
March 2017

The FCA Proposes a Number of Technical and Structural Changes to the UK Listing Regime in its Latest Review of UK Primary Markets

In line with its objective of ensuring the UK capital markets function well and remain effective, last year the UK Financial Conduct Authority (the “FCA”) committed, as part of its 2016/17 Business Plan, to conduct a review of the structure of the primary markets in the United Kingdom. In February, the FCA published a discussion paper and a consultation paper summarizing the findings of its review and proposing a number of technical and structural changes relating to the UK primary markets landscape. The discussion paper entitled “Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape (DP17/2)” (the “Discussion Paper”) provides a broad review of the markets and explores potential structural enhancements. The consultation paper entitled “Review of the Effectiveness of Primary Markets: Enhancements to the Listing Regime (CP17/4)” (the “Consultation Paper”) sets out more concrete proposals for technical amendments to the UK listing regime.

This client alert contains a summary of the potential structural enhancements to the UK primary markets and enhancements to the UK listing regime outlined in the two papers.

The Discussion Paper’s Key Areas of Review

The FCA met with issuers, investors, sell-side firms and advisers to seek their views on potential changes to the UK primary markets structure. The key factors driving the discussions included:

- motivations for seeking access to the UK market;
- barriers to listing;
- the role of a standard listing and whether certain types of issuers should be permitted to apply for a standard listing;
- whether the existing concessionary routes to premium listing for certain types of issuers are still appropriate and whether concessions instead should be granted to certain other types of issuers;
- the effectiveness of the current market structure in providing support for long-term investments; and
- the potential benefits of creating a wholesale debt MTF market in the United Kingdom.

The main themes that emerged as a result of these discussions focused primarily on the continued attractiveness of London as a listing venue, the recent trends in UK initial public offerings (“IPOs”), the need for establishment of more concessionary routes to premium listing and the effectiveness of UK debt markets.

The following changes to the UK equity markets are now being considered by the FCA:

- *The future of standard/premium listing structure and creation of a new “international” segment* – the FCA questions whether the standard segment listing is still fit for purpose in light of stakeholders’ comments that it lacks a clear sense of purpose and that it is often viewed by potential applicants (particularly large overseas companies) in a negative light as “second best.” As such, the FCA seeks views on whether a new “international” segment should be created for use specifically by large overseas companies with primary listings in their home jurisdictions that would like to observe higher standards of conduct without having to comply with the “super equivalent” requirements of a premium listing.
- *The potential applicability of standard listing regime to ETFs* – exchange traded funds (ETFs) currently are only allowed to list on the premium segment. In light of comments from stakeholders, the FCA is seeking views on whether investor protections afforded under the premium segment (e.g., the requirement for a sponsor to be appointed and various post-admission continuing obligations) may be inappropriate and overly burdensome for these types of entities, and whether ETFs should be allowed to apply for admission under the standard listing segment.
- *The potential need for technical enhancements to existing routes to listing for science and technology companies and potential changes to the concessionary route to premium listing affecting other types of issuers* – despite a number of concessionary routes already existing for early-stage science and technology companies to access the market, these companies continue to struggle to effectively raise capital for further growth and development, in particular from two perspectives: provision of capital through the “scale-up” phase when such companies are working to transform from start-up to large, established businesses and provision of so-called patient capital, which is investment based upon long-term considerations. As such, the FCA is seeking views as to the factors that may adversely impact the provision of these forms of capital and what potential enhancements to the primary market framework are needed to promote scale-up and patient capital.

The FCA is also considering whether the existing concessionary route to premium listing for mineral extracting companies is fit for purpose as some stakeholders have argued that it is complicated and difficult to interpret and that it may be best suited for only mature mineral extracting companies. On the other hand, there are other types of issuers, such as property companies without a representative revenue-earning track record, that currently do not benefit from a concession, and the FCA is seeking views on whether such companies should be granted one.

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- *The future creation of a UK primary debt MTF market and retail access to debt markets* – in light of the relative successes of the debt MTF markets in Ireland and Luxembourg and the general popularity of wholesale debt listings, the FCA is seeking input as to whether a similar wholesale bond market should be created in the United Kingdom and what should be the key elements of such a market. Additionally, the FCA is seeking views on whether the current requirement for prospectuses for retail issuances, that they be easily analyzable and comprehensible, has an unintended consequence of discouraging issuers from offering securities to retail investors, and whether this requirement should be removed for certain types of issues, *e.g.*, those where the issuer's business and risks are widely understood and where the security is not complex.

The Consultation Paper's Key Proposals

The Consultation Paper suggests a number of changes aimed at enhancing certain aspects of Listing Rules ("LRs") in order to ensure that they continue to serve the needs of issuers and investors. The majority of the proposed changes consist of technical amendments to existing rules, reordering of rules in chapters and publication of further guidance on how to interpret the rules in the form of technical and procedural notes.

