to the issuer's directors to come to a reasonable opinion that the scope and content of these materials is sufficient and has been understood by the directors.

Finally, in UKLA/TN/718.1 the FCA takes the opportunity to remind issuers of the requirement under LR 8.5.6R to cooperate with sponsors by providing all information reasonably requested by the sponsor for the purpose of carrying out the sponsor service in accordance with LR 8. This reminder was prompted by sponsors and other advisers informing the FCA about instances where issuers have not allowed sponsors to attend board

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meetings, even though attendance at certain board meetings can be integral to a sponsor being able to satisfy its obligations under LR 8.3.4R.

In line with previous guidance on record keeping, the FCA uses the Technical Note to reiterate that a sponsor must document the steps taken to satisfy itself that the directors understand their responsibilities and obligations, and be able to provide the FCA with supporting evidence for the decisions it has made.

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Sponsors' Obligations on Established Procedures

LR 8.4.2R(3) requires that a sponsor must not submit to the FCA an application for admission to the premium listing segment unless it has come to a reasonable opinion, after having made due and careful enquiry, that (amongst other things) the directors have established procedures which enable the applicant to comply with the Relevant Rules on an ongoing basis. The rule sits alongside Listing Principle 1, which requires a listed company to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.

The proposed new Technical Note UKLA/TN/719.1 makes it clear that, whilst the sponsor should consider all of the Relevant Rules, a sponsor should be mindful of LR 7.2.2G (which provides guidance on Listing Principle 1) which states that listed companies should place particular emphasis on ensuring that they have adequate procedures, systems and controls in relation to identifying whether obligations arise under LR 10 (Significant transactions) and LR 11 (Related party transactions) and the timely and accurate disclosure of information to the market. A sponsor should also ensure that the procedures, systems and controls are in place from the point the company becomes a listed company.

The FCA makes it clear that LR 8.4.2R(3) requires sponsors to come to a reasonable opinion on an applicant's procedures, systems and controls and therefore a "one size fits all" approach will not suffice.

Instead, a sponsor should assess the circumstances and characteristics of the applicant and take into account other factors, such as the complexity and geographical spread of its operations, whether the applicant has a controlling or substantial shareholder, the applicant's use of third parties to fulfil its obligations and whether the applicant has prior experience of being a listed company.

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A sponsor should then systematically assess whether the procedures, systems and controls put in place by the applicant are established. It may do so by:

- reviewing documents setting out relevant policies and procedures and assessing the appropriateness of their design and documentation for the applicant and the requirement of the obligation;
- speaking with relevant employees of the company to understand how the procedures will be operated on a practical basis or, in some circumstances, it may be appropriate to examine the effectiveness of procedures by presenting an illustrative scenario and assessing how the procedures would work in practice;
- confirming that the procedures have been approved by the applicant and communicated to other relevant employees;
- confirming that systems are in place and assessing their appropriateness for the applicant and the requirement of the obligation; and
- reviewing the controls in place (such as arrangements to review compliance with procedures on a regular basis) and assessing their appropriateness for the applicant and the requirement of the obligation.

The sponsor will be required to maintain appropriate records in relation to its assessment of the procedures, systems and controls of the applicant.

Sponsors' Obligations on No Adverse Impact

LR 8.4.12R(2) requires that for a class 1 circular or a circular for a reconstruction, re-financing or purchase of own shares (that is required to include a working capital statement), a sponsor must come to a reasonable opinion, after having made due and careful enquiry, that the transaction will not have an adverse impact on the listed company's ability to comply with the Relevant Rules.

At its heart, this obligation is concerned with ensuring that the listed company has procedures, systems and controls in place at the point of completion of the relevant transaction that will enable it to meet the requirements of Listing Principle 1, including in relation to the financial position and prospects procedures of a listed company and its group.

The proposed new Technical Note UKLA/TN/720.1 stresses that sponsor services continue to the point of completion of the relevant transaction and notes that, for some sponsor services (such as class 1 transactions or

reverse takeovers) there may be a period of time between the publication of the circular (and therefore the sponsor's declaration under LR 8.4.12R(2)) and the completion of the transaction.

In assessing the impact of the transaction on the listed company's ability to comply with the Relevant Rules, a sponsor should have regard to the type of transaction being undertaken, the circumstances and characteristics of the company and, if applicable, the subject of the transaction, including:

- in the case of a class 1 acquisition, whether the target is a premium listed company (or listed in a jurisdiction with similar obligations), the experience of the directors and the complexity and geographical spread of the listed company and target's operations;
- in the case of a class 1 disposal, the extent to which the listed company relies on the business, assets or personnel that are the subject of the disposal to comply with its obligations;
- whether the transaction will result in new controlling shareholders, related parties and/or permanent insiders; and
- whether the transaction will result in changes to directors, PDMRs and/or other employees of the listed company who are responsible for performing the procedures, systems and controls for the purpose of Listing Principle 1.

