UKLA fits EU's rules to London's gold standard

Raj Panasar and Haydn Main review changes to the UK listing regime that took effect this month, and find practitioners broadly pleased with the British approach to European regulation

The new UK listing regime, part of the implementation in the UK of the European Financial Services Action Plan (FSAP), will bring about substantial changes in the approach taken to London Stock Exchange listed initial public offerings (IPOs) and other securities listings. The new regime, the final or near final rules for which were published between March and June this year, came into effect on July 1. The new regime is the product of a comprehensive review of the UK Listing Rules by the UK Listing Authority (UKLA), which began in October 2003, designed both to implement the various European regulatory changes (brought about by the new Prospectus Directive and Market Abuse Directive) and, more generally, to simplify and modernize the existing listing regime.

The new regime will be based on a revised version of the existing UKLA sourcebook, which will be divided into three parts: (i) the prospectus rules, which will govern the content and publication requirements for prospectuses filed in connection with an offer of securities to the public in the European Economic Area (EEA), or an application for admission to trading on an EEA regulated market, (ii) the disclosure rules, which will contain rules and guidance on the publication and control of inside information and the disclosure of transactions by management and (iii) the listing rules, which will contain rules and guidance for issuers of securities admitted (or seeking admission) to the UKLA's Official List of London listed companies. The sourcebook is together referred to as the Listing Rules.

Home member state

Perhaps the most fundamental change to the Listing Rules will be in the review process: even if listing is being sought in the UK, another European country's regulator may be charged with vetting the prospectus and regulating the issuer on a continuing basis. Odd as this may seem, it is the consequence of the European Commission's vision of a single home member state for companies (other than for offerings and listings of high denomination non-equity securities (€1,000) minimum denominations and above), issuers of which will retain discretion to select a regulator on a case by case basis for each particular issue).

In broad terms, the home member state for EEA issuers of equity securities or low denomination non-equity securities will be their state of incorporation. It seems that the intention of the Prospectus Directive was that the home member state of third-country issuers would be wherever they first made their public offer or listing application of equity or low denomination non-equity securities after December 31 2003, perhaps with the thought that a company could naturally choose to be regulated in a jurisdiction with which it has a close connection. In any event, the ambiguous drafting of the directive has led to a variety of interpretations among market participants, regulators and even the European Commission, resulting in widespread uncertainty and the potential election of a home member state with which a company has little connection.

Given the uncertainty and the potentially critical status of the first offering or listing application made since December 30 2003, non-EEA registered companies have had to consider carefully the impact of making a public offer (even under an employee incentive plan) or listing application (even of debt securities) in an EEA state. Their decision may determine their home member state under the Prospectus Directive for all future offerings and listings of equity securities and low-denomination non-equity securities, regardless of the jurisdiction of the later offering or listing being sought.

One of the benefits of the new Prospectus Directive regime in respect of prospectuses is that, once approved by the competent authority of the home member state, say, the UKLA, those prospectuses will be valid for use as an offer document or listing document in any other EEA state (the host member state) with minimal translation requirements (if any), so long as formalities relating to certification and notification are complied with. The simplification of the EEA passport process represents a significant part of the EEA's drive towards a single European market in financial services and a significant improvement to the existing mutual recognition system, which has been hampered by many EEA states' insistence on local language translation of the whole prospectus and the obligation to seek consent from all host member states for any derogations from EEA disclosure requirements.

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As issuers will generally be regulated by their home member state, it will present particular challenges to companies that want to be subject to London's so-called gold standard primary listing requirements, such as the class tests for substantial acquisitions and disposals, if their home member state, whether inadvertently or intentionally chosen, is elsewhere. It seems, however, that the UKLA intends to accommodate such issuers by relying on the existing Consolidated Admissions and Reporting Directive to impose super equivalent continuing obligations, that is, obligations beyond those required by the European Directives.

