



New Proposed Rule for Listing of Sovereign Controlled Companies on London Stock Exchange

Curtis Insight: Capital Markets – Sovereign Controlled Companies

London Client Briefing
September 2017

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A. Summary of Proposal

In July 2017 the UK Financial Conduct Authority (FCA) issued a proposal (Proposal) to make the premium listing regime on the London Stock Exchange more attractive for companies controlled by a shareholder that is a sovereign country.

1. Context

In February of this year the FCA published a discussion paper (DP17/2 'Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape') in which it discussed the role of listed primary markets as an important component of the broader capital markets landscape, and the structure of the UK listing regime in supporting that role. One of the questions the FCA identified in the discussion paper and on which it invited further comments was the broad question of whether the existing listing arrangements might be improved for international companies and, if so, how.

2. Proposal

The proposed amendments to the listing regime would include a new premium listing category. Currently, premium listing is sub-divided into three categories (premium listing of commercial companies, closed-ended investment companies and open-ended investment companies).

The FCA proposes to add another category that would be available to commercial companies controlled by a shareholder that is a sovereign country. The investor protections applicable to the current premium listing for commercial companies would continue to apply except that the following rules would not be applicable for the sovereign controlling shareholder:

- the related party rules; and
- the controlling shareholder rules.

The Proposal considers that in addition to equity shares, the new premium listing category would be open to commercial companies who would like to list Depositary Receipts.

3. Goal

The FCA's goal is to ensure that the UK's investment markets work well but become more accessible for sovereign controlled companies.

4. Process

The FCA has set a deadline for responses to its Proposal by October 13, 2017 and expects to publish the final rules and its Policy Statement by the end of the year.

B. Broader Landscape

1. Initial FCA Discussion Paper

The FCA discussion paper (DP17/2, ‘Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape’) published in February this year reviewed the role the UK listing regime could play in supporting the growth of science and technology companies, improving debt capital markets and how it might address the needs of international companies that are interested in listing in the UK.

The responses about a distinct international segment were mixed and the FCA has therefore decided to publish a more targeted proposal which it believes would make the listing regime work better for companies with a substantial level of ownership held by a sovereign country.

2. Existing Listing Categories

The FCA proposes to amend the existing listing regime to include a new premium listing category. There are currently three categories within the premium listing regime.

Listing Categories Explained

The listing regime is divided into premium and standard listings. These segments are then further subdivided into individual categories. There are currently three premium listing categories and five standard listing categories.

The requirements for the five standard listing categories stem broadly from the applicable framework of EU directives. They are consistent with the regulatory frameworks for listed securities across the EU.

The premium listing categories build on those requirements by adding certain ‘super-equivalent’ rules. These require issuers to meet additional conditions and, in the case of admission criteria, a greater degree of business maturity. At present, however, the premium segment is only available for equity shares of: (i) commercial companies; (ii) closed-ended investment funds; and (iii) open-ended investment companies.

The ‘Premium listing (Commercial Companies)’ categories requires commercial companies to demonstrate that the company carries on an independent business, has a three-year revenue earning track record, sufficient working capital and unqualified financial statements.

The individual categories set out specific requirements for different company or security types. Each category is essentially a separate set of obligations that apply to an issuer of securities as a result of the security being listed. Investors and issuers know which obligations apply to the issuer’s listing because the relevant category is shown against the particular entry on the official list.

In certain circumstances, issuers can apply to the FCA to have their listing re-categorised. As a result, their obligations under the Listing Rules will change. The FCA allows a re-categorisation as long as the issuer’s securities are eligible for inclusion in the new category and they comply with the processes required by the relevant Listing Rules.

C. Proposed Modification for Sovereign Controlled Companies

1. Rationale

The FCA believes that sovereign controlled companies are sufficiently distinctive to justify a modified set of arrangements within the existing UK listing regime. According to the FCA, previously introduced changes to the Listing Rules did not specifically address the potential impact on companies that are sovereign controlled or on the sovereign controlling shareholders. The FCA takes the position that sovereign owners tend to be different from private-sector individuals or entities in both their motivations and their nature, i.e., in terms of their structure and the extent of their activities. Sovereign states may own enterprises for historic reasons, among others, for example, as a result of government bailouts or nationalisation policies or because the enterprise carries out activities of strategic importance to the state. The responsibilities and scope of the sovereign entity's involvement in these enterprises may sometimes be of a statutory nature. Additionally, a sovereign state's interests may be pursued through many entities and across a broad range of activities.

The FCA believes that the current listing regime does not, in some respects, easily accommodate issuers with sovereign controlling shareholders, because of the different nature of a sovereign owner as opposed to private-sector individuals or entities. Although the group of sovereign controlled commercial companies is not likely to be large numerically, their likely market value, for example arising from major privatisation transactions, is large enough to justify creating a new regime category to address a perceived market gap.

