UKLA Publications

FSA®

LIST!

Issue No. 2 – May 2003

Introduction

Introduction from Ken Rushton, Director of the UK Listing Authority

Welcome to this second edition of List! We have been very encouraged by the positive feedback received from the first edition and have taken on board your suggestions where possible. The technical section was particularly well received and we intend this to become a regular feature. This month we shall look at 'the 10% rule' for listing particulars. We have also introduced, at your request, a section on frequently asked questions, which we hope will be useful – no doubt you will let us know!

Since our last edition our policy department has been working hard on the second phase of the Listing Review and has published three Consultation Papers. These were on Investment Companies, the new fee proposals and, most recently, Treasury Shares, published on 8 May. We have also taken part in the debates on corporate governance, auditing and accounting policies.

The Feedback Statement on the Listing Review Discussion Paper was published in January and the work of the theme teams ended in early March. We are now drafting a policy Consultation Paper that we hope to issue in the next Quarter. This will focus on the overall structure of the new regime, rather than detailed rule changes at this stage. We will consult on issues such as whether the regime should have over-arching principles, what the future role of sponsors should be, and what level of super-equivalence over and above the proposed EU Directives we should keep going forward. Please note that the slippage in the EU timetables means that we are not now expecting the Prospectus Directive to be implemented until June 2005.

We would like to thank all those who have contributed to the Listing Review so far, and appreciate the time taken out of busy schedules to provide valuable input. For those who have not yet been involved, we do hope that you will respond to the consultation so we can get as broad an input as possible.

The closing date for responses to CP164, dealing with the proposed Listing Rules changes relating to investment companies was 14 April. We received over 200 responses which we have analysed, with a view to preparing the Policy Statement and revised Rules. Broadly, the response has been positive to our objective to tighten up the rules in this area, but concerns have been raised that some of our proposals may have unintended consequences.

On our fee proposals that formed part of CP168, we received very few responses. We intend that the fees proposed will become effective from 1 June 2003. Please note that in future the vetting fee will be payable when the vetting process starts, and will not be refundable if the document is withdrawn before approval. You can find details of the new fee structure on our website at www.fsa.gov.uk/pubs/cp/168/index.html.

CP182 consults on our proposed changes to the Listing Rules to take account of the introduction of treasury shares when The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 come into force later this year. The principal additions to the rules that we propose are:

- a prohibition on the sale or transfer of shares out of treasury at price-sensitive times;
- a requirement to disclose sales and transfers of shares into and out of treasury; and
- a limit to the discount to market price at which shares can be sold out of treasury non pre-emptively.

The closing date for responses to CP 182 is 8 August 2003.

Last month, the FSA submitted its comments on the Higgs Report. We suggested that some redrafting be done to the Combined Code so it is less prescriptive. We are pleased to see that the Financial Reporting Council has responded positively. We will annex the final Code to the Listing Rules in place of the 1998 Code.

Finally, for the last six months we have been building a new case management IT system (ELMS), which went live this month. This has been very successful; it will provide an invaluable management tool and will enable us to work more efficiently. As with any new system, there may be some teething problems in the initial months and we ask that you bear with us on these.

Guidance

In this newsletter we have tried to give broad coverage of topical issues of both a technical and non-technical nature. We are limited in the way we can address technical matters by the requirements of the Financial Services and Markets Act 2000, which restricts the scope for issuing guidance without prior consultation. It is important to understand that none of the contents of this newsletter are intended to be guidance as contemplated by the Act, and the contents should neither be interpreted, nor relied upon, as guidance. You should refer to the UKLA Guidance Manual for general guidance and, where you need individual guidance, you should approach us. Technical explanations given in this newsletter are illustrative only and are intended to give an indication of how the UKLA may expect certain issues to be addressed.

Risk-focused approach

In the first edition of List! we mentioned the new Technical Team (now called the Central Equity and Debt Team – CEDT) within our Equity and Capital Markets Group, and we set out the improvements we have made to our helpdesk operations. In this edition we discuss some developments in our approach to document vetting and approval.

So, why has our approach changed? Well, it hasn't, that much. For several years we have tried to ensure a risk-focused approach to vetting and approving listing particulars and circulars. This means we have prioritised the key investor protection issues early on in the review. When the first substantially complete draft of a document is submitted, a manager or senior technical associate performs a high-level review (known as a Key Points Review or KPR) within 24 hours. This is intended to identify the key issues for our readers to focus on.

