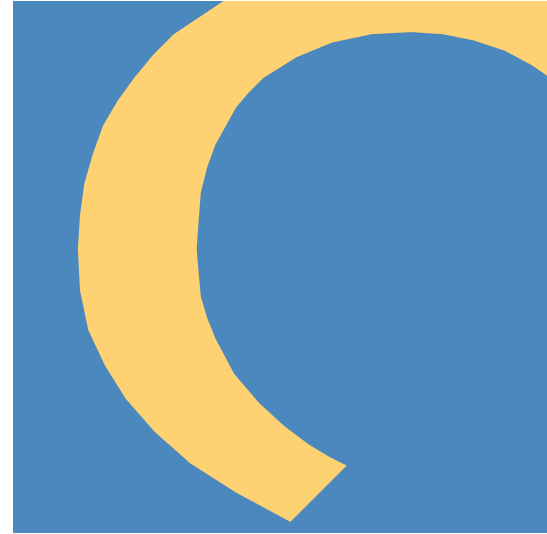




The Listing Review

Consultation paper



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Introduction

The Financial Services Authority (FSA) is carrying out a fundamental review of the Listing Rules. It has published a consultation paper (CP) that outlines its proposals to reform the listing regime against the background of the changes that will be introduced by European legislation. The consultation follows the discussion paper that was issued in July 2002. The FSA invites responses by 31 January 2004.

This briefing paper examines the FSA's key proposals for change and assumes that the reader is broadly familiar with the existing listing regime. The CP, which was published on 8 October, is available at www.fsa.gov.uk/pubs/cp/203/.

If you would like to discuss any of the issues raised in the CP, please contact your relationship partner, Tim Jones, Will Lawes, Vanessa Knapp or Charles ap Simon.

The key proposals

The FSA's proposals for reform will, if implemented, mostly impact equity issuers and sponsors, although there is a chapter in the CP dealing with debt. The FSA is consulting on the following key proposals.

Listing Principles: to introduce six overarching Listing Principles to reflect the fundamental obligations of all listed companies.

Corporate governance:

- to introduce a listing rule to deal with directors' conflicts of interest;
- to give the FSA power to disqualify directors of listed companies for serious breaches of the Listing Rules; and
- to streamline the Model Code and ensure that it operates in a way that is complementary to the market abuse and insider dealing regimes which will be brought in by European legislation.

Class tests:

- to maintain the existing requirement for shareholder approval of major transactions; and
- to revise the Class 1 rules so as to ensure that all transactions that are outside the ordinary course and result in a change in shareholders' economic interest in an asset are classifiable if they meet specified size thresholds.

Financial information:

- to remove the requirement to report on prospective financial information except where such information is in a prospectus; and
- to implement a more flexible approach to the presentation of financial information so that issuers may include audited and unaudited figures as long as they make it clear how unaudited figures have been sourced and ensure that there is subsequent comparability.

Sponsors: whether to retain the requirement for issuers to engage a sponsor for new issues and major transactions or to abolish the mandatory requirement and leave it to issuers to decide whether or not to use a sponsor.

Eligibility requirements: whether to retain eligibility requirements for equity listings that go beyond core EU requirements (for example, the requirement for a 'clean' working capital statement) or whether to leave exchanges to impose additional eligibility requirements.

Delisting: whether to require issuers to obtain shareholder approval in order to delist in certain circumstances.

Overseas issuers:

- to require overseas issuers with a primary listing to comply with the same rules as UK issuers as far as possible including having to ‘comply or explain’ against the Combined Code, comply with the Listing Rules requirements on pre-emption rights and report their financials under International Accounting Standards/International Financial Reporting Standards (IAS) or US GAAP; and
- to require overseas issuers with a secondary listing to use IAS or US GAAP in their financial statements.

