Discussion Paper

08/1

Financial Services Authority

A review of the Structure of the Listing Regime

January 2008

FSA®

Contents

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In addition, please copy any comments in repsect of the third bullet point in paragraph 6.11 to Bhavika Chauhan at HM Treasury, email: Bhavika.Chauhan@hm-treasury.x.gsi.gov.uk and David Moran at HM Revenue and Customs, email David.Moran@hmrc.gsi.gov.uk.

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1 Synopsis of the Discussion Paper

1.1 The global capital markets are in a period of change, driven by new legislation, consolidation and competition among trading platforms, and new sources of economic growth and demand for capital. The UK Listing Regime is a key element of the UK capital markets offering, both domestically and overseas, and one of the reasons for its success. Although we have reviewed the details of the regime thoroughly in recent years, the continuing evolution of global markets, and concerns by some market participants about the potential for confusion between the different Listing segments in the light of this evolution, mean that now is a good time to consider the structure of the regime as a whole, and in particular how it fits within the changing EU legislative structure. We would welcome a full and open debate on how the Listing Regime should be structurally developed in view of these changes.

1.2 In this Discussion Paper, we aim to:

- describe the structure and recent growth of the global and UK capital markets;
- explain the current structure of the Listing Regime, in particular in relation to equity securities and certificates representing equity securities;
- consider the role of listing, and where the regime fits in the context of the other regulatory segments available for primary market activity;
- set out some options and a series of sub-options to address concerns around the lack of clarity as to what the different Listing segments represent in the evolving global context, and what regulatory provisions attach to them, including options which would restructure the regime.

1.3 Our over-riding objective in considering the issues discussed in this DP is to ensure that the Listing Regime is optimally structured to support an appropriate balance between investor protection and maintaining the competitiveness of the UK capital markets for both UK and overseas issuers, recognising the wider primary market choices which issuers have. Key elements of any structure which achieves that balance will be clarity as to what each of the segments of the Listing Regime represents, the standards which apply, particularly in relation to the “super-equivalent” elements of the Primary Listed segment, and a continued attractiveness for both UK and overseas issuers. This will ensure that the regime continues to have the confidence of market participants, and remains a destination of choice for issuers from across the globe.

1.4 In terms of market structure, we note that:

- EU and global capital markets are becoming more integrated and more competitive. Issuers and investors alike have a wider choice of platforms and regulatory regimes than they did 10 or 15 years ago;
- a range of choices – both listed and non-listed – is available in the UK, a factor which has enhanced our international attractiveness;
- the UK has increased its share of the global IPO market in recent years, with most of the growth coming through GDRs or non-listed markets (e.g. AIM), as opposed to the Primary or Secondary Listing segments. Indeed, the number of issuers in the latter two categories has fallen since 2000, as companies have sought to make use of other forms of capital raising, including debt and private equity, a trend which has been a global phenomenon; and
- the overall number of overseas listed issuers in the UK has also fallen sharply since 2000, but the composition of new overseas issuers has been dominated by emerging market issuers seeking to raise capital.

1.5 We are the competent authority for Listing. In several other European jurisdictions, exchanges fulfil this role. Two consequences flow from this. First, there is considerable scope for confusion about what the term “Listing” means in the UK. In most jurisdictions, it is synonymous with admission to trading on an exchange, whereas in the UK, admission to the Official List and admission to trading are different (although linked) concepts. Second, although historically long-associated with the London Stock Exchange’s (LSE) Main Market, the Official List is not in fact no longer linked to any single trading platform or venue. We would welcome views on whether there should be flexible in our rules to allow all types of trading platforms which could satisfy the relevant standards to have securities which are traded on such platforms admitted to the Official List.

