DEVELOPMENTS IN THE LONDON LISTING MARKETS: LISTING RULES REFORM, MARKET SOUNDINGS AND FCA PROSPECTUS APPROVAL

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In our final article of this series, we focus on upcoming changes to the Listing Rules and updates to the guidance around market soundings under the UK market abuse regime. We also discuss (a) the High Court's recent dismissal of environmental activist group, ClientEarth's, application for judicial review of the Financial Conduct Authority's ("FCA") decision to approve Ithaca Energy plc's prospectus and (b) the proposals for share digitisation.

Our previous articles in relation to developments in the London listing markets can be found **here.**

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LISTING RULES REFORM

The London Stock Exchange's Main Market is due to undergo significant changes by an overhaul of the Listing Rules. The FCA launched its most recent round of consultations on the new Listing Rules in December 2023, with the aim of publishing in late 2024. The proposals should ultimately lead to a simplified and more attractive market for companies already listed and potential new entrants, especially international companies, and address concerns around the relatively low level of regulation in the current standard segment.

Proposed key changes

The key changes proposed include relaxing some of the current rules for companies seeking to list on the Main Market and relating to the continuing obligations of listed companies. These changes should result in a reduced regulatory burden for "premium" listed companies, but an increased burden for "standard" listed companies (as summarised in the table below).

The current categories of "premium" and "standard" listed will be amalgamated into a single "commercial company category" ("ESCC"), covering a range of companies with equity shares. Other categories for shell companies and issuers of non-equity shares are also proposed, which will not be examined here. The current categories covering investment funds and non-equity securities will be retained. There will also be a transitional category for existing listed companies to allow time to adapt before being moved to the ESCC. The new ESCC will retain some of the current requirements such as minimum market capitalisation and pre-emption rights.

Eligibility criteria for new entrants

The current requirements for companies to have a three-year financial earning track record and a 'clean' working capital statement before they can be listed on the premium segment will be removed, a change which should allow growth companies (e.g. tech companies) to list more easily. Whilst, in practice, the FCA and the company's financial advisors will still want to ensure that the company will have adequate working capital, the proposed change should allow more flexibility as to what information can be provided.

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The requirement for a relationship agreement between a company and its controlling shareholder will become optional, but the risks related to the relationship between them would need to be expressly disclosed.

Dual class shares structures

The current limit of five years for dual class structures, where shareholders with a specific class of shares are entitled to exercise enhanced voting rights that are disproportionate to their economic interests in the company, will increase to 10 years, provided that only directors and natural persons (that are also investors, shareholders or employees) will be able to hold shares with enhanced voting rights on a first listing. Shares with enhanced voting rights will also remain subject to transfer restrictions.

Shareholder approval for transactions

For significant transactions, shareholder consent and the publication of circulars will no longer be required, except for reverse takeovers and related party transactions. The class test regarding profits will be removed. Sponsors will also have greater discretion over how significant transactions should be treated. The requirement for announcements and circulars for transactions meeting the thresholds in the Class 2 tests will also be removed. However, there will be enhanced notification requirements for transactions that meet the current Class 1 threshold, such as disclosure of key details including historical financial information. The requirement for a fair and reasonable statement from the board and accompanying sponsor confirmation will remain in place. These changes are indicative of the FCA's focus on a disclosure-based regime and encouraging greater scrutiny and engagement by large investors. The current requirements for listed companies under the market abuse and prospectus regimes will also remain in place, which should provide comfort to minority shareholders concerned by the proposed removal of shareholder approvals.

Sponsors

The requirement for a sponsor will be extended to all ESCC companies whereas previously a sponsor was only required for a premium listing. The role of the sponsor will largely be the same as now at the IPO stage, but with a focus on ongoing disclosure and, as mentioned, a larger advisory role on significant and related party transactions. The FCA is consulting on the role of sponsor for secondary issues as part of the updated UK prospectus regime, which should align with the proposed changes to the Listing Rules.

> "The simplified, disclosure focused Listing Rules should result in a regulatory landscape which is clearer and more flexible for companies and advisors to navigate."

Commentary

The simplified, disclosure focused Listing Rules should result in a regulatory landscape which is clearer and more flexible for companies and advisors to navigate. The table below summarises the key changes and how premium and standard listed companies will be affected. The proposed changes may also improve the attractiveness of companies looking to dual list on the Main Market, as companies which may have previously considered the standard segment will be subject to greater regulation under the ESCC. Those companies that prefer greater flexibility should consider listing on AIM instead, as AIM is geared towards newer companies and reduced regulatory burden.