- *Clarification to the premium listing eligibility requirements in LR 6* – the FCA proposes the following amendments to LR 6 eligibility requirements:
 - clarification of the applicability of LR 6 via a deletion of the term "new applicant," a clarification that a company that is an applicant for premium listing by virtue of being inserted as new holding company (topco) for an existing premium listed company will not necessarily be subject to LR 6 requirements, and a clarification that LR 6 does not apply to further issues of shares of the class already listed unless they occur in connection with reverse takeover;
 - insertion of an explicit statement that any additional financial information (which may be required where there have been acquisitions during the three-year financial track record period) needs to be audited;
 - clarification of the three-year financial track record requirement via an explanation that only a company that has been generating revenues in its declared line of business for the past three financial years will meet this requirement, addition of new technical notes providing further guidance on this requirement, deletion of guidance stating that the FCA may waive this requirement as it is misleading since the FCA very rarely does provide a waiver, and clarification that this requirement does not apply to mineral extracting companies;
 - reordering and separation of the three independence requirements into three separate rules: (1) a rule on the need to carry on a standalone business, (2) a rule on the need to have a business

independent of any controlling shareholder, and (3) a rule clarifying that an issuer should be able to control the business; these new rules will be accompanied by new guidance and a new technical note will be produced to help interpret more complex provisions;

- deletion of the guidance stating that the FCA may dispense with the requirement to provide a working capital statement – the FCA considers this statement to be misleading as it has never agreed to waive this requirement and does not plan to do so in the future; and
- insertion of an explicit statement in LR 6 that an issuer’s constituent documents must allow it to comply with the LRs.

- *Changes to the concessionary routes to premium listing* – the FCA has examined whether the existing two concessionary routes to premium listing (one for scientific, research-based companies and one for mineral extracting companies) remain appropriate and up to date. As a result of the review, the FCA proposes adding two new technical notes, one for each route. Based on stakeholder feedback, the FCA is also considering creating a new concessionary route for two specific subcategories of property companies: (i) companies that have been established for less than three years, but predominately hold mature, leased assets that generate revenue, and (ii) companies that develop assets and have done so for the requisite period of time (three years) but that focus on long-term projects that may only be revenue-generating after a number of years.

- *Classifying transactions and the treatment of transactions outside of the ordinary course of business* – the FCA proposes two changes to its approach to profits test (which is one of the tests used to determine the applicable disclosure and approval requirements for a transaction undertaken by a premium listed issuer outside its ordinary course of business) in order to ensure that the test produces the appropriate result and reflects the true size of the transaction being undertaken:
 - First, it is proposed that premium listed issuers may disregard the profits test where the result is anomalous, the result is 25% or more and all other class tests are under 5%; if this occurs, issuers would be allowed to treat the transaction as unclassified, without having to consult the FCA first. Issuers would be required to continue to obtain their sponsor’s guidance in this area and, in a situation where in a sponsor’s view the result of the profits test should not be treated as anomalous (despite other tests being under 5%) due to the sponsor seeing it as reflecting the true size of the transaction, the FCA should be contacted for further guidance.
 - Second, it is proposed that when the result of the profits test is 25% or more and is considered anomalous, premium listed issuers would be allowed to make certain adjustments to the profit figures they use in calculating the profits test. The FCA proposes to allow issuers to adjust profits for costs incurred by the issuer or the target in connection with its IPO and closure costs incurred by either the issuer or the target that are not part of ongoing restructuring as long as both sets of

costs are genuine one-off costs. The issuer or the target would also be allowed to adjust profits for historical financing costs where it has recently completed its IPO and undertaken a capital restructuring. These adjustments would be subject to guidance from the sponsor, but no approval from the FCA would be necessary.

It is important to note that the two proposed changes would apply only to Class 1 transactions. For all other types of transactions, such as related party transactions and Class 2 transactions, the FCA would retain the requirement that the issuer must consult it if it wants to modify the way in which the profits test rules apply.

- *Suspension of listing for reverse takeovers* – the FCA proposes to delete from the LRs guidance requiring listed equity issuers (other than shell companies¹) to provide certain additional information in order to ensure that the FCA does not suspend the listing of company's securities if the company is planning to undertake a reverse takeover. A longstanding view of the FCA has been that it may be necessary to suspend a company's listing in a reverse takeover situation because insufficient information would be available to the market that could lead to disruption in the orderly functioning of the market. To remove the existing presumption of suspension, the FCA is proposing to amend LR 5.6 and delete its technical note on reverse takeovers – the two key sources of the presumption. The FCA is also proposing to remove the requirement for issuers or their sponsors to contact the FCA as soon as possible before announcing a reverse takeover to discuss whether a suspension is necessary or where details of the reverse takeover have been leaked in order to request suspension. Additionally, the FCA is proposing to amend the guidance on circumstances where the FCA would be satisfied that a suspension is not necessary in order to reflect changes made elsewhere in the rules to remove the presumption of suspension.

Next Steps

The responses to questions posed in both the Discussion Paper and the Consultation Paper are due May 14, 2017. The FCA plans to publish revised rules discussed in the Consultation Paper in the second half of 2017. A consultation will also be published if the FCA decides to explore further the issues raised in the Discussion Paper.

A copy of the Discussion Paper is available at:

<https://www.fca.org.uk/publication/discussion/dp17-02.pdf>

A copy of the Consultation is available at:

<https://www.fca.org.uk/publication/consultation/cp17-04.pdf>

¹ Shell companies are defined in LR 5.6.5AR as issuers whose assets consist solely or predominantly of cash or short-dated securities, or whose predominant purpose or objective is to undertake an acquisition or merger (SPACs).

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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