In this initial review we are looking to assess whether the transaction has been correctly classified, e.g. have any related-party issues been properly identified, or is it a reverse takeover rather than a class 1 acquisition? Are there working capital concerns that require further disclosure? We also focus on whether the financials are in the correct form (comparative table or accountants report) and whether they cover the correct period e.g. three years and dated within six months. This KPR therefore ensures that our document vetting process is efficient and issue-focused.

Recently, we have been refining our risk-focused approach. For every transaction received, as well as a KPR, we also now complete a risk assessment which considers the company, sector, type of transaction and key issues identified. This enables us to assign an overall risk rating to that transaction. All low risk transactions are now handled by CEDT and will usually only require one rather than two readers, which frees up resource in our Transaction Teams to focus on the more complex transactions. These operational changes bring us more in line with the regulatory approach in the rest of the FSA. We will continue to develop ways to target our resources to the areas that pose most risk to our objectives of balancing investor protection with access to capital markets.

As mentioned in the first edition of List!, we will pay increased attention to the disclosures made in listing particulars about the risks of investing in securities. We have written to sponsors and authorised advisers confirming that, while we do not at present propose to change the Listing Rules for risk disclosures, we will be asking issuers and sponsors to consider:

- the risk factors which should be disclosed in a document;
- whether care has been taken to ensure that risk factors are clear, comprehensible and comprehensive; and
- where an explanatory statement has been included at the beginning of a document, whether this represents the appropriate balance between benefits and associated risks.

We are also making changes in our Monitoring function, focusing our effort on sectors and themes that present the greatest risks to our objectives. We are seeking to anticipate problems and encourage issuers to think ahead as to how they will comply with their continuing obligations under the Listing Rules. Creative policing techniques already in use include approaching issuers directly and discussing with them their processes for reviewing the timely release of information to the market. In our next edition of List! we will present a detailed account of our change in approach.

Central Debt Desk (CDD)

CDD was launched in January 2002 and has proved to be a tremendous success; it is a good example of how the risk focused review works in practice. Vanilla bonds, programme updates and supplementary listing particulars are channelled through CDD and can be reviewed and commented on within the fast-track turnaround times we offer. CDD is now encompassed within CEDT and is managed by Beth O'Halloran. She ensures documents are promptly allocated and that comments are returned by the appointed Associate(s) within two clear days from the date of receipt. We are only able to do this with the full co-operation of the Authorised Advisers who do not submit documents until substantially complete, and that any further drafts submitted for review are clearly black-lined. Please forward any views on how the service provided could be improved to Beth O'Halloran at: beth.o'halloran @fsa.gov.uk or call her directly on 0207 943 0930 (her new number is 020 7066 8222).

10% rule (5.27(e))

We often receive queries on behalf of issuers who wish to clarify whether a further issue of shares would require the publication of listing particulars.

Rule 5.27 sets out various situations where listing particulars will not be required (unless otherwise decided by the UKLA). 5.27(e) specifies that listing particulars will not be required where the number of shares issued under a further issue is less than 10%. For this purpose a series of issues connected with a single transaction, or a series of transactions that we regard as a single transaction, will be deemed to be a single issue.

The basic principle is that further issues that are connected should be aggregated against the prevailing share capital. For example, if the company's opening share capital is 100 shares, and the company makes a series of connected issues of 4, 6, and 1 shares, the calculations for the purposes of 5.27(e) would be as follows:

(a) 4 shares are issued – share capital increases by 4% (4/100) – new prevailing share capital = 104

(b) a further 6 shares are issued – share capital increases by 9.6% (4+6/104) – new prevailing share capital = 110

(c) a further 1 share is issued – share capital increases by 10% (4+6+1/110) – the requirement for listing particulars is triggered.

In the above example, if there had been a non-connected issue of 5 new shares between points (b) and (c), the appropriate test is still against prevailing share capital (110). However, those 5 shares would not be aggregated with the shares already issued under (a) and (b), as they are not part of the same connected issue. The appropriate calculation would therefore be 5/110 = 4.5%. Listing particulars are not required. The calculation in (c) would now however include the 5 new shares for the purposes of calculating prevailing share capital. The new calculation in (c) would therefore be 4+6+1/115 = 9.6%. Listing particulars are not now required.

