

UKLA Publications LIST!



Issue No. 11 – September 2005

1. Introduction

Introduction from Sally Dewar, Markets Division

Welcome to this 11th edition of List!, the first since we implemented the new regime on 1 July. The last time I introduced an edition of List!, in December of last year, we were still in the consultation stages for the new regime. Since then, a tremendous amount of work has been done to implement the regime on time. Much of the work we did was, by its nature, unseen by our customers and I would now like to take this opportunity to publicly thank all those involved here for their hard work and dedication to the project. We were conscious that the day-to-day operations of the UKLA must continue and should not suffer while this work was going on under the new regime. So I hope that the amount of work involved in implementing the new regime went largely unnoticed by you, our customers.

As well as the work on drafting and implementing the new rules, we have also spent significant amounts of time speaking at external conferences, conducting a series of seminars for Sponsors on the new rules and of course ensuring our own staff are fully trained in the application of the new rules.

We are also in the process of upgrading the UKLA website so that it not only takes account of the new rules but also is more user-friendly. If you haven't already, please do take a look. You will find all the new rules, all our publications, checklists and forms and the slides we used at the sponsor seminar mentioned above. We are making changes to the site almost daily at the moment and I hope that you find it a great improvement: www.fsa.gov.uk/Pages/Doing/UKLA/index.shtml .

As well as grappling with the new rules on behalf of their clients, our sponsor firms have also had to deal with the new provisions applying to sponsor firms. Over the past six months the sponsor supervision team have visited the majority of firms to give clarification on the application of the new rules and advise on any eligibility issues which firms have encountered.

Since December last year, we have published three editions of List!. If you have not yet had the chance to read editions 9 (on 'Dealing with inside information: Advice on good practice') and 10 (on the Prospectus Directive) I would encourage you to do so.

In this edition, we concentrate on the issues on which we have had the most queries since implementing the new rules. Although much of the experience we have built up over the years on interpreting the listing rules is still relevant under the new regime, new rules have been implemented, notably in relation to the Prospectus Directive. These rules require new interpretations and we have no previous experience or precedent for them. I hope that over the coming months you will understand that some decisions we are asked to make will have a significant impact on how the regime operates in future. So they may require us to give detailed thought to our interpretation. As ever, though, we will strive to give timely decisions – particularly where they relate to live issues where speed may be of the essence.

I hope you find this edition useful. As always, we would be most interested in any issues you wish to raise, suggestions for future articles and any

general comments you may have on improvements. Please feel free to contact me or any of my colleagues at the UKLA.

Guidance

In this newsletter we have tried to broadly cover 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 (FSMA), 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 described by FSMA, and the contents should neither be interpreted, nor relied upon, as guidance. You should refer to the Listing, Prospectus and Disclosure Rules 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 indicate how the UKLA may expect certain issues to be addressed.

2. Complex Equity

2.1 Supplementary Prospectuses

A supplementary prospectus is required if, during the relevant period, there arises – or is noted – a significant new factor, material mistake or inaccuracy relating to the information contained in the prospectus (S.87G(1) of FSMA).

S.87G(3) of FSMA implements Article 16 of the Prospectus Directive and sets out the period during which a supplementary prospectus may be required. The ‘relevant period’ begins when the prospectus is approved and ends either with the closure of the offer, or, when trading of the securities on a regulated market begins. Neither the Prospectus Directive nor FSMA say whether the earlier, or later, of the closure of the offer or admission to trading should apply in transactions involving both a public offer and admission to trading of securities. We have discussed this issue with market practitioners. This is a matter of law and is, ultimately, for the courts to decide. However, the better interpretation appears to be that where there is both a public offer and admission to trading, the relevant period will end at the *later* of the closure

of the offer or when trading of the securities on a regulated market begins.

The Prospectus Directive generally treats the obligations in relation to public offers separately from those relevant to admission to trading. For example, each has its own stand-alone set of exemptions from the obligation to publish a prospectus, and it seems sensible to treat obligations in relation to public offers and admission to trading separately in this instance as well. In addition, if the correct time was determined as the *earlier* of the closure of the offer or when trading of the securities on a regulated market begins, this would mean offerors/issuers would be treated differently in similar circumstances. For example, a fully listed issuer could make a securities exchange offer to target shareholders which requires an approved prospectus. Note that if it issued an equivalent document under PR 1.2.3 or 1.2.4 it would not fall within the supplementary prospectus regime and the relevant period would cease when the consideration securities were admitted to trading (usually the day on which the offer is declared or becomes wholly unconditional). This is the case, even though the offer usually remains open after this event to allow holders to accept it. In the case of an offeror whose securities were not admitted to a regulated market (such as private companies, AIM or OFEX issuers or US listed issuers) the relevant period would run until the offer closed.

2.2 Withdrawal Rights – specifically in relation to takeovers and rights issues

S.87Q(4) of FSMA provides withdrawal rights to an investor who, before a supplementary prospectus is published, had agreed to buy or subscribe for transferable securities to which the supplementary prospectus relates. Such an investor may withdraw his acceptance before the end of the period of two working days beginning with the first working day after the date on which the supplementary prospectus was published.

