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The FCA Adopts a Number of Technical and Structural Changes to the UK Listing Regime

On October 26, 2017, the UK Financial Conduct Authority (the "FCA") published a policy statement (the "Policy Statement")[1] that introduces a number of changes to the UK Listing Rules ("LRs") and related guidance. The changes were designed to improve and clarify certain aspects of the UK listing regime and ensure that the UK capital markets function well and remain effective. These changes stem from a discussion paper[2] and a consultation paper,[3] both published by the FCA earlier in the year, that explored structural enhancements to the UK equity capital markets and set out proposals for technical amendments to the UK listing regime.

This client memorandum summarizes the final changes to the relevant LRs and related technical notes, which will become effective on January 1, 2018.

Summary of the Amendments

Below is a summary of the amendments to the LRs contained in the Policy Statement. The changes consist of technical amendments to existing rules, the reordering of rules in chapters and the publication of technical notes that provide further guidance regarding the interpretation of the rules.

- *Clarification of the premium listing eligibility requirements in LR 6* – LR 6 sets out the requirements an applicant for a premium listing has to comply with in order to qualify for a premium listing. Below is a list of amendments that the FCA made to LR 6 in order to provide greater certainty as to what is required.
  - The term "new applicant" has been replaced with the term "applicant" in order to streamline the applicability of LR 6. The revised rules clarify that a company that is an applicant for a 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 eligibility requirements unless it is, at the same time, entering into a transaction classified as a reverse takeover (LR 6.1.1.R(1)). LR 6 will also not apply to a company that is applying for admission of shares that constitutes a further issuance of

1 Review of the Effectiveness of Primary Markets: Enhancements to the Listing Regime (PS17/22), October 2017, available here.

2 Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape (DP17/2), February 2017, available here.

3 Review of the Effectiveness of Primary Markets: Enhancements to the Listing Regime (CP17/4), February 2017, available here.

shares of the class already listed unless such issuance is undertaken in connection with a reverse takeover (LR 6.1.1.R(2)).

- An explicit statement has been added stating that any additional financial information (which may be required from an applicant where there have been acquisitions during the three-year financial track record period) will need to be audited (LR 6.2.4R).

- An explicit reference to a revenue earning track record has been inserted to highlight that only an applicant that has been generating revenues in its declared line of business for the past three financial years will meet the three-year financial track record requirement (LR 6.3.1.R(2)).

- A new technical note has been added that provides further guidance on the interpretation of the financial information, in particular the calculation of the 75% requirement (that requires the applicant's financial information to represent at least 75% of the applicant's business) and the track record requirements. The FCA also clarified that the 75% requirement will not apply to mineral extracting companies, and it withdrew its prior guidance stating that the FCA may waive the requirement for financial information and track record (the guidance was viewed as misleading since the FCA very rarely provides such waivers).

- The three independence requirements were reordered and split into three separate sections in order to set out more explicitly which factors within the existing guidance apply to each of these requirements: (1) the requirement that an applicant carry on an independent business as its main activity (LR 6.4.1R), (2) the requirement that an applicant demonstrate that it is able to carry on a business independent of any controlling shareholder (LR 6.5.1R) and (3) the requirement that an applicant demonstrate that it exercises operational control over its business (LR 6.6.1R). The new rules will be accompanied by a new technical note that will assist with the interpretation of more complex provisions by listing the circumstances in which (i) further inquiry may be necessary regarding the requirement to carry on independent business, (ii) particular consideration should be given to the applicant's ability to control its business or (iii) a controlling shareholder is able to influence the applicant's operations in such a way that subverts its normal governance process.

- The FCA withdrew its prior guidance stating that it may dispense with the requirement to provide a working capital statement. The guidance was misleading as the FCA has never agreed to waive this requirement and does not plan to do so in the future although, as clarified in the Policy Statement, the FCA's waiver power has not been removed and it is still possible for an applicant to seek such waiver.

- An explicit statement has been added to LR 6 stating that an applicant's constituent documents must allow it to comply with the LRs (LR 6.9.1.R).

- *Changes to the concessionary routes to premium listing* – although, ordinarily, companies applying for a premium listing are required to have a three-year revenue earning track record, the FCA has provided concessionary routes for companies in certain sectors that exempt new applicants from this requirement due to the special attributes such companies may have. Following a review of whether the existing concessionary routes to premium listing (one for scientific research based companies ("SRBCs") and one for mineral extracting companies) remained appropriate and up-to-date, the FCA has updated the relevant LRs to make consequential changes arising from the reordering and the amendments of LR 6 as a whole, and has updated the technical note on SRBCs and added a new technical note covering mineral extracting companies in order to provide additional guidance on the interpretation of these concessions.