The Listing Principles

The proposed introduction into the Listing Rules of six Listing Principles, which are to be enforceable by the UKLA as rules, represent a novel and potentially important addition to the existing Listing Rules. The UKLA has stated that the Listing Principles are meant to reflect the "fundamental obligations" of listed issuers, and are "designed to ensure adherence to the spirit – as well as the letter – of the rules in the interests of promoting a fair and orderly market."

The draft Listing Principles will apply to issuers with a primary listing of equity securities in relation to their obligations under the Listing Rules. The Listing Principles will require that each issuer: (i) takes reasonable steps to enable its directors to understand their responsibilities and obligations as directors, (ii) takes reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules, (iii) acts with integrity towards holders and potential holders of its listed equity securities, (iv) communicates information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuance of a false market in such listed equity securities, (v) ensures that it treats all holders of its listed equity securities that are in the same position equally, in respect of the rights attaching to such listed equity securities, and (vi) deals with the UKLA in an open and cooperative manner.

While the concept of the Listing Principles is new to the Listing Rules, the use of such principles has been a feature of financial services regulation for several years now. It is therefore a regulatory tool with which the UK market is largely familiar. Opinion in the legal and financial community is nevertheless split on the usefulness or otherwise of the Listing Principles. On the one hand, it is widely accepted that the use of such regulatory principles elsewhere, such as in the City Code on Takeovers and Mergers, has shown the potential for them to create greater legal certainty by providing a clear context against which specific rules can be interpreted and by filling the gaps left by those rules where no particular result is dictated. On the other hand, many market participants have expressed concern that the UKLA might use the Listing Principles (in particular, the fourth principle on avoiding a false market) to take action against issuers that have not breached any specific rules, thereby exploiting the inherent ambiguity in the Listing Principles. In response, the UKLA has indicated that it will exercise its enforcement powers "reasonably and proportionately." We expect that this concern will abate with time.

The Prospectus Directive has brought about fundamental changes to the financial disclosure requirements

Financial disclosure

The Prospectus Directive has brought about fundamental changes to the financial disclosure requirements. The Prospectus Directive has been implemented both by national legislation and by European Regulations, which are directly effective in member states. The UKLA's approach has been to restate certain Prospectus Directive and European Prospectus Regulation requirements in the new prospectus rules section of the revised sourcebook.

Under the new Listing Rules, there will be a basic requirement to prepare accounts in accordance with International Financial Reporting Standards (IFRS) or, for non-EEA issuers, IFRS or a set of generally accepted accounting principles (Gaap) that has been determined (by the European Commission) to be equivalent to IFRS. This represents a significant departure from the flexible requirements in the current Listing Rules, particularly for global depositary receipt (GDR) listings, which allow US Gaap and many other Gaaps that have been deemed to meet appropriate standards. Issuers that do not prepare their accounts in accordance with IFRS or an equivalent Gaap may face the burdensome task of restating their accounts to IFRS before they can obtain a London listing. Transitional provisions included in the Prospectus Regulation should in general, however, allow issuers to use Gaaps other than IFRS and equivalent Gaaps until 2007.

The new rules will also introduce a requirement for *pro forma* accounts for share issuers where there has been a significant change in the issuer's group (for example, because of a significant acquisition). The *pro forma* accounts for the last annual period and any subsequent interim period would show the effect of the transaction had it occurred at the beginning of that financial period. These *pro forma* accounts will be required to have been reported on by independent accountants that, in their opinion, the *pro forma* financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the issuer. This contrasts to the current rules on significant acquisitions, which trigger a requirement for separate financials for the acquired business, but not *pro forma* accounts. Although not specifically required, it seems probable that issuers will continue to include separate historical financials for the acquired company. The number of years of historical financials (up to three) may well depend on the level of significance of the transaction.

The current requirement for financial information in many cases to be presented in the form of an accountant's report (with a new true and fair view opinion for all three years) has also been dispensed with. Instead, the historical accounts can simply be included, accompanied by the audit opinions previously issued.

