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UK FCA Publishes Policy on Recapitalisation Issuances by Listed Companies During COVID-19 Crisis

April 8, 2020

The UK Financial Conduct Authority (FCA) published a policy statement and two associated technical supplements on April 8, 2020, announcing a series of measures aimed at assisting companies to raise new share capital in response to the COVID-19 crisis and related disruption, while retaining an appropriate degree of investor protection.

Smaller share issues not requiring a prospectus (i.e., issuances of less than 20% of existing issued share capital)

Temporary relaxation of pre-emption guidelines

The UK Pre-Emption Group (PEG) published a statement on April 1, 2020, about its expectations for non-pre-emptive issuances during the COVID-19 crisis and recommended that investors consider, on a temporary and case-by-case basis, supporting non-pre-emptive issuances by companies of up to 20% of their issued share capital, rather than 5% for general corporate purposes, with an additional 5% of specified acquisitions or investments – as set out in the PEG statement of principles. For further information, please refer to **our recent alert**.

The FCA noted that the Association for Financial Markets in Europe agreed with the temporary relaxation of the guidelines in the PEG statement of principles and confirmed the importance of this to companies considering making use of the ability in the Prospectus Regulation ((EU) 2017/1129) to issue up to 20% of share capital without a the requirement to publish a prospectus.

PEG conditions

The FCA reiterated conditions, previously set out by PEG, to be applied where companies are seeking this additional flexibility:

- The particular circumstances of the company should be fully explained, including how they are supporting their stakeholders;
- Proper consultation with a representative sample of the company's major shareholders should be undertaken;
- As far as possible, the issue should be made on a soft pre-emptive basis; and
- Company management should be involved in the allocation process.

What is soft pre-emption?

Soft pre-emption in the context of a placing of shares is where the bookrunner allocates shares to investors in accordance with an allocation policy that seeks, to the extent possible within the constraints of the exercise, to replicate the existing shareholder base.

The FCA stated that it encourages issuers to contribute to delivering soft pre-emption rights by exercising their right enshrined in Article 40(5) of MIFID Delegated Regulation ((EU) 2017/565) to be consulted on and to direct bookrunners' allocation policies. The FCA also noted that where the disclosure of inside information for the purposes of Article 7 of Market Abuse Regulation ((EU) No 596/2014) (MAR) is made during the consultation process, market participants who comply with the market sounding provisions in Article 11 of MAR and in technical standards will be protected from allegations of unlawful disclosure of the inside information.

The FCA made clear, however, that it will be monitoring how these new practices are applied and whether any risks to market integrity or consumer protection arise.

Share issues requiring a prospectus (i.e., issuances of 20%or more of existing issued share capital)

Shorter form prospectuses

The FCA took this opportunity to encourage listed companies that have been admitted to trading on a regulated market (e.g., the main market for listed securities of London Stock Exchange plc (LSE)) or SME growth market (e.g., AIM) for at least 18 months that are seeking to issue 20% or more of their existing issued share capital in a secondary issuance to avail themselves of the simplified prospectus regime.

The rationale behind the regime is that investors are already familiar with the company and will be focused on changes that have occurred since the publication of its previous annual report, as well as the reasons behind the secondary issuance. Disclosures that are not required under the simplified regime include an operating and financial review and disclosures on organisational structure, capital resources, remuneration, benefits and board practices. All of these should already have been disclosed to the market by companies.

Using a simplified prospectus is unlikely to be an option where the offering is being extended to US investors and the prospectus needs to conform to certain US, as well as UK, disclosure requirements.

MAR

The FCA reminded issuers and investors that MAR remains in force and companies are still required to fulfil their obligations concerning the identification, handling and disclosure of inside information. In the context of recapitalisation, this will include sharing inside information in accordance with MAR and maintaining appropriate insider lists.

The FCA emphasised that it will continue to monitor, investigate and enforce against abusive behaviours and that companies, advisers and other persons who have access to inside information must continue to assess carefully what information constitutes inside information, recognising that the COVID-19 pandemic and policy responses to it may alter the nature of information that is material to a business' prospects, and in relation to market recapitalisations.

Policy intervention: working capital statements

What is the purpose of a working capital statement in a prospectus?

The working capital statement in a prospectus tells investors whether or not, in the issuer's opinion, it and its group have sufficient working capital for their present requirements (i.e., "for at least 12 months from the date of [the] prospectus"). It provides a forward-looking assessment of whether or not the issuer has sufficient financial headroom to cover the reasonable worst-case scenario.

This assessment will take into account a wide range of variables, sensitivities and information and be supported by extensive due diligence in the form of detailed financial modelling undertaken by the company and its advisors.

Unqualified vs. qualified

Under the European Securities and Markets Authority (ESMA) prospectus recommendations, a working capital statement can only take two forms – it can either be unqualified (also known as clean) or qualified:

- An unqualified statement confirms that the issuer "has sufficient working capital for its present requirements, that is for at 12 months from the date of [the] prospectus." If it is unqualified, it is not normally acceptable for the working capital statement to have any caveats, qualifications, assumptions, sensitivities or cross-references to risk factors.
- If it is qualified, the ESMA prospectus recommendations requires further disclosure. A qualified statement must begin with a confirmation that the issuer "does not have sufficient working capital for its present requirements, that is for at least 12 months from the date of [the] prospectus." It must then explain why and set out the proposed action plan to remedy the current shortfall in working capital.

