FCA IMPLEMENTS NEW PREMIUM LISTING CATEGORY FOR SOVEREIGN CONTROLLED COMPANIES

On 8 June 2018, the FCA announced it was taking forward the new listing category for sovereign controlled companies, with the new rules taking effect from 1 July 2018. The new rules, which are contained in Policy Statement PS 18/11, will allow sovereign controlled companies to obtain a premium listing of shares or global depositary receipts (GDRs) and benefit from modifications to the existing premium listing rules. In particular:

- sovereign controlled companies will not be required to enter into a relationship agreement with the sovereign; and
- the requirements to obtain a fair and reasonable opinion from a sponsor for all but the smallest, and exempt, related party transactions, and the need to obtain independent shareholder approval for the largest related party transactions, will not apply to sovereign controlled companies.

Background

In July 2017, the FCA published a consultation paper, CP 17/21, on the creation of a new listing category for companies controlled by a shareholder that is a sovereign country. The rationale for introducing a new listing category for such companies is that whilst these companies are able to meet with the vast majority of the requirements imposed by the premium listing regime, two particular premium listing requirements - the requirement for a controlling shareholder agreement and advance approval of transactions with the sovereign - can present practical obstacles to some sovereign companies. Rather than create a structural barrier that excluded such companies from obtaining a premium listing, the FCA is introducing a new regime which recognises that the relationship between a company and a sovereign controlling shareholder is likely to be different from that with other types of controlling shareholder, with sovereigns often having different motivations and constraints from other shareholders and issuers having a different or wider range of interactions with a state, or parts of a state, than they would with other controlling shareholders.

The FCA's final rules for the new category contain two key amendments to the proposals put forward in CP 17/21. Firstly, there will not be a requirement for

Key issues

- A new listing category is being introduced allowing sovereign controlled companies to obtain a premium listing of shares or global depositary receipts.
- Modifications to the existing premium listing rules will apply, in particular:
  - sovereign controlled companies will not be required to enter into a relationship agreement with the sovereign; and
  - the requirements to obtain a fair and reasonable opinion from a sponsor for all but the smallest, and exempt, related party transactions, and the need to obtain independent shareholder approval for the largest related party transactions, will not apply to sovereign controlled companies.
- A company must demonstrate that "substantive control" is being exercised by the State in question to be eligible for the new listing category.
- The new rules take effect on 1 July 2018.

companies to enter into a legally binding controlling shareholder agreement (i.e. a relationship agreement) with the sovereign. Secondly, there will not be a requirement for a company to obtain a fair and reasonable opinion from a sponsor for all but the smallest, and exempt, related party transactions, and the need to obtain independent shareholder approval for the largest related party transactions will not apply to sovereign controlled companies.

Key provisions of the new regime

Eligibility

In order to fall within the definition of a sovereign controlled company, a company will need to demonstrate that substantive control is being exercised by the State in question. In particular, the State will need to hold 30% or more of the voting rights of the company. The FCA has stated that a passive stake held by a sovereign wealth fund is unlikely to meet the requirement to demonstrate substantive control by the State. The State which is the sovereign controlling shareholder will need to be one which is recognised by the UK at the time of the application. There are to be no restrictions on eligibility based on the country of incorporation of the applicant company. Note, however, that companies that are not incorporated in the UK may not be eligible for index inclusion in the FTSE UK series.

Sovereign controlled companies will be required to comply with the higher regulatory standards applicable to premium listings rather than the standards applicable to a standard listing (such as appointing a sponsor and demonstrating that the company can operate as an independent business, having a three-year revenue earning track record, having sufficient working capital and having unqualified financial statements).

The new listing category will also be extended to companies listing interests in their equity in the form of GDRs as an alternative to the listing of their equity shares directly. An additional eligibility condition and continuing obligation will require that the rights attaching to the underlying equity shares must be capable of being exercised by the GDR holders as if they were the holders of the equity shares.

Investor protections

All the existing investor protections applicable to existing premium listings (commercial companies) will apply, subject to two specific modifications which the FCA considers appropriate for sovereign controlled companies:

- the requirement for there to be a controlling shareholder agreement (i.e. a relationship agreement) between the sovereign and the company will not apply. However, the rules requiring a separate shareholder resolution of independent shareholder on the election and re-election of independent directors will still apply to sovereign controlled companies; and
- whilst the sovereign controlling shareholder will be considered a related party, the requirement to obtain a fair and reasonable opinion from a sponsor for all but the smallest, and exempt, related party transactions, and the need to obtain independent shareholder approval for the largest related party transactions, will not apply to sovereign controlled companies. However, sovereign controlled companies will still be required to disclose details of any smaller and Class 2 related party transactions to the market at the time of the transaction on the same basis as conventional commercial companies. This is an express recognition of the fact that

sovereign countries are very different entities from private-sector controlling shareholders with different motivations. Investors will be left to make their own judgement of how the sovereign interacts with the company based on these market disclosures.

Transfers between premium listing categories

Under the new rules, companies with an existing premium listing (commercial companies) which satisfy the eligibility requirements for this new category are entitled to transfer their listing to take advantage of the new rules but require a vote of the independent shareholders in order to do so.