The listing particulars triggered at point (c) should cover all shares causing the 10% limit rule breach; but obviously an application for listing is only made for the first share triggering the listing particulars. Following publication of the listing particulars, the slate is wiped clean and the 5.27(e) calculation will recommence. Another single issue of 11 shares could be made under the connected issue without the need for further listing particulars. Also, if the company chose to issue listing particulars at point (b) (9.6%), the slate is not wiped clean. Listing particulars would still be required when the 10% threshold is reached at (c). This is a directive driven requirement.

An example of an issue connected with a single transaction is a series of issues under an equity credit facility. In this scenario, the issuer may have a shelf document in place, in which case the requirement for listing particulars will be satisfied by publication of an issue note under 5.36. In the example above, an issue note will only need to be published at point (c), where the increased share capital reaches 10%.

Where there are separate issues connected with a series of transactions, in determining whether the

transactions are connected, and so whether the resulting share issues should be deemed a single issue, the UKLA may be guided by the principles set out in 10.26 (aggregation of transactions). Please note that aggregation is not restricted to a 12 month period.

Dual listed companies vs dual headed structures

It is clear from some recent queries that it would be useful for us to clarify the application of Guidance Note 3, "Non-controlling Interests in a Merged Business effected through a Dual Headed Structure".

GN3 was introduced to deal with merged businesses jointly managed and controlled by two or more listed parent companies, one of which is listed overseas. The key feature of such dual headed structures (DHSs) is that the UK listed issuer could hold only a non-controlling interest in the merged business. The assets of the UK listed company could accordingly comprise simply a minority interest in the combined business, which will normally be equity accounted in the issuer's financial statements.

The requirements of GN3 seek to ensure that the UK listed company always exercises a minimum level of control over the merged business. So, it must hold at least 30% of the merged business, and must also demonstrate that it has joint control at the operational level through, for instance, a deadlocked board or a shareholder agreement.

The DHSs contemplated by GN3 are now very rare, and seem to have been largely superseded by dual listed companies (DLCs). In a DLC, the two companies enter into an equalisation agreement and, following the transaction, will each have identical boards. The UK-listed limb of the DLC does not own a defined stake in a single merged business, and therefore the requirement for a minimum 30% interest does not arise. The equalisation agreement does serve to ensure that shareholders in each company have equivalent voting and dividend rights over all the assets of both companies. The interests of both sets of shareholders are accordingly aligned, and are protected by a single body of directors constituting the boards of both companies.

DLCs are very different from DHSs and it is not appropriate to apply GN3 in these circumstances. Besides, each new DLC structure we have considered to date has had unique features that have required detailed consideration. So, it is not possible to provide a useful guidance note about DLCs and each will be considered case by case. We would urge anyone contemplating either a DLC or a DHS to contact us at an early stage to discuss the detail of the transaction.

Working capital report

Paragraph 2.18 of the Listing Rules sets out the requirements for a working capital report from the sponsor to the UKLA where an issuer prepares:

- listing particulars;
- a Class 1 circular; or
- a circular containing proposals concerning refinancing or reconstruction which includes a working capital statement.

Paragraph 2.18 (b) requires sponsors to report that the persons or institutions providing finance have stated in writing that the relevant financing facilities exist. If a sponsor sought to rely on third party confirmations to comply with this listing rule, then the sponsor would have to convince the UKLA that this was an acceptable practice (a third party confirmation in this case could be a letter from the issuer or reporting accountants stating it has received responses from its bank circularisation). This is likely to be a very difficult task for the sponsor as it appears that such an approach would go against the rule which requires that the sponsor apply its mind to the relevant facts and documents to satisfy itself that the requirements of the rule have been met. The UKLA is very likely to take the view that the sponsor must review the relevant written confirmations directly.

Reminder on class tests

We would remind issuers of the need to consider whether they require shareholder approval before entering into a transaction that is not of a revenue nature in the ordinary course of business.

Chapter 10 of the Listing Rules contains class tests, the aim of which is to gauge the size of the transaction compared with the size of the issuer. The class tests compare key financial data of the issuer and the acquisition or disposal entity (e.g. profits/profits, consideration/market capitalisation).

If any of the ratios exceed 25% then shareholder approval for the transaction will be required.

The class tests should be calculated immediately before announcement of the transaction. Class tests do not need to be submitted for our approval. However, we have has discretion to take anomalous results into account and may be able to accept alternative tests. So, please contact our helpdesk on 020 7943 0333 Option 1 (the new number is 020 7066 8333 Option 1) with any questions about class tests. Entering into a class 1 or reverse take-over without shareholder approval is a breach of the Listing Rules and could lead to enforcement action.

