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CLIENT BRIEFING

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UK LISTING REGIME REFORMS

FCA PUBLISHES FINAL VERSION OF NEW LISTING RULES

The FCA has published the final version of the new UK Listing Rules (UKLR), which will come into force on 29 July 2024. Designed to help improve the appeal of the UK's equity capital markets, the new rules represent the most far-reaching reforms of the listing regime in over three decades. In this briefing, we look at how the changes will affect companies that have ordinary shares already listed, or that may be considering a listing, and highlight areas in which the FCA has modified its original proposals in response to market feedback.

BACKGROUND

In CP 23/31, published on 20 December 2023, the FCA set out details of how it intended to reform the listing regime. At a broad level, the premium and standard segments will be collapsed into a single segment for equity shares of commercial companies (i.e., non-investment companies) (**ESCC**), whose rules will be based mainly on the current premium segment rules but with some eligibility criteria and continuing obligations dropped or simplified. Draft rules for the ESCC category were published at the same time, and on 7 March this year the FCA published a draft version of the whole UK Listing Rules Sourcebook that will replace the current Listing Rules.

Most of the key elements of the new UKLR, and especially the ESCC, that were laid out in CP 23/31 and in the draft version of the new rules were the product of extensive previous consultations. However, market participants were invited to submit views on the FCA's proposed approach, particularly on those elements that were new. In response to feedback, the FCA has made a number of modifications to its original proposals, particularly in relation to the rules around disclosures for significant transactions, the controlling shareholder regime and dual class share structures (**DCCS**).

The final version of the new UKLR and an accompanying Policy Statement (PS 24/6) were published on 11 July 2024. The box on the right summarises the key features of the new ESCC category. Below we provide further detail of the new UKLR and highlight areas in which the FCA has modified its original proposals.

Key features of the Equity Shares in Commercial Companies (ESCC) category

- Significant transactions (25% or more in any class test) will not require shareholder approval; but a company will have to make an enhanced announcement containing certain key information about the transaction and how it will affect the company.
- Shareholder approval will continue to be required for a reverse takeover and certain other specific types of transaction.
- Related party transactions (**RPTs**) will also not require shareholder approval; but the other main safeguards will remain, including the requirement for a sponsor's "fair and reasonable" opinion.
- For the purposes of both significant transactions and RPT rules, there will be additional guidance on which types of transactions are exempt on the basis that they are within a company's "ordinary course of business".
- A company with a controlling shareholder will have to demonstrate it can carry on business independently from its controlling shareholder. However, there will no longer be a requirement to enter into a controlling shareholder agreement. Instead, protection will be via disclosures and mechanisms through which directors can challenge certain resolutions proposed by a controlling shareholder.
- To make it easier to list, some eligibility criteria that currently apply on the premium segment will be relaxed; and companies will have more leeway to adopt a DCSS if they wish.
- The sponsor regime will be retained, but sponsors will have a role on fewer transactions.

The FCA plans to carry out a formal post-implementation review of the listing regime in five years' time to provide a more holistic assessment of the impact of the new UKLR. It has also reiterated that it intends to consult on the UK's prospectus regime (including the rules on whether and when prospectuses are required) later this summer.

MAPPING OF EXISTING COMPANIES TO UKLR CATEGORIES

Overall, five new listing categories will be created: *ESCC*; *Shell companies (SPACs)*; *Transition*; *Secondary listings*; and *Non-equity shares and non-voting equity shares* (such as preference shares and deferred shares). Various existing categories will be retained, including *Closed-ended investment funds*; *OEICs*; *Depositary receipts*; *Debt securities*; and *Warrants, options and other miscellaneous securities*. A table summarising how companies will be mapped to the five new categories can be found on page 115 of CP 23/31.

All existing listed companies were informed in May or June this year which UKLR category the FCA intended to map them to. Broadly speaking, all commercial companies currently listed on the premium segment will be mapped to the new ESCC category. All commercial companies currently listed on the standard segment will be mapped either to:

- the new Secondary Listing category, if the company satisfies the requirements for this category; or
- the new Transition category.

