

UK listing reforms: FCA asks investors to embrace greater risk to help reignite the capital markets

Last week, the Financial Conduct Authority (FCA) published a further consultation paper, [CP 23/10](#), setting out proposals to make the UK public markets a more attractive and trusted place to list companies.

CP23/10 takes a very clear position: the current listing regime is too onerous and restrictive. In the FCA's view, to entice companies on to the UK public markets, the rules need to provide more flexibility and investors must be willing to take on greater investment risk and responsibility in holding companies to account. The reforms are radical and represent a fundamental shift in approach from the FCA away from prescriptive rules to a disclosure-based regime.

The FCA recognises that changing the listing regime is not a cure-all to the current lethargy in the UK capital markets, but as other global exchanges are becoming more competitive, the FCA is focussed on ensuring the UK listing regime does not serve as a reason for companies to shy away from London.

Reform will take time but the FCA anticipates substantial progress will be made by the end of 2023. Further details on the reforms, including areas not covered by CP 23/10 will be fleshed

out in another consultation paper due in the autumn. The consultation closes on 28 June.

Summary of key changes

Key changes proposed by CP 23/10 include:

- a single listing segment with categories for different types of companies and securities
- no requirement for shareholder approval for significant transactions (other than reverse takeovers) or related party transactions (RPTs)
- a more permissive regime for dual class share structures (DCSSs)
- removal of certain premium listing eligibility requirements, including the 3-year track record and clean working capital statement, as well as modified requirements around control and independence eligibility requirements
- modified requirements around controlling shareholders with a "comply or explain" and disclosure regime
- a reduced role for Listing Rule sponsors after IPO

"[But] we must be upfront that these changes we are proposing to the listing regime will mean passing greater investment risk to investors and greater responsibility on to shareholders to hold the companies they own to account."

**Nikhil Rathi, Chief Executive Officer
Financial Conduct Authority**

	ESCC	Premium	Standard
Overarching			
Listing Principles	Enhanced principles with more onus on directors' role	↑	↑
Co-operation and information gathering	New requirement to enhance access to information	↑	↑
Sponsor regime	Applies, but role reduced after IPO	↓	↑
Eligibility			
3-year track record	Not required and no need for 75% of business (although complex financial history prospectus requirements will apply)	↓	-
"Clean" working capital	Not required	↓	-
Independence / control of business	More flexibility and focus on ability to comply with MAR, LR and TR	↓	↑
Controlling shareholders	"Comply or explain" and disclosure regime	↓	↑
Dual class share structures	Broadly permitted with 10 year sunset and anti-dilution protection on discounted share issuances	↓	↑
Pre-emption rights	Required	-	↑
Continuing obligations			
UK Corporate Governance Code	Required (potentially special rules for companies adhering to overseas code)	-	↑
Related party transactions	Disclosure and sponsor confirmation, but no shareholder vote	↓	↑
Significant transactions	Prescribed announcement for class 1s; no prescribed disclosure for class 2s; no requirement for shareholder approval or circular; no requirement for profits test	↓	↑
Reverse takeovers	Shareholder approval; readmission process; refine definition of reverse takeover	-	↑
Delisting	Shareholder approval and controlling shareholder regime applies	-	↑
Shareholder vote on discounted offers	Required	-	↑

Key: ↑ Increased obligations under the Listing Rules
 ↓ Decreased obligations under the Listing Rules
 - No substantive change

A single listing segment

The cornerstone of the new regime will be the replacement of standard and premium listing segments with a single listing category for commercial company issuers of equity shares (ESCC).

This will mean that existing commercial companies with standard listed ordinary shares (other than where the standard listing is a secondary listing) will have to “step up” to the ESCC category. However, as set out below, the eligibility and continuing obligations of the ESCC category are substantially less onerous than those of the current premium listing regime.

Aside from the ESCC category, there will be other listing categories for equity shares of closed ended investment funds (CEIFs), open ended investment companies (OEICs), special purpose acquisition companies (SPACs) and other equity shares (e.g., secondary listings and preference shares) and also, as is currently the case, for debt securities, depositary receipts, securitised derivatives and miscellaneous securities (e.g. warrants).

The FCA suggests that the current listing category for sovereign controlled commercial companies could be removed, depending on feedback. This seems sensible bearing in mind that there should now be sufficient flexibility within the ESCC category for any such company.