2. Eligibility Criteria

The proposed new premium listing category would be available to "sovereign controlled commercial companies" and will not be restricted based on country of incorporation or national identity. The definition of "sovereign controlled commercial company" proposed by the FCA encompasses companies with a shareholder that is a sovereign country which controls 30% or more of the voting rights of the company.¹ The State which is the sovereign controlling shareholder must be recognised by the UK government as a state at the time the application is made.

When assessing eligibility for this new category the FCA states that it will examine the substantive control being exercised by the State on a case-by-case basis. While the FCA is unlikely to agree that a passive stake held by a sovereign wealth fund would demonstrate substantive control by the State, it would assess the question of control on the facts specific to an application at the time it is made.

3. Proposed Modifications to Key Investor Protections

The new premium listing category would effectively relax the current premium Listing Rules applying to sovereign controlled companies by modifying certain investor protections currently applying to commercial companies as follows:

i) Related party rules

The existing related party rules represent a significant shareholder protection within the current premium listing regime. Chapter 11 of the Listing Rules requires that a commercial company with a premium listing of equity shares: (i) sends an explanatory circular to its independent shareholders (explaining the transaction to

¹ Note that in proposing a 30% threshold, the definition of sovereign controlled commercial company will be aligned to the "controlling shareholder" definition set out in LR 6. It is also the threshold that the Takeover Panel uses for its obligation on parties buying shares that will raise their holding to or above 30% to make a mandatory offer under Rule 9 of the Takeover Code.

shareholders and including an opinion from the board, supported by a sponsor firm, that the terms of the transaction are 'fair and reasonable' so far as the shareholders are concerned), (ii) obtains independent shareholder approval, and (iii) notifies a Regulatory Information Service (RIS) of any transaction it enters into with a related party. These related party rules aim to provide scrutiny and allow for the approval by independent shareholders of transactions and arrangements between listed companies and their 'related parties'. LR 11.1.4R provides that 'related parties' include substantial shareholders, directors or shadow directors, persons exercising significant influence, and associates of a related party. According to LR 11.1.4AR, a substantial shareholder is a person who is entitled to exercise, or to control the exercise of, 10% or more of the votes able to be cast on all, or substantially all, matters at general meetings of the company (or of any company which is its subsidiary undertaking, parent undertaking or of a fellow subsidiary undertaking of its parent undertaking).

The related party rules provide a number of exemptions for different transactions and arrangements, including exemptions based on the size of the transaction and its type. They also provide for modified requirements for what are classified as 'smaller related party transactions' in the Listing Rules. Currently, under these modified requirements, no prior shareholder approval is required and instead the company obtains a 'fair and reasonable' opinion from its sponsor, and makes an announcement giving details of the transaction. The related party rules are not applicable to companies in the standard listing segment.

Under the FCA's new proposed premium listing category, sovereign controlling shareholders will not be considered a related party for the purposes of LR 11, therefore none of the related party rules will apply to transactions between the premium listed sovereign controlled company and the sovereign controlling shareholder and/or its associates (as defined in the Listing Rules). All other aspects of the related party rules would remain in respect of any other parties that would otherwise be covered by the definition of a related party. So, for example, a transaction between the listed company and any of its directors (including any director who may have been appointed by the sovereign controlling shareholder) or with any other substantial shareholder would still be treated as a related party transaction.

ii) Controlling shareholder rules

Currently, chapter 6 of the Listing Rules applies to commercial companies with a premium listing and is designed to protect minority shareholders of any such company that has a controlling shareholder. LR 6 requires a commercial company with a premium listing to (i) enter into a relationship agreement with any controlling shareholder to ensure that it does not abuse its shareholding to the detriment of other shareholders; and (ii) ensure that its constitution provides for the election and re-election of independent directors subject to the separate votes of all shareholders and independent shareholders.

The definition of controlling shareholder is set out in LR 6.1.2.A R as any person who exercises or controls on their own or together with any person with whom they are acting in concert 30% or more of the votes able to be cast on all or substantially all matters at general meetings of the company.

Under the FCA's new proposed premium listing category, the controlling shareholder rules in LR 6 will no longer apply to issuers in the new category in respect of a sovereign controlling shareholder (but will continue to apply to any other controlling shareholder). However, note that all other LR 6 eligibility requirements will continue to apply to the applicant.

With the exception of the above modifications, it is proposed that, amongst other key investor protections that are currently required for a premium listing by a commercial company, the following will continue to be required for the proposed new fourth premium listing category:

- a requirement for a new applicant to have an audited three-year revenue earning track record;

- a requirement that the company's application is supported by a sponsor firm, and that the company continues to consult with a sponsor on the application of certain continuing obligations under the Listing Rules;
- a requirement that the working capital statement is not qualified;
- the requirement for a new applicant to demonstrate that it will be carrying on an independent business as its main activity, and that it has strategic control over its business;
- related party rules governing transactions between the listed company and directors, substantial shareholders or their associates;
- rules governing significant transactions (e.g., shareholder approval will continue to be required for class 1 transactions including in relation to transactions with the sovereign controlling shareholder) and the buying back of shares; and
- controlling shareholder provisions in respect of such shareholders that are not the sovereign controlling shareholder.