We have had many discussions about the interpretation and operation of withdrawal rights, specifically in relation to takeover offers and rights issues. We also discussed the matter with the Takeover Panel before the release of its

statement (2005/29). This also raises matters of law which would ultimately be for the courts to decide. However, we consider that the withdrawal rights conferred by S.87Q(4) of FSMA do not apply in relation to any investor whose agreement to buy or subscribe for securities is not subject to any condition, in effect that the contract between the offeror and the offeree has been effectively performed. In relation to the payment of consideration by the issue of securities we would expect this to be the time that the securities are unconditionally allotted. S.87Q(4) of FSMA refers to the situation where a person has ‘agreed to buy or subscribe’ and only permits the withdrawal of an acceptance. In our view, this should not apply once the securities have been unconditionally allotted to the acceptor.

In relation to a rights issue, applying the above approach, the most appropriate time for withdrawal rights to cease is when shareholders pay up their subscription in full. This seems to represent the closest time at which the contract ceases to have an element of conditionality and when allotment effectively becomes unconditional.

If you have any comments or queries on this article please do not hesitate to contact Richard Brearley at: Richard.Brearley@fsa.gov.uk

2.3 Six day rule PR 3.2.3R

In issue 10 of List! we clarified how PR 3.2.3R applies in relation to prospectuses which are approved and published under the provisions of PR 2.3.2R. In these circumstances, the six day period runs from the date the prospectus prepared under PR 2.3.2R is approved. This is because, once approved, this document is a valid prospectus even though it does not contain the final price or number of securities. We also clarified that issuers can choose to prepare a pathfinder or pre-marketing document under the advertisement regime (PR 3.3). However, in this case the six day period does not begin until the actual prospectus is approved and published. It does *not* begin when the pathfinder or pre-marketing document is published, at which point the document constitutes an advertisement rather than an approved prospectus.

We have been asked how PR 3.2.3R applies where an issuer raises funds by way of an institutional placing when seeking admission to the Official List for the first time. To market to the institutions, the issuer produces a pre-marketing document under the advertising regime in PR 3.3. In these circumstances, while there is a public offer there is no requirement to produce a prospectus in respect of that offer, as the offer is exempt since it is made to qualified investors. A prospectus is produced and approved only when the offer is effectively closed and priced and it fulfils the requirement to have a valid prospectus in relation to admission to trading on a regulated market. In these circumstances, the six day period set out in PR 3.2.3R does not apply as there is no public offer which requires the production of a prospectus, therefore there is no requirement for that prospectus to be made available to the public six days before the end of the offer.

2.4 How we will deal with documents from AIM issuers

The Prospectus Directive, which was implemented on 1 July 2005, requires offerors, including AIM issuers, to prepare a prospectus when undertaking a public offer of securities. Historically, there has been no requirement for AIM issuers to submit their documents to the UKLA for approval. But from 1 July 2005 we have been vetting and approving all prospectuses, where there is a public offer of securities, to ensure full compliance with Prospectus Rule requirements. We will vet prospectuses prepared for AIM issuers to the same standard as those produced for fully listed companies.

PR 2.2.1R sets out the requirements for the formatting of a prospectus and states that a prospectus may be drawn up as a single document or as three separate documents (registration document, securities note and summary). If the prospectus is drawn up as a single document it must be prepared in line with the format set out in article 25.1 of the Prospectus Directive Regulation (PD Regulation). If it is drawn up as separate documents it must be prepared in line with the format set out in article 25.2 of the PD Regulation. Where the order of disclosure items in the prospectus differs from the order of information provided for in the schedules

and building blocks to the PD Regulation then a cross reference list must be submitted to the UKLA. These are available on our website at: www.fsa.gov.uk/pages/Doing/UKLA/forms/checklists.shtml.

The requirements about including a summary within a prospectus are detailed in PR 2.1.2UK - PR 2.1.7R. These indicate that a prospectus must in most cases include a summary, which should not generally exceed 2,500 words. Before the prospectus is submitted to us, the issuer must ensure that information contained in the summary also appears elsewhere in the prospectus. The summary must contain a warning that it should be read as an introduction to the prospectus and that any decision to invest should be based on a consideration of the whole prospectus. In addition to including a summary in a prospectus, the prospectus rules (PR 2.4.1R - PR 2.4.6EU) also allow an issuer to incorporate information by reference into its prospectus provided that this information has been approved by the FSA or filed in accordance with PR 2.4.1R.

When an issuer first submits to us a prospectus for review, they must also send us a completed Form A. This form is available on our website at: www.fsa.gov.uk/pubs/forms/PR_FormA.pdf. It asks, among other things, for confirmation that the UK is the issuer's Home Member State for the purposes of the Prospectus Directive.

For reviewing documents prepared in line with the Prospectus Directive, we will apply the same turnaround times that we apply for fully listed companies. As such, an issuer will generally receive first comments five clear business days after the document is submitted and three clear business days after the submission of subsequent drafts. However, these timings depend on the quality of the documentation submitted, and how quickly the issuer addresses the comments we raised.

Before submitting a document, we expect the issuer and its advisers to ensure that all the requirements of the Prospective Directive have been met. In addition to this, we remind issuers and their advisers that before submitting a

document for review they should have considered all the relevant CESR recommendations. Before we approve a prospectus it must have received all of the relevant document approval items. You can see these details at: www.fsa.gov.uk/Pages/Doing/UKLA/forms/approval.shtml.