1.6 The implementation of the Financial Services Action Plan (FSAP) directives[1] in the last three years – the Prospectus Directive (PD), Transparency Directive (TD) and the Market Abuse Directive (MAD) – repealed a large proportion of the Consolidated Admission and Reporting Directive (CARD)[2], the EU directive from which some parts of the former Listing Rules were derived, causing us to strip out a substantial amount of material, and replace it with the Prospectus Rules and Disclosure and Transparency Rules. These new EU provisions now apply – in a largely harmonised manner across Europe – to a broader category of securities, encompassing all “securities admitted to trading on a regulated market”. The main provisions remaining in the Listing Rules for trading companies are the ‘super-equivalent’ provisions which relate to eligibility criteria, overarching Listing principles, the requirement for a sponsor, and corporate governance type provisions which give

1 The Prospectus Directive (2003/71/EC), The Transparency Directive (2004/109/EC) The Market Abuse Directive (2003/6/EC), and The Markets in Financial Instruments Directive (2004/39/EC)

2 2001/34/EC

shareholders decision-making rights over key transactions and CARD minimum standards. These key provisions (with the exceptions of the CARD minimum standards) only apply to Primary Listed equity securities. In addition, the Markets in Financial Instruments Directive (MiFID), which took effect from November 2007, has introduced standards for admission to Regulated Markets in the EEA which are distinct from “Official Listing” under the CARD.

1.7 Listing in the UK has traditionally symbolised a distinctive set of standards, separate from those attaching to other market segments. But the recent development of substantive EU directive provisions for admission to trading has served to blur that distinction and, to some extent, Listing’s historic role. Nonetheless, there continues to be a distinctive set of ‘super-equivalent’ requirements for the Primary Listing of equities segment. The standards for Secondary Listing and the Listing of GDRs on the other hand, are not distinctive from, and are now substitutes for, the EU standards for securities admitted to trading to a Regulated Market. These standards have been collectively agreed by Member States and the European Parliament as being appropriate for such securities.

1.8 Against that background, we pose the questions as to whether the “super-equivalent” provisions should be retained, and as to whether we should continue to be responsible for setting them. Our expectation is that market participants are likely to want to retain the super-equivalent provisions, and to prefer that we, rather than exchanges, undertake the role of setting them, as this is more likely to produce a single set of high quality standards, and avoid conflicts of interest.

1.9 In terms of the Listing segments for equity securities, we believe that there is scope for some confusion as between Primary Listing, Secondary Listing, and the Listing of GDRs. It is the Primary Listing segment which embodies the higher standards – the other two are based on the minimum requirements of the European directives, and as such, mirror the standards which are common elsewhere in Europe. Yet there is concern that market participants may, wrongly, attribute the higher quality status to Secondary Listing or Listed GDRs because they are all loosely referred to as a ‘London Listing’. Another concern is that some market participants may believe that the regulatory standards which apply to Secondary Listing and Listed GDRs, and the FSA’s role in relation to these segments, are substantively different to those which apply to non-listed “directive minimum” Regulated Market segments, which is not the case. However, some market participants consider that the lable of being ‘Listed’ in the UK is an attractive important factor.

1.10 We therefore invite market participants to provide their views on two structural options for amending the Listing Regime that we have set out in this paper as ways of achieving greater clarity, in the light of the global developements about the regulatory content of the Listing Regime:

- One approach to securing clearer labelling would be to drop Secondary Listing and the Listing of GDRs altogether from the Official List, and retain only the super-equivalent Listing for Primary Listing. Securities which would previously have received the Secondary or GDR Listing label could still be admitted to trading on a Regulated Market on a ‘directive-minimum’ basis, with us playing exactly the same regulatory role, in terms of approving prospectuses, and monitoring ongoing disclosures by issuers and major shareholders.

- The other is to modernise the existing two-tier Listing Regime, maintaining both "super-equivalent" and "directive minimum" segments to reflect current market practice. The Primary Listing segment would be re-labelled as a "Tier 1 Listing". All other segments on the Official List would be labelled "Tier 2 Listing". UK companies are not currently eligible for a Secondary Listing. In a context of greater choice, and recognising that UK companies could seek admission to a directive-minimum "Listing" on non-UK EU markets, a variant on the *status quo* option would be to remove that restriction.

