Bird & Bird

A return to laissez-faire? The FCA's surprising proposals to relax the Listing Rules.

June 2023

"Our rules cannot prevent every risk to shareholder value or be a substitute for investors carrying out their own analysis to support investment decisions"

Introduction

Currently, commercial companies listing their shares on the London Stock Exchange's Main Market must choose between two segments – a Standard Listing, which applies the bare minimum standards historically imposed by European legislation; and a Premium Listing, which includes more stringent rules, and is aimed at blue chip companies.

Over the past year, the FCA has been consulting on proposed changes to blend the Premium and Standard Listing segments into one segment for equity shares in commercial companies (ESCC). Overall, the extent to which they propose to relax the Listing Rules is quite surprising. So, for market participants it's worth looking back at the consultation process, considering the proposals in the round and getting ready for some material changes in 2024.

The FCA's approach addresses two broad concerns – that the Standard Segment is too lax and therefore can attract companies that would actually benefit from closer regulation (in spite of recent changes to increase the minimum market capitalisation to £30m and force smaller, higher risk companies to growth exchanges like AIM or AQUIS); and that the Premium Segment is too burdensome in its requirements and therefore off-putting, particularly to international companies whose domestic exchanges have lighter touch regulation. It's clear that London markets have been losing some ground, and the FCA and LSE have both been working hard to try to make a London listing more attractive.

The proposed new rules which, following further consultation this autumn, we would expect to be brought into force in the first half of 2024, remove a number of the "gold standard" requirements of a Premium Listing, relying instead on disclosure and transparency to protect shareholder interests; and raise the requirements for a Standard Listing. Companies with a current Premium Listing should find their burden and costs eased, as (for example) fewer corporate actions will require shareholder consent. Companies with a current Standard Listing will, after a transition period, find their compliance costs increasing. Investors will need to increase their vigilance, as more of a burden is being placed on them to do their due diligence on companies.

In its most recent consultation paper - CP23/10– the FCA explicitly (and repeatedly) acknowledges that the proposed new rules will pass greater investment risk and responsibility to investors, who must hold companies to account. They see this as a reasonable trade-off for attracting a more diverse range of applicants and bolstering the competitiveness of the UK's capital markets by lowering the cost and regulatory burden associated with a London listing. They have found that the incremental investor protections of a Premium listing are not considered a significant factor in investment decisions.

This is perhaps a surprising (but refreshing) approach for a regulator but, whilst we are supportive of the overall direction of these proposals, they do leave unanswered some important questions, particularly for overseas companies with an existing domestic listing who are seeking a dual listing in London.

The key changes are outlined below, and at the end of this article we include a comparison table summarising the main areas that will affect companies with an existing Premium or Standard Listing – at a glance, how are companies with an existing listing going to be affected?

Relaxed admission and ongoing eligibility requirements

In December 2021, the FCA introduced a minimum market capitalisation threshold on listing of £30m (up from a very outdated £700,000) but reduced the required 'free float' – the required proportion of shares in public hands – from 25% to 10%. These changes reflected the FCA's desire to raise the bar for listings, with a reasonably blunt (but quite effective) minimum size requirement; but they also reduced the barriers to entry created by the previous high free float requirement.

These requirements will remain for the single ESCC listing category, but the eligibility requirements for the Premium Segment that currently require a three-year financial and revenue earning track record (other than for certain specialist issuers, like minerals companies and scientific research-based companies) and a 'clean' working capital statement, will be removed. These changes will bring the Premium Segment level with the existing Standard Segment requirements, and make it easier for growth companies to list, albeit subject to the minimum £30m market capitalisation.

The removal of the requirement for a 'clean' working capital statement – i.e. that a new issuer must confirm that it has sufficient working capital for at least the 12 months following publication of its listing prospectus – is initially surprising. Currently, this is a requirement for admission to the Premium Segment, but not the Standard Segment, where a working capital statement can be qualified. However, anyone who has advised on the Standard Segment listing of a company with a qualified working capital statement will appreciate the rigour that the FCA attaches to their review of the qualifications, including a requirement for an extensive and well-reasoned explanation as to how any working capital shortfall will be addressed. This would typically necessitate the production of a working capital model and report, and the company's financial adviser will also want to be satisfied as to a company's solvency. We would not expect this rigour to diminish, so in practice, this relaxation is unlikely to materially reduce costs and seems unlikely to result in a higher proportion of newly listed companies failing.

