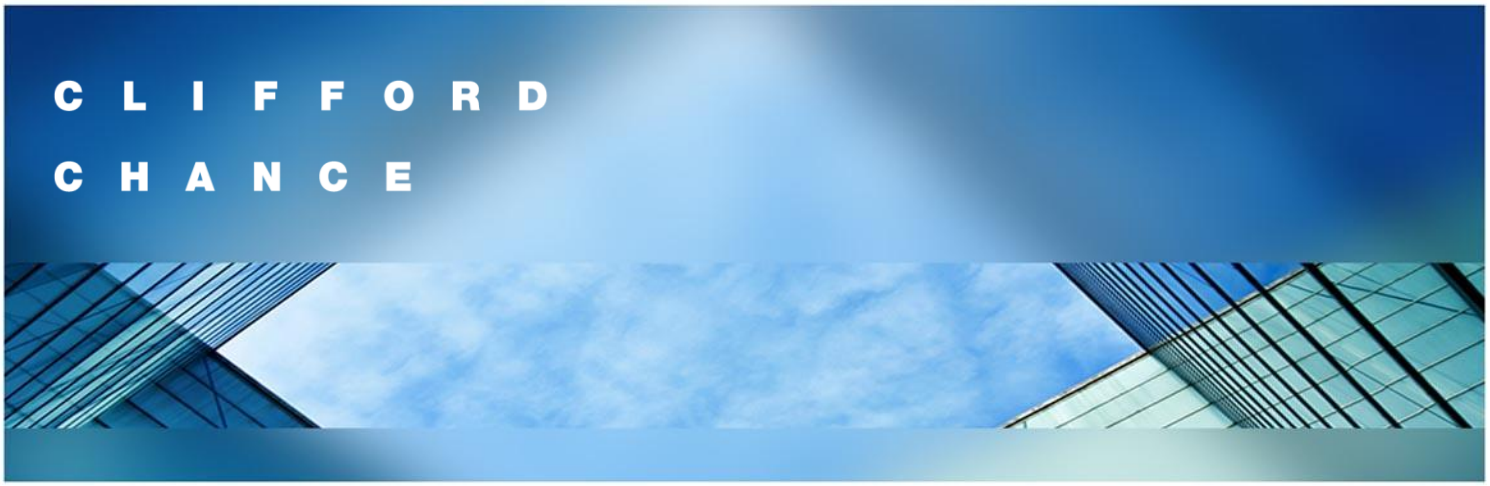


# FCA PUBLISHES DISCUSSION PAPER ON UK LISTING REGIME REFORMS

On 26 May 2022, the FCA published a discussion paper (DP 22/2) seeking views on replacing the existing Premium and Standard listing segments with a proposed regime for a single listing segment for equity shares in commercial companies. The proposals include a single set of eligibility requirements, mandatory continuing obligations and optional supplementary continuing obligations. The Discussion Paper also provides the FCA's views on the effectiveness of the sponsor regime and how this regime would apply within a single listing segment regime.

## BACKGROUND

The Discussion Paper is part of the broader review of the wider listing and financial ecosystem recommended by Lord Hill. By way of reminder:

- 19 November 2020 – the UK Listings Review, chaired by Lord Hill, was launched as a part of a plan to strengthen the UK's position as a leading global financial centre;
- 3 March 2021 – Lord Hill published his report, which included 14 recommendations;
- 19 April 2021 – the Chancellor announced the UK Government's intentions in response to the 14 recommendations made by Lord Hill;
- since April 2021 – the FCA has made new changes to the Listing Rules to:
  - make it easier for Special Purpose Acquisition Companies (SPACs) to list on the London Stock Exchange;
  - allow dual class share structures to be eligible within the Premium Listing segment; and
  - reduce the minimum level of shares in public hands (or free float) from 25% to 10%.

Another of Lord Hill's recommendations was to "re-brand and re-market" the Standard listing segment to make it more attractive to a broader range of issuers, including high-growth and innovative companies. In its Discussion Paper, the FCA indicated that it does not believe that it is practical to make changes to the existing regulatory regime for Standard listing that would address the key reasons cited for disliking the existing arrangements (i.e. the lack of FTSE index inclusion and poor perception of issuers of the Standard segment compared with the Premium segment).