Product approach: to restructure the listing rules sourcebook so that it is divided into three sections under the categories equity, debt and financial products and to incorporate the guidance manual into the rulebook. The FSA is hoping that this will make the sourcebook more user-friendly and flexible. New products will be analysed against each category and a ‘building block’ approach will apply to ensure that the relevant rules from each section are applied.

Debt:

- whether to retain the eligibility requirement for a two-year track record for specialist debt issuers or move to the European core requirement of two years’ accounts or, if the issuer has been in operation for less than two years, audited accounts for that shorter period;
- whether to retain the requirement for specialist debt issuers to retain an authorised adviser; and
- whether to drop the requirements for a working capital statement and a three-year track-record on non-specialist debt issues (retail debt issues) and move to the European minimum requirement of a two-year record supported by audited accounts.

European influences

The future of the listing regime has to a large degree been dictated by European legislative initiatives designed to deliver a single market for financial services across the EU (known as the Financial Services Action Plan). The key directives that will impact on the listing regime in the future are:

- the Prospectus Directive (the PD), which sets out the contents requirements for prospectuses;
- the Transparency Directive (the TD), which imposes continuing disclosure requirements on issuers, including financial reporting and the disclosure of major shareholdings; and
- the Market Abuse Directive (the MAD), which aims to harmonise the rules on the prevention of insider dealing and market manipulation and will govern the dissemination of price sensitive information.

Another European development which will affect the Listing Rules is the requirement for most UK listed issuers to use IAS in preparing their consolidated financial statements for accounting periods beginning on or after 1 January 2005.

The delay in bringing forward a new Companies Bill, following the recent company law review, means that any knock-on effects of that Bill will only be known after the listing review is complete.

Listing principles

The FSA proposes to introduce six Listing Principles that are intended to provide flexibility, transparency and consistency in interpreting and applying the Listing Rules. The FSA would be able to enforce these as rules against issuers, although third parties (such as investors) would not be able to take action against an issuer for breaches of principles.

The proposed Listing Principles are that an issuer must:

- ‘1. take all reasonable steps to enable its directors to understand their responsibilities and obligations under the Listing Rules;
2. take all reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with the Listing Rules, both on initial admission to listing and on a continuing basis;
3. act with integrity in its relations with holders and potential holders of its listed securities;
4. communicate information to holders and potential holders of its listed securities as required under the Listing Rules in a clear and timely manner, and take all reasonable care to ensure that such information is not misleading, false or deceptive;
5. ensure equality of treatment for all holders of the same class of its listed securities in respect of the rights attaching to such securities; and
6. deal with the Competent Authority on the application of the Listing Rules in an open and co-operative manner.’

The impact of the introduction of Listing Principles could be far-reaching, particularly bearing in mind that directors are exposed to disciplinary action for being knowingly concerned in a breach of the Listing Rules. For instance, Listing Principle 2 will require issuers to have procedures, systems and controls in place to ensure that they can announce price sensitive information without delay. The fundamental concern with a principles-based approach, particularly where disciplinary action can be brought on the basis of breach of principles alone, is that it is very difficult to measure conduct against principles with any degree of certainty.

Corporate governance

In its White Paper on Modernising Company Law, the DTI proposed to establish a new body, the Standards Board, which would be responsible for keeping the Combined Code under review and taking enforcement action via the proposed Reporting Review Panel. Until the Standards Board is established and its role is determined, the FSA will continue to require listed companies to comply with the Combined Code or explain why it is not practicable for them to do so.

The FSA is proposing to introduce a new rule requiring issuers to ensure that its directors are free from conflicts on a continuing basis and not simply as an eligibility requirement for listing. The FSA believes that the introduction of this new rule, together with Listing Principles 1 and 2, will avoid the need to impose a more prescriptive approach.

The FSA also wants to gauge support for its proposal that the FSA be given the power to disqualify directors from being directors of listed companies for serious breaches of the listing rules. It is for consideration whether the disqualification will relate only to listed companies or would prevent someone from being a director of any company. It is not clear whether the FSA intends this power to extend to directors of non-UK companies.