Waiving the consideration to market capitalisation test

Historically, we have regarded a company's market capitalisation as significant in assessing the size and importance of a particular transaction. Generally we have not been minded to allow enterprise value to be used as a substitute test – the key reasons have been:

(a) the market capitalisation test is the primary indicator of a listed company's size as at the date of the transaction;

(b) it is the only test which does not use historic financial information;

(c) if the company was to be sold or become the subject of a takeover offer, the market capitalisation is the starting point for valuation; and

(d) anomalous arguments relating to market capitalisation are inherently flawed as, if the market is valuing companies incorrectly, this would suggest full information is not in the market.

There is now a substantial body of precedent where we have not waived the market capitalisation test. While we will continue to assess each request as it arises, we believe that our general approach continues to be appropriate.

Variations from the Public Offers of Securities Regulations 1995

We are the competent authority for considering requests for variations from the Public Offers of Securities Regulations 1995 (POS), if the variation request is made under regulation 11(3) of POS.

Regulation 11(3) states:

"The competent authority for the purposes of Part IV of the Act ("the competent authority") may authorise the omission from a prospectus or supplementary prospectus of information whose inclusion would otherwise be required by these Regulations, if –

(a) the information is of minor importance only, and is not likely to influence assessment of the issuer's assets and liabilities, financial position, profits and losses and prospects; or

b) disclosure of that information would be seriously detrimental to the issuer and its omission would not be likely to mislead investors with regard to facts and circumstances necessary for an informed assessment of the securities."

We will not advise on whether POS applies to an offer of securities or to the interpretation of any of the POS regulations – these are legal issues on which legal advice should be obtained. Our role is to determine if a variation from a Regulation should be approved.

Historically, most variation requests we receive relate to companies offering securities while listed or seeking to be admitted on AIM. However, it should be noted that the London Stock Exchange and not the UKLA grant AIM company variations under regulation 8(4) and (5) of POS.

To apply for a variation under regulation 11(3), an applicant must send us a written request containing:

(1) full details of the offer being made under POS;

(2) reference to the Regulation from which the variation is being sought;

(3) reasons for the variation request;

(4) basis on which the UKLA is being asked to grant the variation i.e. under regulation 11(3); and

(5) details otherwise required by paragraph 6.3.3 of the UKLA Guidance Manual.

A cheque for £1,000 plus VAT is payable in advance and must accompany the written request, which should be sent to Lee Alam or Gavin Richards.

We will normally advise an applicant by telephone of our decision within ten clear business days from

receipt of the written variation request. If the variation request is approved, we will also send written confirmation of our decision to the applicant.

EU update

There are two directives to cover here: the Prospectus Directive (PD) and the Transparency Directive (TD).

With the PD, the publication date is still planned for November 2003, depending on the European Parliament being able to agree the text. Some changes have been proposed that are significant. One example is that issuers of non-equity securities should be able to choose the competent authority for prospectus approval irrespective of the denomination size of the issue.

Much of our work has been with CESR, which is due to provide the European Commission with detailed technical advice as to how the PD should be implemented. These have already been extensively consulted on in terms of text for Equity and Retail debt. However, on other subjects, e.g. Wholesale Debt and Depository Receipts, the draft advice will be the subject of an open hearing on 27 May in Paris. Full details are available on CESR's website: www.europefesco.org. Advice will then be sent to the Commission on 31 July.

CESR's work will continue with Derivatives, Base Prospectuses, Closed-end Investment Companies and Financial Information; these will be sent to the Commission on 30 September. We urge you to read CESR's draft advice and take part in the consultation process. To those of you who have done so we are very grateful for the contribution you have made.

The draft text of the TD was published in April. We are now working on it with the Consultative Working Group. Key proposals include:

- to require IAS standards for annual financial statements from 2005;
- quarterly financial reporting by all issuers whose shares are admitted to trading on regulated markets;
- twice-yearly reporting for issuers of debt;
- much tighter reporting timeframes;
- provisions on disclosure of shareholdings; and
- greater freedom for how information is disseminated by issuer;

Our continuing obligations such as class tests and related party transactions are not affected.

We will work closely with CESR to provide advice to the Commission on more detailed implementing measures. Please note that the implementation timetable will be much tighter than with the PD, as the advice will have to be finalised by December this year. Again, we would urge you to play as full a part as you can in the consultation process.

Frequently asked questions

All questions listed below have been received by the UKLA's helpdesk in the last few months.