The FCA is also considering whether there is a need for a specific segment for companies who act as strategic investors by taking non-controlling positions in companies but which are not diversified fund vehicles. However, the FCA infers that it believes these sorts of companies may be accommodated within the ESCC category given the changes to the eligibility requirements around control of business and independence (see below).

It is also questionable whether there is need for a separate SPAC listing category, bearing in mind

that other jurisdictions such as the Netherlands do not have this and the overall desire to make the regime less complex. It will depend how prescriptive the FCA envisages eligibility rules for SPACs should be.

CP 23/10 focuses on the ESCC category with little guidance as to what the other listing categories will look like. It appears the requirements for these segments will be fleshed out in the autumn consultation, which is also expected to contain draft rules. As such, CEIFs, OEICs, SPACs, overseas companies with a secondary listing and debt issuers will have to wait to see what is proposed for them under the new regime.

Equity shares in commercial companies

Financial information requirements

The FCA is proposing to abolish the existing financial information eligibility requirements for premium listed securities, including the need for:

- 3 years of historic financials representing 75% of the company’s business up to a date no earlier than 6 months prior to publication of the prospectus (and 9 months prior to admission)
- a revenue earning track record
- a clean working capital statement

The requirements for specialist companies (for example those in the property, mining and oil and gas sectors) would then be obsolete and will therefore also be deleted.

These proposals are not as ground-breaking as they perhaps sound. Whilst they will mean that companies can list shares on the ESCC category before they have 3 years of financials (which is helpful), assuming the Prospectus Regulation Rules do not change, a company with a complex financial history (e.g., which has made a significant acquisition) will not be able simply to publish its own historic accounts. The FCA also

hints in CP23/10 that the new prospectus regime will set a new time limit on how fresh the financial information in a prospectus needs to be and it would not be much of a surprise if the 6 month / 9 month threshold is readopted in those rules having been deleted from the eligibility requirements.

Independence and control of business

The FCA is proposing a modified form of the current requirements for a premium listed company to demonstrate that it carries on an independent business as its main activity and has control of its business. The FCA believes this change will enable the ESCC category to welcome companies with diverse business models and more complex corporate structures.

Instead of focussing on ensuring a listed company has sufficient independence and control, the FCA proposes that the key eligibility threshold should be that a company can keep the market apprised of its operations, current trading position and performance, including by being able to obtain, identify and disclose inside information. This would assist a wide array of companies in obtaining a listing, including for example companies whose revenue is generated through franchise or royalty arrangements and companies which have non-controlling shareholdings in other companies.

Under the proposed new regime, companies will be required to demonstrate that they are able to gather the requisite information from their business, have in place appropriate record keeping arrangements for storage of relevant information and that information held outside the UK is easily accessible from the UK.

In addition, an IPO applicant will be required to confirm its ability to comply with its continuing obligations in the same way that a sponsor does. Listed companies will also be required to provide the FCA with contact details of key persons within the company such as the CEO, CFO and COO. The sponsor will be required to due

diligence the new requirements as part of its sponsor assessment of eligibility and ability to comply on an on-going basis.

Whilst the FCA does not reference its Final Notice against Cathay International Holdings Limited, it appears that much of these rules are intended to protect investors against a repeat of a similar set of circumstances, where a premium listed company was unable to obtain trading information regarding a Hong Kong listed subsidiary and therefore could not update the market properly.

Controlling shareholders

The Listing Rules currently require that a company with a controlling shareholder must demonstrate that it is independent of its controlling shareholder and that it has put in place a relationship agreement with any such shareholder.

CP 23/10 suggests that the FCA is willing to consider the removal of much of the current eligibility requirements around the independence of listed company from a controlling shareholder. It does say that a company must be able to demonstrate that it has not and is not required to grant security over its business in connection with a controlling shareholder. However, the FCA is seeking views as to whether to delete the other existing guidance around factors that demonstrate that a company is not independent of a controlling shareholder (i.e. that the controlling shareholder appears able to influence operations of the company outside of the company's governance structures or through its shareholdings, the controlling shareholder appears to be able to exercise improper influence over the company, and a company cannot demonstrate that it has access to financing other than from a controlling shareholder). It would simplify the rules if this guidance was removed, but at the same time it is difficult to imagine a company listing where these standards were not met.

The FCA is also proposing a new risk-based disclosure approach to controlling shareholders that puts the onus on shareholders to satisfy themselves that the nature of the relationship between the company and any controlling shareholder is within their risk appetite. The current requirement for a relationship agreement will instead be reframed as a “comply or explain” obligation so that if there is no agreement this fact will be disclosed in the IPO prospectus and annual reports. There will also be a requirement to notify the market if such an agreement is altered post listing.

