

## Enhancing the Effectiveness of the UK Listing Regime – Feedback and Further Consultation

November 7, 2013

On November 5, 2013, the UK Financial Conduct Authority (the “FCA”) published near final rules and a further round of consultation on enhancing the effectiveness of the UK Listing Regime (CP13/15). The paper develops the proposals published by its predecessor, the FSA, in its October 2012 consultation paper (CP12/25).

With corporate governance standards at several London listed issuers firmly in the public spotlight and a general downturn in equity capital markets issuance at that time, CP12/25 identified a wide range of issues relating to the quality of the premium listing segment (the FCA’s “super-equivalent” listing regime for companies traded on the main market of the London Stock Exchange), minority shareholder protection and free float requirements. It proposed a number of significant changes to the UK Listing Rules, which are the rules applying to issuers listed, or applying for listing, on the FCA’s Official List. Whilst the vast majority of changes are more relevant to commercial companies, a number impact investment companies also. The FSA’s CP12/25 was followed by a report from the Association of British Insurers in July 2013 on encouraging equity investment in the UK, whose recommendations echoed many of those set out in CP12/25.

The FCA has now finalised its policy position in relation to some of these changes but, in view of the responses received, has decided to undertake a further round of consultation on certain aspects of the revised rules. This further consultation period runs until 5 February 2014 and the FCA has indicated that it intends to implement the full package of measures in mid-2014.

### Key proposed changes to the UK Listing Rules

The proposals will have the greatest impact on premium listed companies (or new applicants for premium listing) with controlling shareholders. The proposed package includes three important protections for independent shareholders in these companies:

- a requirement for a premium listed company with a controlling shareholder to enter into an agreement containing certain provisions safeguarding the company’s independence, backed up by veto rights for independent shareholders, which would be activated where the company’s independence is compromised;
- additional voting power for independent shareholders when electing independent directors;
- enhanced voting power for independent shareholders where a company with a controlling shareholder wishes to cancel its premium listing.

Other key changes include:

- enhancements to the Listing Principles, including additional Listing Principles for premium listed companies and the introduction of two existing Listing Principles for standard listed companies;
- clarifications around the operation of the free float provisions;
- removal of the eligibility requirement that a new applicant for premium listing demonstrate control of the majority of its assets, focusing instead on the requirement to carry on an independent business as its main activity;

- an obligation on premium listed companies to notify the FCA of non-compliance with certain continuing obligations; and
- a tightening of the more relaxed eligibility requirements for mineral and scientific research based companies seeking a premium listing.

## Controlling shareholders and the relationship agreement

### Definition of controlling shareholder

A new definition of controlling shareholder has been introduced for consultation. A controlling shareholder would be a person who either on its own or with associates, together with persons “acting in concert” with them, controls 30% or more of the votes on all or substantially all matters at general meetings.

### Independence requirements

Where a premium listed company has a controlling shareholder, the new rules require a written agreement to be entered into between them to ensure that the company is able to operate independently of that shareholder. Although voluntary relationship agreements between issuers and their controlling shareholders have been a feature of the London IPO market for many years, the FCA is now requiring these agreements to meet certain standards.

The agreement between a premium listed company and its controlling shareholder will need to expressly provide that (i) transactions with the controlling shareholder and its associates are conducted at arm's length and on normal commercial terms; (ii) the controlling shareholder and its associates do not take any action that would prevent the company from complying with its obligations under the Listing Rules; and (iii) no controlling shareholder or associate will propose or procure the proposal of a shareholder resolution which is intended to or appears to be intended to circumvent the proper application of the Listing Rules. These provisions are referred to as the ‘independence provisions’.

As a continuing obligation, a premium listed company will need to comply with the requirement for such an agreement at all times. The company's annual report will need to contain a statement by the board of directors that the company has entered into the required agreement and that the independence provisions have been complied with throughout the financial year, or give a description of non-compliance (including confirmation that the FCA has been informed of such non-compliance).

### Enhanced oversight

The FCA is consulting further on new enhanced oversight measures if (i) a premium listed company has failed to put a documented agreement in place with any controlling shareholder; (ii) an independence provision contained in any such agreement is not complied with; or (iii) an independent director does not agree with the related statements in the annual report.