The Secondary Listing category is designed for non-UK incorporated companies that have a primary listing overseas. Its rules are very similar to the current standard segment and effectively maintain the standard listing rules; generally compliance with the rules of primary listing will be sufficient. In particular, companies in this category are permitted to report against a corporate governance code of their choice. UK companies with a primary listing overseas are not eligible to list in this category, with the FCA noting in PS 24/6 that this category is specifically designed to have limited scope and is designed to accommodate those overseas companies where either domestic company law or rules flowing from their 'primary' listing venue may make it more difficult to additionally meet certain requirements of the ESCC. UK incorporated companies that wish to have a secondary listing in the UK are expected to apply for a listing in the ESCC.

The Transition category has been created to enable existing standard segment companies to continue "as they are" for the time being, and its rules are based on the current standard segment rules. No other companies will be able to join the Transition category. It will have no end date, although the FCA may consult in future on closing it. Companies that are mapped to this category will be able to apply to transfer to the ESCC category or another category if and when they choose to do so – for example, if they wish to be included in a FTSE UK index (see below). However, the FCA will require companies in the Transition category that undertake a reverse takeover to transfer to the ESCC or another category in order to retain their UK listing. Transferring to the ESCC will require a sponsor to be appointed, who will need to be satisfied that the company will be able to comply with all the continuing obligations for the ESCC category, particularly the additional requirements around significant transactions, related party transactions and annual reporting obligations; but there will be a "modified transfer process" under which some of the usual eligibility criteria will be disapplied.

NEW ESCC CATEGORY: KEY RULES

Significant transactions

As originally proposed, an ESCC company that enters into a non-ordinary course of business transaction that represents 25% or more in any class test (which is currently categorised as a Class 1 transaction) will not need to obtain shareholder approval or publish an FCA-approved circular. Removing these requirements is designed to enable UK listed companies to compete for assets more effectively against global competitors.

In order to ensure that investors are given sufficient information, and to help ensure boards conduct a robust assessment of the benefits and risks attached to a transaction, a company will have to include in its RIS announcements some of the information that must currently be included in a Class 1 circular. These RIS announcements will not be subject to prior FCA approval (unlike the current regime for Class 1 circulars). Originally the FCA had proposed to require a company to include all the required information in a single announcement to be released on signing. However, many companies and other market participants raised concerns about the difficulty of pulling together all the information needed, particularly financial information on the target, and obtaining suitable comfort on its accuracy, by the time of signing.

In response, the FCA has moved to allow the flexibility for companies to take a "staged" approach to disclosure (although issuers who prefer to make a single notification at signing that complies with the enhanced disclosure requirements can do so, if the information is available at

that stage). Under the new UKLRs, the following announcements will be required in relation to a significant transaction:

- **Initial disclosure** - As soon as possible after the terms of a significant transaction are agreed, a company must release an announcement stating why the transaction is notifiable under the UKLR, giving key details about the transaction and how it will affect the company, and any other details it considers to be inside information. Essentially this will continue current market practice as the content broadly reflects what is required under the current Listing Rules for a class 1 / class 2 transaction, with some enhancements, along with a "sweeper" provision requiring the issuer to consider whether further information should be notified. This announcement must also include a statement from the board that the transaction is, in the board's opinion, in the best interests of shareholders as a whole.

- **Enhanced disclosure** - As soon as possible after (a) the terms of significant transaction are agreed and (b) the relevant information has been prepared or the company becomes aware of it, and in any event no later than completion of the transaction, the company must release an announcement containing certain additional non-financial information (including material contracts and significant litigation) and (for disposals only) financial information relating to the target of the transaction. Essentially this will replace the current requirement to include additional information in the Class 1 circular, although overall less information will have to be disclosed than at present.

- **Post-completion disclosure** – As soon as possible after the completion of a significant transaction, the company must release an announcement confirming that completion has taken place and that, except as disclosed, there has been no material change affecting any matter contained in the announcements described above.

In addition, the FCA has, in respect of acquisitions, removed the requirement to include historical financial information on the target. Further details of the disclosure requirements for these announcements are given in the box below.