It will be interesting to see how such a “comply or explain” approach works in practice. We assume that the starting point on most IPOs will be that investors will want to know that some form of relationship agreement is in place, as is already the case on AIM and the standard listing segment, and also in many European markets such as Amsterdam.

Dual class share structures (DCSSs)

The FCA is proposing a more flexible approach to DCSSs than the current regime which came into force for premium listed companies in December 2021. The proposals include:

- allowing enhanced voting rights on all matters at all times except for the issuance of new shares at a discount of more than 10 per cent. (which is much less restrictive than currently)
- a sunset clause of 10 years (rather than 5 years as currently)
- allowing enhanced voting rights to apply to shares held by a director (like the current provisions)
- the removal of limits on the maximum enhanced voting ratio (these are currently set at 20:1)

The FCA notes that it had considered requiring a holder of shares with enhanced voting rights to retain a minimum level of economic interest in

the company but that it thinks that this would add complexity, be difficult to monitor and may limit forms of DCSSs. The revised regime also includes the current requirement that the regime only applies to founder shareholders who are directors rather than any shareholders as is the case in the United States, which seems perhaps an arbitrary distinction.

The FCA considers that the 10 year sunset clause is key to shareholder protection, however, we query how much real benefit that will be to minority investors.

The FCA acknowledges that the DCSSs listed to date on the standard segment (and therefore with no prescribed restrictions) have developed as a result of pre-IPO discussions with investors, who will ultimately decide what they are willing to live with.

There must be an argument that if DCSSs are to be accepted as a concept the rules should remain silent on sunset clauses (and for that matter all other mechanics around DCSSs) and instead the market should dictate what it will accept. The danger of including any restrictions (as has been seen by the absence of any listings of DCSSs on the premium listing segment following the reforms in December 2021) is that they may quickly become outdated as the market develops new structures that do not work within the rules.

Significant transactions

One of the most eye-catching changes in CP 23/10 is the proposed removal of the need for class 1 transactions to be approved by shareholders. Currently companies must publish a class 1 circular containing significant disclosures on the target/ disposed asset, including 3-year IFRS financials compiled using the same accounting policies as the listed company. Anecdotally, this requirement has led in some cases to London listed companies missing out in auction processes where other

bidders for targets were not faced with any such restriction.

Instead, transactions where a 25 per cent. class test threshold is met will, under the new proposals, require a company to publish an announcement containing the information currently required in a class 2 announcement and any information required to be published under MAR.

The class tests will be amended to remove the profits test as the FCA considers it frequently produces anomalous results and sponsors will be allowed more discretion to apply modifications to the class tests without having to seek guidance from the FCA, for example, in relation to reserves for natural resources companies.

In practice, these changes will mean that shareholders will no longer have the right to vote on a significant transaction (other than reverse takeovers) and may be given substantially less information than has previously been the case. It will be at the discretion of companies how they liaise with shareholders around potential acquisitions (noting that they will have to comply with MAR with regard any discussions prior to announcing the transaction) and what information they provide. It may be helpful if the new rules provided some guidance (or the FCA were to publish a Technical Note) as to how companies should approach disclosure of, amongst other things, target financial information and new risks that might apply to the company following completion of a large transaction. We note that the table on page 14 of CP 23/10 specifically refers to seeking views on requiring market notifications to include additional financial or other information that is currently required in a shareholder circular, although the FCA states later on in CP23/10 that it is not minded to impose disclosure requirements that go beyond the current class 2 requirements.

Further, whilst the new proposed regime is of benefit to listed companies in reducing execution risk on a transaction by removing the need for shareholder approval and is cost saving as there is no need to produce a lengthy circular or hold a general meeting, we would suggest that the existing regime does have also have some benefits that may be lost if the class 1 regime is reformed as proposed.

Having acted on approximately 30% of the announced class 1 transactions in 2022, we believe that the rigour of the current regime (including in the preparation of a circular) allows a company to assess its ability to comply with its listing obligations post-completion and to plan for the implementation of any changes it needs to make to its policies and procedures. It will be important, if the class 1 requirements are fundamentally changed as proposed, that companies nevertheless still undertake sufficiently robust diligence on a target's policies and procedures to prepare for post-completion integration.