No substantial amendments have been made to the existing requirements for continuing disclosure of financial information, as they will be replaced by rules implementing the Transparency Directive in early 2007. The UKLA expects to commence its consultation on the implementation of the Transparency Directive in early 2006.

Price-sensitive information and insider lists

The Financial Services Authority conducted a separate market consultation for the implementation of the Market Abuse Directive, including in relation to the disclosure of inside information. The UKLA has stated that "in most cases" determining what information should be disclosed and in what format should not lead to a different conclusion than under the current listing rules. Nevertheless, the potential broadening of the general requirement for ongoing disclosure of price-sensitive information has caused some concern. In particular, since *inside information* (as broadly defined in the Market Abuse Directive) that will be required to be disclosed is no longer tied to actual changes concerning the issuer or the securities, there has been discussion as to whether this would require corrections of wholly unfounded rumours resulting in a false market. However, the guidance to the new Listing Rules makes clear that the knowledge that a rumour is false is in most cases unlikely to amount to inside

information and, even if it did, the issuer would usually be able to delay disclosure, often indefinitely. Particular difficulties, however, may arise for companies with securities listed in more than one jurisdiction because the UKLA's approach may not be followed elsewhere in Europe. This would be a particularly unfortunate consequence given the European legislative aim of creating a level playing field throughout Europe.

More significantly on a day-to-day basis, perhaps, is the requirement in the new Listing Rules for an issuer to ensure that it and its agents and advisers keep and maintain insider lists of those employees who have access to inside information, and to ensure that its employees acknowledge their legal duties. The UKLA's consultation disclosed serious concern among market participants that this broad requirement (applicable to issuers of listed debt as well as listed shares) would impose a significant new burden on those affected. Insofar as adviser and agent lists are concerned, although the issuer is ultimately responsible for the maintenance of these lists, it is not required to include such lists within its own. Guidance suggests that it will be enough for an issuer to obtain assurances, probably based in contract, from advisers and agents as to the maintenance of lists and its right to access them from a designated contact person. As to the issuer's own list, the UKLA has insisted this should be a relatively simple exercise in good corporate practice and that issuers should already have similar lists as required under the Model Code. It is questionable, however, whether very many issuers' lists of relevant employees under the Model Code will be enough to require only slight adjustments. In addition, many companies that are not subject to the Model Code, that is, those with London listings other than primary listings, may not have the advantage of only having to modify lists they have already.

Sponsors

The UKLA has for many years relied on the sponsor regime to provide additional comfort that listed issuers are complying with the Listing Rules. Following some discussion during the consultation period of the possible merits of making the regime voluntary, or even abandoning it altogether, the UKLA rejected these options in favour of maintaining, and indeed strengthening, the existing sponsor regime for applications for primary listings and major transactions undertaken by issuers with primary listings. The UKLA reached the conclusion that the sponsor regime plays "an important role in helping to ensure that issuers meet the required standards". The requirement for a sponsor has, however, been dispensed with for secondary listings, in line with the policy to bring the requirements for secondary listings closer to the European directive minimum.

Many of the changes to the sponsor regime are simply to provide clarification. The new Listing Rules pared back many rules published with the interim consultation paper in October 2004, which would have substantially enhanced sponsors' responsibilities. Nevertheless, significant changes remain. A new whistle-blowing obligation, for example, has been introduced (a sponsor will be required to disclose material information of which it has knowledge which addresses non-compliance with the Listing Rules. This goes further than the current requirement to provide such information relating to compliance as was reasonably required by the UKLA. A sponsor can no longer wait for the UKLA to ask for information about non-compliance.

Changes have also been made to the nature of the sponsor's declaration required to accompany an application for admission. In particular, the key standard under which the declaration is given has been amended, so that a sponsor must not merely be satisfied, but must come to a reasonable opinion as to the matters (such as compliance with the Listing Rules) to which its declaration relates. This adds a potentially important additional element of objectivity to a sponsor's declaration and arguably places greater weight on the sponsor's own analysis and conclusions (rather than those of third parties on whose findings and opinions a sponsor might otherwise seek to rely).