On the basis of this greater clarity, we would propose to work with market participants on how the market uses the various labels in everyday parlance.

1.11 Overseas companies with a Primary Listing currently do not have to "comply or explain" against the UK Combined Code. Instead, overseas companies must disclose whether or not they comply with the corporate governance regime in their country of incorporation, and also disclose the significant ways in which their actual corporate governance practices differ from those set out in the Combined Code. Nor do pre-emption rights apply to overseas companies. We would be interested in views on the merits or demerits of aligning all companies to the same provisions, on a "comply or explain" basis in the case of overseas companies. In particular, we would welcome views on whether such rule changes would lead to substantive changes in behaviour by overseas issuers and/or investors and whether they would enhance clarity for the Primary Listed segment.

1.12 Finally, the paper considers whether there is a case for amending the regulatory standards which apply to GDRs. We note that the GDR market remains a specialist market. New admissions are often offered as placings to institutional investors and secondary market trading is limited to a dedicated trading service and dominated by sophisticated investors, with Know Your Customer (KYC) obligations binding brokers under the new Conduct of Business rules. These securities are not included in the FTSE UK Index series. Prospectuses for GDR issues tend to make clear the specialist nature of the securities. We also note that this market segment is likely to be highly internationally mobile. If there were to be a substantial change in the degree of retail participation in this market, there could be a case for reassessing the regulatory provisions which apply. We believe that this would be best done at the European level. We have devoted more of our regulatory resources to this market segment, both in terms of admission and on-going oversight, in line with its relative growth. We would propose to introduce the clearer labelling set out above, but do not otherwise at this time suggest any further regulatory changes.

2 Background

2.1 We stated in April 2007 in the context of an update on the Investment Entities Listing Review (IELR) that we would formalise a wider debate about the structure and quality of the market for listed securities in London through discussions with stakeholders. In June 2007 we held a roundtable discussion with a select group of market participants across a broad spectrum of interests in the securities market on this issue to kick-start this debate[3], and we have followed that up with a number of more detailed discussions since then. We also stated that we would publish a DP as part of this review in order to canvass the views of a wider group of market participants.

Evolution of the markets

2.2 The principal catalyst for this debate is the fast pace of change in the London capital markets in the post-millennium period which has prompted us to take stock and consider the way forward for the Listing Regime. The face of the UK capital markets and indeed the global markets is changing. Competition and choice in primary and secondary markets services and products is intensifying, partly as a consequence of a more integrated EU financial services market arising from new EU legislation (PD, TD, MAD and MiFID), partly as a consequence of consolidation and new entry among market operators. The change has also been driven partly as a consequence of more emerging markets companies (mainly from Russia, China and India) seeking to raise capital and seeking liquidity in London and other more established capital markets.

2.3 In this context, over the past year or so, a number of market participants have expressed some concerns to us that there is a lack of clarity and therefore some confusion in the market as a result of the different segments and markets offered by the FSA and the London Stock Exchange (LSE), such as Primary Listing, Secondary Listing, GDRs and AIM, which are all loosely referred to as a 'London Listing'. This lack of clarity is said to be exacerbated by the significant rise in overseas companies coming to raise capital or seek liquidity in London. This is partly illustrated by the strong growth in the number of companies listing GDRs. There has also been some comment that some overseas companies with a Primary Listing may not offer the same level of corporate governance and some shareholder protections, such as pre-emption rights as

3 See http://www.fsa.gov.uk/pubs/ukla/roundtable.pdf for notes of the roundtable.

UK companies. Historically, some of these companies nevertheless obtain access to the FTSE UK Indices series by virtue of their Listing and tracker fund managers were obliged to invest the shares of these companies by virtue of their presence on the FTSE indices. Although we note that the FTSE has subsequently introduced changes which require Primary Listed overseas issuers to meet additional obligations before being considered for inclusion. Some market participants have noted that while the position may be tolerable in a relatively benign market, this confusion may be of more concern if the equity markets conditions become turbulent. Whilst we do not necessarily share these concerns, we recognise that the Listing Regime needs to be robust, well-understood and create an environment which reflects confidence in its operation, if it is to continue to support effectively the position of the UK in the global markets both now and in the longer term.

