FCA CONSULTS ON NEW PREMIUM LISTING CATEGORY FOR SOVEREIGN CONTROLLED COMPANIES

On 13 July 2017, the FCA published a consultation paper, CP 17/21, on the creation of a new listing category for companies controlled by a shareholder that is a sovereign country. The FCA is consulting on the addition of a new additional category of premium listing for such companies whereby all the existing investor protections applicable to the existing premium listings will apply, subject to two specific modifications.

Key issues

- FCA intends to create new premium listing category for sovereign controlled companies
- Sovereign must control 30% or more of voting rights for company to be eligible
- Current premium listing investor protections would apply, subject to two limited modifications
- New listing category will be open to issuers of depositary receipts

Background

In February 2017, the FCA published a discussion paper[1] examining the structure of the current UK listing regime and whether they could be improved for international companies. This latest consultation paper provides a targeted proposal aimed at providing a route to premium listing for commercial companies controlled by a shareholder that is a sovereign country.

Currently, such companies have difficulties in satisfying certain rules applicable to premium listed companies because, for example, there is a strong continuing relationship between the State and the company, meaning that such companies have to look to a standard listing if they wish to list in London. By enabling companies of this nature to seek a premium listing, they will be required to comply with higher regulatory standards (such as appointing a sponsor and demonstrating that the company can operate as an independent business, has a three-year revenue earning track record, has sufficient working capital and has unqualified financial statements) than would be the case with a standard listing, thereby enhancing overall investor protection. It is proposed that the new category would also be extended to companies listing interests in their equity in the form of global depositary receipts (GDRs) potentially facilitating state controlled GDRs issuers to step up to a premium listing and access a broader range of investors.

Key proposals

Under the proposals set out in CP 17/21, the FCA would create an additional category[2] of premium listing applicable to commercial companies controlled by a shareholder that is a sovereign country.

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1 Discussion Paper 17/2 "Review of the Effectiveness of the Primary Markets: The UK Primary Markets Landscape".

2 Currently premium listing is divided into three sub-categories: commercial companies, closed-ended investments funds and open-ended investment companies.

Eligibility: When assessing eligibility for this category a company will need to demonstrate that substantive control is being exercised by the State in question. In particular, the State will need to hold 30% or more of the voting rights of the company. The FCA has stated that a passive stake held by a sovereign wealth fund is unlikely to meet the requirement to demonstrate substantive control by the State. The State which is the sovereign controlling shareholder will need to be one which is recognised by the UK at the time of the application. There are to be no restrictions on eligibility based on the country of incorporation of the applicant company. Note however that companies that are not incorporated in the UK would not be eligible for index inclusion in the FTSE UK series.

Investor protections: All the existing investor protections applicable to existing premium listings (commercial companies) will apply, subject to two specific modifications which the FCA considers appropriate for sovereign controlled companies:

- under the related party rules, the sovereign controlling shareholder would not be considered a related party. This is an express recognition of the fact that sovereign countries are very different entities from private-sector controlling shareholders with different motivations. Investors will be left to make their own judgement of how the sovereign interacts with the company; and
- the controlling shareholder rules will not apply, meaning that (i) the requirement for there to be a controlling shareholder agreement between the sovereign and the company and (ii) the rules requiring a separate shareholder resolution of independent shareholder on the election and re-election of independent directors will not apply. To the extent that the company has an additional non-sovereign controlling shareholder, the controlling shareholder rules would apply to that shareholder.

The FCA's stated rationale for modifying the related party transaction rules is that sovereign countries have very different motivations as shareholders compared with private-sector shareholders.

Application of the related party transaction rules to a sovereign controlled company may also result in an unduly burdensome regime by virtue of extensive and complex relationships between the sovereign controlled company and the State, for example where many commercial counter parties are State owned or the State is involved in the sale of licences or auctioning rights on a regular basis, although some of these concerns ought to be mitigated by the existing carve-out from related party transactions for ordinary course transactions.

Transfers between premium listing categories: Under the proposals, companies with an existing premium listing (commercial companies) which satisfy the eligibility requirements for this new category would be entitled to transfer their listing to take advantage of the new rules but would require a vote of the independent shareholders in order to do so.

In circumstances where the State ceases to be a controlling shareholder, the company would be required to notify the FCA of that fact and transfer its listing to another listing category (subject to any necessary shareholder vote), failing which the FCA would either suspend or cancel its listing as it would no longer be eligible for inclusion in the sovereign controlled company category.

Depositary receipts: Depositary receipts are not currently eligible for premium listing. However, the FCA is proposing that, in addition to issuers of equity

shares, this new listing category would be open to commercial companies that wanted to list depositary receipts. In this regard, the 30% figure for control would be calculated on the basis of voting rights attaching to the underlying equity shares.

New provisions would operate to ensure that the rights (and in some cases obligations) attaching to the underlying class of equity share must "pass through" to the GDR holder. So, for example, whilst a vote required pursuant to Listing Rule 10 on a significant transaction would be carried out at the level of the underlying class of equity shares, the voting rights must pass through to the GDR holders to enable them to exercise their rights as if they were a holder of the underlying equity shares.