Information to be included in the initial announcement

Among other things, the announcement must include:

a) details of the transaction, including the name of the counterparty

b) an explanation of the reasons for entering into the transaction

c) a description of the business carried on by the target

d) the consideration, and how it is being satisfied

e) the value of the gross assets and profits of the target

f) the effect of the transaction on the listed company, including any benefits which are expected to accrue to the company, and any risks to the company, as a result of the transaction

g) a statement of the effect of the transaction on the group's earnings and assets and liabilities

h) details of any service contracts of proposed directors of the listed company

i) details of any break fee arrangements;

j) for a disposal, how the sale proceeds will be applied

k) for a disposal, if securities are part of the consideration received, a statement as to whether the securities are to be sold or retained

l) details of key individuals important to the target

m) if the transaction is a joint venture, details of any exit arrangement

n) a statement by the board that the transaction is, in the board's opinion, in the best interests of shareholders as a whole

o) any further information the company considers relevant, having regard to the purpose of the significant transaction rules

Information to be included in the enhanced announcement

Among other things, the announcement will have to include:

a) Details of material litigation relating to the listed company or the target

b) Details of material contracts of the listed company or the target

c) Details of any significant change in the listed company's financial position

Information to be included in the enhanced announcement (continued)

In relation to disposals, the announcement will have to include:

- Historical financial information on the target extracted from the listed company's consolidated financial statements, being (i) the last annual consolidated balance sheet, (ii) the consolidated income statements for the last two years, and (iii) the consolidated balance sheet and consolidated income statement from the issuer's interim balance sheet (if published since the last annual financial statements).
- Specific rules apply where the target has been accounted for as an investment or using the equity method. Where information cannot be produced in accordance with the requirements or is not available, the announcement will have to explain how the value of the consideration was arrived at and include a statement that the board believes the consideration to be fair as far as shareholders are concerned.
- Details of any significant change in the target's financial position (as well as the listed company).

Both announcements

- Neither the initial nor enhanced announcement will have to include a working capital statement nor will there be a specific requirement to formally repeat or disavow any extant profit forecast made by the listed company or the target. But for both announcements a company will have to (as at present) take reasonable care to ensure that the information given is not misleading, false or deceptive and does not omit anything likely to affect its import.
- Certain additional information will be required if the company includes pro forma information, details of estimated synergies or other quantified estimated financial benefits expected to arise from the transaction. If an issuer does choose to include pro forma financial information, it will have to cite the sources of any unadjusted financial information included in the announcement and explain the basis on which the pro forma financial information has been prepared. But the pro forma financial information will no longer have to comply with the requirements in the prospectus regime.

Governance around significant transactions

Because the onus of deciding whether to enter into a significant transaction will now lie solely with the board, governance processes around transactions may need to be enhanced. In particular, companies should consider:

- consulting with major shareholders in relation to a proposed transaction, subject to the restrictions of the market abuse regime as to timing and selective disclosure of information;
- including warranties and other provisions in the transaction documents for the purpose of enabling the listed company to comply with its disclosure obligations - such as undertakings to provide certain information about the target that must be included in the enhanced announcement and warranties as to the accuracy of that information;
- whether additional information should be disclosed in order to address known or anticipated concerns of shareholders (i.e. the new 'sweeper' provision which requires companies to include in the announcement any further information that the company considers relevant, having regard to the purpose of the UKLRs on significant transactions);
- how the company's working capital position will be affected by the transaction, particularly if it is taking on new debt to finance the acquisition or it is facing large potential liabilities or uncertainties, and how the transaction will affect the going concern statement in the company's next financial results; and
- what steps should be taken to ensure that post-transaction the company can continue to (i) quickly and accurately assess its financial position and prospects and (ii) comply with the continuing obligations under the UKLR and its general disclosure obligations.

Smaller transactions, indemnities and JV exit arrangements

As originally proposed, no announcement will be required under the ESCC rules for a transaction that represents 5% in any class test but less than 25% in each test (which is currently categorised as a Class 2 transaction). But a company will need to consider whether it needs to disclose certain information in order to keep the market fully informed under its general disclosure obligations.