Scope

2.4 This DP will identify and present the relevant issues for consideration in order for us to strike an appropriate balance between our competitiveness and investor protection objectives through a coherent Listing Regime. The DP does not form part of the IELR but aims to rationalise the whole of the Listing Regime. We will however focus mainly on equity securities and GDRs where market participants have expressed concerns about the clarity of the Listing Regime. The scope of the paper will exclude any detailed discussions on investment entities except in the context of the overall regime. But the structural options discussed in Chapter 6 will apply to the debt securities and securitised derivatives segments. We are not proposing any rule changes at this stage of the review but instead the DP will mainly consist of high- level and conceptual discussions of the Listing Regime.

Objectives of the DP

2.5 Our key objective for undertaking this review and publishing this DP is to explore how the structure of the Listing Regime can best contribute to how we strike an appropriate balance between our objectives of investor protection and making sure that the UK Listing Regime remains competitive in a continuously evolving global markets environment. In order to achieve this, we seek to:

- Ensure that all market participants have a clearer understanding of what the Listing Regime represents and how it relates to other capital market offerings;
- devise a robust segmentation of the regime that improves clarity and which will be long-standing in the face of further market evolution offering competition and choice;
- recognise that the market particularly values the ‘premium brand’ of Primary Listing and therefore improvements to labelling should underpin that value;
- ensure that we position the Listing Regime in a manner which continues to deliver confidence for all market participants in the capital raising process.

Overview of the DP

2.6 We have set out the paper as follows:

- Chapter 1 is a synopsis of the DP.
- Chapter 2 sets out the background, scope, objectives and an overview of the DP.
- In Chapter 3, we describe some of the key elements of the evolution of global markets and the changes in the London capital markets in the post-millennium period since we took over the Listing function.
- Chapter 4 is a synopsis of the structure of the current Listing Regime and the regulatory standards applicable to the equity segments of the regime.
- Chapter 5 is a discussion about the role of Listing today and the role of the FSA in setting Listing standards. We also discuss the appropriate trading platforms for Listed Securities.
- Chapter 6 sets out the different ways the Listing Regime may be segmented. In this section we also discuss whether the core requirements for overseas Primary Listed companies should continue to differ from those for UK companies, in terms of corporate governance and pre-emption rights. We also consider the requirements for GDRs, including whether there should be a requirement to engage a sponsor for transactions involving the listing of GDRs. Finally, we discuss the possible ways of labelling the Listing Regime.
- Chapter 7 explores the relationship between the FTSE indices and the Listing Regime.

In the annexes, we have included a high-level cost benefit analysis together with a literature review and an empirical study conducted by our Economics of Financial Regulation department on the correlation between different capital market regulatory regimes and share price performance. We have also provided a glossary of the terms used in this paper in the annex.

3 An overview of the Listing Regime and the recent evolution of the market

Introduction

3.1 This section provides an overview of the structure of the current Listing Regime, and explains how the regime fits into the broader context of the different ways of raising equity capital in the UK. It goes on to look at some of the main developments in UK and global primary markets since the FSA took over the Listing Authority function in 2000.

