

February 7, 2024

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Greg Norman

Partner / London
44.20.7519.7192
greg.norman@skadden.com

Frank Lech

Trainee Solicitor / London
44.20.7519.7000
franciszek.lech@skadden.com

Abigail B. Reeves

Associate / London
44.20.7519.7282
abigail.reeves@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

22 Bishopsgate
London EC2N 4BQ
44.20.7519.7000

FCA Preserves Key Tool for Activists in Listing Rules Reform

Activist shareholders had a busy 2023: The incidence of activist campaigns in Europe soared by almost 70% compared to 2022, according to data [compiled by Skadden and Activistmonitor](#). As we described in a [previous issue of *The Preferred Return*](#), UK-listed investment trusts were certainly a part of this trend, with several high-profile activist campaigns targeting such funds.

In this alert, we consider whether the Financial Conduct Authority's (FCA's) latest proposals for reforming UK's Listing Rules will address the vulnerability of UK investment trusts to activist campaigns. We conclude that while the proposed changes are relatively modest, by retaining the requirement for shareholder votes on key issues, the FCA is preserving an important tool for activist shareholders to deploy against the boards of listed investment funds.

The proposals also include reforms for open-ended investment companies (OEICs) and special purpose acquisition companies (SPACs), but they are not considered in this alert.

Listing Rules Reforms

The FCA published its latest consultation paper on Listing Rules reforms ([CP 23/31](#)) on 20 December 2023. The FCA labelled its proposals as the "most far-reaching reform" of the listing regime since the 1990s. The existing listing rules will be completely replaced by the new UK Listing Rules (UKLR) sourcebook, shifting towards a disclosure-based regime in an attempt to attract listings of growth-led companies in London.

The effect of the proposals on commercial companies is explored in depth in our January 8, 2024, [Capital Markets Alert](#). Compared to changes across other listing categories, reforms of the rules for investment funds are modest. The new regime essentially restates the current requirements, with slight changes regarding, among others, related-party transactions, significant transactions and listing of so-called "C shares."

Background: Investment Trusts in the UK

Despite their name, "investment trusts" are not actually trusts. They are closed-ended investment funds, structured as public limited companies and traded on a stock exchange. Currently, investment funds that are either seeking a UK listing or that are already listed must comply with LR 15 of the *FCA Handbook*.

Under FCA's proposals, LR 15 would be restated as UKLR 11. While most of the rules would remain the same, the FCA is proposing some minor changes, which we summarise below.

FCA Preserves Key Tool for Activists in Listing Rules Reform

Overview of Proposals

- **Listing category.** Despite calls to merge the closed-ended investment funds into the commercial companies category, the FCA decided to retain a separate listing category for the equity shares of closed-ended investment funds.
- **Significant transactions.** Significant transactions falling outside the scope of the fund's investment policy would continue to require prior shareholder approval and an FCA-approved shareholder circular. This is despite the fact that these requirements would be dropped for commercial companies. The threshold for a "significant transaction" would be equivalent to the current Class 1 threshold (*i.e.*, any one percentage ratio under the Class Test currently set out in LR 10 Annex 1 equal to or above 25%). The "Class 2" significant transactions would be dropped. A comparison of the current and proposed rules on significant transactions is set out in [Annex 1](#).
- **Related-party transactions.** Under the new rules, transactions with related parties would no longer require prior shareholder approval (or a shareholder circular), no matter their size, provided that they are within the fund's published investment policy. "Related party" here means the investment manager and their affiliates. However, other requirements for an announcement and a written confirmation from a sponsor would continue to apply. If a related-party transaction is not within the scope of the investment policy, and it reaches a percentage ratio of 5% under the Class Tests, it would continue to require an FCA-approved circular and prior shareholder approval. A comparison of the current and proposed rules on significant transactions is set out in [Annex 2](#).
- **Sponsors.** The role of sponsors under the new UKLR 11 would remain broadly the same. However, as for other listing categories, a sponsor appointment would now be required for requests for guidance or waivers from the FCA, as well as for the purposes of the significant transactions and related-party transactions requirements.
- **Directors' independence.** The new rules will clarify that notwithstanding an appointment to the board of more than one fund that has engaged the same alternative investment fund manager (AIFM), a director can be considered independent where that AIFM is independent of the fund's investment manager.
- **Listing C shares.** The FCA is seeking to clarify that where an investment fund issues a new class of shares (commonly known as C shares) that is convertible into an existing class of shares and carries voting rights prior to conversion, the C shares will be listed in the closed-ended investment funds listing category. If such shares do not carry voting rights, they will fall within the non-equity and non-voting equity shares category.

