FCA publishes the final rules for the premium listing segment for sovereign-controlled commercial companies

19 June 2018

Introduction

On 8 June 2018 the UK Financial Conduct Authority (the "**FCA**") announced that it is taking forward its proposals to establish a new premium listing category exclusively for sovereign-controlled commercial companies. The new rules, which aim to make the UK capital markets more accessible to companies which are directly or indirectly controlled by a nation state, are set out in the policy statement ***"Sovereign controlled companies – Feedback to CP17/21 and Final Rules"*** ("**PS 18/11**").

There have been some refinements to the proposals that the FCA first published in its consultation paper 17/21 ("**CP 17/21**") in June 2017 (see our previous **Client Memorandum**), most notably concerning shareholder voting requirements for the appointment of independent directors and announcement obligations in connection with related party transactions. However, the new rules retain a number of the concessions from the existing premium listing requirements for commercial companies that were set out in CP 17/21 in order to attract sovereign-controlled commercial companies to London as a viable listing venue.

Issuers will be able to seek admission, or transfer, of securities to listing under the new category from 1 July 2018.

Background

The listing regime for the UK's Official List is divided into the premium and standard listing segments. The requirements for a standard listing stem from the relevant EU directives and regulations that apply to regulated markets across the EU. For admittance to the premium listing segment, an issuer is required to meet higher UK-specific standards that are intended to provide additional investor protection and promote shareholder confidence.

The premium listing segment is currently available only for listings of equity shares by commercial companies, closed-ended investment funds, and open-ended investment companies.

The new rules in PS 18/11 create a new category of the premium listing segment exclusively for sovereign-controlled commercial companies with the aim of attracting companies which, under the current regime, might otherwise look to the standard listing segment of the UK's Official List or decide to list on another venue. According to the FCA, the underlying reasons for the new segment are that sovereign owners tend to be different from private sector owners in their motivations and structure and the extent of their activities, and that investors who choose to invest in sovereign-controlled commercial companies are accustomed to assessing sovereign risk.

Key changes to the original proposals

PS 18/11 refines some of the original proposals of CP 17/21 to reflect feedback received by the FCA during the consultation period. The key changes to the original proposals are to reinstate two requirements that apply to other commercial companies with a premium listing for sovereign-controlled commercial companies in order to limit the differences between the two listing categories.

This means that sovereign-controlled commercial companies will have to comply with the existing requirements applicable to commercial companies with controlling shareholders for **the election of**

independent directors, which require an issuer to put any independent director's appointment to a vote of all shareholders and also to a separate vote of independent shareholders only. If the results of the two votes differ, there is a 90-day cooling off period after which the election can proceed subject to a further vote of all shareholders (LR 9.2.2E R and LE 9.2.2F R).

CP 17/21 had also proposed that sovereign-controlled commercial companies would not be required to comply with the **disclosure obligations for related party transactions** that are currently in place for premium listed commercial companies where the related party is a sovereign-controlling shareholder (defined below) or its associate. The FCA had previously suggested that an issuer's disclosure obligations under the Market Abuse Regulation (Regulation (EU) No. 596/2014) ("**MAR**") would be sufficient, but it now accepts that investors would benefit from information around related party transactions on a timely basis even where such information is not inside information.

Other than these changes, PS 18/11 broadly maintains the proposals in CP 17/21, including:

- disapplying any requirement for **shareholder approval** or **sponsor confirmations** for a related party transaction where the related party is a sovereign-controlling shareholder (defined below) or its associate;
- an exemption for a sovereign-controlling shareholder to enter into a **controlling shareholder agreement** with the issuer; and
- the ability for an issuer to **list depositary receipts on the premium listing segment**.

As in the FCA's original consultation, other features of the premium listing regime applicable to commercial companies will also apply to a sovereign-controlled commercial company.

Eligibility

Sovereign-controlling shareholder

In order to qualify for the new category, a commercial company must have a "**sovereign-controlling shareholder**", which is defined in the new rules as a shareholder:

- who is a sovereign or other head of state acting in his or her public capacity or a government or a department, agency or special purpose vehicle of that government; and
- who exercises or controls 30% or more of the votes to be cast on all or substantially all matters at general meetings of that company.

The definition is broadly the same as for a controlling shareholder under the existing UK Listing Rules (see "Controlling shareholders" below) save that in the definition of sovereign-controlling shareholder there is no reference to aggregating the interests held by parties acting in concert (which means that a sovereign shareholder could not rely upon interests held by concert parties to enable the issuer to be eligible for the new regime).