Proposed change to Listing Rules	Premium segment	Standard segment
Removal of requirement for new issuers to have "three-year financial earning track record and 'clean' working capital statement"	Reduced	No change
Arrangements for controlling shareholders	Reduced - relationship agreements no longer needed	Increased – more disclosure for controlling shareholders
Significant transactions	Reduced – announcement only required where any relevant percentage ratio is more than 25%	Slightly increased – announcements will be required
Reverse takeovers	No change	Increased – shareholder consent to be obtained
Requirement to have a sponsor	Reduced – less sponsor involvement for circulars and shareholder consent not required for significant transactions	Increased – sponsor now required

MARKET SOUNDINGS

On 31 October 2023, the FCA published Market Watch 75, focussing on market soundings and reminding entities of the associated risks. Market soundings (defined in Article 11.1 of the UK Market Abuse Regulation ("MAR")) are used by entities to communicate with investors before the announcement of capital markets transactions to gauge interest in the market to determine the price, size and structure of a transaction. This is a helpful tool for issuers to determine the interest and manage the risk of the deal.

The FCA raised concerns in the latest Market Watch following observations in recent cases where Market Sounding Recipients ("MSRs") had traded financial instruments after a Disclosing Market Participant ("DMP") had initially communicated with them or sought consent from them on receiving market soundings, but before the DMP had disclosed the identity of the financial instruments, the nature of the proposed transaction or the likelihood of the transaction taking place. This particularly occurred where there had been a gap between the initial request for consent from the DMP to the MSR and the MSR providing consent. In these cases, the FCA noted that MSRs may have had other information available which allowed them to identify the financial instruments referred to before consenting to receive inside information, leading to concerns that these MSRs would be at an unfair advantage.

The FCA reiterated the steps that both DMPs and MSRs should take when participating in market soundings to ensure that market requirements are complied with.

DMPs should carefully consider and assess the standardised information which will be provided to MSRs in their initial communications and consent requests. DMPs should also be clear when a communication is a market sounding, to provide the MSR an opportunity to decline. DMPs should be particularly cautious where the financial instrument has fewer parties involved and where potential external information the MSRs hold could reasonably be used to identify the financial instrument.

MSRs should consider putting in place "gatekeeper" arrangements such as effective information barriers within their organisation. MSRs should also ensure that staff who receive and process market soundings are trained in relevant internal procedures and MAR prohibitions on unlawful use of inside information.

Commentary

The latest warnings on market soundings are indicative of the stronger approach by the FCA on enforcement and dealing with market abuse.

R (CLIENTEARTH) V FINANCIAL CONDUCT AUTHORITY AND ITHACA ENERGY PLC

On 13 December 2023, the High Court dismissed ClientEarth's renewed application for judicial review of the FCA's decision to approve a prospectus published by Ithaca Energy plc ("Ithaca"), an oil and gas exploration company operating in the North Sea.

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Background

Under section 87A of the Financial Services and Markets Act 2000, the FCA may not approve a prospectus unless it is satisfied that it contains the information required under the UK Prospectus Regulation (the "Prospectus Regulation").

On 18 October 2022, Ithaca published an FCA-approved registration document and, upon receipt of various queries from ClientEarth in respect of the registration document, published a revised and final version on 9 November 2022.

ClientEarth's claims

ClientEarth alleged that the FCA's decision to approve Ithaca's prospectus was unlawful on the following grounds:

1. Ground 1 and Ground 2: The FCA erred in law by approving Ithaca's prospectus in circumstances where the prospectus failed to disclose, or describe adequately, Ithaca's assessment of the materiality or specificity of its climate-related financial risks, in breach of Article 16 of the Prospectus Regulation; and
2. Ground 3: The FCA's conclusion that the prospectus contained the necessary information which is material to an investor for making an informed assessment of Ithaca's financial position and prospects, as required by Article 6 of the Prospectus Regulation, was rationally unsustainable, particularly considering the potential effects of the implementation of the Paris Agreement on Ithaca's business.