Implementation Timeline

The UKLR will be published in tranches. The first part was published alongside the Consultation Paper, with the second half coming later in the first quarter of 2024. The new UKLR 11, which will pertain to investment funds, will be published in the second tranche.

The FCA has requested comments on the proposals by 22 March 2024, with the final UKLR expected at the start of the second half of 2024. The FCA is currently envisaging a two-week implementation period before the new rules come into force.

Assessment of Changes

FCA's proposals do not portend a radical shift for UK-listed investment funds. The reforms are superficial rather than substantive, and the existing rules under LR 15 will largely be preserved, albeit in new robes. The crucial impact of the new UKLR 11 is not what is changing, but what will remain the same.

While generally requirements for shareholder approval are being scaled back in the UKLR — demonstrating a pivot towards a disclosure-based regime — UK-listed investment funds will continue to have to ask for shareholder approval for crucial matters such as:

- Material amendments to the investment policy.
- Changes to the management fee.
- Some related-party transactions.
- Some significant transactions.

The FCA maintains that this divergence reflects the specific nature of closed-ended investment funds; yet it also preserves an important tool for activist investors to use in their campaigns against the boards of listed investment funds.

As discussed previously in *The Preferred Return*, recent activist campaigns at UK investment trusts demonstrate that shareholder votes are a powerful lever for activist investors to exploit. By retaining the requirement for shareholder votes on these key matters, the FCA is baking in to the new Listing Regime a vulnerability to activist campaigns.

In consequence, the proposals do little to minimise the allure of UK investment trusts for activist investors. Accordingly, boards and investment managers should continue to stay vigilant to the first signs of activist campaigns.

FCA Preserves Key Tool for Activists in Listing Rules Reform

Annex 1: Summary of the New Rules on Significant Transactions

Any Percentage Ratio	Current Rules (LR 15.5.2R / LR 10)		Proposed New Rules (UKLR 11)	
	Outside Investment Policy	In Scope of Investment Policy	Outside Investment Policy	In Scope of Investment Policy
≥25% (Class 1)	<ul style="list-style-type: none"> - Regulatory information service (RIS) notification - FCA-approved shareholder circular - Prior shareholder approval 	No need to comply with LR 10	<ul style="list-style-type: none"> - FCA-approved shareholder circular - Prior shareholder approval 	No requirements
≥5% but each is less than 25% (Class 2)	<ul style="list-style-type: none"> - RIS notification 	No need to comply with LR 10	Class 2 notifications not carried forward	No requirements

Annex 2: Summary of the New Rules on Related-Party Transactions

Any Percentage Ratio	Current Rules (LR 15.5.4R / LR 11.1.10R)	Proposed New Rules (UKLR 11)	
		Outside Investment Policy	In Scope of Investment Policy
≥0.25%	<ul style="list-style-type: none"> - Sponsor fair and reasonable opinion - RIS announcement 	<ul style="list-style-type: none"> - Sponsor fair and reasonable opinion 	<ul style="list-style-type: none"> - Sponsor fair and reasonable opinion
≥5%	<ul style="list-style-type: none"> - Sponsor fair and reasonable opinion - FCA-approved shareholder circular - Prior shareholder approval - Notification 	<ul style="list-style-type: none"> - Sponsor fair and reasonable opinion - FCA-approved shareholder circular - Prior shareholder approval 	<ul style="list-style-type: none"> - Sponsor fair and reasonable opinion