The FCA indicates the following as indicative of its expectations:

- review and challenge by the sponsor of any board memorandum or integration plan prepared in connection with the transaction;
- the sponsor's presence at key meetings where the content of any board memorandum or integration plan are discussed and approved; and
- in the event that not all necessary enhancements required to protect the procedures, systems and controls of the listed company have been effected at the time of the sponsor declaration, the sponsor will have come to a reasonable opinion that the directors have formally committed to implementing the enhancements on a timescale that will ensure that the listed company will, following completion, be in a position to comply with its obligations when required.

The FCA notes that many takeovers are subject to timetables where there is only a short period between the listed company approaching the target and the publication of the circular and that such takeovers may be conducted in circumstances in which speed of execution and confidentiality of information are of paramount importance and, therefore, the sponsor may not be in a position to perform the same level of due diligence it could otherwise undertake. In this event, the FCA recommends that it may be appropriate to ensure that the listed company has interim arrangements in place with the target to ensure that it can comply with its immediate obligations upon completion. Particular focus should be placed on the procedures, systems and controls relating to identifying whether any obligations arise under LR 10 (Significant transactions), LR 11 (Related

party transactions) and timely and accurate disclosure of information to the market under the MAR.

In recognition of the fact that for certain takeovers access to information on the target will be limited, the FCA suggests that the sponsor should seek out the best information available to it for the purposes of forming its reasonable opinion under LR 8.4.12R(2). Where no non-public information on the target is available prior to the sponsor making its declaration under LR 8.4.12R(2), the FCA suggests that sponsors should consider what due diligence can practically be undertaken and whether it would be sufficient to underpin its declaration under LR 8.4.12R(2). Examples provided by the FCA of due diligence strategies in such an instance include:

- review of the target's publicly available accounts and comparing them to the listed company's accounting policies, reporting currency, reporting frequency and financial year-end;
- review of any published details on corporate governance arrangements; and
- review of public announcements for adequacy of compliance with the Relevant Rules.

Again, the FCA requires that appropriate records are maintained by the sponsor in relation to its assessment that there has been no adverse impact.

Other Proposed Guidance

Other items covered in PMB18 include:

- *Quantified financial benefits statements (UKLA/TN/315.1)* – the FCA has published a draft Technical Note setting out its approach to the inclusion in prospectuses and circulars of quantified financial benefits statements prepared for the purposes of Rule 28.1 of the City Code on Takeovers and Mergers (the "**Code**") or confirmatory statements from reporting accountants and financial advisers for the purposes of Rule 27.2(d)(ii) of the Code. The FCA considers such reports and confirmatory statements to be expert reports and statements produced at the issuer's request under item 23.1 of PR Appendix 3 Annex I. Therefore, the FCA states that they should be accompanied by an appropriate consent and authorisation statement or, in the case of inclusion in a class 1 circular, an appropriate consent statement.
- *Profit forecasts and estimates (UKLA/TN/340.2)* – the FCA has proposed an amendment to its Technical Note relating to profit forecasts and estimates, to provide guidance as to the matters to be considered when a profit forecast or estimate is invalid. If a profit forecast or estimate published prior to a prospectus is no longer valid, the issuer is not obliged to state the assumptions behind the forecast or estimate in a prospectus or class 1 circular nor, for a prospectus, to have an accountant report on it, but is required to make an assertion to disavow such profit forecast or estimate. In the proposed amendments to this Technical Note, the

FCA provides guidance as to what an issuer needs to demonstrate to the FCA in order to show that a forecast or estimate is no longer valid and includes a non-exhaustive list of typical factors given to the FCA to demonstrate invalidity.

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- *Exemptions from the requirement to produce a prospectus (UKLA/TN/602.2)* – the FCA proposes amendments to its Technical Note on the exemptions from the requirement to produce a prospectus to reflect changes to the current exemptions made by the new Prospectus Regulation (Regulation (EU) 2017/1129) that came into force on 20 July 2017. Under the new Prospectus Regulation, issuers who are admitting securities to trading on a regulated market that are fungible with securities already admitted to trading on the same regulated market, and that represent, over a period of 12 months, less than 20% of the number of securities already admitted to trading on the same regulated market, are exempt from the requirement to produce a prospectus. Our commentary on the changes to be introduced under the new Prospectus Regulation can be found here.
- *FRS 102 Cash Flow Statement Exemptions (UKLA/TN/635.1)* – FRS 102, which took effect in 2015, exempts investment funds that meet certain conditions from preparing cash flow statements in their annual financial statements. However, a prospectus that includes audited financial information prepared according to national accounting standards is required to include a cash flow statement under Annex 1 Part 20.1 of Appendix 3 to the Prospectus Rules. The FCA recognises that investment companies seeking to pursue a listing may be disincentivised from taking advantage of the FRS 102 exemption as a result of this regulatory dichotomy. To address this, the FCA reminds prospective issuers that it has the power to authorise the omission of information from a prospectus and that investment companies producing a prospectus which have not prepared a cash flow statement should contact the FCA at an early stage if they wish the FCA to consider a request to omit information.

Conclusion

The breadth of regulatory reform to the UK Listing Regime coming into effect shortly (or proposed to) means there is a lot of new information, rules and guidance for issuers, sponsors and underwriters to consider when planning transactions for 2018.

If you have any questions regarding any of these topics or would like to discuss their potential impact on your business, please contact any of the lawyers listed in this memorandum or your regular Davis Polk contact.