In circumstances where the State ceases to be a controlling shareholder, the company would be required to notify the FCA of that fact and transfer its listing to another listing category (subject to any necessary shareholder vote), failing which the FCA would either suspend or cancel its listing as it would no longer be eligible for inclusion in the sovereign controlled company category.

Depositary receipts

Whilst GDRs historically have not been eligible for premium listing, those issued in respect of the equity shares of sovereign controlled companies will be eligible for premium listing under the new listing category. In determining whether the 30% threshold for control in the definition of "sovereign controlled company" has been met, it will be calculated on the basis of voting rights attaching to the underlying equity shares.

As mentioned above, the new rules contain eligibility requirements and continuing obligations designed to ensure that the rights (and in some cases obligations) attaching to the underlying class of equity share must "pass through" to the GDR holder. So, for example, whilst a vote required pursuant to Listing Rule 10 on a significant transaction would be carried out at the level of the underlying class of equity shares, the voting rights must pass through to the GDR holders to enable them to exercise their rights as if they were a holder of the underlying equity shares.

Clifford Chance view

Feedback to CP 17/21

The FCA has acknowledged that the feedback to its consultation paper, CP 17/21, was divergent and polarised, being broadly split between the buy-side and others. Notwithstanding this, the FCA believe it is right to proceed with the new listing category subject to making two important modifications from the proposals as set out in CP 17/21:

- limiting the derogations from the controlling shareholder regime by requiring a separate shareholder resolution of independent shareholder on the election and re-election of independent directors; and
- requiring sovereign controlled companies to disclose details of any smaller and Class 2 related party transaction to the market at the time of the transaction (on the same basis as conventional commercial companies) rather than only having to disclose them in the company's next annual financial statements.

Free float and minority shareholders protections

The FCA has reiterated its position that the minimum free float requirement is included in the Listing Rules to ensure the orderly operation of the market

rather than being a requirement related to corporate governance matters. The FCA has acknowledged that it will typically take into account international investors when determining whether the 25% threshold has been met (whereas the rule expressly refers to the number of shares distributed to the public in one or more EEA States). The FCA also acknowledge that there may be a credible case that there is a liquid market in the shares of some very large companies with a free float of less than 25%.

With the new regime extending to GDRs, there is a possibility that issuers with very low free floats by reference to the total underlying equity capital of the company will be eligible. However, the free float requirements have always applied to a given class of securities rather than to the underlying equity capital and hence this was always a potential concern in relation to GDR listings.

Index inclusion

Whilst some respondents to the consultation paper raised concerns that the categorisation of the new regime as a "premium" listing would increase the likelihood of inappropriate companies being included in FTSE UK indices, the FCA has clarified that whilst it has supervisory oversight over UK-based index providers that are benchmark administrators, such as FTSE, the eligibility criteria and rules for inclusion are set by the relevant index providers. Hence the issue of index composition is distinct from eligibility for listing. Whilst premium listing is a requirement for inclusion in FTSE's UK indices, not all premium listed companies are eligible for inclusion as they do not meet all of the other relevant criteria for index inclusion, such as free float or nationality requirements. For example, FTSE requires a minimum 50% free float for non-UK incorporated companies. This means that, under FTSE's current rules, premium listing would not be expected to lead to inclusion in the UK series for many sovereign controlled companies that might wish to list in the proposed new category.

Sovereign wealth funds

The FCA indicated in CP 17/21 that a passive stake held by a sovereign wealth fund would be unlikely to meet the requirement to demonstrate substantive control by the State (though it would look at this on a case by case basis), and there is no further discussion on this issue in PS 18/11. As such, an entity with a sovereign wealth fund holding more than 30% of its equity shares will need to approach the FCA early in any potential IPO process to determine whether it will satisfy the FCA's requirements in relation to substantive control being exercised by the State.

Considerations for sovereigns in carrying out related party transactions

Notwithstanding the introduction of the new listing category for sovereign controlled companies with modifications to the related party transactions rules, such companies will still want to consider how internal governance procedures should apply to related party transactions.

Whilst approval by independent shareholders may not be required under the Listing Rules, as a matter of good corporate governance, should related party transactions above a certain size be referred to the board for consideration by a committee of independent non-executive directors? In order to discharge their fiduciary duties, independent directors may also wish to consider whether it is appropriate to engage a financial adviser to provide a private confirmation

that the terms of material related party transactions are fair and reasonable as far as the independent shareholders are concerned, even though this would not be formally required under the Listing Rules.

Material related party transactions will still be subject to prior shareholder approval pursuant to the significant transaction regime in Chapter 10 of the Listing Rules – however, the threshold at which prior shareholder approval will be required will be at a much higher level than would have applied under the related party transaction regime (25% under the significant transaction regime compared to 5% under the related party transaction rules) and the State would be able to exercise its voting rights on the shareholder resolution, greatly increasing the likelihood of the resolution being passed.

Further information

The new rules take effect from 1 July 2018 and are set out in Annex D to PS 18/11.

If you would like to discuss the impact of the proposals set out in PS 18/11 and what they might mean for your business, please contact your usual Clifford Chance contact or any of the authors of this note.

For a copy of PS 18/11 see https://www.fca.org.uk/publication/policy/ps18-11.pdf

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