Class tests

The FSA is in favour of retaining the requirement for a shareholder vote on Class 1 transactions but is proposing some modifications. There is a concern that some of the more complex financing transactions undertaken by issuers are not caught by the class tests when they should be. Although the FSA indicates that it does not want to limit the ability of issuers to raise finance, it wants to ensure that shareholder approval is sought for transactions which are outside the ordinary course of business and which change a shareholder's economic interest in the assets or liabilities of the issuer. Examples of transactions that would be caught include joint ventures, DLC combinations involving a contractual merger between two listed companies, and certain securitisations and other structured finance transactions where shareholders are losing an economic interest in the issuer's assets. The CP is asking for views on what quantitative criteria to apply in these situations.

Financial information

The FSA is consulting on ways in which to make the disclosure of financial information easier for issuers and more relevant for investors. The FSA's key proposals follow.

- To repeal paragraph 2.20 of the Listing Rules and allow issuers to disclose information that is not derived from their audited accounts provided that the source of the information and the fact that it is unaudited are disclosed. Such unaudited information should also be capable of subsequent comparison to the actual published results.
- To allow issuers to disclose non-statutory figures (eg EBITDA figures) alongside figures taken from audited sources.
- To encourage the disclosure of prospective financial information by abolishing the requirement to report on such information, unless the disclosure is made in a prospectus (where the PD will require reporting on prospective financial information, including forecasts and estimates).
- To allow more flexibility in the presentation of financial information as long as the underlying principles of reliability, relevance and consistency are adhered to.
- To remove the requirement for significant change statements if quarterly reporting is introduced by the TD. The CP also provides further information about the possible impact of quarterly reporting, including the replacement of preliminary and interim announcements.

Dissemination of price sensitive information (PSI)

In the future, the dissemination of PSI will be governed by the measures to be introduced to implement the MAD and the TD in the UK. These measures will replace paragraphs 9.1 and 9.2 of the Listing Rules. The Listing Principles (particularly Listing Principles 2 and 4) will also be relevant for issuers when they are assessing the circumstances in which an announcement of PSI should be made.

The MAD will also form the framework for the UK rules setting out the circumstances in which an issuer can delay announcement of PSI and the selective disclosures that can be made by issuers. The FSA will consult on the MAD implementation measures separately once the European framework has been finalised.

Sponsors

The CP puts forward two options for the future of the sponsor regime:

- to retain the requirement to have a sponsor for new issues and on certain major transactions; or
- to abolish the requirement to retain a sponsor and allow issuers to decide whether they want to use a sponsor, to use other external advisers or to rely on their own expertise.

Although the FSA is not proposing fundamental changes to sponsors' obligations under the Listing Rules, it is considering the following reforms to the regime:

- to widen the pool of sponsors by lowering the eligibility criteria for firms to become sponsors;
- to change the term 'sponsor' to 'expert adviser';
- to require disclosure of a sponsor's economic interest in the issuer and require a sponsor to give confirmation of independence;
- to request HM Treasury to give the FSA power to impose financial penalties on sponsors;
- to introduce a code of practice for sponsors; and
- to supervise and monitor sponsors more closely.

Eligibility for listing

The FSA is consulting on whether the eligibility criteria for admission to the Official List should be reduced to European core requirements or whether the FSA should continue to impose more stringent eligibility criteria. If European core standards are adopted the eligibility criteria for an equity listing would be:

- three years' published accounts;
- a projected market capitalisation of £700,000 and compliance with the other conditions relating to the securities to be listed (eg that 25 per cent of the shares to which the application for admission relates are in public hands); and
- a prospectus which satisfies the disclosure requirements set out in the PD.

A move to European core standards would remove the following eligibility requirements from the Listing Rules, shifting the emphasis to disclosure and assessment of risk by the investor.