Giving a high-value, exceptional indemnity, and entering into or exiting from a joint venture arrangement, will continue to fall within the scope of the significant transaction rules, but shareholder approval will no longer be required. In relation to threshold for what is considered an exceptional indemnity, the final version of the new UKLR has moved away from the proposal in CP 23/31 and reverted back to the position in the current Listing Rules i.e. the maximum liability equals or exceeds 25% of the average profits of the listed company for the last three financial years (rather than the threshold being 1% of the listed company's market capitalisation) - although the FCA has the flexibility to disregard that calculation if it produces an anomalous result and modify that rule to substitute other relevant indicators of the size of the indemnity.

Other changes

- New guidance makes clearer the types of transactions that can (and cannot) be treated as falling within the "ordinary course of business" for the purposes of both the significant and related party transactions rules.
- The profits test has been removed on the basis that it frequently produces anomalous results.
- Agreeing to pay a break fee, however large, no longer of itself constitutes a significant transaction. Under the current Listing Rules, the requirement for a break fee in excess of 1% of the market capitalisation of the company to be treated as a class 1 transaction has operated as an effective cap for UK companies negotiating break fees. It remains to be seen whether, by removing the requirement for shareholder approval, UK companies will experience inflation in the break fees sought by counterparties in global M&A processes (for example, US market practice, where break fees are significantly higher, may start to influence market practice in the UK).

Related party transactions

Similarly, as originally proposed, an ESCC company will not need to obtain shareholder approval for a transaction with a related party. However, where a non-ordinary course transaction represents 5% or more in any of the class tests (larger RPT), the company will need to make a RIS announcement that includes certain prescribed information. Broadly this will be the same information as premium listed companies are currently required to disclose, although there will also be an explicit requirement to include "*any further information the company considers relevant, having regard to the purpose of* [the RPT rules]". The modified requirements that currently apply for transactions above 0.25% and below 5% in the class tests will be dropped.

As under the current premium segment rules, a sponsor will have to be consulted and confirm that the terms of the transaction are fair and reasonable as far as shareholders in general are concerned.

Fewer transactions will be caught by the RPT rules because a shareholder will be treated as a "substantial shareholder", and hence as a related party, only if they hold 20% (instead of 10%) of the voting rights in the company or of any company which is a subsidiary undertaking, parent undertaking or fellow subsidiary of a parent undertaking of that company). A "related party transaction" will continue to be defined by reference to a bespoke definition in the UK Listing Rules. The FCA decided against moving to a UK-adopted IFRS definition of "related party", which would have aligned the definition with accounting rules (principally IAS 24).

Sensibly, the FCA has decided that ESCC companies will not also have to comply with the RPT rules in DTR 7.3, which originate from the EU Shareholder Rights Directive and are similar but slightly different to the RPT rules in the Listing Rules.

When shareholder approval will be required

An ESCC company will have to obtain shareholder approval for a reverse takeover (which broadly means a transaction in which the listed company buys an asset at least as large as itself or that results in a fundamental change of business or in a change in board or voting control); delisting; non-pre-emptive issue of shares at more than a 10% discount; certain employee share schemes; and certain share buyback arrangements.

Companies with a controlling shareholder

An ESCC company with a controlling shareholder (broadly, a person who alone or with their concert parties holds 30% or more of the voting rights) will have to demonstrate it can carry on business independently from its controlling shareholder. The FCA has moved away from the position outlined in CP 23/31 and has dispensed with the requirement for a company with a controlling shareholder to enter into a controlling shareholder agreement (CSA). As a result of no longer requiring a CSA, the main additional protection built into the new UKLR is to strengthen the mechanism through which directors can challenge any shareholder resolution proposed by a controlling shareholder (or any of its associates) that a director considers is intended or appears to be intended to circumvent the proper application of the listing rules - where this is the case, a

circular is required accompanying the notice of meeting which contains the relevant shareholder resolution and must set out a statement by the board of the director's opinion in respect of the resolution.

Whilst the FCA has dispensed with the requirement for a CSA, in PS 24/6 it does acknowledge that that many issuers will have such agreements already in place or choose to put them in place because they consider them useful corporate governance tools and notes that the FCA continue to support CSAs.

As under the current premium segment rules, such a company will also have to ensure that its constitution allows for the (re-)election of independent non-executive directors to be subject to approval by a majority of independent shareholders as well as by all shareholders (a dual vote).

