SULLIVAN & CROMWELL LLP

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Update — UK's FCA Announces Temporary Measures Designed to Assist Issuers

UK's Financial Conduct Authority (FCA) Announces a Series of Temporary Measures Designed to Assist Issuers Raising Capital During the COVID-19 Pandemic

SUMMARY

On April 8, 2020, the FCA published temporary measures relaxing certain of its listing and disclosure rules designed to assist issuers raising capital during the COVID-19 pandemic. These new temporary measures are intended to strike a balance between enabling issuers to act quickly whilst at the same time providing appropriate protections for investors.

The new temporary measures, include:

- Permitting a clean working capital statement in a prospectus relating to equity shares to include assumptions relating to the impact of the COVID-19 pandemic.
- Permitting shareholder approvals to be obtained for significant transactions or related party transactions without the need to hold a shareholder meeting provided a dispensation is obtained from the FCA and the requisite majority of shareholders give written undertakings confirming their approval of the transaction.
- Welcoming the Pre-Emption Group's revised guidelines on placings of new shares which permit investors to support resolutions to disapply pre-emption rights in respect of up to 20% of an issuer's issued share capital.
- Encouraging eligible issuers to make use of the simplified prospectus regime introduced by the Prospectus Regulation, which recognises that, for certain issuers, investors already have access to a range of information relating to the issuer and accordingly removes the need to include information such as organisational structure, capital resources, remuneration and benefits and board practices.

At the same time, the FCA also reminds issuers and other market participants that, during the period in which these temporary measures apply, such issuers and market participants continue to be subject to the requirements set out in the Market Abuse Regulation (MAR). In particular, the FCA reminds issuers that they continue to be required to fulfil their obligations regarding identifying, handling and disclosing inside information. In the context of issuers raising capital this includes sharing information in accordance with the requirements of MAR and maintaining insider lists. Issuers, insiders and other persons who have access to inside information must continue to carefully assess what information constitutes inside information at this time, recognising that the COVID-19 pandemic and policy

responses to it may alter the nature of information that is material to a business's prospects, and in relation to market recapitalisations.

The new temporary measures apply from April 8, 2020 until the FCA advises otherwise.

Working Capital Statements

Background: The Prospectus Implementing Regulation (Item 3.1 of Annex 11) requires an issuer to include in a prospectus for an issue of new equity securities, a statement (the so-called working capital statement) whether or not, in its opinion, the issuer and its group have sufficient working capital for their present requirements, that is for at least 12 months from the date of the prospectus. The UK Listing Rules also impose a similar requirement for certain types of shareholder circulars. Working capital statements are supported by extensive due diligence which involves, among other things, detailed financial modelling undertaken on the issuer and its group by its advisors.

The European Securities and Markets Authority (ESMA) Recommendations[1] for the consistent implementation of the Prospectus Directive (which also apply to the Prospectus Regulation) contain guidance on the preparation of working capital statements to which the FCA has regard when approving a prospectus. Under the ESMA Recommendations, a working capital statement can only take one of two forms:

- "Unqualified" (or "clean") – this confirms that the issuer 'has sufficient working capital for its present requirements' [that is for at least 12 months], without any caveats, qualifications, assumptions, sensitivities or cross-references to risk factors; or
- "Qualified" – this confirms that the issuer 'does not have sufficient working capital for its present requirements' [that is for at least 12 months], with an explanation of why and a description of the proposed action plan to remedy the current shortfall in working capital. A qualified working capital statement in a prospectus is relatively rare in the UK.

According to the ESMA Recommendations[2], disclosure of the assumptions in the financial models underpinning a working capital statement is generally not acceptable (as it places the onus on investors to reach their own conclusion regarding adequacy of working capital). The FCA supports this approach and, in particular, the position that a clean working capital statement should not normally include assumptions. However, the FCA also now recognises that the economic impact of, and public policy response to, the COVID-19 pandemic makes the financial modelling underpinning working capital statements challenging. In particular, one of the principles in the ESMA Recommendations for preparing working capital statements (both clean and qualified) is that an issuer is expected to have undertaken an assessment of whether there is sufficient margin or headroom to cover a reasonable worst-case scenario. The FCA recognises that, due to the COVID-19 pandemic, and its effects many issuers are

[1] ESMA Recommendations, available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-319.pdf

[2] ESMA Recommendations, paragraphs 116 et seq. available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-319.pdf

currently unable to model such a scenario and that compliance with the ESMA Recommendations in this respect would result in a significant number of working capital statements being qualified.

