How the New FCA Listing Rules Have Changed for Closed-Ended Investment Funds

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Introduction

On 29 July 2024, the new Listing Rules came into force (**new UKLR**), which aim to simplify and streamline the regulatory framework, reduce the administrative burden on issuers, and enhance investor protection and market integrity.

The new UKLR introduced a single listing category for operating companies, known as the equity shares (commercial companies) category (**ESCC**), abolishing the previous two tier structure of premium and standard listings for operating companies.

Closed-ended investment funds have retained their separate listing category, although the relevant rules are now in Chapter 11 of the new UKLR instead of Chapter 15 of the prior rules. Whilst the rules in Chapter 11 are broadly similar for investment funds, particularly on eligibility, there are a number of important changes which simplify and streamline the prior rules, particularly on related party transactions and significant transactions. These are considered further below.

Key changes under the new UKLR for closed-ended investment funds

The new Chapter 11 introduces several changes to the "old" Chapter 15 rules, covering the following main areas:

- Related party transactions
- Significant transactions
- Independent directors
- Sponsor's role

Related party transactions (RPTs)

The threshold at which a "substantial shareholder" becomes a "related party" has increased from 10% to 20% of the voting rights of the issuer. The rest of the definition of a "related party" remains unchanged for investment funds, including the provision that a related party includes any investment manager of the fund and any member of such investment manager's group.

The final rules in Chapter 11 on RPTs align with the equivalent rules for operating companies in the ESCC, with certain modifications and additional requirements. In particular, RPTs no longer require an FCA approved circular and shareholder approval, save for certain "relevant related party transactions" (see below). Instead:

- for large RPTs that exceed 5% or more in any of the applicable class tests (which remain the same as the old rules except for the removal of the "profits test") and which are not in the ordinary course of business, the investment fund must obtain the approval of the independent

board of directors, make certain announcements to the market about the RPT and obtain a "fair and reasonable" opinion from a sponsor (**large RPT disclosure requirements**); and
- for RPTs below 5% in any of applicable class tests, all disclosure requirements have been removed and no announcements or "fair and reasonable" opinions are required.

As was the case under the old rules, transactions with the same related party in any 12 month period must be aggregated.

However, investment funds, unlike operating companies in the ESCC, still need to obtain shareholder approval for certain "relevant related party transactions" (**relevant RPTs**) involving fees or other remuneration payable by the investment fund in connection with services it receives from its investment manager or a member of the investment manager's group. In these cases:

- where a relevant RPT percentage ratio is 5% or more (or it is uncapped), shareholder approval and an FCA approved circular are required; and
- where a relevant RPT percentage ratio is greater than 0.25%, the investment fund must comply with the large RPT disclosure requirements.

Significant transactions

Under the new UKLR, there are no "class 1" or "class 2" transactions, only "significant transactions", which are defined as any transaction where any percentage ratio is 25% or more in any of the applicable class tests.

Investment funds continue to be exempt from the rules on significant transactions where a transaction is in accordance with the scope of its published investment policy.

Shareholder approval is only required if the transaction is a reverse takeover and it falls outside the scope of the fund's investment policy.

An investment fund must comply with certain disclosure requirements if it enters into a transaction that is outside the scope of its investment policy and the transaction is 25% or above in any of the applicable class tests. Bearing in mind that an investment fund must at all times invest and manage its assets in accordance with its published investment policy and any material change to this published investment policy requires FCA and shareholder approval prior to the change, in practice an investment fund will need to change its policy it if wants to pursue a significant transaction which falls outside its investment policy prior to going ahead with the transaction.

If the transaction is 25% or above in any of the applicable class tests but within the scope of the investment fund's investment policy, then no disclosure is required under the new UKLR (though an announcement may still be required under the Market Abuse Regulation (**MAR**)). Like RPTs, certain significant transactions must be aggregated over a 12 month period.

The FCA noted that during the consultation process it received feedback requesting clarification that a transaction within the scope of the investment fund's investment policy includes the acquisition or disposal of another entity, the sole purpose of which is to hold assets that fall within the scope of the fund's published investment policy. The FCA expects to publish separate technical guidance on this point in due course.

See also our LawNow "Practical consequences of the changes to the FCA listing rules on significant transactions" for further details on how the new significant transaction rules apply to operating companies in the ESCC.

Independent directors

Under the old Listing Rules, a director would not be considered as independent if they served on the board of two or more closed-ended investment funds and those funds shared the same underlying external Alternative Investment Fund Manager (**AIFM**). This often limited the availability of certain appointments, particularly the chair. Under the new UKLR, a distinction is made between the AIFM and an investment manager, not in the same group as the AIFM, to which the AIFM has delegated the fund's portfolio management. In such a case, where the director and AIFM are independent of the underlying investment manager, the director is not precluded from being considered as independent. This clarification is helpful in situations where two investment funds have the same AIFM but their investment managers are not part of their AIFM's group.

Sponsor's role

The sponsor rules broadly remain the same. A sponsor is still required on an IPO to assess and provide assurances to the FCA that the applicant has met the listing and prospectus requirements.

A sponsor's ongoing role has been reduced under the new UKLR, and there are fewer instances where an issuer will be required to engage a sponsor. The sponsor's role is now limited to:

- providing a "fair and reasonable opinion" on any large RPTs and any relevant RPTs relating to the investment manager's fees or other remuneration where the percentage ratio is greater than 0.25%;
- supporting issuers seeking individual guidance, or modifications or waivers to the new UKLR, such as a waiver or modification of the significant transactions regime, including the class tests, or the RPT regime;
- transactions involving the submission to the FCA of a reverse takeover circular or a relevant RPT circular; and
- transactions involving the publication of a prospectus.

Indexation

FTSE Russell, which maintains the FTSE indices (e.g. FTSE 100, FTSE 250 and FTSE-All Share), confirmed on 15 July 2024 that ESCC and closed-ended investment fund issuers will be eligible for inclusion in the FTSE UK Index Series, with already listed closed-ended investment funds on the premium segment being automatically mapped to the new distinctive closed-ended investment funds category.

MAR and wider

The new disclosure regime (for example, the disclosure now required for large RPTs of 5% or more in any of the applicable class tests) is in addition to any disclosures required to be made under MAR, as well as any requirements under the Companies Act 2006 (e.g. on loans to directors or substantial property transactions). The FCA has also reminded issuers and other market participants that the wider set of UK market regulation remains in place to protect investors in UK listed markets (such as the Disclosure Guidance and Transparency Rules and the UK Prospectus Regulation).

Specialist Fund Segment

As was the case with the old Listing Rules, the new UKLR do not directly impact investment funds that are traded on the Specialist Fund Segment, as the Specialist Fund Segment is not part of the Official List, so the Listing Rules do not apply. However, it is common for investment funds on the Specialist Fund Segment to publicly state that they will voluntarily comply with certain of the Listing Rules, even though the FCA will not monitor compliance or enforce a breach of its rules. Given the above changes introduced by the new UKLR, investment funds on the Specialist Fund Segment that voluntarily comply with the Listing Rules, should review their public disclosure in light of the new UKLR and consider whether it is necessary to update the market.

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