Issuers with a sovereign-controlling shareholder will be eligible to transfer from a commercial company premium listing into the new category provided approval is received from shareholders, which will involve a vote of all shareholders requiring the approval of not less than 75% of the shares voted on the resolution and a majority of the votes attaching to the shares of independent shareholders must have voted on the resolution (new LR 5.4A.4 R(3)(c)). Existing sovereign-controlled commercial companies with a standard listing will be eligible to transfer to the new category provided they publish an announcement giving notice of their intention to do so (new LR 5.4A.5 R(1) and (2)).

Shares or depositary receipts

The new rules allow depositary receipts over equity shares as well as equity shares to be listed within the new listing category (new LR 1.5.1 G(3)(b)). This is not currently the case for the other categories of the premium listing segment and PS 18/11 does not seek to change this.

For some issuers, depositary receipts will be the only way of accessing the new listing category if they also want the securities to be traded in CREST. Only shares of issuers incorporated in the UK, the Republic of Ireland, the Isle of Man, Jersey or Guernsey can be directly traded in CREST. Issuers from certain overseas jurisdictions can make use of depositary interests ("**DIs**") which are issued to the beneficial owners of the underlying shares in the issuer that are held on trust for them by a depositary. However, DIs are not an appropriate instrument for shares issued in jurisdictions where the local law does not recognise, or there is a risk that the local courts will not recognise, the concept of beneficial ownership of shares. Depositary receipts will typically be English-law governed instruments and can be traded in CREST, thereby providing a viable alternative for sovereign-controlled commercial companies who cannot have their shares (or DIs) traded in CREST.

Depositary receipts may in any case be an attractive option for sovereign-controlled commercial companies that do not wish to satisfy, or seek a derogation from, the 25% free float requirement for premium listed equity shares under the UK Listing Rules. The free float requirement for the premium listing segment is that all securities of the same class must be admitted to listing and 25% of that class (whether shares or depositary receipts) must be in public hands. Therefore, a sovereign-controlled commercial company will not be prohibited from listing a very small percentage of the total underlying equity capital in the form of depositary receipts, as long as those depositary receipts satisfy the free float test by reference to the total number of depositary receipts. The FCA is of the view that sovereign-controlled commercial companies listing on the new category are likely to be large enterprises able to issue in enough volumes to maintain ample liquidity.

A new eligibility condition and matching continuing obligation have been imposed on an issuer to ensure that the rights attaching to the underlying equity shares must pass through to the holders of the depositary receipts. These will require that the rights attaching to the underlying equity shares must be capable of being exercised by the depositary receipt holders as if they were the holders of the equity shares (new LR 21.6.8 R(1) and new LR 21.8.13 R(1)). They will also require an issuer to have arrangements in place to enable depositary receipt holders to exercise those rights (new LR 21.6.8 R(2) and new LR 21.8.13 R(2)).

For the avoidance of doubt, it must be the issuer and no other entity that will issue the depositary receipts in order to be eligible for the new category. The issuer will be required to appoint a sponsor for the purposes of the listing, and whilst a prospectus for depositary receipts does not require the inclusion of a working capital statement, the new rules require that if the issuer does not include the statement in the prospectus, it will have to publish it at the same time as the prospectus or listing particulars in an RIS announcement (new LR 21.6.14 R, new LR 21.6.15 R, new LR 21.8.27 R and new LR 21.8.28 R).

The new rules also try to preserve the spirit of the existing rules to enable depositary receipt holders to vote on matters relevant to a premium listing, whilst appreciating that the listed depositary receipts may not represent the entire underlying share class. As such, in the event of a class 1 transaction/reverse takeover, implementation of a buy-back or employee incentive scheme, an offer of shares at a discount of more than 10% to the market price, or the election of an independent director, the sovereign-controlled commercial company will be required to convene a general meeting of shareholders of the class of shares represented by the depositary receipts (new LR 21.8.5 G(3)-(5) and new LR 21.8.22 R(1)) and ensure that the holders of the depositary receipts are able to exercise their voting rights at such a meeting (new LR 21.8.23 G(1)). The only vote that will be limited to depositary receipt holders will be any vote to cancel or transfer the listing of depositary receipts to a standard listing (new LR 21.8.23 R(3) and (4)).

Sovereign-controlling shareholders will not be able to participate in votes to elect independent directors or to cancel or transfer the listing of the depositary receipts to a standard listing.

Controlling shareholders

For a commercial company to qualify for the premium listing segment, it must ensure that it can remain independent of any controlling shareholder. A "**controlling shareholder**" is broadly defined as a person who exercises or controls on its own, or together with any person with whom it is acting in concert, 30% or more of the votes able to be cast on all or substantially all matters at a general meeting of the company (LR 6.1.2A R).

