

## How effective are the UK's primary markets?

FCA reviews the effectiveness of the primary markets and proposes technical enhancements to the Listing Rules

9 March 2017

On 14 February 2017, the Financial Conduct Authority (FCA) published:

- a [discussion paper: 'Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape'](#) (DP 17/2) which prompts a discussion on the effectiveness of its primary capital markets for issuers and investors (the Discussion Paper); and
- a [consultation paper: 'Review of the Effectiveness of Primary Markets: Enhancements to the Listing Regime'](#) (CP 17/4) which contains proposals to enhance certain aspects of the Listing Rules (LRs) and related technical guidance (the Consultation Paper).

The publications form a key part of the FCA's wider work on improving the efficiency and effectiveness of the UK primary markets for issuers and investors - an objective which was set out in its [2016/17 Business Plan](#).

### Reviewing the structure of the UK's primary markets

The FCA is reviewing the structure of the UK's primary markets to ensure that they continue to meet the needs of investors and issuers. As part of its review, the FCA has conducted an extensive data analysis of the key trends of activity on the UK's primary equity markets in recent years, the results of which are set out in Appendices 1 and 2 of the Discussion Paper. Additionally, the FCA has met with various stakeholders to ascertain the main themes for discussion which it sets out in the Discussion Paper. To read our summary of the key points raised in the Discussion Paper, [click here](#).

Additionally, the Consultation Paper sets out some of the FCA's more developed proposals to enhance certain aspects of the Listing Rules and its related technical guidance. Read on for our summary of the key proposals set out in the Consultation Paper.

### Clarifying the premium listing eligibility requirements for commercial companies

The FCA proposes various amendments to LR 6, which sets out the eligibility requirements for premium listed companies, in order to clarify the drafting and presentation of the existing provisions. In particular, the FCA is proposing to re-structure the presentation of the requirements relating to the independence of an issuer's business in response to concerns that the current structure is unclear and misleading. In conjunction with these amendments, the FCA proposes a new Technical Note, UKLA/TN/103.1 "*The independent business requirements for companies applying for premium listing – interpretation of LR 6.4, LR 6.5 and LR 6.6*" which provides further guidance on the interpretation of the independence requirements and sets out examples of what might be seen as 'improper influence'.



### Contacts

#### [Maegen Morrison](#)

Partner

#### [Richard Ufland](#)

Partner

#### [John Basnage](#)

Partner

#### [Nigel Read](#)

Partner

#### [Daniel Simons](#)

Partner

#### [Danette Antao](#)

Senior Professional Support Lawyer

Visit us at

[www.hoganlovells.com](http://www.hoganlovells.com)

### ***Concessionary routes to a premium listing***

#### *SRBC and mineral companies*

Whilst applicants are usually required to have a three year revenue earning track record in order to be eligible for a premium listing, applicants operating in certain sectors (that is, scientific research based companies (SRBCs) and mineral companies) may follow different rules which exempt them from this requirement (the 'concessionary routes'). The FCA is proposing some minor and consequential changes to the current concessionary routes which arise from its general amendments to LR 6. Additionally, it proposes to replace the existing Technical Note for SRBCs with a new Technical Note on "*Scientific research based companies*" (UKLA/TN/422.3) and proposes a new Technical Note on "*Mineral Companies*" (UKLA/TN/427.1) to help interpret the requirements relating to the two concessionary routes.

#### *New concessionary route for property companies*

The FCA is proposing a new concessionary route for property companies that may not be able to meet the three year track record requirements but whose maturity may be demonstrated in other ways. In particular, the FCA identifies two types of companies that would benefit from the new concessionary route, being:

- companies which have been established for less than three years, but predominantly hold mature, let assets that generate revenue (such as a spin-out and listing of a mature portfolio); and
- companies which have developed assets for three years, but which focus on projects that may only generate revenue in the long term.

The proposed change involves a new rule under which property companies would be exempt from having a three-year revenue generating track record but the applicant must:

- demonstrate that it has three years of development represented by increases in the gross asset value of its assets, supported by a property valuation report, or
- publish a property valuation report that shows that 75% of the applicant's assets by value are revenue generating at the point in time when it makes its application for admission of the equity shares to a premium listing.

The FCA is also consulting on a new technical note on the proposed concessionary route: "*Property companies (UKLA/TN/426.1)*" to complement the new requirements.

### ***Classifying transactions***

Premium-listed companies are required to use the prescribed class tests in the LRs (that is, the gross assets test, profits test, consideration test and gross capital test) to assess the relative size of any proposed transaction in order to determine the disclosure and approval requirements that may apply to that transaction.

