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Enhancing the Effectiveness of the Listing Regime: FCA Consultation Paper CP 13/15

Introduction

On 2 October 2012, the Financial Conduct Authority (FCA) published a wide-ranging consultation paper (CP 12/25) on the effectiveness of the listing regime which proposed a number of changes to the Listing Rules, including in relation to controlling shareholders, corporate governance and free float requirements.

On 5 November 2013, the FCA published its long-awaited consultation paper CP 13/15, which sets out the FCA's feedback to comments received on CP 12/25 and certain final (albeit yet to be approved) rules based on those original proposals. CP 13/15 also contains certain revised proposals in respect of which the FCA is inviting consultation.

The consultation period ends on 5 February 2014. Depending on the results of the consultation, the FCA intends to implement the full and final package of measures by mid-2014.

1. Independence and Control

New Eligibility Requirement and Continuing Obligation

In CP 12/25 the FCA proposed replacing the existing eligibility requirement that the issuer must control the majority of its assets and carry on an independent business with two separate rules requiring it to demonstrate that:

- it controlled the majority of its business; and
- it would be carrying on an independent business as its main activity.

The FCA has confirmed that it will not be adopting the requirement that the applicant must control the majority of its business given that a number of respondents raised concerns that this could prevent issuers from, among other things, buying non-controlling stakes in subsidiaries in line with their strategy.

The FCA is retaining the requirement that the issuer should carry on an independent business. This requirement will apply to both new applicants for a premium listing (as an eligibility requirement) and companies with an existing premium listing at all times and on a continuing basis (with the exception of closed-ended and open-ended investment funds).

Guidance

The FCA has provided guidance setting out the factors that may be relevant in determining whether a new applicant meets the independence eligibility test. The guidance lists factors that may indicate that an applicant is unable to carry on an independent business, including situations where:

- it does not have strategic control over the commercialisation of its products;
- it does not have access to independent financing; and
- a majority of the revenue generated by its business is attributable to business conducted with a controlling shareholder.

The applicant must also demonstrate that it controls the entities in which it holds stakes. The FCA noted that the level at which a non-controlled stake would result in an applicant being considered to lack the requisite independence will be considered in the specific circumstances on a holistic basis, rather than on the basis of a set percentage test.

Mineral Companies

As proposed in CP 12/25, the independence eligibility requirement and continuing obligation will also apply to mineral companies, albeit that these companies will be exempt from the guidance which provides that an applicant may not satisfy the requirement for an independent business if its business consists primarily of holdings in non-controlled entities. This is due to the fact that mineral companies will be eligible for a premium listing if they have a reasonable spread of direct non-controlled interests (LR 6.1.10R(2)).

2. Controlling Shareholders

Against the backdrop of recent concerns over the protection of minority shareholders (particularly where there is a controlling shareholder), and as set out in CP 12/25, the FCA is proceeding with (and further consulting on) various new initial and ongoing requirements that aim to ensure that a premium listed company with a controlling shareholder is capable of acting independently of its controlling shareholder and its associates.

Definition of “Controlling Shareholder”

The FCA have set out a revised definition of “controlling shareholder”, which retains the percentage holding test of 30% (consulted on in CP 12/25), but is now extended to aggregate the interests of a controlling shareholder’s “associates”. Under the revised definition, a controlling shareholder would include any person who individually or together with any of its associates and concert parties exercises or controls 30% or more of the votes able to be cast on all or substantially all matters at the company’s general meeting (with certain voting rights being disregarded for the purposes of the calculation). The FCA is consulting further on the definition of “associate” (including tests to be applied to determine when an individual can be considered an “associate” of a company that is a controlling shareholder).