Other matters to be covered by the revised sponsor's declaration include a new requirement that a sponsor come to a reasonable opinion that the applicant has satisfied the requirements of the Prospectus Directive unless the issuer's home member state is not, or will not be, the UK. This means a sponsor will need to formalize its view, indirectly, to the UKLA (in addition to the advice it will already have given to the issuer) on whether or not the issuer's home member state is the UK, which, as discussed above, may be problematic given the levels of uncertainty surrounding the directive on this issue. Further, a sponsor will for the first time be required to confirm that it is of the reasonable opinion that the directors of the applicant have established procedures enabling the applicant to comply with the

Listing Rules on an ongoing basis. Sponsors may aim to meet this new requirement by a combination of their own due diligence (including, for example, management interviews), reliance on the auditor's due diligence and reliance on comfort given by issuer's counsel as to the advice provided to the issuer's board of directors.

The new rules will also require a sponsor to ensure that all matters known to it which, in its reasonable opinion, should be taken into account by the UKLA in considering whether the admission of equity securities would be detrimental to investors' interests, have been disclosed with enough prominence in the prospectus. This is a watered down provision from that originally proposed by the UKLA in its interim consultation paper, which had required sponsors to consider whether admission would be detrimental to investors (something many market participants complained of as an unfair replication of the UKLA's own fundamental duties). The new rule nevertheless adds to the existing requirement for a sponsor to ensure that it is satisfied that all matters known to it which, in its opinion, should be taken into account by the UKLA in considering the application for listing have been disclosed to UKLA. The key differences are that the sponsor will now be required to declare that it has reached a reasonable opinion on the sufficiency of disclosure, rather than an opinion on the mere fact of disclosure.

Finally, the UKLA will also be devoting extra resources to monitoring and supervising sponsors more closely and to visiting sponsors to review their performance and compliance. This increased degree of regulation will be paid for by a significant increase in sponsor fees.

A market that was built around the existing Chapter 23 might well have had more potential

Debt and specialist securities

One of the UKLA's and many market participants' concerns has been to ensure that the specialist debt market in London is not adversely affected by the new Listing Rules. The UKLA and the London Stock Exchange have cooperated with each other for the introduction of an innovative Professional Securities Market: a listed market for specialist securities that are not traded on a regulated market and which therefore, as a legal matter, fall outside the Prospectus Directive regime. This move is aimed at maintaining the London professional securities markets by providing an alternative regime for issuers, particularly non-EEA issuers, which might otherwise find the financial disclosure requirements of the Prospectus Directive regime too onerous. This new market will allow the listing of straight debt, convertible/exchangeable bonds and GDRs aimed at professional investors. Issuers of the specialist securities admitted to this market will be required to produce a prospectus meeting the same content requirements as those governing wholesale debt or wholesale GDRs (that is, those with a minimum denomination of €50,000 or more) under the Prospectus Directive, regardless of the minimum denomination of those securities, which means that third country issuers will not be required to prepare financial statements in accordance with IFRS or equivalent Gaap.

However, the real potential for this market may not have been tapped by the UKLA by adhering too closely to the regime that would have been required were the Professional Securities Market a regulated market. A market that was built around the existing Chapter 23 may well have had more potential. In any event, its success may be hampered by the uncertainty about whether investors will in practice be willing or able to invest in securities listed on a market that is not a regulated market.

Final judgment

Many questions surrounding the new listing regime remain unanswered, particularly as to the practical workings of the new Listing Rules and the approach of the UKLA towards their enforcement, and it will be some time before a final judgment can be made on the impact of the new regime on London listings. Nevertheless, in so far as the listing review was an opportunity to simplify and modernize the existing listing regime in light of Europe's financial services legislation, the general market view is that the review has been worthwhile and the new Listing Rules will largely succeed in achieving the UKLA's stated objectives. Certainly, the new regime will, for better or worse, give listed issuers and sponsors much to think about. ■

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