Transactions on a short timetable

A company is submitting a document to the UKLA relating to a transaction that is on a very short timetable. If the document is not stamped by the expected approval date, the transaction will not go ahead.

Question: Will the UKLA pre-allocate my document to save time on the allocation process?

Answer: A document will not be pre-allocated. Our allocation process is based on the workload of readers at the time that the document arrives, and considers all transactions received that day. In any event, the time-consuming part of our allocation process involves conducting a risk assessment of the transaction and a key points review. This process cannot be started until a substantially complete document is received.

Question: Can the helpdesk pre-agree a timetable?

Answer: Timetables cannot be pre-agreed. It is the responsibility of the first and second readers on a transaction to agree a timetable, in line with their individual workloads. However, the reader will contact the broker within 24 hours of document submission and a timetable can be agreed at that point.

Question: Can my document be fast-tracked, otherwise the UKLA will be responsible for the deal falling through?

Answer: We do have a fast-track vetting process in place for documents being reviewed through the Central Debt Desk. For all other documents, except supplementary listing particulars, the turnaround time for first comments is five clear business days following receipt, and for new applicant documents or complex transactions, ten clear business days. The turnaround time for comments on follow-up drafts is five clear business days for new applicants and complex transactions and three clear business days for all others, unless the document has been substantially black-lined in which case it will be treated as a

This is not FSA guidance.

first submission. We will always try to be flexible, and aim to meet short timetables. However, this is not always possible and it will depend on individual workloads, the complexity of the transaction, and how complete the document is when submitted.

Chapter 23 – Special Purpose Vehicle Issuers (SPVs) and requirement for accountants' reports

Question: What are the requirements for the inclusion of financial information in listing particulars for specialist debt securities new SPV issuers?

Answer:

(i) New applicant SPV issuers, without any audited accounts, who are issuing specialist debt securities guaranteed by another entity are not required to present an accountants' report as long as eligibility is satisfied by the two year trading record of the guarantor.

(ii) New applicant SPV issuers who are issuing asset-backed securities are not required to include an accountants' report as long as a clear statement is included in the listing particulars that the SPV has not traded since incorporation.

Listing applications

Question: How do I book a listing hearing?

Answer: To book a listing hearing in advance, send a fax to 020 7943 0969 (the new number is 020 7066 8364) specifying the issuer name, type of issue and required hearing date. We will not confirm the booking on receipt but if you do require confirmation, you can speak to a member of the team on the Listing Applications Helpdesk on 020 7943 0333 Option 3 (the new number is 020 7066 8333 Option 3).

Question: Whom do I send the 48 hour documents to?

Answer: Under Rule 7.5, you should send the 48 hour documents directly to Listing Applications even when there is a document being approved by the Equity & Capital Markets Group. Documentation for admission to trading on the London Stock Exchange (LSE) needs to be sent directly to the LSE for the attention of Securities Management, who can be contacted on 020 7797 1586.

Question: Where can I download all the relevant Schedules contained in the back of the Listing Rules?

Answer: The following link contains all the Schedules in both PDF and Word format:

http://www.fsa.gov.uk/pubs/ukla/lr_schedules3/

Question: What documents need to be submitted to fulfil the disclosure obligations under Rule 9.31 & 9.32?

Answer: A listed company is generally required to send us two copies of any listing particulars that they have published or circulars that they are sending to their shareholders. This is so they can be made available for inspection at the Document Viewing Facility. These documents include:

- Annual Report & Accounts
- Class 1 Circulars
- Circulars of a Routine Nature
- Listing Particulars
- Notice of AGM
- Proxy Forms
- SEC Documents

As soon as any one of these documents has been submitted, a company must notify a Regulatory Information Service and announce its availability. Set out below is a suggested format for this announcement:

"Document on [Title of Document]

A copy of the above document has been submitted to the UKLA, and will shortly be available for inspection at the UKLA's Document Viewing Facility, which is situated at:

Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS
Tel. 020 7676 1000"

Question: Is it possible to view the daily admission, restoration, suspension and cancellation notices on the UKLA's website?

Answer: The following link provides this facility:

http://www.fsa.gov.uk/officiallist/

Any further questions can be answered on our helpdesk number: on 020 7943 0333 Option 3 (the new number is 020 7066 8333 Option 3).

Telephone numbers

Please note that all UKLA telephone numbers are changing. Until 30 September callers to the old numbers will be diverted to the new ones. The new UKLA help desk number is 020 7066 8333.