

FCA Creates a New Premium Listing Category for Sovereign Controlled Companies

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On 8 June 2018, the Financial Conduct Authority amended its Handbook to create a new premium listing category for sovereign controlled companies (“SCCs”). The new rules, which took effect on 1 July 2018, are designed to attract more SCCs to the UK’s capital markets, particularly in light of the recent global increase in the listing of SCCs as part of government privatization programmes. Important accommodations under the new premium listing category include allowing SCCs to obtain a premium listing without having to:

1. enter into a relationship agreement with their sovereign controlling shareholders; or
2. obtain an advance fairness opinion from a sponsor or independent shareholders’ approval prior to entering into related party transactions with their sovereign controlling shareholders (other than share buybacks).

In addition, SCCs will be able to obtain a premium listing of depositary receipts as well as equity shares. All other premium listing requirements will, however, apply to SCCs listed on the new premium listing category. In particular, and following feedback received by the FCA on the consultation of the draft rules published in July 2017, the FCA decided to retain the requirements of an independent shareholder vote on the election of independent directors and also the specific requirement for the announcement of related party transactions, even if information about those transactions is not price sensitive. It is also worth noting that the rules relating to related party transactions are disapplied for SCCs listed on the new premium listing category only with respect to sovereign controlling shareholders and their associates, and will continue to apply in relation to other related parties that do not meet the definition of a sovereign controlling shareholder or an associate of a sovereign controlling shareholder.

This memorandum provides a summary of the new rules and their impact on listings of SCCs in the UK.

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I. Scope of the New Rules

To qualify as an SCC that can list its equity shares or depositary receipts on the new premium listing category, a State must exercise or control 30% or more of the votes able to be cast on all or substantially all matters at general meetings of the issuer (a “**sovereign controlling shareholder**”). For the purposes of these rules, a State must be either the UK, or a foreign State recognized by the UK, and includes the sovereign or other head of the State, the government of the State, a department of the State or an agency or a special purpose vehicle of the State. As clarified by the FCA in its July 2017 consultation, a passive stake held by a sovereign wealth fund is unlikely to demonstrate substantive control by the State, and therefore portfolio companies of sovereign wealth funds are unlikely to be eligible for listing on the new premium listing category, although the FCA indicated that it would assess the question of control on the facts specific to an application at the time it is made.

The existence of a sovereign controlling shareholder is both an eligibility requirement and a continuing obligation for listing on the new premium listing category. Should a company listed on the new premium listing category cease to be controlled by a sovereign controlling shareholder, it must notify the FCA of its new status and consider seeking a cancellation of listing or applying for a transfer of its listing category.

II. No Requirement for a Relationship Agreement with the Sovereign Controlling Shareholder

Currently, premium listed companies with a controlling shareholder must enter into a relationship agreement with that controlling shareholder providing that (i) any transaction and arrangements with the controlling shareholder will be conducted at arm’s length and on normal commercial terms; (ii) the controlling shareholder will not take any action that would have the effect of preventing the issuer from complying with the Listing Rules; and (iii) the controlling shareholder will not propose, or procure the proposal of, a shareholder resolution which is intended, or appears to be intended, to circumvent the proper application of the Listing

Rules. In addition, the annual report of a premium listed company must include a statement by the directors that the company has complied with these provisions and include any dissenting opinion of any independent director. Where an independent director declines to support this statement, the company will be subject to more stringent rules in relation to related party transactions with its controlling shareholders.

In recognition of the practical difficulties faced by States in complying with this requirement, particularly as States, unlike commercial companies, are not typically set up in a way that one signatory could bind all facets of the State given their numerous political divisions, the new rules exempt SCCs listed on the new premium listing category from application of the rules related to the relationship agreement with the sovereign controlling shareholder. However, like any other premium listed company, an SCC listed on the new premium listing category will continue to be required to demonstrate that it carries on an independent business as its main activity. This will require SCCs to show that they can run their business separately and without interference from their sovereign controlling shareholders. Since relationship agreements have historically helped demonstrate the requisite level of independence, and indeed the provisions of relationship agreements have customarily gone beyond the requirements of the listing rules, independence for SCCs will need to be demonstrated to the FCA on other bases. The extent to which this ends up being a challenge in practice will be worth watching.

III. Modified Related Party Transaction Rules

The current related party transaction regime for premium listed companies requires issuers that enter into a transaction with a related party, other than a transaction in the ordinary course of business and certain small and exempt transactions, to:

1. make a notification to the regulatory information service (RIS) containing, among other things, details of the transaction, the name of the related party and the nature of its interest

in the related party transaction (the “**Notification Requirement**”);

2. obtain a fairness opinion from a sponsor confirming that the transaction is fair and reasonable so far as shareholders are concerned (the “**Fairness Opinion Requirement**”); and
3. obtain prior independent shareholder approval for transactions that equal or exceed 5% on any of the class tests (the “**Independent Shareholders Vote Requirement**”).