If any of these situations arise, all subsequent transactions with the relevant controlling shareholder must undergo prior independent shareholder approval, regardless of the size of the transaction, until the next annual report where the board is able to make a clean statement of compliance in relation to the entire preceding financial year. If implemented, this will mean that independent shareholders will be able to veto all transactions between the company and its controlling shareholder regardless of their size or nature, creating a powerful sanction against breaches of the new regime.

The FCA is not pursuing the proposals in CP12/25 to require material changes to the relationship agreement to be subject to an independent shareholder vote and for the agreement itself to be available in the annual report or elsewhere.

## Controlling shareholders and board composition

The “comply or explain” regime under the UK Corporate Governance Code stipulates that for FTSE 350 companies, at least half of the board, excluding the chairman, should be independent, and that the chairman should be independent on appointment. The proposed changes to the Listing Rules strengthen the influence of independent shareholders in relation to independent director appointments.

Premium listed companies with a controlling shareholder will be required to implement constitutional changes that provide for a dual-voting structure for the election of independent directors, with separate approvals by the shareholders as a whole and also by the independent shareholders. If the results of these two votes conflict, a further, single, majority vote may take place not less than 90 days later. This proposal remains unchanged from CP12/25.

However, the FCA is no longer proposing the requirement that the board of directors of a premium listed company with a controlling shareholder will need to comprise a majority of independent directors, as it accepts that the proposal could be disproportionate and that it is the quality of independent directors that is important rather than the number. As such, there is a new proposal for premium listed companies with controlling shareholders to disclose enhanced information to shareholders at the time that independent directors are put forward for election by shareholders, in particular to make them aware of any existing or previous relationship between the independent directors and controlling shareholders and to describe how the company has determined that the proposed director is independent.

The rules for companies with controlling shareholders impact both applicants at the eligibility stage for premium listing and on a continuing basis once listed (including existing premium listed companies).

## Transfer and cancellation of listing

As the protections of premium listing fall away after a listing is cancelled, the FCA is presenting a new proposal, alongside the option to retain the current rules, to give independent shareholders additional voting power when a company with a controlling shareholder wishes to proceed with a cancellation. In such circumstances, cancellation would require the approval of a majority of votes of the independent shareholders also. Similar rules would apply on a transfer from a premium listing to a standard listing.

## Other changes affecting all premium listed companies

### Free float

The Listing Rules currently require a company to have at least 25% of its shares in public hands (known as the ‘free float’ requirement). The FCA is consulting on new guidance to be more explicit about the limited circumstances where it may use its existing power to modify the 25% free float requirement where it considers that there is sufficient liquidity for the market to operate properly.

The revised guidance put forward is slightly less prescriptive than in CP12/25: the FCA will look at the number and nature of shareholders as one of the factors in determining whether a modification is appropriate (a number of 100 shareholders is no longer specified), as well as whether the expected market value of the shares in public hands at admission exceeds £100 million (previously £250 million). The reference in CP12/25 to a free float of less than 20% being acceptable only in exceptional circumstances has been removed as the FCA does not wish to set a new floor.

Amendments have been made to what are treated as “shares in public hands” – including guidance that shares subject to a lock up of longer than 180 days will be excluded from the calculation of the free float. The FCA is also proceeding with its proposed new guidance clarifying that individual fund managers in a group may be treated separately for free float calculation purposes, provided that investment decisions with regard to the acquisition of shares are made independently. The guidance will also clarify that

financial instruments that give a long economic exposure to shares but that do not control the buy or sell decision in respect of those shares would not be treated as an interest for free float calculation purposes.

### **Independent business**

The existing eligibility rule requiring a new applicant to demonstrate that it controls the majority of its assets and has done so for a three-year period will be removed. Instead the focus will be on the company being able to demonstrate that it will be carrying on an independent business as its main activity - which will be tested at the time of eligibility and will remain as a continuing obligation. The FCA is no longer proposing the eligibility requirement put forward in CP12/25, which would have required an applicant to control the majority of its business. The new rules will take into account the level of control an issuer has over its businesses as part of the overall assessment of whether an independent business is present. The FCA will add guidance describing a number of factors that may indicate where a company may fail to satisfy the independent business requirement.