Another result of these proposed changes is that the prescribed disclosure requirements for transactions that would currently be classified as class 2 transactions will no longer apply (although MAR disclosure obligations will still need to be considered). We would question whether there is value in retaining these requirements as they are helpful to companies in determining what needs to be included in a transaction announcement and have not generally served as an impediment to a company's ability to execute a transaction.

Whilst the significant transaction regime will change, the rules relating to reverse takeovers will remain broadly the same (i.e. require shareholder approval and readmission), save that the FCA indicates that it may refine the definition of a reverse takeover and, as mentioned above, the profits test will no longer apply.

Related party transactions (RPTs)

As with significant transactions, the FCA proposes that the mandatory independent shareholder vote for RPTs and for RPTs involving a controlling shareholder where circumstances require are deleted together with the disclosure requirements for smaller RPTs.

Instead, an announcement will be required for RPTs above the 5 per cent. class test threshold, which should include a statement by the board that the RPT is fair and reasonable so far as the security holders of the company are concerned and that the directors have been so advised by the sponsor. It is suggested that the current requirement for the company to seek the guidance of a sponsor where it is proposing to enter into a transaction which may be a RPT is retained although the FCA is seeking views on this.

We note that the FCA will be consulting on changes affecting investment funds in the autumn and assume that the FCA will review how the related party rules will work in relation to funds generally and specifically to changes to an investment management agreement, given that changes to the fee structure are currently classifiable as an RPT and therefore require shareholder approval if the 5 per cent. threshold is reached.

Listing Principles

There will be a new set of listing principles which will combine the current Listing Principles and Premium Listing Principles. The FCA is proposing that there will be clarification of the role directors play in relation to a listed company's compliance with the listing principles. It will be interesting to see the drafting when the draft rules are available in the autumn, noting that the FCA will be considering how the proposals interact with UK company law in relation to UK directors.

Other matters

It is proposed that the regime for cancellation of a premium listing remains in place for the ESCC category (i.e. shareholder consent with a 75 per cent. majority) but the FCA suggests that there could be a longer period for cancellations beyond the current requirement of 20 business days following the passing of the shareholder resolution.

The FCA is proposing that all companies listed on the ESCC category should comply with the UK Corporate Governance Code, however, it is seeking views as to whether there may be potential barriers for overseas companies in certain jurisdictions as a result of this approach.

All companies listed on the ESCC category will have to put in place pre-emption rights and, as an anti-dilution protection, seek shareholder authority for non-pre-emptive share issuances at a discount of 10 per cent. or more.

Annual report disclosure around corporate governance, TCFD and diversity will also be a requirement for companies listed on the ESCC category.

Sponsor regime

Both companies listing on the ESCC category and the CEIFs category will require a sponsor, as possibly will SPACs. However, it is unclear whether companies seeking a secondary listing will need to involve a sponsor.

Whilst not explicitly set out in CP23/10, it appears the role of sponsor on an IPO will remain broadly similar to that under the current premium listing regime, save that there may be an additional degree of complexity that sponsors need to consider when undertaking due diligence regarding eligibility and ability to comply with ongoing requirements given the different types of company that would be eligible to list. In addition, the proposed new continuing obligations for listed companies (ability to gather

and store information) will need to be assessed as part of the sponsor’s due diligence.

	Current sponsor regime	Proposed sponsor regime
IPOs	Sponsor declaration	Sponsor declaration
Class 1 transactions	Guidance on application of class tests; sponsor declaration	Guidance on application of class test (if necessary)
Reverse takeovers	Various confirmations Sponsor declaration	Sponsor declaration
RPTs	Guidance on application of class tests; “Fair and reasonable” advice	Guidance on application of class tests; “Fair and reasonable” advice
Further issues	Sponsor declaration	?
Refinancing and reconstructions	Sponsor declaration	?
Share buy-backs with circular	Sponsor declaration	?
Transfer of listing category	Sponsor declaration	Sponsor declaration

The “touch points” for when a sponsor will be required post listing will be reduced given the changes to the significant transaction regime although the FCA does note that listed companies are likely to engage advisers in a non-sponsor capacity as appropriate. One point worth noting is that the FCA seems to be making a distinction as to when sponsor advice should be sought on significant transactions and on RPTs. The proposed rule for significant transactions suggests that listed companies only need to seek guidance from a sponsor on the application of Listing Rules, Disclosure Guidance and Transparency Rules and MAR where they are in any doubt. However, it appears that the FCA wants it to be mandatory for a listed company to seek advice from a sponsor where there is a possibility of an RPT, although it is seeking views

on the proposed distinction. On an RPT, it is expected that a sponsor will still have to provide advice to the board on whether the transaction is fair and reasonable.