If you have any comments or queries on the articles in this section or any general queries on complex equity matters, please do not hesitate to contact Kevin Byrne at: Kevin.Byrne@fsa.gov.uk

3. Central Equity and Debt Team (CEDT)

3.1 Mini-prospectuses

The Prospectus Directive does not provide for the issue and circulation of mini-prospectuses. We have had a number of enquiries from issuers keen to circulate a document similar to a mini-prospectus to prospective retail investors, but any such document must fit within the legislative framework provided by the Prospectus Directive. So there appears to be two routes open to issuers who wish to circulate an abbreviated document, rather than a full prospectus, to prospective investors.

- If it has produced a tri-partite prospectus, an issuer is free to circulate only the summary. However, the summary should normally be no more than 2,500 words, so this document is a good deal shorter than the typical mini-prospectus. We are willing to adopt a flexible approach to this word-limit in relation to unusually complex transactions. However, we would expect such transactions to be infrequent, and would not expect to approve a summary substantially in excess of 2,500 words.
- If issuers do not use this summary route, any document they circulate to investors along the lines of an old-style mini-prospectus would be characterised as an advertisement. So it would have to comply with the provisions of PR 3.3.

3.2 The requirement for a suspension on announcement of a reverse takeover

The explicit automatic requirement for suspending listing when a reverse takeover is announced, which was in paragraph 10.39 of the Listing Rules, has not been retained in the new rules. This does not mean, however, that issuers are no longer required to suspend listing when a reverse takeover is announced.

Under the old rules we had developed a practice of not suspending on the announcement of a reverse takeover in certain circumstances. We did not suspend where we were satisfied there was sufficient publicly available information on the target company to ensure a fully informed market was maintained. Under the new rules we will adopt the same approach, and will have regard to the following factors:

- whether the target company is listed or traded elsewhere;
- the quality of the information that is available; and
- whether the issuer is able to fill any information gap at the time of announcing the terms of the transaction.

There will therefore be a presumption that a suspension will be required, but this presumption can be rebutted as described above.

Where there is not sufficient publicly available information on the target company we will rely upon the general suspension powers in chapter 5 of the Listing Rules, and in particular LR 5.1.2G(4).

3.3 Notification requirements for class 2 and 3 transactions

We have amended the notification requirements in relation to class 2 and class 3 transactions to make it clearer that the notification should include the name of the other party to the transaction. We made this amendment in response to the view, which we did not share, that ‘the particulars of the transaction’ would not necessarily include these details. So issuers and their advisers should be aware when negotiating transactions that

confidentiality arrangements in relation to the identity of the counterparty will not override this disclosure obligation.

If you have any comments or queries about the articles in this section, or any general queries on CEDT matters, please do not hesitate to contact Marc Teasdale at: Marc.Teasdale@fsa.gov.uk

4. Listing Applications

4.1 Exemption Letters

Our Listing Applications Team processes many applications for listing where no prospectus is required. To avoid unnecessary delay in processing these applications we have set out below the key features required of an exemption letter satisfying LR 3.3.2R(2)(c). We would also remind you that at the time of providing this letter there must be a clear and unambiguous statement of the relevant exemptions and that in cases of doubt, you should seek legal advice.

LR 3.3.2R(2)(c)(i) – This part of an exemption letter must refer to the specific exemptions (within PR 1.2.2R and PR1.2.3R) relied upon, but you should also add that no prospectus is otherwise required to be produced. A global statement, in addition to any specific exemptions, would cover instances where there may be a variety of reasons why the public offer limb of the Prospectus Directive might not give rise to the need for such a document.

LR 3.3.2R(2)(c)(ii) – This wording addresses the period between the issuer applying for admission of the securities to listing and the point of actual admission of the securities. It will not apply in all cases – for example, if a public offer *is* being made a general statement that a prospectus is not otherwise required during this period will suffice in all cases.

Please also be aware that the exemption set out in PR 1.2.3R(1) should be used advisedly where other exemptions within PR 1.2.3R would also apply. Quoting this exemption in addition to another exemption under the same rule may result in future discrepancies in the ‘10% calculation’ we perform against that of the issuer.

4.2 Tranche Fee Payment System

As you may be aware, at the end of September 2004 we introduced a system to process pricing supplements before we received the relevant application fee, provided payment was made within 30 days of listing. This system has been problematic so, as of 1 April 2005, as an interim measure, we have introduced an up-front system. We described the new system in CP05/02.

Issuers are now required to make an up-front payment, covering all of the draw downs to be made during the period the programme operates. This payment must be made when the debt or securitised derivative programme is established or updated. Failure to do so by the time of the hearing will result in the programme not being approved or updated. The issuer may make additional payments at any time during the period if required and any unused payment can be carried over to the issuer's programme for the following 12 months, if renewed. If the issuer does not renew its programme, no refunds will be given for any unused tranche fees. We will deduct the relevant amount from an issuer's account for the tranche in question at the time of the listing hearing relating to that tranche.

In recognition of the fact we are receiving a payment up-front, we propose a 10% discount for purchasers of 75 or more tranches in a single purchase (£90 per draw down instead of £100). We believe that this new system will result in more efficient processing of debt tranches.

We would urge issuers that have not yet implemented this system, and even where they are not yet updating their programme, to contact us as soon as possible to establish an up-front payment. The system makes issuing faster and ensures that issues under programmes will not be held up due to unpaid fees.