An Overview of the current Listing Regime

3.2 The FSA, acting through the UK Listing Authority (UKLA) is the UK's competent authority for the regulation of the admission of securities to the Official List[4]. As competent authority, we have the responsibility for maintaining the Official List and for admitting to Listing securities covered by Part VI of FSMA. We are empowered by Part VI of FSMA to make rules through the UKLA governing the admission to Listing, the enforcement of those obligations and suspension and cancellation of Listing. These rules are collectively known as the Listing Rules. Part VI of FSMA and the Listing Rules contain the UK implementation of the CARD which consolidates the Listing Particulars, Admissions and Interim Reporting Directives.[5]

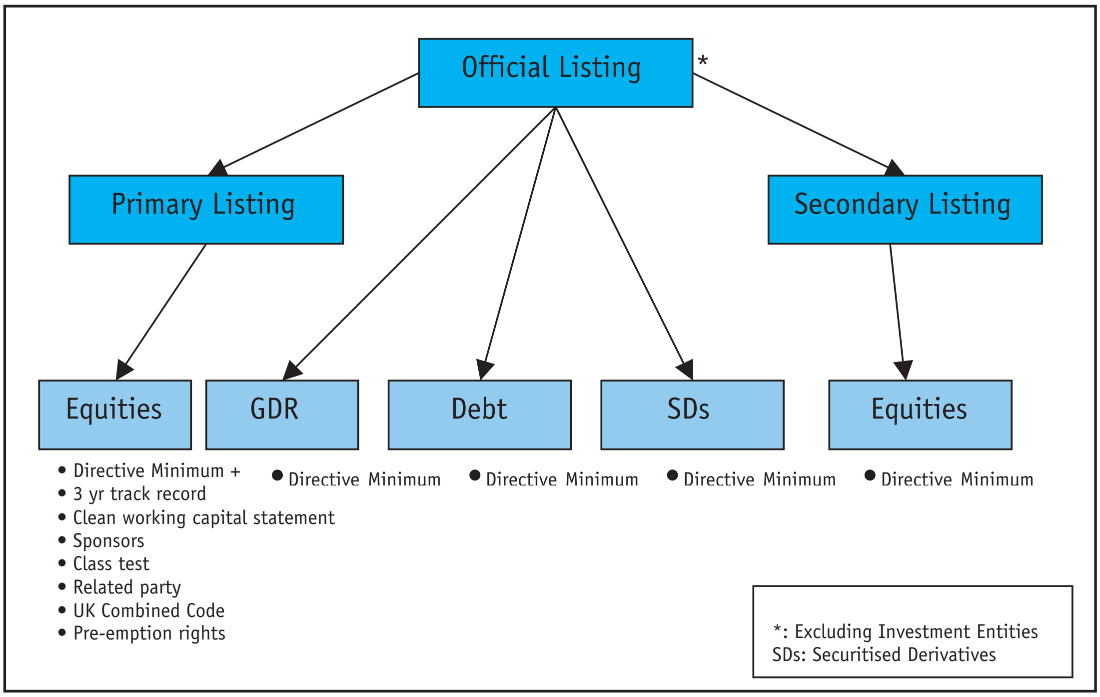
3.3 We assumed our role as competent authority for Listing in 2000 when the Listing function was transferred to us from the LSE following the demutualization of the LSE. Prior to this date, the LSE, under Part IV of the Financial Services Act 1986, was the competent authority for admission of securities to Listing and the subsequent admission of those securities to trading. Both activities were viewed as an inseparable part of a whole and referred to as 'official listing on a stock exchange'. After the transfer of the UKLA function, the admission of securities to Listing became the sole responsibility of the FSA, and admission to trading continued to be the responsibility of the LSE. Although the two functions have now been separated, the trading of securities is still a pre-requisite for admission to the Official List.

4 Section 72 of FSMA

5 80/390/EEC, 79/279/EEC, 82/121/EEC, 88/627/EEC

3.4 The current structure of the Listing Regime dates from 1 July 2005 when we implemented the PD in conjunction with the changes to the Listing Rules following the wholesale review of the Listing Rules. There are currently five Listing segments on the Official List:

Diagram 1



- Primary Listing: available to UK and Overseas companies – 'Super-equivalent' standards.
- Secondary Listing } Overseas companies only
- Global Depositary Receipts[6] } 'Directive-Minimum' standards
- Debt
- Securitised Derivatives

3.5 A UK incorporated company that wishes to admit its equity securities to the FSA's Official List must have a Primary Listing of its equity securities. Overseas companies (including EEA companies) can have either a Primary or Secondary Listing, or alternatively have GDRs Listed. The specific obligations of the various Listing segments are detailed in Chapter 4.