Premium listed companies must also demonstrate that they carry on an independent business as their main activity, and that they exercise operational control over their main business. These listing and ongoing eligibility requirements help define the Premium Segment as a segment for commercial companies, rather than funds, but this can lead to uncertainty for some business models – for example franchise models, or companies making strategic investments in a number of businesses – and there are already concessions for certain industries, like mining and oil & gas. The FCA says that it wants to be open to diverse business models and more complex corporate structures – with clear segments for companies that own and operate a 'proper' business, funds and SPACs/cash shells. What is less clear is how they will treat strategic investors that do not have a typical fund structure.

Where a Premium Listed company has a controlling shareholder (broadly, one that controls 30%+ of the voting rights), certain protections must be put in place at admission, including the company and the controlling shareholder entering into a relationship agreement, designed to ensure that the

company can operate independently of the controlling shareholder. A relationship agreement would also typically be required by the financial adviser to a company seeking a Standard Listing, even though not a requirement under the rules. There are also ongoing minority protections, such as additional voting power for minority shareholders on the election of independent directors and enhanced protections where the company wishes to cancel its listing. The FCA proposes that for the new ESCC segment, relationship agreements should be optional - a company could elect not to have a relationship agreement but would then have to make specific disclosure of the consequential risks in its listing prospectus and annual report. This then puts the onus on shareholders to satisfy themselves as to the risk attached to the relationship between the company and the controlling shareholder. The enhanced voting rights for independent shareholders would remain, so this would be an increased burden for existing Standard Listed companies. In conjunction with the relaxation of the restrictions on related party transactions, explained below, this represents a significant shift in the burden of ensuring that a company is sufficiently independent of its major shareholders, although we expect that in practice sponsors will continue to require a relationship agreement to be put in place.

Treatment of Significant Transactions and Related Party Transactions

A perceived major impediment for Premium Listed companies is the requirement for shareholder approval of significant transactions that are not 'ordinary course' and certain larger transactions with related parties (e.g. directors and significant shareholders). These require a detailed shareholder circular, approved by the FCA. In the case of significant transactions, the cost, and particularly the time, required to obtain such approval, including debating with the FCA whether a transaction is 'ordinary course' or not, and the uncertainty of obtaining shareholder approval, can significantly hamper the ability of a company to execute a large transaction. This is a real concern – the requirements can put Premium Listed companies at a significant commercial disadvantage to unlisted competitors who don't need to satisfy these obligations.

Recognising this, the FCA are proposing to remove the requirement for an approved circular and shareholder approval for both significant transactions and large related party transactions, and instead require the company to make an announcement, with prescribed content. For significant transactions, the class test threshold will be 25%, and for related party transactions, 5%. This is in addition to the announcement obligations that all listed companies have under the Market Abuse Regulation.

In the case of significant transactions, the debate as to what is, or isn't, 'ordinary course' will remain, but the distinction will not be so critical where the ramification is simply an announcement obligation rather than a need to obtain shareholder approval. A company will be required to obtain guidance from its sponsor where there is any doubt as to the treatment of a particular transaction.

The way in which transaction size is assessed will also change slightly. Class tests will still be applied to test the size of the transaction against the size of the company, using metrics such as turnover, purchase price, market capitalisation, etc. However, the profit test, which often produces anomalous results, will be removed; and in the case of significant transactions (but not related party transactions) sponsors will have more discretion to apply modifications to the class tests (including using appropriate substitute tests) without having to request an FCA derogation.

In addition, for related party transactions that require announcement, the independent members of the board will have to include a statement that the transaction is fair and reasonable so far as the security holders of the company are concerned, and that the directors have been so advised by their sponsor.

This may seem like a surprising relaxation, but the FCA found that in practice, related party transactions that are large enough to require a shareholder vote are infrequent – just a few instances per year - and usually result in approval. Interestingly, setting the threshold at 5% means that shareholders in Premium Segment companies will lose the current assurance of announcement requirements for transactions between 0.25% and 5% - those transactions could actually be quite substantial, but would not require announcement.

Whilst this is a relaxation for Premium Segment companies, the requirement to consult with a sponsor, make a prescribed announcement and, in the case of a related party transaction, make a 'fair and reasonable' statement, confirmed by the sponsor, will increase the burden for companies with a current Standard Segment listing (although it is worth noting that this is not significantly different to the current AIM rules requirement).

Finally, the requirement for shareholder approval of a reverse takeover would remain. Currently, this is a requirement for the Premium Segment but not for the Standard Segment.

Dual Class Share Structures

In December 2021, the FCA finalised rules to permit a limited form of dual class share structures, to allow founders of growth companies to exercise enhanced voting rights and keep control of the company for five years. The FCA are considering expanding this further and making it more competitive with the US and other markets that inspired it, noting that around 45% of tech companies in the US have some form of dual class structure.

