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FCA Publishes New Related Party Transaction Rules

In May, the Financial Conduct Authority (“FCA”) published “Policy Statement: PS 19/13, Proposals to promote shareholder engagement: Feedback to CP19/7 and final rules” (available [here](#)) discussing the implementation of the new related party transaction rules (“RPT rules”) for companies with either a premium or standard listing on the London Stock Exchange. The RPT rules implement the requirements of the revised EU Shareholder Rights Directive (“SRD II”), which are designed to ensure that companies with shares admitted to trading on EEA-regulated markets adequately disclose transactions that are entered into with certain persons who may exercise influence over the companies (related parties) and that may affect shareholders’ assessments of company valuations.

We provide below an overview of the RPT rules and their applicability. The RPT rules are found under the corporate governance requirements in the FCA Disclosure Guidance and Transparency Rules (“DTRs”) and corresponding amendments have been made to the FCA Listing Rules (“LRs”) to bring all issuers covered by the RPT rules in scope.

Issuers covered by the RPT rules

The RPT rules cover the following types of issuers:¹

- UK-incorporated companies with shares that carry the right to vote in general meetings and are admitted to trading on an EEA-regulated market (including, for example, on the premium² or standard segments of the London Stock Exchange); and
- Certain non-UK companies that are incorporated outside the European Economic Area (EEA) and that have premium or standard listed shares or premium listed Global Depository Receipts (GDRs) admitted to trading on the FCA’s Official List³ provided they are not already required to comply with

¹ See DTR 1B.1.0 and 1B.1.11.

² While it is generally recognized that premium listed issuers should technically have no further obligations resulting from the RPT rules as they already are subject to similar related party requirements in LR 11, premium listed issuers will, nevertheless, need to be mindful of the RPT rules as the two regimes exist in parallel and there may be instances where the new regime could apply whereas the LR 11 regime would not (*e.g.*, the RPT rules use a different definition of a related party and have different rules on aggregating RPT transactions).

³ Issuers with standard-listed GDRs are exempt from the RPT rules as GDR issuers are not within the scope of SRD II.

corresponding related party transaction rules imposed by another EEA state (such issuers are referred to as “Rest of World issuers” or “ROW issuers”).

While the FCA had proposed an exemption for ROW issuers already subject to broadly similar regimes (*e.g.*, in their home jurisdictions), in response to negative feedback for its proposal, the FCA decided not to proceed with such an exemption. Instead, it made other changes designed to reduce the compliance burden for ROW issuers, including that such issuers will not be subject to specific board approval rules and will be permitted to use an equivalent definition of “related party” under the non-International Financial Reporting Standards (“IFRS”) accounting standards applicable to them (provided such standards are recognized as equivalent).

Related party transactions covered by the RPT rules

The RPT rules apply to transactions that fall within the definition of “a related party transaction” and are material.

Definition of a “related party transaction”

Under the RPT rules, a “related party transaction” means:

- a transaction (other than a transaction in the ordinary course of business and concluded on normal market terms) between an issuer and a related party;
- an arrangement (other than an arrangement in the ordinary course of business and concluded on normal market terms) pursuant to which an issuer and a related party each invests in, or provides finance to, another undertaking or asset; or
- any other similar transaction or arrangement (other than a transaction or arrangement in the ordinary course of business and concluded on normal market terms) between an issuer and any other person the purpose and effect of which is to benefit a related party.

While this definition is similar to the one under the LR 11 regime, the key difference between the two definitions is that the definition found in the RPT rules specifically includes transactions and arrangements with related parties concluded on non-market terms whereas under the LR 11 regime this constitutes a factor to be considered when assessing whether a transaction or arrangement is in the ordinary course of business.

Materiality

The materiality of a related party transaction under the RPT rules is determined by assessing the transaction’s size relative to that of the issuer proposing to make it. The materiality threshold has been set

at 5% or more in size as determined by reference to the percentage ratios resulting from applying one of the four related party test calculations (the gross assets test, the profits test, the consideration test and the gross capital test) to the transaction. The related party tests are set out in more detail in Annex 1 to DTR 7; they correspond to the percentage tests used under the LR 11 regime applicable to premium listed companies.

Aggregation of related party transactions

The RPT rules provide that if an issuer enters into transactions with the same related party (or any of its associates) in any 12-month period, and the issuer has not been required to comply with the RPT disclosure rules, then the transactions must be aggregated.

If any percentage ratio is 5% or more for the aggregated transactions, the issuer must comply with the RPT rules disclosure requirements in respect of each of the aggregated transactions.

Exempt transactions

The following is a list of related party transactions⁴ that are specifically exempt from the application of the RPT rules:

- a transaction or arrangement between the issuer and its subsidiary undertaking provided that the subsidiary is wholly owned or no other related party of the issuer has an interest in the subsidiary undertaking;
- a transaction or arrangement regarding remuneration, or certain elements of remuneration, of a director of the issuer, where the remuneration to be awarded or due to the director is in accordance with the issuer's directors remuneration policy set in accordance with applicable rules; or
- a transaction offered to all shareholders of the issuer on the same terms where equal treatment of all shareholders and protection of interests of the issuer is ensured.

Definition of a related party

For EEA issuers, the RPT rules use the definition of a "related party" found in SRD II that, in turn, cross-references the definition in IFRS. ROW issuers have a choice of using either the definition of "related party" under IFRS or the definition provided in the equivalent (as determined by the European Commission) accounting standards that the issuer uses to prepare its consolidated annual financial statements.

⁴ See DTR 7.3.5.

The disclosure and approval requirements under the RPT rules

The RPT rules require⁵ an issuer entering into a material related party transaction to:

- publish, as soon as the terms of the transaction are agreed, an announcement via a Regulatory Information Service (“RIS”) setting out the nature of the related party transaction, the name of the related party, the date and the value of the transaction and any other information necessary to assess whether the transaction is fair and reasonable from the perspective of the issuer and of the shareholders who are not a related party;
- obtain the approval of its board of directors for the transaction before it is entered into; and
- ensure that any director who is, or an associate of whom is, the related party, or who is a director of the related party, does not take part in the board’s consideration of the transaction and does not vote on the relevant board resolution.

ROW issuers are subject to a lower compliance burden as they are only required to make an announcement via a RIS regarding the related party transaction and are not required to obtain board approval or ensure that any related party directors are excluded from voting on the transaction.

Additionally, all issuers are required to establish and maintain adequate procedures, systems and controls to enable them to assess whether a transaction with a related party is in the ordinary course of business and has been concluded on normal market terms.

Timeline for entry into force

The RPT rules are applicable to the relevant issuers from the start of their first financial year beginning on or after June 10, 2019. Accordingly, issuers with December 31 year-end will need to comply with the RPT rules starting on January 1, 2020.

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⁵ See DTR 7.3.8.

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:

Mark S. Bergman
+44-20-7367-1601
mbergman@paulweiss.com

Securities practice management attorney Monika G. Kislowska contributed to this Client Memorandum.