The focus of the new regime is therefore on disclosure, and the FCA notes that in the absence of regulatory requirements for CSAs, investors will have to determine whether the relationship between a company and its controlling shareholder(s) aligns to their risk appetite in the same way they have to consider other potential risks and opportunities.

Annual disclosure requirements

ESCC companies will have to make most of the annual report-related disclosures currently required of premium segment companies, including the extent to which they comply with the UK Corporate Governance Code and the extent to which they have disclosed all the climate-related information mandated by the TCFD framework. Board diversity disclosures will also be required.

But non-UK incorporated companies that currently have a secondary listing of shares on the standard segment will not have to start reporting against the UK Corporate Governance Code: as noted above, under the rules of the new *Secondary Listing* category they will be able to report against a code of their choice.

Sponsor regime

The sponsor regime will be retained but in a modified form. ESCC companies will require a sponsor when first applying for admission, and a sponsor declaration to the FCA will be required on IPO. But a sponsor declaration will not be required on a significant transaction.

A sponsor's role will therefore be primarily confined to transactions that involve a further issue of securities where a prospectus is required; reverse takeovers, larger related party transactions (where a sponsor must give a "fair and reasonable" opinion); transfers into or out of the ESCC category; and instances where a company needs to seek individual guidance, a modification or waiver from the FCA.

Eligibility criteria for admission

Generally, the eligibility criteria for the ESCC will be based on the current premium segment criteria. But a company will not be required as a condition of listing to:

- demonstrate it has an independent business and operational control over its main activities (but see above in relation to companies with a controlling shareholder);
- demonstrate a three-year revenue-earning track record. This will make it easier for high growth and pre-revenue companies to join the ESCC;
- ensure its historical financial information covers at least 75% of its business. This will make it easier for companies that have been very acquisitive to join the ESCC; or
- give a clean working capital statement.

By removing the requirement to have an independent business and to exercise operational control over main activities, the FCA hopes to make it easier for "franchise" type companies and strategic investment companies to list and remain listed. In respect of all these issues, appropriate disclosures will need to be included in the company's IPO prospectus, where they will be scrutinised by the FCA. Together, these changes are designed to provide a shorter and broader path to listing and to allow investors to decide for themselves whether and on what terms to invest in a company with an unusual history or structure.

Under the new UKLR, the board of a company applying for admission will have to confirm in writing to the FCA that the company has in place systems and controls that will enable it to comply with the listing regime. As a company's sponsor already needs to satisfy itself and make a declaration to the FCA to this effect, the new requirement is unlikely to add significantly to existing IPO procedures.

Dual class share structures (DCSS)

DCSS are controversial in the UK, with many buy-side investors keen to preserve the "one share, one vote" principle. Ultimately, though, the FCA believes that regulation of DCSS should be kept to a minimum, and investors should be left to assess and price in the risks on

a case by case basis. An ESCC company that wants to adopt a DCSS from IPO will therefore be given more leeway than is currently afforded to premium segment companies. In particular:

- the high vote shares will be able to cast multiple votes on any resolution proposed at any time, apart from a resolution to approve an issue of shares at a discount over 10%, a delisting, a transfer between listing categories or an employee share scheme;
- there will be no limit on the voting ratio; and
- except in relation to pre-IPO institutional investors (see below), there will be no time limit on a DCSS arrangement (whereas the FCA had originally proposed a ten year limit).

High vote shares may be held by any person who on the first occasion the applicant makes the application for admission to listing was (i) a director of the applicant; (ii) an investor in or shareholder of the applicant; (iii) an employee of the applicant or (iv) a vehicle established for the sole benefit of, or solely owned or control controlled by any person specified in (i), (ii) or (iii). As an expansion from the position set out in CP 23/31, those persons falling within (ii) may include any legal person (e.g. institutional investors), and not just natural persons - provided that the high vote shares held by any such legal persons will be subject to a ten year sunset. The FCA has stated that the ten years is a cap and is not intended to be an anchor point, noting that they expect it will be the case some companies choose to set shorter sunset clauses below the ten year maximum based on the views of investors.