The FCA considers that such qualified working capital statements will not be very useful to existing and potential investors. Consequently, the FCA has published a Technical Supplement on working capital statements in prospectuses and circulars[3], setting out the following approach:

- Key modelling assumptions underpinning the reasonable worst-case scenario will be permitted to be disclosed in an otherwise clean working capital statement.
- These assumptions may only be related to COVID-19 and they must be clear, concise and comprehensible. Consistent with usual standards, assumptions unrelated to COVID-19 are not permitted to be included.
- There must be a statement that the working capital statement has otherwise been prepared in accordance with the ESMA Recommendations, and the FCA's Technical Supplement on working capital statements in prospectuses and circulars.

Shareholder Meetings

Background: Under the UK Listing Rules, premium listed issuers (which comprise those UK and overseas issuers which have a premium listing of equity securities) are required to convene a shareholder meeting to obtain shareholder approval for Class 1 transactions and for related party transactions.

Class 1 Transactions: Transactions are classified according to their size relative to that of the issuer as a result of applying certain percentage ratios (the gross assets, profits or gross capital of the business being acquired or sold against those of the issuer or the size of the consideration to be paid for the acquisition or disposal against the market value of the issuer). A Class 1 transaction is one where any percentage ratio is 25% or more.

Related Party Transactions: A related party transaction is one between a premium listed issuer (or any of its subsidiaries) and a related party (with only certain limited exceptions). Related parties include any person who holds 10% or more of the voting shares of an issuer, the issuer's directors (or a director of a subsidiary or parent of the issuer), a person exercising significant influence or an associate of any such related party.

The FCA recognises that, during the COVID-19 crisis, issuers may face challenges in holding shareholder meetings required to approve a Class 1 transaction or a related party transaction. Further, the notice period typically required for a shareholder meeting adds to the transaction timetable and might also jeopardise an issuer's ability to complete a critical fundraising transaction quickly. Consequently, the FCA is temporarily modifying the UK Listing Rules requirements for Class 1 transactions and related party transactions, on a case-by-case basis, in the circumstances described below.

[3] FCA Technical Supplement on working capital statements in prospectuses and circulars during the coronavirus epidemic, available at: https://www.fca.org.uk/publication/primary-market/working-capital-technical-supplement.pdf

Conditional dispensation available: A premium listed issuer undertaking a Class 1 transaction or a related party transaction may apply to the FCA for a dispensation from the requirement to hold a shareholder meeting but the issuer would still be required to produce an FCA-approved explanatory circular to shareholders. A dispensation from the requirement to hold a shareholder meeting will be granted on a case-by-case basis in relation to each transaction, subject to the two conditions below being met.

1. The issuer has obtained, or will obtain, a sufficient number of written undertakings from shareholders (who are eligible to vote under the UK Listing Rules) that they approve the proposed transaction and would vote in favour of any resolution to that effect at a shareholder meeting were it to be held, so that the relevant threshold for obtaining shareholder approval would be met.
2. The issuer provides written confirmation to the market that it has obtained sufficient written undertakings to meet the relevant threshold to pass the resolution(s) and, subject to the dispensation being granted, is not proceeding with a shareholder meeting. This written confirmation could be included in the relevant FCA-approved explanatory circular and accompanying announcement via a regulatory information service (RIS). Alternatively, if sufficient written undertakings to meet the threshold have not been obtained at the time the FCA-approved explanatory circular is sent to shareholders, it could be included in a subsequent announcement (see below).

Where an issuer has already obtained written undertakings from a sufficient number of shareholders when the circular is published, the transaction can complete once the circular has been published (subject to the satisfaction of any other conditions which may apply). Where an issuer is yet to obtain written undertakings from a sufficient number of shareholders at the time when the circular is published, then when written undertakings from a sufficient number of shareholders are obtained, the issuer should release an additional announcement via a RIS announcing that these have been received. The transaction can complete at the point at which the additional announcement is issued (again, subject to the satisfaction of any other conditions which may apply).

The FCA has stated that an issuer must, where there is a material change to the terms of a transaction before the transaction has completed (LR 10.5.2R for Class 1 transactions and LR 11.1.7AR for related party transactions), continue to comply with the UK Listing Rules requirement to produce a new circular and obtain a new shareholder approval for the transaction as changed. This means that an issuer which had obtained a dispensation from the requirement to hold a shareholder meeting would have to re-run the process of obtaining shareholder undertakings following any material change. Either of the methods set out above could be used.