It is envisaged that sponsors will also be required where a company is changing listing category.

As CP23/10 does not make it clear what the obligations of a listed company will be with regard to share buy-backs, further issues or refinancings and reconstructions, it is not clear whether sponsors will have any role on those forms of transactions under the new regime.

As a result of the proposed changes, it is nevertheless expected that there will be less sponsor transactions so the FCA is likely to propose making amendments to the competency regime to make it clear that when assessing transactions it will consider other types of transaction that do not require a sponsor declaration such as advising companies admitted to AIM. This will require a more case by case assessment of competence by the FCA. These proposed changes seem sensible given the change in the sponsor role.

Finally, for the moment the FCA is deferring reporting back on sponsor record keeping which was one of the topics of the previous discussion paper DP 22/22. It will include further details on this in the autumn consultation paper although it does state that no specific issues were raised other than a call for further clarity as to the FCA’s expectations in practice.

What is not covered in CP23/10

Continuing obligations

CP 23/10 does not provide any insight into how the new rules may deal with several continuing obligations in the current premium listing regime. For example, there is no indication if the current share buy-back requirements will apply or if there will be restrictions around equity issuances (other than the restriction on discounts mentioned above). Premium listed companies

also have obligations around notifications of certain events and the contents of circulars other than class 1 circulars. It is unclear whether these will survive.

The FCA states that reconstructions and refinancings (LR9.5.12R) will be covered in the autumn consultation paper, but it is unclear whether they will require a shareholder vote (as is currently the case) or be treated akin to a class 1 transaction under the proposed new regime. As mentioned above, it is also unclear whether a sponsor may have a role on these transactions.

Other categories

However, it is those companies which are not commercial companies with a primary listing of shares on the Official List (i.e. companies with secondary listings, CEIFs, OEICs, SPACs, debt issuers etc.) who are most in the dark. CP 23/10 gives very little indication what life will be like for these companies under the new regime.

Retail participation

We find it slightly surprising that, given Lord Hill's focus on the retail participation, CP23/11 does not contain any proposals as to how the rules may be used to this end. For example, the FCA does not appear to have taken up the suggestion made by the Joint Listing Authority Advisory Panel and Markets Practitioner Panel Response to DP22/2 that there should be a mandatory retail tranche of 10 per cent of the offering in an IPO.

Transitional provisions

It is not clear from CP 23/10 how existing premium and standard listed companies will transition to the ESCC category. It seems that LR 5.4A will not apply, but that sponsors will have a role in assisting companies in transferring to the new category. Further detail on these arrangements will follow in the autumn consultation paper.

CP23/10 helpfully notes that standard listed companies who do not want to transfer to the new ESCC category should be permitted to transfer to the other shares category, although this may be on a time limited basis. In relation to premium listed companies, CP23/10 notes that a period between the final rules being made and coming into force may be appropriate.

Timetable

The consultation closes on 28 June with a further consultation paper including draft rules expected in autumn 2023. The aim is for substantial progress to be made by the end of 2023 with the new regime in place in 2024.

Concluding remarks

A company's decision to list (and where to list) is driven by a number of factors including valuations and depth and liquidity of capital markets, which are in the end more important than the rulebook. As such, these changes to the UK listing regime may not in themselves be sufficient to revitalise the UK capital markets, but as Nikhil Rathi the FCA CEO states in his introduction to CP 23/10, they are a sign that the regulator is playing its part in the debate.

The FCA is now awaiting feedback from market participants. Given the nature of the changes, we expect some lively debate to come as the FCA seek to land on the right balance between flexibility for issuers and investor protection.

But eyes will not only be on what investors have to say. Indexation is seen as key for listed companies in securing liquidity and therefore, for the rules to have the best chance of achieving their aims, companies will want to know that FTSE Russell is broadly supportive of the reforms and will seek to amend its Ground Rules to welcome in companies with a listing on the ESCC category. We note the comment from the FCA that it will be up to index providers to set higher or different standards to those set out in the listing rules or to create alternative indices reflecting different users' preferences.

Finally, there must also be a question as to the future of AIM. If the proposals in CP23/10 broadly form the basis of the new requirements for the Official List, AIM will surely have to change its rules as it will, in comparison, now appear to contain more onerous continuing obligation requirements.

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