### Clifford Chance view

The FCA's proposals in DP 22/2 would mark a significant change to the existing UK listing regime. Notably, the FCA have concluded that they may not be best placed to determine the specific criteria imposed on specialist or high-growth companies intending to list on the London Stock Exchange and have proposed a more disclosure-based approach, focused on providing flexibility for such companies whilst seeking to maintain adequate protections for investors. In the spirit of providing greater flexibility to issuers and to account for their specific business models, the FCA has also proposed introducing a set of mandatory obligations (focused on transparency and investor protection in areas of particular risk, e.g. where the interests of management or a significant shareholder, may be different to that of ordinary shareholders) and a set of optional supplementary obligations (where an issuer is able to explain why they are choosing to apply these (or not) in the context of their overall business strategy, e.g. if their strategy is to be particularly acquisitive and they want to benefit from flexibility in this regard).

The effectiveness of this new continuing obligations regime will be largely dependent on whether FTSE considers the proposed mandatory obligations as sufficient to protect the interests of institutional investors. If FTSE requires issuers to adopt the supplementary obligations in order to be included in its indices, the new regime will not be entirely different from the current Standard/Premium distinction. It remains to be seen whether FTSE will align itself with the spirit of the FCA's new proposals. We will likely have a better sense of FTSE's position once we see the outcome of the FCA's proposals for revising the prospectus regime in light of this more disclosure-based approach.

The Discussion Paper also asks questions about whether there is scope to improve the sponsor regime, which will be of interest to all investment banks which provide sponsor services.

## SINGLE LISTING SEGMENT WITH MANDATORY AND SUPPLEMENTARY CONTINUING OBLIGATIONS REGIMES

As such, the Discussion Paper sets out the FCA's proposal to move from the current two listing segments (i.e. Premium and Standard) to a single listing segment for equity shares in commercial companies. This would have consequences for companies wishing to IPO and also for existing listed companies.

Under the proposals:

- there would be a single set of eligibility criteria, which would include the need to appoint a sponsor at the time of Admission;
- issuers would have to follow a set of mandatory continuing obligations and would have the ability to opt into a second set of supplementary continuing obligations;
- the supplementary continuing obligations would be on an "all or nothing" basis (i.e. it would not be possible to opt in piecemeal to some but not all of the supplementary continuing obligations);
- issuers would be expected to seek the views of their current or potential shareholders when reaching a decision whether to opt into the supplementary continuing obligations regime;
- issuers seeking to IPO would need to seek out the views of potential shareholders as part of the pre-IPO investor marketing process on whether to adopt the supplementary continuing obligations regime;
- for companies that are already listed, the FCA is contemplating that shareholders be asked to vote at a general meeting of shareholders whether to opt in to the supplementary continuing obligations;
- moving in and out of the supplementary regime would be analogous to moving between listing segments under the current regime:
  - shareholders would vote to opt out of the supplementary regime once an issuer had elected to be part of it; and
  - there would be a FCA eligibility assessment before a company can move into the supplementary regime.

## ELIGIBILITY CRITERIA FOR THE SINGLE LISTING CATEGORY

The FCA's proposed starting point for the new eligibility criteria is to combine the current eligibility requirements under Chapters 2 and 6 of the Listing Rules, with certain eligibility criteria removed (i.e. those criteria where investors, through disclosures in the prospectus, can decide for themselves whether to invest based on the characteristics of each issuer on an individual basis). So, for example, the FCA is proposing to remove the following current Premium listing eligibility requirements:

- a three year representative track record;
- three years of audited historical financial information that represents at least 75% of the issuer's business; and
- an unqualified working capital statement.

In addition, the FCA is considering removing eligibility criteria which are duplicated as both eligibility criteria and continuing obligations, with a view to reducing unnecessary complexity in the rulebook. Eligibility requirements that could be removed on this basis include the requirements in relation to:

- control of the business;
- carrying on an independent business;
- controlling shareholders;
- externally managed companies; and
- constitutional arrangements related to the company's share structure and the rights associated with it.

These eligibility criteria could be replaced with a general requirement that the issuer has the ability to comply with the mandatory continuing obligations (and the supplementary continuing obligations, if applicable).

Finally, the FCA is considering extending the application of the Premium Listing Principles so that all companies within the single listing segment would have to comply with both the current Listing Principles and the Premium Listing Principles (even to those companies that currently have a Standard listing and hence are not subject to the Premium Listing Principles).