With a similar approach to the other relaxations, the FCA is seeking to limit the regulation of dual class share structures and allow the market (i.e. investors on listing) to dictate commercially desirable parameters, albeit with some boundaries to prevent abuse of the structure. Under the proposals, enhanced voting rights would apply to all matters at all times – not just matters relating to board and company control – with the exception only of issues of shares at a discount of over 10%; and would last for 10 years rather than five years. The enhanced rights attaching to founders' shares could only be held by directors and would automatically be lost if the holder ceased to be a director. There would be no cap on the voting multiple, again leaving the market to dictate what it considers to be reasonable.

Other Provisions

Cancellation of a listing will require an FCA-approved shareholder circular and the approval of a 75% shareholder majority. This reflects the current requirement for Premium Segment companies but will be a new requirement for Standard Segment companies that, curiously, are not currently required to obtain shareholder approval for delisting.

Placings and other share offerings that are not made pre-emptively are subject to shareholder approval where the discount exceeds 10%. Again, this reflects the current Premium Segment requirement, but will be an additional burden for existing Standard Segment companies.

Finally, ESCC Segment companies will be required to 'comply or explain' against the UK Corporate Governance Code, which is the UK's top tier governance code. Currently, Standard Segment companies can choose another governance code, such as the less stringent QCA code.

Transitional provisions

The FCA has not given a great deal of detail, but they recognise that some transitional arrangements will be necessary. In particular, they will allow companies affected by the proposals sufficient time to prepare and implement the necessary changes. Proposed changes would take place from a specified date, although we do not know when this is, or what length of notice companies will be given – just that it may involve transitional provisions "in certain areas". Where relevant, certain companies may seek to move to another listing category instead of the new ESCC category. Clearly, the least impact will be on companies with an existing Premium Segment listing.

What news for companies seeking a dual listing?

Historically, the Standard Segment was seen as a 'no frills' way for a company with an existing overseas listing to access the London markets without significant additional compliance cost. In our view, there is a good argument for a separate 'Secondary Listing' segment for companies with an existing listing on one of the main boards of a limited number of recognised overseas exchanges –

for example, NYSE, Nasdaq, ASX, TSX and some of the European exchanges – which already have high standards of regulation.

Previous consultation papers hinted that this may be considered but disappointingly, the current consultation paper does not devote much time to it. There is reference to a separate "Other Shares" listing segment, which would include secondary listings, but also seems to be aimed at companies that don't quite fit into the new ESCC Segment – for example, shell companies, open-ended investment companies that are currently bundled into the Standard Segment and other equity categories, like preference shares.

We think that an obvious opportunity is being missed here. What better way to attract quality overseas companies to access the UK's capital markets than if a lighter-touch listing category was made available for those that already had to comply with the requirements of a quality overseas stock exchange?

What this means for companies that are listed, or contemplating a listing, and for sponsors

Companies with an existing **Premium Segment** listing will have to do very little. Their regulatory burden will decrease. They simply need to educate themselves on the new rules as and when they come into force.

Companies with an existing **Standard Segment** listing will have to educate themselves on the new rules, and prepare themselves for any transitional period. They will have to budget for increased compliance costs. Certain companies, for example SPACs, cash shells or companies with fund-like structures, will need to consider whether the new ESCC Segment is right for them, or whether one of the other listing segments might be more suitable. In particular, SPACs and cash shells are expected to have their own, separate listing segment.

Companies that are **contemplating a London listing** should carefully consider the scope of the new rules, and the timing of their introduction. Smaller companies who might previously have considered a Standard Segment listing should consider whether an AIM or AQUIS listing would be more suitable, as the new ESCC segment represents an increase in compliance costs over the existing Standard Segment. In particular, a sponsor will now be required on listing, and for certain transactions. Larger companies should welcome the reduction in compliance costs and see London as a more attractive listing venue than it currently is.

Companies seeking a **dual listing** should watch this space. At first glance, the new ESCC Segment imposes greater burdens than the Standard Segment, which was typically the chosen home for dual-listed companies. However, given the FCA's focus on attracting overseas companies to the UK, we would hope that a new segment could be introduced to facilitate dual listings. In conjunction with the FCA's proposals to simplify the prospectus regime, this could make London much more attractive to quality overseas companies.

Sponsors should note that the sponsor regime will apply to all companies in the new ESCC category, whereas previously it only applied to companies with a Premium Segment listing. In practice, many larger Standard Segment companies retain a financial adviser anyway, but there will likely be an increased compliance cost where certain pieces of advice will now fall within the sponsor regime, and additional advice will be required, for example in relation to categorising significant transactions or assessing related party transactions. Sponsors should review their existing portfolio of client companies, and advise them accordingly; and of course may find additional opportunities with better Standard Segment companies that do not have an existing retained financial adviser. They should also review their engagement terms, which may require amendment.