3.6 A **Primary Listing** of equity securities is the 'premium brand' of the Official List to which additional requirements, otherwise known as 'super-equivalent'[7] requirements, apply. All the other Listing segments are based on 'directive-minimum'[8] standards

6 Although UK incorporated companies may technically list GDRs, their underlying equity must also be Primary Listed.

7 These are requirements over and above the 'directive-minimum' requirements which may be found in the Listing Rules.

8 These are requirements derived either from CARD, PD, TD or MAD

only – i.e. the minimum standards which EU legislation requires us to impose on all securities trading on a Regulated Market and/or offered to the public. This structure was put in place in July 2005, after extensive consultation with the market as to whether we should retain our 'super-equivalent' standards following the introduction of the new EU legislation. There was an overwhelming response from the market that we should retain these standards.

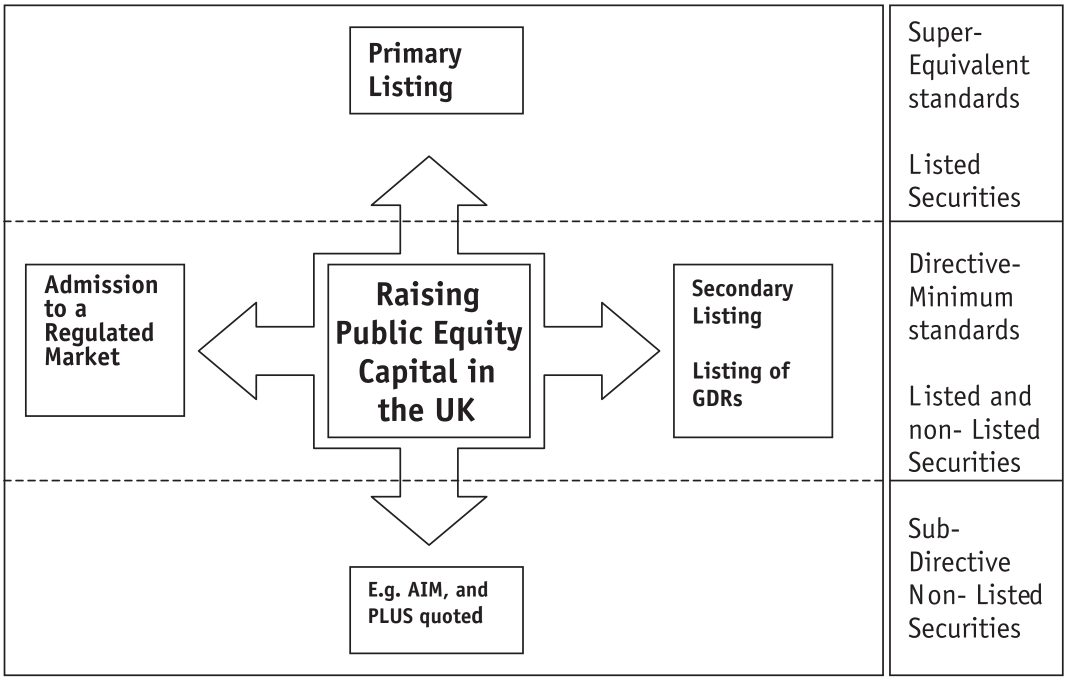
3.7 A **Secondary Listing** only applies to the equity securities of overseas companies. Prior to July 2005, a company seeking a Secondary Listing was required to have a Primary Listing in its home jurisdiction. This requirement was abolished in 2005 to allow all overseas companies, in particular EU companies, wishing to List in the UK to do so unfettered by any conditions or additional requirements to those of the recent EU directives. It was felt that, given that companies could seek admission to any Regulated Market in the EU on the basis of a prospectus approved under the PD, it would not be attractive to continue to require a Primary Listing in the home market. The standards which apply on the markets in other EU Member States are generally directive minimum standards, rather than 'super-equivalent' standards.