Relationship Agreement

The FCA is proceeding with the requirement proposed in CP 12/25 that a written and legally binding agreement be entered into between a premium listed company and a controlling shareholder so as to ensure the independence of the company. The overall framework for relationship agreements will include the following:

- **Content:** The mandatory content requirements have been reduced from those proposed in CP 12/25 to focus on provisions relating to the independence of the company. The FCA is not proceeding with its proposal in CP 12/25 that the controlling shareholder must not influence the day-to-day running of the company as it did not want to prohibit a shareholder from holding a board position. The revised requirements provide that the agreement must contain provisions ensuring that:
 - the controlling shareholder (and its associates) do not take action to prevent the company from complying with its obligations under the Listing Rules;
 - transactions with the controlling shareholder (or its associates) are conducted at arm’s length and on normal commercial terms; and

- the controlling shareholder (and its associates) do not propose a shareholder resolution to circumvent the proper application of the Listing Rules.
- **Duration:** The agreement must remain in place, and the independence provisions contained in it must be complied with, for so long as the premium listed company has a controlling shareholder.
- **Amendments:** There can be no changes to the relationship agreement in respect of the fundamental principles of independence. As a result, the FCA's proposal in CP 12/25 that all amendments to the relationship agreement be approved by the independent shareholders is no longer relevant.
- **Disclosure:** A copy of the relationship agreement need not be included in the company's annual report as proposed in CP 12/25. However, the FCA is proposing that the report contains certain disclosures relating to the relationship agreement. These include a statement by the directors that the company has entered into a relationship agreement, that the company and the controlling shareholder have complied with the mandatory independence provisions in the relationship agreement throughout the financial year and, if an independent director does not support the board's statements regarding the entry into a relationship agreement or compliance with the independence criteria, a statement to that effect.
- **Multiple controlling shareholders:** The FCA has said that it will regard each person whose shares are included in the calculation of whether a controlling shareholder exists to be a controlling shareholder in its own right. It has clarified however that the company does not need to enter into a separate agreement with each of its controlling shareholders if one of them can with reasonable certainty procure that its associates or those acting in concert with it will comply with the independence provisions in the agreement.

The FCA is proposing a transitional period of six months for existing premium listed companies with a controlling shareholder to comply with the relationship agreement requirement. The same period is proposed for companies that acquire a controlling shareholder following admission.

Sanctions for Breach of Relationship Agreement

The FCA is proposing the introduction of enhanced oversight measures which would require all transactions with the relevant controlling shareholder to be subject to prior independent shareholder approval in the event that the mandatory independence provisions in the relationship agreement are breached. These measures are proposed to be triggered in the following circumstances:

- where the company does not have a required relationship agreement in place;
- where the company breaches the independence provisions in the relationship agreement;
- where the company becomes aware that a controlling shareholder is breaching an independence provision in the relationship agreement (the company should have adequate systems and controls in place to identify such breaches); or
- where any independent director disagrees with the board's assessment of whether the obligations have been complied with.

It is proposed that the sanctions remain in place until the publication of the next annual report in which the board makes a clean compliance statement without any disagreement from independent directors. During this period, none of the safe harbours in Listing Rule 11 (Related Party Transactions), including those for small transactions and ordinary course transactions, would apply in respect of

transactions between the company and the controlling shareholder (effectively meaning that independent shareholders could veto any transaction between the company and the shareholder, regardless of its size). This would however be subject to the FCA's ability to exempt ordinary course transactions if the enhanced oversight measures would impede the operation of the company's business. The FCA is proposing guidance to clarify that it will only waive the enhanced oversight measures in exceptional circumstances.

3. Independent Directors

Whilst the FCA is not proceeding with its proposals in CP 12/25 regarding the board composition of a company with a controlling shareholder (although it notes that it may revisit this issue in the future), the FCA is proceeding with the requirement for a dual voting structure to apply to the appointment of independent directors. This would require any such appointments to be approved both by the shareholders as a whole and by the independent shareholders. In the event that the results of the votes conflict, a further vote of all shareholders may take place not less than 90 days later on a simple majority basis. Due to concerns raised regarding the status of an appointed director in this period, the FCA is proposing to introduce guidance clarifying that a director who has been appointed may remain in office until the second vote.

The dual voting structure must be provided for in the company's constitution although the FCA is proposing to delay this requirement until the next general meeting for which notice has not already been given (to allow companies time to amend their articles if necessary).

Increased disclosure requirements are also being proposed to ensure that, where the company has a controlling shareholder, independent shareholders are aware of factors that may be relevant to a determination of whether the proposed director is independent (including details of any historic or current relationship between the independent director and the company, its directors or any controlling shareholder).