The FCA has published a Technical Supplement on the modification of shareholder meeting requirements under the UK Listing Rules which includes further information on how the dispensation works in practice, including FAQs[4].

[4] FCA Technical Supplement on modification of general meeting requirements under the Listing Rules, available at: https://www.fca.org.uk/publication/primary-market/modification-general-meeting-technical-supplement.pdf

Shareholders' Pre-Emption Rights

The FCA has also welcomed the statement by the Pre-Emption Group which has relaxed its usual guidance to investors voting on the disapplication of shareholders' pre-emption rights in response to the COVID-19 crisis.

Background. Shareholders in UK-listed issuers will benefit from pre-emption rights on the issue of new shares for cash, either because, in the case of a UK issuer, shareholders are granted pre-emption rights under statute or, in the case of an overseas issuer with a premium listing, the UK Listing Rules require such issuers, as a condition to obtaining a premium listing, to grant to their shareholders pre-emption rights which are equivalent to the statutory pre-emption rights enjoyed by shareholders in UK issuers.

These pre-emption rights are considered to be very important by UK institutional investors and the bodies that represent them, in particular the Pre-Emption Group, which issues guidelines advising its members how to vote at meetings on resolutions involving the issue of shares.

Under normal circumstances, the Pre-Emption Group guidelines advise investors to be supportive of proposals by issuers for general disapplications of pre-emption rights only where such disapplications are limited to issues of up to 5% of an issuer's issued share capital for general purposes, and up to a further 5% in connection with a specified acquisition or investment. In addition, the Pre-Emption Group guidelines recommend that general disapplications should have a duration of no more than 15 months, and that issuers should issue no more than 7.5% of their issued share capital for cash on a non-pre-emptive basis over a rolling three-year period.

On April 1, 2020, the Pre-Emption Group published a statement[5] regarding its expectations for new issues of shares during the COVID-19 crisis, designed to assist issuers raising capital. The statement explains that the Pre-Emption Group recommends that investors, on a case-by-case basis, consider supporting issuers that wish to issue new shares for cash representing up to 20% of their issued share capital. The new 20% limit is important because it is in line with the exemption in the Prospectus Regulation that allows issuers to issue and admit to trading new shares representing up to 20% of their issued share capital without a prospectus. The Pre-Emption Group statement also recommends that, where issuers are seeking to use this additional flexibility, the following process should be followed:

- The particular circumstances of the issuer should be fully explained, including how it is supporting its stakeholders.
- Proper consultation with a representative sample of the issuer's major shareholders should be undertaken.
- As far as possible, the issue should be made on a soft pre-emptive basis, i.e., the bookrunner should allocate shares to investors in accordance with an allocation policy which, to the extent possible, replicates the existing shareholder base. The limitations of the exercise mean, however, that it is likely not all shareholders will be able to participate.

[5] Pre-Emption Group statement on expectations for issuers in the current circumstances, available at: https://www.frc.org.uk/news/april-2020/pre-emption-group-expectations-for-issuances-in-th

- An issuer's management should be involved in the allocation process.

Simplified Prospectus Regime

Background: Article 14 of the Prospectus Regulation introduced a simplified prospectus regime for issuers who have had securities admitted to trading on a regulated market for at least 18 months. The rationale for this simplified prospectus regime is that investors will already be familiar with such issuers as a result of the requirement for them to make periodical financial and other disclosures (such as ad hoc disclosures of inside information under MAR) to the market, and therefore that such issuers should not be required to publish a full prospectus under the Prospectus Regulation.

FCA Statement: In its statement, the FCA encourages listed issuers issuing new equity in response to the COVID-19 crisis to use the simplified prospectus regime where possible in order to enable investors to focus on changes that have occurred since the publication of the issuer's previous annual report, as well as the reason why the issuer is issuing new equity. Disclosures which are not required under the simplified prospectus regime include an operating and financial review together with disclosures on organisational structure, capital resources, remuneration and benefits and board practices, all of which will already have been disclosed by the issuer. Although the FCA's statement does not state this expressly, having to produce a much shorter document should enable issuers to prepare a prospectus more quickly and with less expense. The FCA notes, however, that use of the simplified prospectus regime may not be an option where the offer has a non-EU component in a jurisdiction with its own disclosure requirements, for example if the offer has a US element.

Conclusion

These new temporary measures are designed to help streamline and potentially shorten the transaction process for UK-listed issuers, in particular for issuers who are required to publish a prospectus and/or whose capital raising may require shareholders' approval to disapply pre-emption rights, or who are undertaking a Class 1 transaction or a related party transaction.

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