  The FCA has also created a new concessionary route for property companies[4] that focuses on the property valuation report (which is to be included in the prospectus) rather than the applicant's historical financial information. The following two specific subcategories of property companies could qualify for the new concessionary route: (i) companies that have been established for less than three years, but predominately hold mature, leased assets that generate revenue (*e.g.*, a spin-off of a mature portfolio in which the performance of assets held by the new entity is more important than the entity's track record), and (ii) companies that develop assets and have done so for the requisite period of time (three years) but focus on long-term projects that may only be revenue-generating after a number of years. A new technical note on this concessionary route has also been added to explain the new requirements.

- *Classifying transactions and the treatment of transactions outside of the ordinary course of business* – the FCA made two changes to its approach to the profits test (which is one of the tests used to determine the applicable disclosure and approval requirements for a transaction undertaken by a listed company 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, listed companies will not be permitted to disregard the profits test where the result is anomalous, the result is 25%[5] or more and all other class tests are under 5%. If the profits test produces such an outcome, companies will be allowed to treat the transaction as unclassified, without having to consult the FCA first. Listed companies will be required to continue to obtain

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4 A "property company" is defined as a company primarily engaged in property activities including: (i) the holding of properties (directly or indirectly) for letting and retention as investment; (ii) the development of properties for letting and retention as investments; (iii) the purchase and development of properties for subsequent sale; and (iv) the purchase of land for development of property for retention as investments.

5 The profits test is calculated by dividing the profits attributable to the assets subject to the transaction by the profits of the listed company. (LR 10 Annex 1)

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, if the result of the profits test is 25% or more and is considered anomalous, listed companies will be permitted to make certain adjustments to the profit figures they use in calculating the profits test. The amended LRs will allow listed companies to adjust profits for costs incurred by them or the target in connection with their IPOs and for closure costs incurred by either them or the target that are not part of ongoing restructuring as long as both sets of costs are genuine one-off costs. The listed company or the target will also be allowed to adjust profits for historical financing costs (*i.e.*, interest rates) where it has recently completed its IPO and undertaken a capital restructuring as long as these costs are substituted in the calculations in the profits test with costs that would have been incurred under new facilities in the relevant period. These adjustments should be applied equally to both the company and the target company to ensure a like-for-like comparison. The applicant should seek guidance from the sponsor for the adjustments, but no approval from the FCA would be necessary. To help listed companies in their assessment of whether an item is an exceptional, one-off cost for purposes of the profits test, the FCA has updated its technical note on the classification tests with new guidance on when the profit figure in the profits test may need to be adjusted.

These changes apply only to Class 1 transactions involving reverse takeovers. For all other types of transactions, such as related party transactions and Class 2 transactions, the FCA has retained the requirement that the listed company first consult the FCA if it wants to modify the way in which the profits test rules apply.

- *Suspension of listing for reverse takeovers* – the FCA has long taken the view that it may be necessary to suspend a listed company's listing in a reverse takeover situation because the market in the company's securities will not be operating smoothly if sufficient information about the proposed transaction is not available to the market for proper price formation to take place. Recently, however, based on its experience with reverse takeovers, the FCA has determined that, for most listed companies, it is no longer necessary to suspend listing in a reverse takeover situation and that disorderly markets can be avoided and proper price formation can happen on the basis of the information that the listed companies already make public as part of their compliance with other existing obligations, in particular the EU Market Abuse Regulation.

As result, the FCA has removed the existing rebuttable presumption of suspension that previously applied to all listed companies, and narrowed the scope of LR 5.6 so that it will only cover shell companies[6] undertaking reverse takeovers as different considerations apply to this type of company. As explained in the Policy Statement, the FCA has kept the current requirements for shell companies because, based on its review of recent transactions, share prices for this type of company can experience high levels of volatility at the time of proposed transaction as compared with other types of companies, which may suggest that the market priced the transaction based on incomplete information. The FCA has also removed the requirement for issuers (other than shell companies) 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. This change has also been reflected in the updated technical note on dealing with the FCA.

The FCA has also withdrawn its technical note on reverse takeovers and incorporated the guidance from the withdrawn note in the updated technical note on SPACs, which also provides expanded guidance on the term "shell company" and the eligibility for listing for such companies.

Conclusion

Although the latest round of FCA amendments to the LRs and the accompanying guidance consist mainly of technical and structural amendments, and avoid any significant substantive changes, they are a welcome development and hopefully signal a willingness to take a more practical approach to their regulatory mandate.

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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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6 Shell companies are now defined in LR 5.65AR as (1) issuers whose assets consist solely or predominantly of cash or short dated securities or (2) issuers whose predominant purpose or objective is to undertake an acquisition or merger, or a series of acquisitions or mergers.