According to the ESMA prospectus recommendations, disclosure of the assumptions in the financial models underpinning the statement places "the onus on investors to reach their own conclusion regarding adequacy of working capital and [is] therefore not normally acceptable."

The FCA supports this approach and, in particular, the position that a clean working capital statement should not normally include assumptions.

A qualified working capital statement in a prospectus is a relatively rare event in the UK. The clarity of the disclosure assists investors in identifying companies whose working capital position suggests that any investment will be relatively high risk. However, the FCA appreciates that uncertainty created by the COVID-19 pandemic and the economic impact of the public policy response makes the financial modelling underpinning the working capital statement uniquely challenging.

Modelling the reasonable worst-case scenario

The FCA notes a particular challenge arising from the ESMA prospectus recommendations requirement that issuers model a reasonable worst-case scenario. Constructing such a scenario is extremely difficult in the current circumstances. Companies are experiencing unprecedented interruptions and disruptions in their business as a result of government restrictions such as social distancing measures necessary to contain the virus, as well as from the impacts of COVID-19 and the consequent fall in demand. There is significant and unprecedented uncertainty as to the future impact and duration of the disruption.

Many firms are currently unable to model a reasonable worst-case scenario. Without modification, the approach set out in the ESMA prospectus recommendations would result in a significant number of working capital statements published as part of a recapitalisation exercises being qualified. Therefore, the FCA is of the view that disclosure on working capital would need to state that the issuer "does not have sufficient working capital for its present requirements, that is for at least 12 months from the date of [the] prospectus."

The FCA doubts this is useful to existing and potential investors and wants to ensure that prospectus disclosure gives them an accurate picture of the financial condition of the issuer. Where numerous companies are giving qualified statements that, absent the current unprecedented level of uncertainty relating to COVID-19 assumptions, would be clean, this may not help to ensure that investors are being fully informed.

Modified approach

Investors should, according to the FCA, be provided with the necessary information to distinguish, for example, otherwise financially sound companies that need to repair their balance sheet due to COVID-19-related disruption and those companies with more profound problems that do not have sufficient working capital to cover at least the next 12 months.

Accordingly, the FCA has set out a modified approach to working capital statements, which will apply for the duration of the COVID-19 crisis only. The approach will also apply to shareholder circulars published by premium listed companies where the FCA's Listing Rules require a working capital statement to be included.

In summary, under this 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 COVID-19-related. They must be clear, concise and comprehensible. Non-COVID-19 assumptions may not be included.
- There must be a statement that the working capital statement has otherwise been prepared in accordance with the ESMA prospectus recommendations and the technical supplement to the FCA statement of policy on the COVID-19 crisis.

For further detail, please refer to the related FCA **technical supplement**.

The FCA recognise the urgent need for clarity in the UK market and will be working with ESMA and relevant national competent authorities in Europe to agree a consistent approach where this will benefit market participants.

Policy intervention: the requirement for general meetings in the context of Class 1 and related party transactions

The FCA notes issuers may currently be facing challenges in holding the general meetings, which are required in a number of instances under the Listing Rules, and that the notice period for general meetings adds to transaction timetables and might jeopardise an issuer's ability to complete critical fundraising transactions quickly.

To address the challenges faced by issuers and alleviate the time constraints imposed by the notice period during this difficult period, the FCA are proposing temporarily to modify the Listing Rules on a case-by-case basis with regards to Class 1 transactions (LR 10.5.1R(2)) and related party transactions (LR 11.1.7R).

Premium listed companies undertaking a transaction within the scope of this policy may apply to the FCA for a dispensation from the requirement to hold a general meeting. (It is worth noting that that standard listed issuers are not required to comply with Listing Rules 10 or 11.)

In order to receive the dispensation, issuers will need to have obtained, or will need to obtain, written undertakings from shareholders (who are eligible to vote under the Listing Rules) that they approve the proposed transaction and would vote in favour of a resolution to approve the transaction if a general meeting were to be held.

Issuers will need to obtain a sufficient number of undertakings to meet the relevant threshold for obtaining shareholder approval. When the requisite number of written undertakings is obtained, the issuer will be required to inform the market. This could be via the relevant FCA-approved explanatory shareholder circular and announcement via a regulatory information service (e.g., the Regulatory News Service of the LSE).

Issuers may either:

- Obtain sufficient written undertakings from eligible shareholders prior to publishing a circular and announcing the transaction; or
- Publish a circular that states they are yet to obtain such a written undertaking from a sufficient number of shareholders and will be applying for dispensation. When these issuers receive sufficient written undertakings they will be required to release an additional announcement confirming the number has been reached.

For further detail, please refer to the related FCA **technical supplement**.

This policy is intended to be temporary during the period of extreme disruption caused by COVID-19. Where issuers have provisions in place to provide for holding virtual general meetings, the FCA continues to support this as a means for gaining shareholder approval.

Duration

The policy interventions regarding working capital statements and general meeting requirements for Class 1 and related party transactions will apply until the FCA advises otherwise.

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