Clifford Chance view

Free float and minority shareholders protections

In 2012 and 2013, the Financial Services Authority (the predecessor to the FCA) consulted on minority shareholder protections in the context of premium listings and whether it was necessary to modify the minimum free float requirements against the backdrop of concerns raised by the buy-side community about the independence of premium listed companies with a controlling shareholder. In CP12/25, the FSA noted that the free float requirements were derived from European legislation and were explicitly framed in reference to liquidity consideration alone. In CP13/15, the FSA reiterated its view that the minimum free float requirement was designed to ensure liquidity in the secondary market and concerns surrounding shareholder protection ought not to be addressed by adjusting minimum free float levels. At that time, the FCA stated that enhanced protections for minority shareholders provided an effective remedy to the concerns raised by the investment community.

These enhanced protections for minority shareholders, introduced following CP 12/25 and CP 13/15, included (1) a mandatory agreement between the controlling shareholder and the company (although there was a long standing market practice of these being entered into) to ensure dealings between the parties were on arms length terms and the company maintained independence from its shareholder and (2) greater influence for independent shareholders on the election and re-election of independent directors through a requirement for a separate shareholder resolution of independent shareholders (although a controlling shareholder would still be able to count in a shareholder vote following a 90 day "cooling-off" period). Following CP 13/15, if a controlling shareholder did not comply with these provisions, a number of concessions in relation to related party transactions would cease to apply, creating requirements for a vote of independent shareholders on all related party transactions between the parties – even those that were small in size or in the ordinary course of business. If adopted, the proposals in CP 17/23 would exempt sovereign controlled companies from having to comply with these rules.

There is no direct discussion in CP17/21 about relaxing the free float rules for sovereign controlled companies with a premium listing. However, by allowing the proposed new listing category to apply to sovereign controlled companies listing GDRs, this creates the opportunity for a sovereign controlled company to obtain a premium listing with less than 25% of its equity share capital being in public hands. In particular, a sovereign controlled company with a GDR listing need only ensure that there are a sufficient number of GDRs in public

hands, rather than ensuring that there is a sufficient free float in its equity shares. The FCA is also proposing to mirror the guidance which applies to premium listing (commercial companies) and standard listing (GDRs) that it "may modify LR 21.6.17R (relating to certificates in public hands) to accept a percentage lower than 25% if it considers that the market will operate properly with a lower percentage in view of the large number of certificates of the same class and the extent of their distribution to the public".

Index inclusion

Much of the concern around the free float levels of non-UK incorporated premium listed companies has been raised in the context of their inclusion in FTSE's UK indices which are passively tracked by many investors. The FTSE indices are operated by FTSE independently of the FCA. Under FTSE rules, companies must be included in the premium list in order to be included in the FTSE UK index series. However, a company in the proposed new premium listing category would also have to satisfy other criteria to join the FTSE's UK indices, including FTSE's nationality and free float criteria - FTSE requires a minimum 50% free float for non-UK incorporated companies. This means that, under FTSE's current rules, premium listing would not be expected to lead to inclusion in the UK series for many sovereign controlled companies that might wish to list in the proposed new category. FTSE tightened its free float criteria in 2011 and 2012 and has not indicated to date that it intends to review these rules.

Sovereign Wealth funds

A number of countries have sought to place state assets or cash generated by state assets or resources in sovereign wealth funds. The FCA has stated that a passive stake held by a sovereign wealth fund is unlikely to meet the requirement to demonstrate substantive control by the State though it will look at this on a case by case basis. The criteria applied to this assessment of control is likely to be a key determinant of the number of companies that will be capable of taking advantage of the new listing category.

Should premium listing be extended to all GDR issuers?

State controlled companies that are unable to settle shares of their home jurisdiction through CREST have historically been directed towards a standard listing of GDRs. The possibility of a premium GDR listing will erode the difference between the two categories and it raises the question whether non-State controlled companies should also be permitted to obtain a premium listing of GDRs if they are willing to comply with the higher regulatory requirements of the premium listing regime.

Considerations for sovereigns in carrying out related party transactions

Sovereign controlled companies should consider how internal governance procedures would apply to related party transactions even though the Listing Rules regime would not apply. Should they, for example, require that related party transactions above a certain size be referred to the board for consideration by a committee of independent non-executive directors? They would need to be reported on in the financial statements under IFRS but should any of the other reporting requirements applicable to smaller related party transactions be followed on a voluntary basis to provide information to shareholders?

Under the Listing Rules, material related party transactions would still be subject to prior shareholder approval pursuant to the class test regime - however the threshold at which prior shareholder approval would be required would be at a much higher level than would have applied under the related party transaction regime (25% under the class test regime compared to 5% under the related party transaction rules) and the State would be able to exercise its voting rights on the shareholder resolution, greatly increasing the likelihood of the resolution being passed.

Sovereign controlled companies might also consider whether they should as a matter of prudence and good governance obtain a fair and reasonable opinion from an independent financial adviser in connection with material related party transactions, confirming that the terms of the transaction are fair and reasonable as far as the independent shareholders are concerned, even though this would not be formally required under the Listing Rules. As the market views the related party transactions rules as an important shareholder protection within the premium listing segment, private-sector investors may seek to impose additional governance procedures such as these arguing they are proportionate and broadly compatible with the intentions of the new premium listing segment.

Further information

The consultation closes on 13 October 2017, with the outcome of the consultation being published in a policy statement to be made available by the end of 2017.

If you would like to discuss the impact of the proposals set out in CP 17/21 and what they might mean for your business, please contact your usual Clifford Chance contact or any of the authors of this note.

For a copy of CP17/21 see
https://www.fca.org.uk/publication/consultation/cp17-21.pdf

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