### **Structural changes to prevent avoidance**

Two new Listing Principles will be introduced for premium listed companies: (i) all equity shares in a class listed must carry an equal number of votes; and (ii) where more than one class of shares is listed, the aggregate voting rights of the shares in each class should be broadly proportionate to the relative interests of those classes in the equity of the issuer. This proposal remains unchanged from CP12/25.

The FCA has also confirmed its intention to apply two of the current Listing Principles to companies with a standard listing (including those companies with listings of GDRs or debt securities), meaning that standard listed companies must now “take reasonable steps to establish and maintain adequate systems and controls” and “deal with the FCA in an open and co-operative manner”. Until now, the Listing Principles have applied only to premium listed companies.

In addition, to ensure that corporate structures cannot be used to evade the protections for shareholders provided by the Listing Regime, the FCA is proposing (subject to further consultation) a new requirement that only holders of premium listed shares may vote on matters that require shareholder approval by virtue of the company’s premium listing (that is, excluding votes of holders of unlisted share classes in the company). Examples include the need for shareholder approval for significant transactions and related party transactions.

### **Additional continuing obligations**

There are new continuing obligations including that (i) a premium listed company must notify the FCA without delay if it no longer complies with certain continuing obligations relating to eligibility or if there is any non-compliance with any of the independence provisions (as described above); and (ii) a company’s annual report must set out all the disclosures required by LR 9.8.4R (such as details of LTIPs) in a single identifiable section.

If a company finds itself unable to comply with any of the continuing obligations set out in LR 9.2 (which include eligibility requirements that have continuing effect and the new independence requirements, as well as compliance with the Disclosure and Transparency Rules and the Model Code, amongst other matters), it should consider seeking a cancellation of listing or applying for a transfer of its listing category. Early consultation with the FCA would be appropriate in these circumstances.

In addition, although the FCA is no longer pursuing its proposal to require more fulsome disclosures in relation to smaller related party transactions in a company’s annual report, it is consulting on changes to the regime for smaller related party transactions set out in chapter 11 of the Listing Rules. Changes proposed include removing its pre-vetting role in relation to such transactions and requiring that details of smaller related party transactions be announced to the market immediately rather than waiting for the next annual report to disclose them.

## Mineral and scientific research based companies

Historically, in light of the fact that mineral and scientific research based companies often do not have revenue earning records and may have unconventional corporate structures (for example, co-venturing on mineral projects), the eligibility requirements for such companies have been more flexible. However, the changes to the Listing Rules will mean that, in the case of both mineral and scientific research based companies, the rules relating to controlling shareholders will apply, as will the eligibility requirement that a new applicant is able to demonstrate that it will be carrying out an independent business as its main activity.

## Transitional provisions

A number of transitional provisions are proposed to smooth the introduction of the new rules. The FCA proposes that existing premium listed companies with a controlling shareholder will have a period of six months to put a relationship agreement in place, or amend an existing agreement to include the required independence provisions. The same period will apply to premium listed companies that acquire a controlling shareholder in the future. The FCA is proposing to give companies until the next general meeting (for which notice has not already been given) after the proposals are effective to change their constitutions to allow the election of independent directors under the dual voting structure, and to adopt the new dual independent director election arrangements. For the requirement that only premium listed shareholders can vote on the matters required by the listing rules that apply only to premium listed companies, a period of two years from implementation is proposed. And finally, the requirement for a standalone section in the annual report dealing with independence will apply to financial years ending after a three month period from the implementation date.

## Impact of the changes

According to the FCA there are presently some 50 premium listed companies that have a controlling shareholder or have structured themselves in a way that would not comply with the voting arrangements proposed. These companies in particular will need to work closely with their sponsors and other advisers to navigate the impact of the changes once they become effective. As to whether the changes will strengthen the premium listing brand as intended, this remains to be seen.

If a company is contemplating an IPO in 2014, it will need to take these requirements into account when formulating its corporate governance arrangements.

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