To achieve this, the UK Listing Rules require that an issuer enters into a relationship agreement with a controlling shareholder, which includes prescribed provisions designed to ensure the issuer's independence and compliance with the UK listing regime (LR 6.5.4 R). Under the new rules, this requirement will not apply to a sovereign-controlling shareholder, but would apply to any other controlling shareholder of that issuer.

The FCA believes that, notwithstanding the absence of an agreement by the sovereign-controlling shareholder to be bound by the independence provisions, there will be sufficient safeguards for investors, including:

- as referred to above, any cancellation of listing or transfer of listing would require the approval of shareholders, excluding any controlling shareholders (new LR 5.2.5 R(2) and (2A) and new LR 5.4A.4 R(3)(d) and (e));
- the guidance as to whether an issuer is complying with its ongoing obligation to remain an independent business will explicitly state that the grant of security over its business in connection with the funding of the sovereign-controlling shareholder may indicate that the issuer does not satisfy its eligibility for listing requirements (new LR 21.6.10 G); and
- under section 75(5) of the Financial Services and Markets Act 2000, the FCA has an overarching power to reject any application for listing where it would be detrimental to investors. As such, even if a sovereign-controlled commercial company met all the UK listing requirements, the FCA would still have the power to deny the listing (CP 17/21, paragraph 3.41).

PS 18/11 makes clear that the FCA will keep under review the need for any rules surrounding any shareholder agreements between a sovereign-controlling shareholder and the issuer, presumably to prohibit the inclusion of obligations on the listed company that would threaten its independence. The FCA is of the view that no specific rules are necessary at this point in time but that they have an expectation that an issuer will make appropriate disclosure at the time of its initial listing (not least to satisfy the disclosure requirements in the Prospectus Directive (EU Directive 2003/71/EC)) and update such disclosure if the arrangements between the sovereign-controlling shareholder and the issuer change. The FCA has committed to monitor market practice in this regard.

Related parties

The premium listing regime imposes certain controls on commercial companies entering into a transaction with a "**related party**", which includes any shareholder of the issuer who is entitled to exercise, or to control the exercise of, 10% or more of the votes able to be cast on all or substantially all matters at a general meeting of the issuer.

These controls include:

- for larger transactions, where one of the ratios relating to the gross assets, profits, consideration or gross capital of the issuer and the target is at least 5%, the issuer must seek

shareholder approval from all shareholders other than the related party (LR 11.1.7 R - LR 11.1.9 R); and

- for smaller transactions, where all of those ratios are less than 5% but one exceeds 0.25%, the issuer must announce such transaction and have an investment bank, acting as the issuer's sponsor, confirm in writing that the terms of the transaction are fair and reasonable as far as the shareholders of the issuer are concerned (LR 11.1.10 R).

As mentioned above, in light of feedback received during the consultation period, the FCA has decided not to disapply the related party regime in its entirety for transactions between an issuer and its sovereign-controlling shareholder or its associates, although there will be no requirement to seek shareholder approval in such circumstances.

In addition to its obligations under the MAR to disclose inside information, a sovereign-controlled commercial company will, in respect of a related party transaction involving the sovereign-controlling shareholder or its associates, be required to publish an RIS announcement where one or more of the ratios explained above exceeds 0.25% (LR 11.1.11 R(3)(b)), with a requirement to meet the class 2 notification requirements if one of the ratios reaches 5% (new LR 21.5.1 R and new LR 21.5.2 R(1) and (2)).

Issuers will also be required to aggregate related party transactions with the sovereign-controlling shareholder and its associates over a 12-month period. If one of the aggregated ratios exceeds 0.25%, the issuer will be required to make an RIS announcement disclosing all of the transactions and if any of the aggregated ratios reaches 5%, such RIS announcement will have to contain the requirements of a class 2 notification in relation to the latest related party transaction.

The UK Listing Rules' requirements to obtain sponsor guidance on transactions with related parties, as well as sponsor confirmation in relation to *smaller* transactions with related parties, do not apply in the new regime for related party transactions with sovereign-controlling shareholders (unless the related party transaction is, or may be, a purchase by the issuer of its own equity securities or preference shares) (new LR 21.5.3 R and new LR 21.5.2 R(1)(b) and (d)).

It should be noted that the related party regime will apply to sovereign-controlled commercial companies for transactions with related parties other than the sovereign-controlling shareholder or its associates as it would for other premium listed commercial companies.