The proposals are in response to issuers' concerns that the profits test results may produce an inaccurate representation of the size of a transaction. Having considered feedback and taking into account its own experience in assessing transactions, the FCA proposes the following amendments to the way in which the profits test should be applied.

#### *Disregarding an anomalous profits test*

It is proposed that, where the profits test result is 25% or more, but the results of all other applicable class tests are below 5% and the profits test result is anomalous, the issuer may, having sought the guidance of its sponsor, disregard the profits test result without consulting with the FCA in advance. Consequently, the transaction will be treated as unclassified.

### *Adjustments to the profits test*

The FCA notes that in addition premium listed issuers, having sought guidance from a sponsor, should be able to adjust their calculations of the profits test if the transaction's classification would otherwise be anomalous, without consulting the FCA in advance. The FCA is proposing that an issuer should be permitted to adjust profits for:

- costs incurred by the issuer, or the target, in connection with its IPO; and
- closure costs incurred either by the issuer, or the target, that are not part of an ongoing restructuring that will span more than one financial period,

provided that the relevant item is a genuine 'one-off' cost.

In assessing whether the item is a genuine one-off cost, the issuer and sponsor should have regard to the proposed revisions to the Technical Note: "*Classification tests*" (UKLA/TN/302.2).

It is also proposed that the issuer or target may adjust profit before tax (PBT) for historic financing costs where it has recently completed its IPO and undertaken a capital restructuring. An issuer, therefore, would be able to adjust PBT to remove historic financing charges incurred during private ownership which are no longer relevant. These charges should be substituted on a pro-forma basis with the costs of the issuer's current borrowing arrangements.

### *Sponsor guidance and consulting the FCA*

The FCA notes that the above proposals regarding an issuer's ability to disregard the profits test results or adjust the profits test would only apply where the transaction would otherwise be classed as a class 1 or reverse takeover. Issuers will still be required to consult with their sponsors in these cases but will no longer be required to consult with the FCA.

For all other situations where an issuer considers that the profits test produces an anomalous result, the FCA proposes that issuers should continue to consult the FCA if they wish to modify the way they apply the profits test rules.

Note that these proposals do not apply to standard listed issuers, who are required to consult the FCA before adjusting or disregarding any class test results.

### *Profit test calculations – further enhancements?*

In conjunction with these proposals, the FCA asks whether there are any further enhancements to the calculation of the profits test that could be made or whether there are any alternative profit measures that should be used with, or in place of, the current profits test.

### **Suspension of listing for reverse takeovers**

The FCA is proposing to remove the presumption that, where a reverse takeover is in contemplation, there will be insufficient information in the market about the target unless the listed company can provide it. Instead, the FCA will assume that the market can operate smoothly on the basis of the information that listed companies already make publicly available as part of their compliance with existing obligations, principally their obligation to disclose inside information under the Market Abuse Regulation.

The proposals come in response to stakeholder feedback that the presumption of suspension has a serious impact on investors and issuers. Investors are concerned by the suspension of trading which prevents them from trading out and stops potential investors from buying interests. Additionally, the FCA notes that, although it does not frequently suspend a listing in connection with a reverse takeover, there is concern that issuers are discouraged from contemplating such transactions. Companies may consider that the benefits of a potential transaction are outweighed by the impact of a potential suspension of listing.

The proposal to remove the presumption of suspension for reverse takeovers and its related obligations will

extend to all issuers with a premium or standard listing of securities - but not to shell companies. In order to reflect its proposals the FCA will also update its technical note on "*Listing Principle 2 Dealing with the FCA in an open and cooperative manner (UKLA/TN/209.2)*" to reflect these proposals and delete its technical note on reverse takeovers (*UKLA/TN/306.2*).

The FCA does not, however, propose to change its general position that it may still suspend a listing if it considers that the issuer is unable to accurately assess its financial position and inform the market accordingly, or where there is insufficient information in the market. In that context, the FCA does not plan to treat reverse takeovers differently from class 1 transactions.

#### *Shell companies*

The FCA intends to retain the current requirements (and related rules and guidance) on the rebuttable presumption of suspension where a reverse takeover is announced or leaked for listed companies that are shell companies (as defined in the FCA's proposed new LR 5.6.5AR). The FCA proposes to update its existing technical note on special purpose acquisition companies, which it proposes to present in a new note: "*Cash shells and special purpose acquisition companies (SPACs) (UKLA/TN/420.2)*".

#### **Next steps**

Responses to the Discussion Paper and the Consultation Paper must be submitted by 14 May 2017. The FCA proposes to publish the new rules in the second half of 2017.

If you have any queries on the Discussion Paper or the Consultation Paper, please contact your contact at Hogan Lovells or one of the listed contacts.