3.8 **GDRs –** Any trading company may apply for a Listing of its GDRs, although they are typically issued by overseas companies. As an anti-avoidance measure, UK companies wishing to list GDRs must have their underlying equity securities Listed as a prerequisite for Listing. We have not required overseas issuers of GDRs to have a Primary Listing in their home jurisdiction since 2000.

Different routes to raising equity capital in the UK

3.9 Companies bring their securities to the market with the aim of raising capital and/or seeking liquidity. Access to the wide and deep pool of capital available in London is attractive as it helps companies to reduce their cost of capital in the long term, and raise their profile internationally. The UK equities market has traditionally had several tiers of ways in which a company may raise capital, not all of which are listed segments. Broadly, the choices available for a trading or commercial company wishing to raise public equity capital in London today are depicted in diagram 2 below. As well as the 'super-equivalent' standards of Primary Listing, and the directive minimum standards of Secondary Listing and GDRs, there are also successful "junior" non-Listed markets, such as AIM and the PLUS quoted market, which operate outside the scope of many of the provisions of the EU directives which apply to "directive minimum" markets. Finally, since the implementation of the FSAP directives, there is the possibility of a Regulated Market segment which operates to "directive minimum" standards, but which is not listed. Virt-x and the Specialist Fund Market which the LSE opened in November 2007 are examples of this segment.

Diagram 2



Evolution of the markets since 2000

3.10 The post-millennium period in the UK, since the Listing function was transferred to the FSA, has witnessed some significant changes in the UK, EU and global capital markets. These include:

- The FSAP directives which have an impact on securities regulation[9] were launched and implemented during this period. It is estimated that 70% of the UK financial services law now emanates from EU directives. These directives were introduced to deepen a single market in financial services across Europe thereby integrating the market for all primary and secondary market activity in the EU. These directives are not referenced to 'Official Listing', but rather to 'securities admitted to trading on a Regulated Market'. Therefore, a company could raise capital in the EU by meeting the minimum requirements without the need for an admission to the 'Official List'. The FSAP measures also mean that issuers and investors can access markets on a cross-border basis across the EU more easily.

- The post-millennium period has also witnessed the consolidation of exchanges on a global level as a result of the responses to challenges posed by new and innovative electronic trading systems that are reducing transaction costs and facilitating cross-border trading. This has brought about the transformation of the market relating to the provision of trading platforms, reflecting and in part intensifying the competition between them. MiFID has introduced a more detailed and more harmonised rules for EU Regulated Markets but has also created a new pan-European regime for MTFs. Recent major developments globally include:

9 The Prospectus Directive (2003/71/EC), The Market Abuse Directive (2003/6/EC), The Transparency Directive (2004/109/EC) and The Markets in Financial Instruments Directive (2004/39/EC)

- The creation of Euronext – a merger between the Paris Bourse, the Amsterdam Stock Exchange, the Brussels Stock Exchange (the Lisbon and Oporto Stock Exchange were added in 2002)[10]. Subsequently, the merger between NYSE and Euronext took place in April 2007.
- OMX Nordic exchange– an alliance between the Copenhagen Stock Exchange, the Iceland Stock Exchange, OM Stock Exchange and the Oslo Stock Exchange. (The Baltic stock exchanges were added in 2004)[11].
- The LSE has completed a merger of Borsa Italiana[12].
- Plus-Market became a Recognised Investment Exchange (RIE) in 2007, providing a second UK venue for the admission of listed securities.

- Capital raising tends to be cyclical, mirroring economic growth. After a dip between 2000 and 2003, London has seen a rapid growth in IPOs over the last five years and has surpassed the other main European exchanges in terms of total offering value and number of IPOs. London generated €29.7Bn, which represents 45% of the money raised on the EU Regulated Markets in 2006. This pattern of growth continued in Q1 & Q2 2007. London was the largest European market in terms of offering value raising (€14,808m) and volume (102 IPOs) in Q2 2007 compared to 108 IPOs raising €6,454m in Q2 2006. However Q3 saw a fall in comparison with 2006. (Q3 2007 €6354m; Q3 2006 €11681m)[13].