**Clifford Chance view**

In moving towards a more disclosure-based approach, the FCA is proposing to allow investors to decide whether to invest rather than impose stringent eligibility criteria. This should allow greater flexibility for a broader range of issuers, particularly newly established and high growth companies. The FCA recognise that they may not be best placed to determine what criteria should be imposed on specialist or high-growth issuers and cite the tailored listing route for scientific-research based companies which has not been used by any issuers since 2018 (when exemptions for these issuers were introduced by the FCA).

## CONTINUING OBLIGATIONS – MANDATORY AND SUPPLEMENTARY

Under the single segment regime proposed by the FCA, the continuing obligations in the existing Listing Rules would be recategorised into two groups: one mandatory for all issuers; another supplementary for relevant issuers that voluntarily apply to it. Obligations under the Market Abuse Regulation and the Transparency Rules would continue to apply as part of the wider continuing obligations requirements. The FCA would monitor and enforce against listed companies in relation to their adherence to all requirements that are applicable to the listed company, including the supplementary continuing obligations, where appropriate. The intention behind having a two tier system of continuing obligations is to address feedback that greater flexibility is required as some of the existing continuing obligations can hinder certain business models.

At a conceptual level, the proposed mandatory continuing obligations are those that focus on (1) transparency, and (2) protecting shareholders where management's, or a significant shareholder's, interest may be different to that of ordinary shareholders, thereby providing an appropriate baseline of investor protection and corporate governance.

The supplementary continuing obligations would be those Premium listing requirements that provide an enhanced role for shareholders to have a greater role in holding the company to account on an on-going basis. The supplementary continuing obligations should be those where an issuer is able to explain why they are choosing not to apply the additional requirements in the context of their overall business strategy. The three key areas which the FCA contemplate would be supplementary continuing obligations are:

- the controlling shareholder regime (i.e. the requirement for a relationship agreement with any controlling shareholders to safeguard the independence of the issuer);
- the independent business requirements; and
- the significant transactions regime, including the requirement for a shareholder vote in the event of a reverse takeover (NB. the FCA is asking for views on whether the class test thresholds should be revised).

Other existing Premium listing continuing obligations would fall under the mandatory regime, including:

- control of business requirements;
- related party transactions regime;
- one share one vote requirements (although see below in relation to dual share class structures);
- shareholder approval for the cancellation of listing;
- the requirements relating to rights issues and open offers, including the 10% discount rule;
- pre-emption rights;
- the rules around employee share schemes, discounted option arrangements; and
- dealings in own securities and treasury shares.

These proposals represent a more stringent regime for companies which currently have a Standard listing.

### Clifford Chance view

Whilst the proposed scope of the mandatory continuing obligations includes the related party transaction regime, the FCA is not proposing to include the current controlling shareholder requirements (which, amongst other things, require a Premium listed company to put in place a relationship agreement with any controlling shareholders to safeguard the independence of the issuer). This is an extension of the principle adopted by the FCA in 2018 when it extended the ability to list in the Premium segment to sovereign controlled issuers without the need for a relationship agreement, partly on the basis that investors would be able to make an informed investment decision based on the disclosures in the prospectus about the nature of the relationship between the issuer and the controlling sovereign shareholder.

One of the key benefits to companies with a Premium listing is the potential inclusion in FTSE's UK indices. As such, whether the FCA's proposal will be a success is largely dependent on whether FTSE will require adherence to both the mandatory and supplementary continuing obligations (or even potentially other criteria) as a condition to inclusion in FTSE's UK indices. If FTSE were to require adherence to both the mandatory and the supplementary regimes then, in practical terms, there would be little benefit in having a single listing category with two sets of continuing obligations (i.e. the outcome would likely be the same bifurcation of companies between those that are included in FTSE's UK indices and those that are not, similar to the current division between Premium listed companies and those that are Standard listed). Whilst the FCA has sought to reassure that it has been holding an open dialogue with index providers in relation to the proposals put forward in the Discussion Paper, ultimately it will be for the index providers, such as FTSE, to reach a decision in line with their own internal processes. As with the relaxation of the minimum free float requirements, our hope is that FTSE will reach a decision which supports the FCA's desire to reshape the listing regime in a meaningful way.