Remaining eligibility requirements and ongoing obligations

Other than as set out above, the rest of the UK Listing Rules, UK Disclosure Guidance and Transparency Rules and the MAR will apply to a sovereign-controlled commercial company with a premium listing. This means that, in order to list, an issuer will, amongst other things, need:

- a three-year financial history (LR 6.2.1 R);
- an ability to demonstrate that it will be carrying on an independent business as its main activity (LR 6.4.1 R);
- an unqualified working capital statement (LR 6.7.1 R); and
- sufficient securities to be placed in public hands (LR 6.14.1 R).

Once its shares or depositary receipts are admitted to listing, the issuer will need to comply with the continuing obligations for a premium listed commercial company, including requirements in relation to significant transactions and share buy-backs (LR 10 and 12) as well as, amongst other things:

- the requirements for periodic financial reporting (DTR 4 and LR 9.7A and 9.8);
- the vote holder and issuer notification rules (DTR 5);

- the requirement to make a corporate governance statement (DTR 7.2);
- the disclosure of inside information (MAR, Article 17); and
- the disclosure of dealings by persons discharging managerial responsibility (MAR, Article 19).

Given developments in other leading listing venues, it is noteworthy that neither CP 17/21 nor PS 18/11 contain any proposal or discussion around granting sovereign-controlled shareholders preferential voting rights over other shareholders, which are currently not permitted for a premium listed issuer in respect of matters relevant to a premium listing (LR 9.2.21 R).

Sovereign-controlled commercial companies could seek to provide a sovereign-controlling shareholder with special voting rights by seeking permission, under the existing LR 9.2.22 G(1), to modify the one share, one vote requirement on the grounds of protecting the national interest. Such derogations have historically been granted only to a handful of issuers, and given the FCA's apparent commitment to retaining the parity of voting rights for holders of premium listed securities, it would have to be presumed that a very compelling case would need to be made.

FTSE UK Index Series inclusion

Currently, only companies with equity shares listed on the premium listing segment are eligible to be included in the FTSE UK Index Series. Without changes to the FTSE UK Index Series eligibility criteria, while equity shares admitted to the new listing segment could be included, any listing of depositary receipts would be excluded. Sovereign-controlled commercial companies issuing equity shares would still have to meet the other criteria set out in the **FTSE Ground Rules**, including a free float requirement for issuers without UK nationality of greater than 50% which, given the nature of such issuers, may not be achievable.

Feedback to CP17/21 implied that a number of stakeholders wanted all securities on the new listing segment, whether or not they met the current eligibility criteria, excluded from the FTSE UK Index Series on the basis that passive investors in the FTSE UK Index Series would be exposed to a different type of risk from that which they had assumed. PS 18/11 is clear that the FCA is not responsible for the FTSE UK Index Series and that index providers subject to the **EU Benchmarks Regulation No. 2016/1011/EU** must take account of the need for the inputs to adequately represent the market each benchmark intends to measure.

It remains to be seen whether FTSE will follow the FCA's example and look to accommodate sovereign-controlled commercial companies' securities within the FTSE UK Index Series, retain the current rules or restrict access to all securities on the new listing segment. If, as expected, sovereign-controlled commercial companies are, in the main, large and already well-known names, it may well be the case that the availability of index inclusion is not a priority for them.

Exiting the new category

Where an issuer listed on the new category of the premium listing segment no longer has a sovereign-controlling shareholder, it will be required to move its listing to the commercial company category on the premium listing segment or to the standard listing segment, or otherwise delist (new LR 21.4.9 G).

In these circumstances, if the issuer chooses not to keep its listing on the premium listing segment, this will require a shareholder vote which will exclude all non-independent shareholders (new LR 5.2.5 R(2) and (2A) and new LR 5.4A.4 R(3)(d) and (e)). If the issuer has listed depositary receipts, it will be required to move to the standard listing segment or delist, as depositary receipts cannot currently be listed on the premium listing segment other than in the sovereign-controlled commercial company category.

Stakeholder reaction

Reaction to the new rules has been mixed. The *Investment Association*, which represents UK investment managers and had been critical of the initial proposals, has reacted favourably to the refinements made to the final rules, but remains of the view that sovereign-controlled commercial companies should not be admitted to the FTSE UK Index Series. The *Institute of Directors*, which represents UK business leaders, has expressed disappointment with the new rules, particularly on the lack of a requirement for binding independent votes on independent directors.

It remains to be seen whether the new rules will serve their intended purpose to make London the preferred listing venue for sovereign-controlled commercial companies and, if it does, how investors will respond to any listings on the new segment.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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