We are working with practitioners to further enhance the current system and will be consulting on our revised proposals early next year.

4.3 Medium Term Note Issuance

Although essentially unchanged as a result of the new listing regime, we would like to re-emphasise

the procedures that make for good practice when submitting final terms or pricing supplements for the listing of MTN issues under issuance programmes

Submission of final terms often takes place at a late stage relative to admission of the related security, with the Listing Rules only requiring this to take place by at least 2pm the day before admission. To ensure that pricing supplements and final terms can be processed without delay it is important that:

- the final terms relate to a programme for official listing that has not expired;
- the final terms do not relate to a security that would require a supplementary prospectus to provide significant new information not previously provided in the programme documentation; and
- all application fees have been paid (see also Tranche Fee Payment System above).

In the first instance final terms and pricing supplements should be submitted by email to listingapplications@fsa.gov.uk. We would strongly advise issuers or their agents to confirm safe receipt of any such submission by calling the listing applications team on 020 7066 8333 (option 3).

We would also remind anyone submitting final terms in relation to MTN tranches that the Issuer Implementation Team at the London Stock Exchange (020 7797 1614) should also be contacted in respect of every tranche to be admitted to one of the LSE markets for listed securities. And you should also note that a tranche is only officially listed when that fact is published by the UKLA in a dealing notice.

If you have any comments or queries on the articles in this section or any general queries on Listing Application matters, please do not hesitate to contact Chris Williams at: Chris.Williams@fsa.gov.uk

5. Sponsor Supervision

5.1 How to Become an Eligible Employee

As sponsor firms will be aware, the new sponsor supervision regime, as set out in LR 8, came into force on 1 July 2005.

Some sponsor firms have expressed concern at how they can reconcile the need for each transaction to be supervised by a 'suitably experienced' employee, with their desire to bring other employees through to 'suitably experienced' status as part of their career progression. So we thought it would be useful for us to set out the process we intend to use when sponsors wish to notify the ULKA of an additional 'suitably experienced employee' (SEE).

We expect all transactions that require a sponsor to be supervised within a sponsor firm by a SEE. If a sponsor would like an employee, whose name is not on the list of SEEs maintained under LR 8.6.15R, to be able to claim the credit for such a transaction, you should notify the sponsor supervision team when submitting the document that relates to the transaction. This will alert us to the fact that a less experienced employee will be leading the transaction and allows us to allocate our resources accordingly. We would expect our initial transaction phone call to be with this person to assure ourselves about their competence (for further information on these calls please refer to the September 2004 edition of List! www.fsa.gov.uk/pubs/ukla/list_sept04.pdf). Please note we would also expect a SEE to be assigned to the transaction to ensure that support is provided where necessary.

When the transaction is completed, the sponsor firm's relationship manager will provide confirmation (or otherwise) that the employee is able to count the transaction towards meeting 'suitably experienced' status.

Once a sponsor firm feels that one of its employees can demonstrate the experience set out in LR 8.6.9G, and would like that individual's name to be added to the list of SEEs maintained under LR 8.6.15R, it should submit a Sponsor Employee Application Form to us for approval. Please note that we expect all potential SEEs to be able to make autonomous decisions on behalf of

the sponsor. We would only expect to receive an application form for an individual that has gained the appropriate level of experience and expertise. The sponsor must be happy that the individual can lead a Listing Rules transaction independently of senior colleagues.

Sponsor firms will be aware that in assessing eligibility we expect that each of its SEEs should be able to cite at least one 'Listing Rule transaction' (i.e. the occasions under LR8.2.1R where a sponsor must be appointed) upon which no other SEE relies. This is also the case for new SEEs.

If you are an existing sponsor firm and this approach is likely to create problems, please make early contact with our Sponsor Supervision Team, contact details are set out at the end of this section.

5.2 Sponsor independence

The requirements on a sponsor regarding independence are set out in LR 8.3.6R and LR 8.3.7G. The two paragraphs deal with distinctly different types of potential influence a sponsor needs to have in mind when deciding whether it can act for an issuer on a particular transaction.

LR 8.3.6R deals predominantly with financial considerations. These include holdings in the issuer's shares or debt securities and the existence of significant business relationships with the issuer which compromise the sponsor's independence through the potential for monetary gain or advantage. The situations the rule describes are very likely to be objectively quantifiable and so a sponsor with an adequate system of internal controls should have no trouble identifying them.

LR 8.3.7G is a different matter. This guidance recognises that there are other types of influence that can exist in the relationship between a sponsor and their client that are not evidenced simply by financial statistics. The possible guises for these influences are numerous. So the guidance does not define them by detailing any specific set of circumstances. Rather, it defines them by their common effect of preventing the sponsor from acting in the independent fashion the rules require, either by leading it to try influencing the outcome of a transaction or by limiting the nature of the advice it can give.

Situations caught by the guidance might include where the issuer does not cooperate in providing adequate or timely information to the sponsor and as a result the sponsor cannot build its own dispassionate view of the state of affairs of the issuer. Another example is where the business that the issuer gives the sponsor is disproportionately significant in the context of the sponsor's business as a whole so it is able to influence the conduct of that business. Sponsors may have to make a judgement call in some circumstances about acting on a transaction where such influences exist, but in nearly all instances the correct answer will be not to act. Certainly, if a sponsor is considering acting in such circumstances it should always consult our Sponsor Supervision Team before agreeing to do so.

