FINANCIAL CONDUCT AUTHORITY

Technical Note

The independent business requirements for companies applying for premium listing – interpretation of LR 6.4, LR 6.5 and LR 6.6

This Technical Note is intended to provide a non-exhaustive guide to cases where we are required to consider an applicant's ability to meet the requirement for an independent business.

We also discuss the requirement for an applicant to control its business, and situations where there is a controlling shareholder.

General requirement to carry on an independent business (LR 6.4)

The independent business rule in LR 6.4.1R is intended to ensure that a premium listed issuer is operating a meaningful business in its own right, and does not for example simply exist as part of a wider enterprise.

The vast majority of applicants to premium listing will clearly demonstrate an independent business. However, in a small number of cases, further careful enquiry will be required. Whilst every applicant's circumstances are different, the circumstances in which such further enquiry might be necessary include where:

- an applicant has been carved out of a wider group, and which has retained close ties with its former parent. Such ties may take the form of extensive services being provided by the former parent, beyond normal outsourcing arrangements or Transitional Services Agreements. Particular regard should be had to circumstances where an applicant is required to source those services from its parent, or may not have control over information that is essential to decision making at the applicant's level.
- key contracts are contingent on the relationship with the parent, or where the applicant's business is predominantly generated through the parent group. This kind of dependency might also exist with a single party outside the applicant's group (beyond a normal key customer or supplier relationship), to the extent that the business could not survive without the relationship.
- an applicant cannot access financing other than through the parent group. This is different from circumstances where an applicant has chosen to finance itself in a certain way for commercial reasons. The evidential threshold here will clearly be applicant specific. A profitable, credit-worthy applicant may find it much easier to

demonstrate that its financing arrangements are based on commercial decision-making rather than reliance on a parent. The guidance relating to financing being obtained only from one person is not intended to apply to situations where an issuer has finance on normal commercial terms from an unrelated financial institution.

- a business is based on an applicant's rights as a franchisee under a franchise agreement. Often franchise agreements will be entirely acceptable, as the applicant can control the day to day running and the key strategic choices of its business. In these circumstances we will seek to understand the details of a franchise agreement to form a view on a specific applicant. This will include what control the issuer has over future changes to the terms of the agreement, and whether there is a risk of abrupt loss of value in the business at the discretion of the franchisor.

- constitutional arrangements give a third party control over voting rights that would normally be conferred on shareholders. Such arrangements are often in place in order to circumvent foreign ownership restrictions. The requirement for an issuer to be able to implement its business strategy is not meant to prohibit premium listed issuers from having majority shareholders who might be expected to use their voting rights and rights of appointment to significantly influence an issuer's strategy.

Considering continuing obligations, there may be circumstances in a rescue situation where an issuer can only access finance from a controlling shareholder. This does not mean that an issuer would automatically be unable to meet the continuing obligations set out in LR 9.2.2ABR - we would clearly need to consider the circumstances of the business in the round.

Control of business (LR 6.6)

The control of business rule in LR 6.6.1R is intended to prevent the listing of corporate structures that do not provide an applicant's Board or shareholders with effective control over the listed group.

Without such control, the ability of the issuer to keep the market informed of price sensitive information on a timely and on an ongoing basis may be compromised. The shareholders of the issuer may also be unable to avail themselves of the protections offered by Chapters 10 and 11, or to determine the listed group's strategy.

To demonstrate compliance with this requirement, an issuer should have positive control over the majority its business. However, there may be circumstances where an issuer's eligibility is in doubt regardless of whether the non-controlled parts of the issuer's group make up the majority of that group. Conversely, an issuer with direct control over only a minority of the group's businesses may still be eligible for listing. We are therefore seeking to engage in a broader principles-based assessment. However, we are likely to consider a structure that consists wholly of non-controlled stakes as ineligible for premium listing.

The circumstances where particular consideration should be given to the issuer's ability to control its business include circumstances where:

- a predominant part of an issuer's business is held through minority stakes or joint venture arrangements
- an issuer owns a majority stake in its subsidiaries, but a third party has special rights that allow it to control the strategy of the underlying business, for example, because of a legacy relationship with the underlying business

An issuer may have to use assets as security for loans provided by genuine third party finance providers. Such scenarios are not intended to be captured by the control of business provisions.

Applicants required to comply with the PRA rules for ring-fenced bodies are able to satisfy the requirements of LR 6.6.1R providing they can still demonstrate effective control over the business to be listed.

Relationship with the controlling shareholder (LR 6.5)

LR 6.5.3G provides a number of indicators of the circumstances in which an applicant may be unable to demonstrate sufficient independence from a controlling shareholder. One of these circumstances is where a controlling shareholder is able to influence the operations of the issuer in a way which subverts its normal governance processes.

Examples of circumstances where this might be the case include:

- using financing or other business arrangements to unduly influence the strategy of the company
- using significant stakes in subsidiaries of the listed company to exert indirect control over the group as a whole
- installing staff with familial or other relationships in key roles to gain day-to-day control

Where a controlling shareholder has a majority stake in the issuer, it will necessarily be the case that the controlling shareholder will have significant practical control through the normal exercise of its voting rights and its ability to appoint directors to the Board of the listed company.

The controlling shareholder provisions do not seek to limit the controlling shareholder's ability to exercise its rights in this way, and do not seek to vest disproportionate control in minority shareholders.

A controlling shareholder should therefore generally be able to do the following, in the absence of other factors, without compromising the independence of the listed issuer:

- accept or make a takeover offer, or propose a scheme of arrangement to effect a takeover offer.
- give an irrevocable undertaking to a third party in connection with a takeover offer.
- propose a resolution for the company to pay a dividend.