- A three year track-record showing that the issuer has been revenue earning for the last three years.
- Unqualified accounts.
- A 'clean' working capital statement. This will be replaced by the PD requirement for a working capital statement showing that the issuer has sufficient funds for the next 12 months or a statement of how it proposes to provide the additional working capital required.
- That the directors and senior management collectively possess the requisite skills and experience to manage the group's business. This will be replaced by the PD requirement that the prospectus must provide sufficient information about the directors and senior management to enable investors to assess their individual experience, qualifications and compensation as well as their relationship with the issuer.
- That, in circumstances where the issuer has a controlling shareholder, it must demonstrate that it can carry on business independently of the controlling shareholder. This requirement will be replaced by Listing Principle 2 and a continuing obligation for such independence.
- That the issuer must have control over its assets.

If additional eligibility requirements are to be retained, the FSA is seeking views on whether the FSA should require them or whether

exchanges should be left to impose them as part of distinguishing their different markets.

Delisting

Following recent concerns regarding shareholder protection where an equity issuer intends to delist, the FSA is proposing to introduce a requirement that any equity issuer intending to delist must first obtain the approval of 75 per cent of its shareholders in general meeting. This requirement would not apply to:

- takeover offers where an offeror has declared its intention to delist the target in the offer document and it has received acceptances from 75 per cent of the target's shareholders;
- schemes of arrangement which have received court sanction; or
- where the issuer is moving its listing to another quoted market.

Overseas issuers

Overseas issuers with a primary listing have to comply with very similar requirements to UK issuers. The FSA is proposing to minimise the concessions in the Listing Rules given to overseas issuers with primary listings. If the recommendations are implemented, an overseas primary listed issuer would have to:

- report its financial statements under IAS or US GAAP;
- comply with the Combined Code or explain in its annual report why it is not appropriate to do so; and
- implement the Listing Rules on pre-emption rights or provide appropriate alternative protections to its shareholders.

Overseas issuers with a secondary listing will be required to comply with European requirements as they apply to all issuers whose securities are admitted to trading on a regulated market. This means that secondary listed issuers will be subject to higher standards of regulation than they are at present. For instance, under the TD and the MAD they will have to make financial and other disclosures that they are not required to make at the moment.

The FSA is also consulting on whether the market feels it appropriate to require secondary listed issuers to account in IAS or US GAAP. The FSA indicates that the requirement for primary and secondary listed issuers to account under IAS or US GAAP could restrict access to the primary market in London for overseas issuers.

Debt

The FSA wants to ensure that the specialist debt market in London is not adversely affected by changes to the Listing Rules. The FSA proposes to retain the distinction between specialist and non-specialist issuers. A lighter regulatory regime will continue to apply to debt issues that are not aimed at, or are unlikely to be bought or traded by, retail investors.

Unfortunately the PD does not apply the same test to distinguish between retail and wholesale debt issues. Under the PD the wholesale debt regime will apply to debt securities with a per unit denomination of €50,000 or more. This means that debt issuers listing securities with denominations of less than €50,000 aimed at professional investors will need to comply with the PD prospectus requirements for retail debt issues but will be able to take advantage of the less stringent regime for specialist issues in relation to eligibility requirements and continuing obligations under the Listing Rules.

The FSA is proposing to amend the eligibility requirements for specialist and non-specialist issuers. In future, specialist debt issuers would only be required to have two years' accounts or, if the issuer has been in operation for less than two years, audited accounts for that shorter period. The FSA is consulting on removing the requirement for specialist debt issuers to appoint an authorised adviser as it questions the value that authorised advisers add to such issues.

The FSA is also proposing to remove the requirement for non-specialist debt issuers to have a three-year trading record and a 'clean' working capital statement. Non-specialist issuers would only have to have a two-year trading record supported by audited accounts covering a period not more than six months before the date of the prospectus. A working capital statement will no longer be required for non-specialist issuers.

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