These changes should help attract founder-led companies to join the ESCC - although in practice founders may need to accept tighter restrictions in order to attract (IPO) investors.

The FCA has also clarified that they consider the range of matters that holders of enhanced voting rights are permitted to vote on, does enable the holder to exercise 30% or more of the votes able to be cast "on all or substantially all matters at general meetings of the company", and therefore the holder will be treated as a "controlling shareholder": see above.

TRANSITIONAL PROVISIONS

The new UKLR include transitional provisions that deal with, among other things:

- "mid-flight" transactions by companies that were premium listed – i.e. where a significant or related transaction was under way immediately prior to the new UKLR coming into force but had not completed by that date;
- "inflight applicants" – i.e. where a company seeking to get its securities admitted to listing has made a complete submission to the FCA for an eligibility review for listing by 4pm on 11 July 2024 (the date the UK Listing Rules Instrument was published) but whose securities have not been admitted to listing prior to 29 July 2024 (i.e. the date the new UKLR come into force); and
- transfers between listing categories.

CLOSED-ENDED INVESTMENT FUNDS AND SPACS

The rules around closed-ended investment funds will continue largely unchanged. However, the significant and related party transactions regime for closed-ended investment funds will be aligned more closely with that for commercial companies, and will not require separate shareholder approvals or circulars for the majority of transactions. A transaction with the company's investment manager (including changes to fees or other renumeration) will continue to be treated as a RPT and require a sponsor to provide a "fair and reasonable" opinion if any class test is 0.25% or more; and, if the transaction is 5% or more in any class test and falls outside the scope of the company's investment policy, shareholder approval and an FCA-approved circular will also be required. The role of sponsors in relation to closed-ended investment funds will remain broadly unchanged.

For SPACs (shell companies), some of the current rules will be amended. In particular, to be eligible for the new *Shell companies (SPACs)* category, a SPAC's constitution will have to set a deadline of 24 months from admission for it to complete an acquisition; however, the FCA has provided flexibility for this initial period to be extended by 12 months up to three times, subject to shareholder approval (i.e. enabling an extension of 36 months in total beyond the first 24 months) and an additional extension of up to six months in certain circumstances (intended to address the scenario where a deal has been announced or is near to completion). SPACs will also have to ensure that money raised from public shareholders is appropriately ring-fenced. Transitional rules will apply to SPACs that are already listed. Refinements will also be made to the process that must be followed where a SPAC makes an initial acquisition (reverse takeover); but most of the other rules that apply on a continuing basis will be left unchanged.

INDEXATION

The FCA does not control the index rules, so neither CP 23/31 nor PS 24/6 deals with indexation. However, in March FTSE Russell published an overview of the provisional changes it expects to make to the Ground Rules for its FTSE UK Index Series. The overview gave market participants a strong indication of how the Ground Rules are likely to be changed and hence which companies will be eligible for inclusion in UK indices such as the FTSE 100 or FTSE 250. Subject to the ratification by the FTSE Russell Index Governance Board, in summary when the new listing regime comes into force (Day 1):

- All companies with shares in the new ESCC category or the Closed-ended investment fund category will be potentially eligible for inclusion in the FTSE UK Index Series. As all premium segment companies will be mapped to one of these categories, they will continue to be eligible for inclusion.

- Companies with equity shares in the Transition category or Secondary Listing category will not be eligible for the FTSE UK Index Series. Most companies that currently have a standard listing will be mapped to one of these categories so, as at present, they will remain ineligible for inclusion.

- FTSE Russell does not intend to introduce any new index inclusion requirements: for example, a company will not need to have particular corporate governance arrangements. However, as at present, if a company has or will have a DCSS, it will need to assess whether it can satisfy the requirement for more than 5% of voting rights to be in public hands.

Due to the automatic mapping of premium-listed companies to the ESCC on Day 1, there will be no immediate impact on the FTSE UK Index Series' composition. Companies with shares in the ESCC, Transition or Secondary Listing category will be eligible for inclusion in the FTSE Global Equity Index Series (FTSE GEIS) and associated indices. The immediate impact to the composition of the FTSE GEIS on Day 1 is therefore also likely to be minimal.

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