Sponsors should also note the shift in emphasis away from the FCA giving assurance on certain matters (for example, determining whether a significant transaction is 'ordinary course') and towards the sponsor forming a view on the matter. These rules changes will likely require a period of

education for sponsors' client companies, so that they are familiar with the parameters of the new rules, and for the staff of sponsors. Again, terms of engagement may need to reflect the new regime.

Finally, given the reduction in the number of post-IPO transactions that will require the appointment of a sponsor, the FCA recognises that it may be harder for sponsors to demonstrate ongoing competence based on the current requirements. They are therefore looking to modify the requirements better to reflect the proposed relaxations of the rules, for example allowing other transactions (including transactions on AIM) to count towards sponsor competence.

It should also be noted that index providers will need to reconsider what criteria they use to determine index inclusion – these could conceivably be higher standards than those imposed by the single listing segment.

Ultimately, whether or not a particular stock exchange is attractive to companies will depend on a range of factors. The cost and burden of listing is one factor; as is the confidence that investors have in the particular exchange. We see the combination of the Standard and Premium segments, and the simplification of the Listing Rules, as a positive step in attracting quality companies to list in London and (for many companies) to reduce regulatory burden. However, the proposed Listing Rules changes need to be considered in light of the proposed changes to the prospectus regime, which is also currently ongoing as a separate exercise. To make London truly attractive to overseas companies, we would like to see a relaxation of the current requirement to publish a prospectus as a result of certain large issues of shares, and a streamlining of the listing process. This is perhaps one of the greatest impediments to the London listing of growth companies and overseas companies seeking a dual listing.

Consultation closed on 28 June 2023. The Bird & Bird ECM Team have responded to the consultation in relation to some of the points included in this article. Further consultation, together with draft rules, is expected in autumn 2023 and we look forward to also participating in that. The FCA are aiming for "substantial progress" by the end of 2023 with implementation being, presumably, in the early part of 2024.

The table below summarises how the proposed changes will affect companies with an existing Standard or Premium Segment listing. It also compares the proposed new rules against the current equivalents for AIM.

Proposal	Standard	Premium	AIM
Minimum market capitalisation of £30m	*No change*	*No change*	*No minimum*
Minimum free float of 10%	*No change*	*No change*	*No minimum, but Nomad would require at least 10%*
Removal of eligibility requirement for a three year financial track record	*No change*	*Reduced burden – three year track record currently required*	*No financial track record requirement*
Removal of eligibility requirement for a clean working capital statement on listing	*No change*	*Reduced burden – clean working capital statement currently required*	*Requires a clean working capital statement*
Simplification of eligibility and ongoing requirement of an independent business and operational control.	*No change*	*Reduced burden – likely to remove restrictions, or address within different listing segments*	*No strict requirements – these are a matter of Nomad discretion*

Controlling shareholders	*Increased burden – no Relationship Agreement required, but enhanced voting rights for minority shareholders on certain resolutions*	*Reduced burden – Relationship Agreements are optional, replaced by a disclosure requirement*	*No strict requirement, but typically Nomad would require a Relationship Agreement for a controlling shareholder*
UK Corporate Governance Code	*Increased burden - must now 'comply or explain' against UK Corporate Governance Code*	*No change*	*Must 'comply or explain' against a chosen suitable corporate governance code.*
Significant transactions	*No practical change – no requirement for shareholder vote, just prescribed announcement if >25%*	*Reduced burden – no requirement for shareholder vote, just prescribed announcement if >25%*	*No requirements beyond shareholder approval for fundamental changes of business*
Related party transactions	*Increased burden – no requirement for shareholder vote, but must give 'fair and reasonable' confirmation if >5%.*	*Reduced burden – no requirement for shareholder vote, but must give 'fair and reasonable' confirmation if >5%.*	*No requirement for shareholder vote. 'Fair and reasonable' confirmation if >5%*
Reverse Takeovers	*Increased burden – now requires shareholder approval.*	*No change – requires shareholder approval.*	*Requires shareholder approval.*
Discounted share issues	*Increased burden – now requires shareholder approval for discount >10%*	*No change – requires shareholder approval for discount >10%*	*No requirements.*
Cancellation of listing	*Increased burden – now requires shareholder approval.*	*No change – requires shareholder approval*	*Requires shareholder approval.*
Sponsor regime	*Increased burden – no current requirements to retain a Sponsor.*	*Reduced burden – less sponsor involvement in significant transactions*	*Nomad must be retained at all times.*

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Note to editors

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