LR 8.3.7G also requires the sponsor to consider situations where although there may not have been an actual influence that means the sponsor cannot act independently of the issuer, a third party armed with the relevant facts might think there had been. By definition, these situations are more remote than those identified above. But they might include, for example, a long standing personal association with the issuer by members of a sponsor's team who then represent that issuer. Or there might be instances where the sponsor's own reputation could be at stake if the transaction is unsuccessful. LR 8.3.7G recognises the fact that at least some of these situations can be adequately resolved by means other than the sponsor refusing to act. So, the final part of LR 8.3.7G allows the sponsor to act despite a potential conflict, as long as it takes adequate steps to resolve that potential conflict. Such solutions are as varied as the problems requiring them but might include changing the advisory team for a particular deal, using a different office to provide the requested services or simply fully disclosing the nature of the potential conflict and its effect in any documents available to investors. As always, in cases of doubt, please consult the Sponsor Supervision Team before acting.

Finally, it is worth noting that the UKLA fully recognises that relationships between sponsors and their issuer clients are dynamic. Although a transaction can start off free from the types of conflict identified above, they can develop as the engagement progresses. So it is important that sponsors who do not feel they can resolve such

conflicts quickly and easily, contact us as soon as they become aware of the difficulty to discuss how the situation might best be resolved.

If you have any comments or queries on the articles in this section or any general queries on Sponsor Supervision matters, please do not hesitate to contact Helen Butterworth at : helen.butterworth@fsa.gov.uk

6. Specialist Equity and Debt

6.1 Non Qualifying Investments (NQIs) held in Venture Capital Trusts (VCTs)

In the past, VCTs would typically hold the 30% of funds raised (which the tax laws allow to be held in non qualifying investments (NQIs)) in cash or near cash instruments and they would use this as a buffer for further investment in existing qualifying investments. To differentiate themselves in an increasingly competitive market, some new VCTs are using NQIs more creatively. For example, many VCTs are now investing in AIM stocks rather than engaging in conventional venture capital activities and to an extent the need for a buffer does not apply to these companies. Accordingly, there is some logic in a generalist AIM VCT using the 30% allowance to invest in, say, FTSE 100 stocks or unit trusts rather than cash. Indeed, we have already listed a number of VCTs that do this.

Other VCTs have much more innovative investment policies in relation to NQIs such as investing in derivatives and Chinese private equity. This concerns us because shareholders may not appreciate the risks associated with NQIs, as the focus of the product is bound to be on the qualifying investments. This is particularly the case where a company may be investing all of the proceeds of an issue in NQIs while seeking appropriate qualifying investment opportunities (i.e. it may initially have 100% of its funds invested in the NQIs).

We therefore look closely at the eligibility of the non-qualifying investment policy as if this were a separate investment vehicle. For example, the investment managers must be able to demonstrate sufficient and satisfactory experience of such investments and there

must be sufficient spread of risk within the non-qualifying portfolio. In addition to the eligibility requirements noted above, we would expect the risk factors section of the document to highlight any specific additional risks that investors may be exposed to as a result of a company's NQI policy.

For the time being we will continue to list VCTs which have an unusual investment policy regarding NQIs, provided they meet the full eligibility criteria. However, please note we are currently carrying out a wholesale review of our rules on investment companies which will result in new rules coming into force in the final quarter of next year. Our approach in this area may change as a result of this review.

6.2 Changes for property companies

The old Listing Rules recognised that special arrangements were merited for certain specialist companies and contained a series of chapters modifying the basic regime for such issuers. Modifications for property and property companies were dealt with in chapter 18.

Under the new prospectus regime, special arrangements for specialist issuers such as property, scientific or shipping companies are contained within the CESR Recommendations - paragraphs 128-130 deal with property companies. In PR 1.1.8G we emphasise that we will consider the CESR Recommendations when deciding whether a prospectus is complete.

The principal change for property companies is that the old chapter 18 required only new applicant property companies to include a property valuation in their listing particulars or prospectus. There was no such requirement for further issues by property companies. However, the new prospectus regime makes no distinction between new and further issues. So all prospectuses issued by property companies, as defined in the CESR Recommendations, will require a property valuation report.

However, previously issuers had to provide a valuation report with a date of valuation within 42 days of the document. This usually necessitated a complete revaluation exercise on the whole portfolio. Now, the CESR Recommendations

permit an effective date of up to a year from the date of the prospectus. This is provided the issuer states in the prospectus there has been no material change since the effective date.

Also, the CESR Recommendations allow the issuer to use a condensed format in the valuation report, provided the report includes all relevant details for each material property.

Much of the detail in the old chapter 18 concerned the detailed contents of property valuation reports. This has now gone. In PR 5.6.5G we clarify that we would expect a valuation report produced by a UK incorporated property company under the CESR Recommendations to be in line with the 'Red Book' - the Appraisal and Valuation Standards issued by the Royal Institution of Chartered Surveyors. For circulars, a similar requirement for the valuation to be in line with the Red Book is contained in the LR Appendix 1 definition of the term 'property valuation report'. Valuation reports in circulars should be the same as under the old rules as the changes arising from the CESR Recommendations only apply to prospectuses.