## DUAL CLASS SHARE STRUCTURES

The FCA is seeking views on how companies with dual class share structures should be treated under a single listing regime. In particular, whether only to permit the form of dual class share structures that were recently introduced as being eligible for Premium listing within the single listing segment (i.e. weighted voting rights which: (i) have a maximum ratio of 20:1; (ii) may only be held by directors or beneficiaries of a director's estate; (iii) can only be exercised on a vote to remove the holder as a director or following a change of control; and (iv) are time limited to a five year period). If this approach were adopted, the question would then be what would happen to Standard listed companies whose dual class share structures do not meet these requirements. The FCA has noted that transitional provisions might be required to allow issuers to retain a Standard listing, although it is not clear whether this would be a permanent grandfathering or a time limited transitional period requiring adherence by a specified deadline.

## SECONDARY LISTINGS, GDRS AND INVESTMENT COMPANIES

The FCA is proposing that the new single listing category would only apply to the listing of equity shares in commercial companies. In other words, the existing concept of a Standard listing would be retained for the following categories of listings:

- secondary listing of overseas companies;
- SPACs;
- preference shares;
- GDRs;
- closed-ended investment funds (listed under chapter 14);
- open-ended investment companies; and
- warrants, options and other similar securities.

## IMPORTANCE OF THE SPONSOR REGIME AND SCOPE FOR IMPROVEMENTS

The FCA continues to believe that sponsors will provide a key assurance role over a company's documentation and capability at the time of IPO (or when moving from the mandatory continuing obligations regime to the supplementary continuing

obligations regime). As such, the FCA intend that all listed companies in the new segment would require a sponsor in the same way as the current Premium listing regime does. This would be a departure from the current regime where a Standard listing can be obtained without the need to appoint a sponsor.

The FCA have also noted that some concerns were raised in feedback to their consultation paper CP21/21 (Primary Markets Effectiveness Review) in relation to the sponsor regime. In particular, the FCA may review the sponsor record keeping obligations and sponsor remuneration in order to reduce burdens on issuers or to better align a sponsor's incentives with the long-term interests of an issuer.

## Record keeping

The FCA notes that complying with the sponsor record keeping requirements can require a significant time commitment and there is no "one size fits all" for sponsors in terms of the systems and controls needed to comply with their obligations. There have been calls for a lighter touch or principles-based sponsor regime; however, in the context of record keeping, the FCA has questioned whether a reduction in the requirements on sponsors could:

- risk introducing inconsistency in the standard of record keeping among sponsors;
- increase the risk of inadequate records; and
- adversely impact the FCA's ability to supervise sponsors effectively.

In the Discussion Paper, the FCA calls for views on whether:

- specific elements of record-keeping requirements could be more proportionate;
- a reduction in requirements would undermine the benefits of the sponsor regime;
- the FCA Technical Note on sponsor record keeping obligations should be made clearer or more helpful; and
- market practice on record keeping is driving disproportionate standards and costs.

### Clifford Chance view

It is clear that the FCA and investors consider the sponsor regime to be a cornerstone of the UK listing regime, with companies required to engage the support of sponsor firms with appropriately qualified persons at the time of listing and for certain significant corporate transactions once listed. The sponsor regime provides a dual role of helping to advise companies but also ensuring that a company is able to meet the required regulatory standards, thereby protecting investors, which increases confidence in the market. However, the regime places a considerable burden on sponsor firms, particularly the need to keep records in a way that demonstrates how they have discharged their regulatory obligations in a manner which will withstand the FCA's scrutiny after the fact when subjected to periodic post-transaction reviews. There is a cost and reputational risk in performing the role of sponsor and if investment banks are to continue to be willing to provide sponsor services, more granular guidance on the FCA's expectations would be helpful as would a more proportionate approach which reflects the size, complexity and risk profile of the transaction in question.

## Conflicts of interest and fee structures

The FCA received feedback to its Consultation Paper CP21/21 which suggested that conflicts of interest could be better addressed if there was better alignment of a sponsor's fees with the long term interest of an issuer and that sponsor firms providing multiple services to a company should differentiate their sponsor and non-sponsor fees for transparency.

The FCA has indicated that it is not their place to specify how sponsors charge issuers. However, they are seeking views on whether more transparency or disclosure of how a sponsor's fees are derived would help to clarify the role of a sponsor or to avoid conflicts of interest that could adversely affect a sponsor's ability to perform its function. In particular, the FCA is seeking views on:

- whether more transparency of how sponsor fees are calculated would help issuers and investors better understand sponsor services and the role of a sponsor;
- if sponsor services and non-sponsor services should be more clearly differentiated; and
- what could be done to better align a sponsor's incentives with the long-term interests of an issuer and the interests of their investors (and if more information regarding the performance of the sponsor and the performance of the issuer, at IPO and thereafter, could help demonstrate this).