The FCA notes, however, that it has specifically included guidance in the draft instrument for the new listing rule chapter clarifying that, in addition to the factors listed in the proposed guidance, the granting of, or the requirement to grant, security over its business in connection with the funding of the sovereign controlling shareholder is a factor which may indicate an applicant does not carry on an independent business. It should also be noted that the factors set out in the guidance to LR 6 are non-exhaustive and the FCA may take other factors into consideration when determining whether an applicant is carrying on an independent business as its main activity.

Companies with a premium listing of equity shares in the new category would also have to comply in full with a range of disclosure and transparency rules² and meet its obligations as a company admitted to trading on regulated markets, as set out in the EU Market Abuse Regulation (MAR), including regarding disclosure of inside information.

The FCA states that the proposed modifications recognise the fact that sovereign countries are very different entities from private-sector shareholders. The FCA believes that when making an investment in a sovereign controlled company, an investor is making a judgement about how the sovereign will interact with that company. Capital markets, many of whose participants have extensive experience of investing in sovereign securities, understand this and are well positioned to assess the relevant sovereign and jurisdictional risks.

The FCA therefore thinks it is justifiable and realistic to take a different approach where there is a sovereign controlling shareholder. Sovereign controlled companies seeking to expand their international investor base are likely to have extensive and complex relationships with the sovereign controlling shareholder. The proposed modifications to the UK's premium listing segment is therefore aimed at encouraging sovereign controlled companies to list in the UK.

² Including DTR 4 (periodic financial reporting); DTR 5 (vote holder and issuer notification rules); DTR 6 (continuing obligations and access to information); and DTR 7.2 (corporate governance statement).

4. Depositary Receipts

The FCA's Proposal also proposes that the new premium listing category should be extended to sovereign controlled issuers of depositary receipts, who are currently only eligible for a standard listing. Where depositary receipts are eligible for listing, all relevant premium listing requirements applicable to equity shares would also apply to those depositary receipts.

Note that for a listing of depositary receipts, the 30% threshold over which control by a sovereign shareholder is established is calculated on the basis of voting rights attaching to the underlying equity shares.

To be eligible for listing in the new category (i) the depositary receipts must be admitted to trading on a regulated market, (ii) the depositary receipt holders must be afforded all the rights attached to the underlying shares and those shares must be eligible for premium listing, and (iii) the holders must be able to exercise the votes attached to the underlying equity shares. There must also be a full pass-through of other rights attached to the underlying shares (such as rights relating to a rights issue or open offer, or in relation to participation in a share buyback).

5. Applying for the New Category

If implemented, the new rules will only apply to companies that apply for and are granted a listing in the new category, having met the applicable criteria.

It is proposed that a sovereign controlled company with an existing listing under the premium listing (commercial companies) category will be entitled to apply to the FCA to transfer their listing to the new category in order to benefit from the new rules. In order to do so, a sovereign controlled company is required to obtain the approval of the independent shareholders of the company (in other words, no sovereign controlling shareholder or other controlling shareholder would be permitted to participate in such a vote).

Note however that the FCA will retain its power as competent authority for listing under s75(5) of FSMA to refuse an application for listing if it determines that granting the application would be detrimental to the interests of investors.

6. What Happens When the Sovereign State Ceases to be a Controlling Shareholder?

Companies wishing to take advantage of the new premium listing category will be required to meet a continuing obligation that such company has a sovereign controlling shareholder. Where a company no longer complies with or breaches its continuing obligation (for example, when a sovereign shareholder ceases to hold the required threshold of 30% of the company's voting rights), the company will be required to notify the FCA.

Following any such notification, the FCA would then expect the company to commence discussions in relation to the transfer of its listing to a premium listing of equity shares for commercial companies.³ Alternatively, it may seek to transfer to a standard listing or cancel its listing, subject to the approval of independent shareholders. If those shareholders vote against such a proposal, the FCA would have power under LR 5.1 and 5.2 to suspend and cancel a listing on the grounds that the issuer has breached its continuing obligation and lacks eligibility for the new category.

³ Note that a shareholder vote would not be required for a transfer to the premium listing (commercial companies) category, due to the fact that investor protections will increase.



An issuer of depositary receipts listed under the new category would have to apply to transfer to a standard listing or to cancel the listing, subject to the vote of the independent holders of the listed depositary receipts. Again, in the event of a vote against any such transfer, the FCA could suspend and cancel the listing on the grounds of ineligibility.



Questions, Comments, Suggestions?

If you have any comments or queries, please do not hesitate to get in touch with your usual Curtis contact, or one of the Corporate team members below.

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