There are no changes in the classification rules applicable to listed property companies, other than for Handbook style. The modified class test applicable to property companies is to be found in LR 10.7. The 'size and incidence' concept in the old Listing Rule 18.4 (that in assessing whether a transaction is in the ordinary course the UKLA has regard to the size and incidence of similar transactions), now applies to all companies, not just property companies. You can find it at LR 10.1.5G.

Another change which will affect property company prospectuses but not circulars is that a responsibility statement is required for all expert reports where the person issuing the report authorises the contents (PR5.5.3(f)). Clearly this will include property valuation reports.

If you have any comments or queries on the articles in this section or any general queries on Specialist Equity and Debt matters, please do not hesitate to contact Richard Brearley at : Richard.Brearley@fsa.gov.uk

7. Complex Debt

7.1 Historical financial information on a Guarantor in a Non Equity Prospectus

Annex VI of the PD Regulation requires that a guarantor must disclose information about itself as if it were the issuer of that same type of security that is the subject of the guarantee. So, a guarantor's historical financial information will need to be disclosed - according to either 13.1 of Annex IV or 11.1 of Annex IX or Annex XI (banks), which depends on the denomination of the securities to be issued.

If an issuer is issuing guaranteed securities, Regulation (EC) No 1606/2002 (the application of international accounting standards - the IAS Reg) does not apply to the issuer if it doesn't produce consolidated accounts. The guarantor may not itself have securities admitted to trading on a regulated market at its balance sheet date (see Article 4 of the IAS Reg). But we will expect a Member State guarantor with consolidated accounts to comply with the provisions set out in the IAS Reg as though its securities had been admitted to trading. This follows the requirement set out in 3, Annex VI of the Prospectus Rules that the guarantor must disclose information about itself as if it were the issuer. In these circumstances, we will allow the guarantor to take advantage of the 'transitional arrangements' which are detailed in Article 35 of the PD Regulation as if it did have securities admitted to trading on a regulated market.

7.2 Requirement to disclose Cashflow per 13.1 Annex IV of the PD Regulation - Retail Debt

Requirement 13.1 within Annex IV for an issuer to produce a cash flow when its financial information has been prepared to its national accounting standards has been causing problems for some issuers. These are issuers that have not produced a cashflow because they have used an exemption within their local accounting standard to not produce one. Under UK GAAP FRS 1 a wholly owned subsidiary, or one whereby at least 90% of the voting rights are controlled within its group, does not have to produce a cashflow on the grounds 'that the liquidity, solvency and financial adaptability of the subsidiary

undertaking will essentially depend upon the group rather than on its own cashflows' (Article 12(b) Appendix 3 of FRS1).

If a subsidiary has not produced a cashflow because it has used the exemption available in FRS 1, then the requirement under 13.1 of Annex IV would impose a significant burden on the issuer if an audited cashflow had to be prepared. Accordingly, an issuer which finds itself in this position can approach us about a request to omit information from the prospectus on the grounds that disclosure of cashflow is of minor importance to investors.

If you have any comments or queries on the articles in this section or any general queries on Complex Debt matters, please do not hesitate to contact Graham Walker at: Graham.Walker@fsa.gov.uk

8. Monitoring

8.1 Transactions by persons discharging managerial responsibilities and their connected persons – DR3.1.8R

Chapter 3 of the Disclosure Rules (DR 3) obliges persons discharging managerial responsibilities and their connected persons to notify an issuer of all dealings conducted on their own account in its shares. The issuer is then required to notify a Regulatory Information Service of this information.

The introduction in DR 1 makes it clear that DR 3 applies to issuers incorporated in the UK whose financial instruments are admitted to trading on a regulated market. DR 3 also applies to non-EEA issuers that are required to file with us annual information in relation to shares in line with Article 10 of the Prospectus Directive. Essentially, this latter category would consist of non-EEA issuers with shares admitted to trading in the UK where the UK has been chosen as the home member state.

DR 3.1.8R extends the scope of DR 3 to cover issuers that have financial instruments admitted to trading in the UK, but which do not fall within the categories outlined above. Issuers falling into this category could be:

- an EEA incorporated issuer (non-UK) which has shares admitted to trading in its home member state and also in the UK; or

- a non-EEA issuer with shares admitted on its domestic market, the UK and another EEA jurisdiction where the other EEA jurisdiction has been chosen as the home member state.

The intention behind this rule is to ensure that information equivalent to that which the issuer is required to disclose in the country of its primary listing, or in the jurisdiction of its home member state, is also made available in the UK. We do not require such an issuer to publish more information in the UK than it does in its country of primary listing / home member state. Some concerns have been raised that the rule's construction does not necessarily achieve this objective. We are currently re-examining this provision to ensure that we have achieved our policy objective in drafting the rule.

8.2 Dealing on own account Disclosure Rule

3.1.2R

Disclosure Rule 3.1.2R requires persons discharging managerial responsibilities and their connected persons (PDMRs) to notify an issuer of transactions conducted on their own account in shares of the issuer, or derivatives or any other financial instrument relating to those shares. We have received a number of queries in respect of what is meant by 'on own account'. The following paragraphs, although not formal FSA guidance, set out our views on this issue and we hope this will help issuers interpret this rule.