### Clifford Chance view

We note that some feedback was received in response to Consultation Paper CP21/21 that there should be better alignment of sponsors' fees with the long-term interests of an issuer to help avoid conflict of interests, with the fee based on the success of the IPO for the market and company share price (as opposed to being based, for example, on the size of the offering in the IPO). In addition, feedback was received that there should be transparency between sponsor and non-sponsor fees. In our view, as dedicated senior personnel are needed to provide sponsor services and there is considerable cost and reputational risk in performing the role, it is appropriate that a separate sponsor fee is paid and that issuers and investors understand the importance of the role so that they are willing to pay an appropriate level of compensation. As the sponsor performs a dual role which includes helping to maintain market standards and protecting investors, structuring compensation so that it is linked to the success of the transaction or the subsequent performance of the company share price does risk the perception that the sponsor's duties might be compromised. More granular disclosure of fees is something that has been required for some time under the UK Takeover Code and the general consensus is that this has not been an adverse development to advisers.

## Role of the sponsor regime within the wider reforms

If the FCA were to adopt a single listing segment, in practical terms the sponsor regime would be extended to all issuers of equity shares in commercial companies. As such, the FCA is seeking views on whether the role and purpose of the sponsor regime should generally remain as currently in place. A requirement to have a sponsor for all companies in the single listing segment would be a raising of standards for those companies which are listed, or in the future might opt for listing, in the Standard listing segment. However, whether a sponsor needs to be appointed after initial listing would depend on the level of continuing obligations which an issuer (and its shareholders) decides to follow. The FCA also note that the number of times that a sponsor would be required to be engaged after initial listing would depend on

where the threshold for the significant transaction regime is set, i.e. if the current 25% threshold were increased, there would be fewer transactions requiring a sponsor. Similarly, if the significant transaction regime were not part of the mandatory continuing obligations but only part of the supplementary continuing obligations, this would again reduce the number of times during an issuer's lifecycle at which a company would need to appoint a sponsor.

The FCA is seeking views on whether the sponsor regime should be reformed in the context of a single listing segment. In particular if:

- modifications are needed if the sponsor regime were to apply to all issuers under a single listing segment;
- there are any risks arising from longer periods of time between sponsor engagement;
- the role of sponsors after initial listing can be reduced without materially impacting the benefits gained from the sponsor regime; and
- the sponsor regime can be extended or applied more widely i.e. to other issuers of securities currently listed in the Standard listing segment.

**Clifford Chance view**

The question as to whether the sponsor regime could be extended or applied more widely (i.e. to other issuers of securities currently listed in the Standard listing segment) brings to mind the pre-2002 requirement that the listing of specialist securities, such as GDRs and bonds, needed to be accompanied by a declaration by a "Listing Agent" (which was not as onerous as the declaration which needed to be given by the sponsor at that time). Whilst we could see that the FCA and investors might see the benefit of having the concept of the sponsor regime extended to cover additional categories of securities, given the regulatory burden on sponsor firms, any such proposal may prove to be unattractive unless it was accompanied by a scaling back of the duties and responsibilities of the sponsor in connection with such additional categories of securities.

Whilst the FCA has asked for views on changing the "class 1" threshold for the significant transactions regime from 25%, is there the opportunity to streamline some of the requirements themselves rather than merely changing the thresholds (i.e. should the requirements for a working capital statement and confirmation of no adverse impact on the ability of the company to comply with the Listing Rules and the Transparency Rules be revisited)? The working capital requirement, in particular, can be onerous and have a significant impact on the lead time to prepare a class 1 shareholder circular.

## NEXT STEPS

The deadline for providing feedback to the FCA on Discussion Paper DP 22/2 is 28 July 2022. The FCA will then decide whether to issue a Consultation Paper or a further Discussion Paper in late 2022. Their target is to consult on new rules in early 2023 with a view to the new regime taking effect later in 2023 or in 2024. If you have any questions on the Discussion Paper or if it would be helpful to set up a call to discuss the proposal in greater detail, please reach out to the Clifford Chance contacts below.

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