4. Free Float

The FCA did not propose in CP 12/25 to increase the free float requirement. The FCA is however proceeding with its proposals to clarify the operation of the free float provisions to companies with a premium listing which include the following:

- Locked-up shares. Shares subject to a lock-up period of more than 180 calendar days (instead of 30 calendar days, as originally proposed) will be excluded from the free float calculation.
- 25% free-float requirement: The FCA is consulting on guidance setting out the factors that it may take into account when considering if a free float level below 25% will be acceptable. The draft guidance provides that the FCA will consider shares that are held in non-EEA States even where they are not listed, the number and nature of public shareholders and whether the expected market value of the free float shares is over £100 million at admission (rather than £250 million as originally proposed).

The FCA is not proceeding with its proposal that shares should be distributed to at least 100 public shareholders. The FCA has also removed reference to a free float percentage of 20% from the guidance regarding the circumstances where the FCA may accept a lower threshold, due to the concern that this may be viewed by market participants as the de facto permitted level of free float.

While the FCA had originally consulted on the above for premium listed companies only, it is now also consulting on whether the rules described above should be extended to applicants for listing on the standard segment (including issuers of GDRs).

5. Continuing Obligations

The FCA has set out a number of additional amendments to the continuing obligations of companies with a premium listing, which include the following:

Voting by Premium Listed Shares

To prevent share structures existing or being created which allow matters subject to a shareholder vote imposed by virtue of the premium listing regime to be decided by a company's holders of unlisted shares, the FCA has provided that certain matters requiring shareholder approval in the listing rules must be approved by holders of the premium listed shares. The FCA will have the power to modify this requirement in exceptional circumstances and is consulting on a transitional period of two years during which existing premium listed companies will not be required to comply with this requirement. A new applicant's constitution must allow the company to comply with this requirement.

Annual Report Disclosures

Any disclosures made pursuant to the Listing Rules in the annual report will be required to be set out in a single identifiable section (or a cross-reference table should be included to the relevant disclosures). The FCA is consulting on whether this should only apply to premium listed companies with accounting periods that end at least three months after the rule has been implemented.

Smaller Related Party Transactions

The FCA is consulting on whether smaller related party transactions (falling within the range of 0.25% to 5% on the class tests) should be announced via an RNS at the time they take place (rather than being reported in the company's next annual report and accounts).

Duty to Notify FCA of Non-Compliance With Continuing Obligations

The FCA will not proceed with its proposal that it be notified of a company's non-compliance with any continuing obligation. Instead, companies will be required to notify the FCA of non-compliance with those eligibility requirements with continuing effect, such as the requirement to carry on an independent business.

6. Listing Principles

The following changes to the Listing Principles will be introduced:

- **Application to standard listed issuers and re-characterisation:** The FCA has confirmed that Listing Principle 2 (adequate systems, procedures and controls) and Listing Principle 6 (dealing with the FCA in an open and cooperative manner) will now also apply to standard listed issuers (including debt and GDR issuers). The other four Listing Principles have been re-characterised as Premium Listing Principles and will continue to apply only to premium listed issuers.
- **Voting power of individual shares:** A new Premium Listing Principle will require each premium listed share in a class to have equal voting power, with the intention of preventing super voting shares being included in premium listed classes of shares via a company's constitution.
- **Aggregate voting rights of the shares in each class:** Another new Premium Listing Principle will require that, where a company has more than one class of equity shares admitted to a premium listing, the aggregate voting rights of the shares in each class should be broadly proportionate to the relative interests of those classes in the equity of the company (with the intention of preventing share structures which intend to allow control to rest with a small group of shareholders).

7. Cancellation of Listing

Although this was not consulted on in CP 12/25, the FCA has now decided to consult on the current rules relating to a cancellation of listing to address concerns raised by market participants. Currently, a listing may be cancelled by a premium listed company only after it has obtained the prior approval of not less than 75% of the holders of the securities as a vote in person or, where allowed, by proxy.

The FCA is consulting on whether the existing 75% threshold should be retained or whether, in cases where there is a controlling shareholder, the approval of a majority of the votes attaching to shares of those independent shareholders voting to be in favour of cancellation should also be required. In both cases, the FCA is proposing to amend the 75% threshold to require approval by a majority of not less than 75% of the votes attaching to the shares of those voting on the resolution.

The FCA is also consulting on the application of the above proposal in the context of the various routes by which a premium listing may be cancelled, including following a takeover offer, in the context of a scheme of arrangement and transferring from the premium segment to the standard segment.