We expect most transactions that require notification under s324 Companies Act 1985 (reading that section as if any reference to a director of a company were a reference to PDMR) would require notification under DR 3.1.2R. For example, the following would require notification under DR 3.1.2R:

- acquisitions of shares;
- disposals of shares;
- acceptance of awards; and
- accepting or receiving an option or gifts from the issuer or a third party and the exercise of options by a PDMR.

However, not all transactions caught by s324 Companies Act 1985 would be considered transactions 'on own account'. Transactions unlikely to be considered 'on own account' but which are caught by s324 Companies Act 1985 could be transactions for which the PDMR has not given any instruction, consent or otherwise had any control over. An example would be the automatic vesting of an option. Similarly, in the case of an employee share scheme administered by an employee benefit trust (EBT) in which PDMRs are participants, dealings by an EBT for the benefit of all participants would not require notification by PDMRs under DR 3.1.2R. Only when the EBT's transaction is in line with the instruction of a PDMR – for example, an instruction to liquidate their interest on leaving the scheme – would a transaction require notification.

There may be some transactions which do not fall within s324 Companies Act 1985 (reading that section as if any reference to a director of a company were a reference to PDMR) but which still may need to be notified to an issuer under DR 3.1.2R. An example of such a transaction might be the placing of a spread bet related to the share price of an issuer.

It is impossible to set out a definitive 'on own account' test that would be applicable to all transactions that a PDMR may conduct. However, we think the following principles suggest that a transaction by a PDMR is 'on own account':

- a transaction which is the result of an action taken by a PDMR or otherwise undertaken with their consent;
- a transaction whose beneficiaries are mainly PDMRs; and
- transactions having a material impact on a PDMR's interest in an issuer.

Each transaction by a PDMR ought to be considered on its own facts to assess if it was conducted 'on own account'.

8.3 Identifying UKLA representatives

It has recently been drawn to our attention that a listed company was contacted by a person falsely purporting to be a representative of the UK

Listing Authority and attempting to coerce the company into making a regulatory announcement under threat of suspension of its listing. We are aware of other cases where firms or their advisers have been phoned up by people impersonating FSA staff. We would therefore recommend that, where there is any doubt as to the identity of a caller, companies request that the caller leave their name and verify that they are a representative of the UK Listing Authority by returning the call through the FSA's switchboard on 020 7066 1000. Where the caller refuses to divulge their name, companies can draw the conclusion that they are dealing with a bogus approach. We would be grateful if any such approaches could be reported to us via the UKLA helpline (020 7066 8333).

If you have any comments or queries on the articles in this section or any general queries on Company Monitoring matters, please do not hesitate to contact Richard Emery at:
Richard.Emery@fsa.gov.uk

9. Financial reporting

9.1 Interim Reports

LR 9.9.8R(3) sets out the minimum content requirement of interim reports. LR 9.9.8R(3)(c) sets out a requirement for operating profit or loss to be disclosed. Whilst this requirement will still be relevant for those issuers using UK GAAP in their interim reports, under IFRS operating profit is not a defined term or required disclosure. Companies using IFRS are therefore not required to disclose a figure for operating profit or loss in their interim reports. Companies are free to disclose additional non-GAAP numbers in their interim accounts but should make clear the basis on which such numbers are calculated in order to avoid misleading investors. We would not expect non-GAAP figures to be given greater prominence in interim announcements than any GAAP numbers.

If you have any comments or queries on the articles in this section or any general queries on Financial Reporting matters, please do not hesitate to contact James Anderson at:
James.Anderson@fsa.gov.uk

10. Frequently asked questions

10.1 Loss numbers in class tests

Q – How will the UKLA treat a class test where either – or both – the issuer or the target has produced a loss in the most recent year?

A – We will no longer treat the result as necessarily being anomalous. For instance, if an issuer is acquiring a company that has made a loss which would have cancelled out a significant proportion of its profits, we would maintain that this is an important indicator of the impact of the transaction. So in the first instance, we will disregard the negatives and perform the class test in the normal way, although we can still decide that this produces an anomalous result.

10.2 Investment entities

Q – Am I required to include a working capital statement in a prospectus for an investment entity or venture capital trust (VCT)?

A – The disclosure requirements for a prospectus for an investment entity or VCT are in Annexes I and III as modified by Annex XV of the Prospectus Directive. The requirement for a working capital statement is contained in Annex III, and as this requirement is not disapplied by Annex XV, prospectuses for these companies must contain a working capital statement. The provisions in LR 15.2.5R and LR 16.2.6R disappling LR 6.1.16R relate only to the eligibility requirements under the Listing Rules, and not the disclosure requirements under the Prospectus Rules.

So, although an investment entity or VCT need not have a clean working capital statement to be eligible for listing, any prospectus they produce must nevertheless include a working capital statement. As stated in our last edition of List!, we are very unlikely to waive this requirement under the PD omission of information provisions.

10.3 100,000 Euro Exemption

We have received a number of questions about the interaction between the 100,000 euro exemption from the requirement to produce a prospectus in Section 86(1)(e) of FSMA and the 2.5m euro exemption in paragraph 9 (1) of Schedule 11A. These provisions implement in the UK Article 3(2)(e) and Article 1(2)(h) respectively of the Prospectus Directive.

These directive articles were negotiated at different times, with the 2.5m euros exemption being a late addition in the European Parliamentary process. So the interaction of these two provisions was not necessarily considered in depth during the European legislative formation process. It could be argued that there is no longer any need for the 100,000 euros exemption given the 2.5m euros exemption.