When the FCA initially proposed the new rules during the July 2017 consultation, it proposed to disapply the related party transaction regime in its entirety in the new premium listing category for transactions with sovereign controlling shareholders. However, and based on the feedback received from the respondents to the July 2017 consultation, the FCA decided to retain the Notification Requirement in the new premium listing category and to exempt SCCs listed on this category from the Fairness Opinion Requirement and the Independent Shareholders Vote Requirement only.

In addition, as an exception to the modified related party transaction rules for SCCs listed on the new premium listing category, share buy-back transactions between the SCCs and the sovereign controlling shareholders or their associates remain subject to the full related party transaction rules without modification. The FCA justified this exception on the premise that share buy-back transactions are rare, and so compliance by SCCs

with the related party transaction rules with respect to these transactions should not be burdensome.

It is worth emphasising that the rules relating to related party transactions are not disappplied in their entirety just because the company has a sovereign controlling shareholder. The related party transaction

rules are, by their nature, extremely broad. For example, transactions entered into with a very broad universe of potential related parties that are not a sovereign controlling shareholder or an associate of a sovereign controlling shareholder would still be caught.

IV. Depositary Receipts Issued By SCCs Are Eligible For The New Premium Listing Category

Unlike other premium listing categories that admit only shares, depositary receipts will be eligible for listing within the new premium listing category. This new rule is expected to benefit foreign issuers, particularly those incorporated in certain civil law jurisdictions, who may find themselves unable to obtain a share listing in the United Kingdom if their shares are ineligible for settlement in

CREST, even through the use of CREST depositary interests.

In order for depositary receipts to be eligible for listing on the new premium listing category, the issuer must demonstrate that the rights attaching to the equity shares which the depositary receipts represent are capable of being exercised by the holders of the certificates as if they were the holders of the relevant equity shares. This analysis is likely to differ from jurisdiction to jurisdiction, and the

Impact of the new rules

- **New premium listing category for sovereign controlled companies**
- **No relationship agreement between the issuer and the sovereign controlling shareholder is required for listing on the new category, but the issuer must still demonstrate that it carries on an independent business as its main activity**
- **No requirement for fairness opinion or independent shareholder vote with respect to most related party transactions with the sovereign controlling shareholder**
- **GDRs issued by sovereign controlled companies will be eligible for listing on the new premium listing category**

potential challenges in concluding such rights are so exercisable should not be underestimated.

Because the 25% free float requirement is calculated by reference to the class of securities being listed, a listing of depositary receipts allows a much smaller percentage of voting rights to be put into public hands. The FCA does not expect the free float implications of this rule to frustrate orderly trading, which is essentially the original policy rationale for the free float requirement, as SCCs are likely to be large enterprises able to issue even depositary receipts in large enough volumes to maintain liquidity.

V. Impact on Indexation

The new premium listing category opens up potential FTSE UK Index inclusion for SCCs. However, FTSE indexation will not be automatic for SCCs listing their shares on the new premium listing category. In addition to the premium listing condition for inclusion, the FTSE UK Index Series Ground Rules include a number of other eligibility requirements relating to the issuer's nationality, liquidity, free float and voting rights, which an SCC listed on the new premium listing category may or may not satisfy. For example, an SCC incorporated outside the UK will not be eligible for inclusion in the FTSE UK Index Series unless it has a free float greater than 50%, a threshold which far exceeds the 25% free float requirement for a premium listing. In addition, and unless FTSE UK Index Series Ground

Rules are amended, depositary receipts will not be eligible for FTSE UK Index inclusion even if they are listed on the new premium listing category, as FTSE indexation is currently limited to equity shares.

VI. Transfer Between Segments

While SCCs are eligible for listing on the new premium listing category for sovereign controlled companies, they remain eligible for listing on the premium listing category for commercial companies as well as for a standard listing, subject to meeting the requirement of each listing category. The new rules also regulate the transfer of an SCC between different listing categories.

Current premium listed companies that meet the definition of SCC will continue to be subject to the full premium listing rules applicable to other commercial companies unless they transfer to the new premium listing category, which will require the approval of (a) at least 75% of the votes cast by their shareholders; and (b) a majority of the votes cast by independent shareholders. A similar majority of votes cast by shareholders would be required if an SCC listed on the new premium listing category for sovereign controlled companies were transferring into the standard listing category.

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