High Court's decision

The High Court dismissed ClientEarth's application for judicial review, on the basis that:

- Grounds 1 and 2: The FCA's interpretation of Article 16 of the Prospectus Regulation was correct as Article 16 requires the disclosure of material risk factors, but it does not impose a separate requirement for the issuer to disclose its assessment of risk, materiality, and specificity; and
- Ground 3: The High Court held that Ground 3 had no realistic prospect of success on the basis that Ithaca identified the Paris Agreement as a material risk for the business in its prospectus and referenced the difference of view between ClientEarth and Ithaca as to its compatibility with the Paris Agreement in the prospectus.

> "It is important that issuers continue to monitor and reappraise risks rather than slavishly following risk factors that they may have used in the past."

The High Court also rejected an argument by ClientEarth that the claim was an Aarhus Convention claim which could have otherwise limited the costs that could be recovered from the losing party.

Commentary

ClientEarth's application for permission to pursue its judicial review application followed a position paper it had issued in July 2022, arguing that the FCA should strengthen its approach to disclosures in prospectuses by:

- subjecting climate-exposed listings to heightened scrutiny;
- issuing guidance to the market explaining the FCA's approach to such listings; and

- requiring companies to demonstrate Paris-alignment as a condition of listing.

ClientEarth argued that these actions would be consistent with the FCA's existing powers, but stopped short of claiming that the FCA had a positive obligation to undertake these steps.

The High Court's decision underlines that the approval of prospectuses remains a matter for the FCA's discretion. What counts as "adequate" environmental disclosure remains a question for the FCA, whose evaluative judgment cannot be replaced by the specific requirements advocated for by ClientEarth. This is consistent with the historic reluctance of the courts to interfere with the discretion of regulatory authorities in their decision-making. Unless and until the FCA decides to publish any definitive guidance or its regulatory powers and obligations are otherwise changed by new regulation, prospective issuers should continue to prepare prospectuses in line with official guidance. The High Court's decision not to classify the claim as an Aarhus Convention claim may deter future claims of a similar nature.

It is important that issuers continue to monitor and reappraise risks rather than slavishly following risk factors that they may have used in the past and ensure that they are mindful of following the existing requirements for risk factors in setting them out in order of priority. Whilst relevant issuers may be relieved by the approach the court took in this case, it is fair to assume that activist groups will look for other angles of attack.

SHARE DIGITISATION

In July 2022, the government announced the creation of a taskforce (the "Digitisation Taskforce") to drive full digitisation of the UK's current shareholding framework and secure consensus on a set of improvements to benefit all market participants. Share digitisation involves eradicating paper-based processes, particularly paper share certificates, in the securities settlement infrastructure for capital markets and reforming the current shareholding framework. The current mix of digitised and paper-based share certificates requires companies and financial market participants to manage different systems for the issuance and settlement of shares and for communications and corporate actions between companies and shareholders. These arrangements are costly and inefficient.

The Digitisation Taskforce published its interim report in July 2023, listing the following potential recommendations:

- legislation should be brought forward, and company articles of association amended, as soon as possible to stop the issuance of new paper share certificates;
- legislation should be introduced to require dematerialisation of all share certificates at a future date, to be determined as soon as practicable;
- the government should consult with stakeholders on the preferred approach to "residual" paper share interests and whether a time limit should be imposed for the identification of untraced ultimate beneficial owners ("UBOs");
- intermediaries offering shareholder services should be fully transparent about whether clients can access their rights as shareholders, as well as any charges for their services;

"Share digitisation involves eradicating paper-based processes, particularly paper share certificates, in the securities settlement infrastructure for capital markets and reforming the current shareholding framework."

- where intermediaries offer access to shareholder rights, the service should facilitate the ability to vote, with confirmation that the vote has been recorded; and
- following digitisation of certificated shareholders the industry should move, with legislative support, to discontinue cheque payments and mandate direct payments to the UBO's nominated bank account.

The Digitisation Taskforce is expected to publish its final recommendations and an implementation plan during spring 2024.

Commentary

Modernising the shareholding framework will have the benefit of making UK capital markets more efficient, ensuring investors are able to properly exercise their rights attached to shares whilst supporting innovation.

CONCLUSION

In this series of articles, we have outlined a number of developments designed to improve the attractiveness and operation of the London listing markets and UK fundraisings. As we have seen, there have been quite a few changes and there are more to come. As 2024 progresses, we will be watching with interest how these changes meet their aims.

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