However, there is another possible interpretation. The 2.5m euros exemption takes such offers outside the scope of the Prospectus Directive. This allows each Member State to apply national legislation to such public offers of securities. But it can be argued that offers for less than 100,000 euros are within the scope of the Prospectus Directive and so national legislation cannot require that a prospectus or similar document is produced in relation to an offer for such an amount.

The question is not relevant in the context of the UK legislation as the Treasury has decided not to require prospectus style documents to be produced for offers for less than 2.5m euros. However, it may be more relevant in other jurisdictions and offerors should take legal advice about applying these directive provisions in other jurisdictions.

10.4 Sponsor independence: What is meant by 'significant interest' in debt securities?

LR 8.3.6 R (1) states that a sponsor must be independent of the issuer where it provides the issuer with any service, assurance, guidance or advice. LR 8.3.6 R (1)(b) goes on to state that a sponsor may not advise an issuer where the sponsor has '*a significant interest in the debt securities of a listed company or applicant or any other company in the company's group*'.

The rule is to be interpreted widely; the relevant test to be applied being: whether the interest in the

debt securities is significant from the perspective of *either* issuer *or* sponsor. The rationale being that either type of interest will result in the financial interests of issuer and sponsor being intertwined to a degree that may compromise the sponsor's ability to act independently of an issuer.

LR 8.3.6R (1)(b) is the 'debt equivalent' of LR 8.3.6 R (1)(a), which relates to a holding of ordinary shares. This rule deems that if a sponsor holds 30% or more of the ordinary shares of an issuer, the sponsor will *prima facie* not be deemed independent from the issuer and may not advise the issuer. The rule relating to a debt holding is less prescriptive than its sister rule and, ultimately, the sponsor must come to its own conclusion on whether the size of a debt holding is significant in the particular circumstances.

In determining whether an interest is 'significant' the sponsor firm should consider a broad range of factors, including, but not limited to, the significance or impact of the interest in relation to the sponsor's or issuer's financial position.

Where a sponsor is in any doubt as to whether a debt holding is significant and therefore whether it may be permitted to act on behalf of an issuer, it should seek advice from our Sponsor Supervision Team in good time.

10.5 Shares in public hands held outside EEA

We have received enquiries about the amount of securities which must be held in an EEA state to satisfy the requirements of LR 6.1.19R. Wherever possible, we will try to operate a flexible approach when exercising the discretion allowed to us under LR 6.1.20G. An issuer will need to demonstrate that the market will operate properly with a percentage lower than 25% in EEA states. For example, although a significant proportion of the public hands element is held outside an EEA state, all trades will nevertheless take place in London.

However, this should not be taken to mean that the overall amount of securities in public hands can be less than 25%. Such requests are granted only rarely and are only considered for the largest of issuers.

Sponsors are advised to raise any questions on this issue at an early stage and no later than when they submit on eligibility.

11. Errata

11.1 Amendment to LR 9.3.7 Proxy forms for re-election of retiring directors.

The above rule should read as follows;

9.3.7 R If the resolution to be proposed includes the re-election of retiring directors and the number of retiring directors standing for re-election exceeds five, the proxy form may give shareholders the opportunity to vote for or against the re-election of the retiring directors as a whole but **must** also allow votes to be cast for or against the re-election of the retiring directors individually.

There is no material change from the old Listing Rule 13.29

11.2 Public Sector Issuers

We have received a number of questions about applying LR 3 to Public Sector Issuers where no prospectus is required because the securities are of a type specified in Schedule 11A of FSMA, and where LR 4.1.1R also provides that no document is required in respect of the official listing of those securities.

In applying LR 3 we would expect an issuer to have met its obligations if it satisfies LR 3.4.9R and LR 3.2.2R (which in most cases will only involve paying the application fee). Applications under LR 3.4.9R should be made by at least 2pm the day before dealings are due to start and will incur an application fee of £100 per tranche. We have created a more appropriate application form for applications under LR 3.4.9R and this is currently available on our website. Using this form will avoid the need to also supply the pricing supplement, final terms or any other such document containing details on the securities.

For clarification, Public Sector programmes for issuing debt securities that fall outside of LR 3.4.9R should be dealt with as if LR 3.4.7R and LR 3.4.8R also apply.

11.3 The publication of half-yearly reports by overseas companies with a secondary listing

We have recently received several queries from overseas companies regarding the publication of half-yearly reports and the requirement to send them to holders of the issuer's listed equity securities or to insert them in a national newspaper (LR 14.4.9R).

In our view, to meet the requirements set out in CARD Article 102(2), an issuer must comply with either of the options set out in LR 14.4.9R but may alternatively act in accordance with LR 14.3.6R and 14.3.7R, which requires an overseas company with a secondary listing to forward two copies of the half-yearly report to the FSA and to notify a Regulatory Information Service that these documents have been so forwarded and where copies can be obtained.

11.4 Conversion or exchange exemption

In List! 10 we included an article on the subject of the conversion or exchange exemption. The penultimate sentence of that article contained an error and should have read; 'We will require both the convertible security and the resulting share class to have been admitted to trading for the exemption to apply.'

Should you wish to provide feedback on this publication or suggest topics for discussion in future editions of List!, please contact David Freeman at David.Freeman@fsa.gov.uk