Figure 1[14]

10 22 September 2000

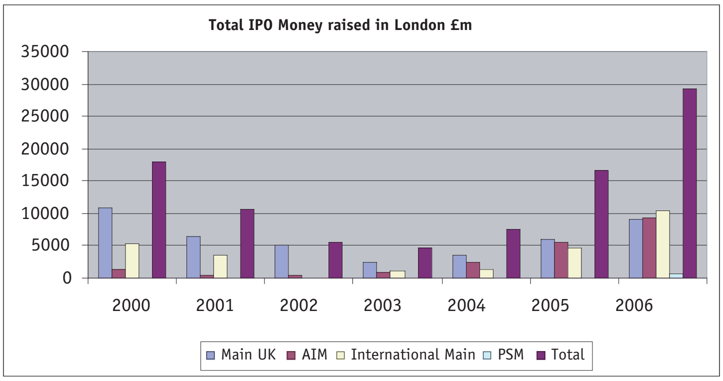
11 2003 -2004

12 1 October, 2007

13 Source: PWC IPO Watch Europe – Review of the year 2006

14 Source: PWC IPO Watch Europe – Review of the year 2006

Figure 2[15]



- On the back of high commodity prices and reduced country risk, there has been a strong growth in the economies of emerging market countries, such as China, India and Russia. The IMF noted recently that 'For the first time, China and India are making the largest country-level contributions to world growth'….China, India and Russia 'alone have accounted for one-half of global growth over the past year. Robust expansions also continued in other emerging market and developing countries, including low-income countries in Africa.'[16] This growth has translated into emerging market companies seeking to raise capital on global markets, including the UK, and also into high capital flows into emerging economies. This growth is illustrated by the sharp rise in the MSCI Emerging Markets Index in the post-millennium period. (See figure 4). This point is further illustrated by the steep rise in the growth of GDR issuers listed in London during the same period.

Figure 3

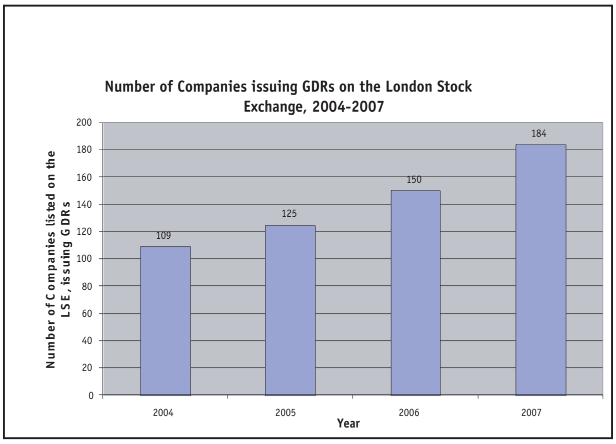
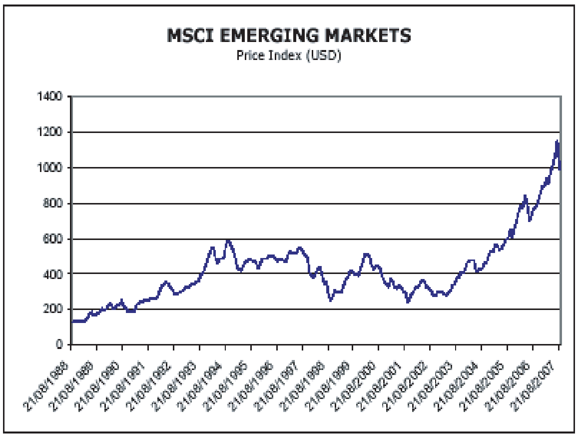


Figure 4

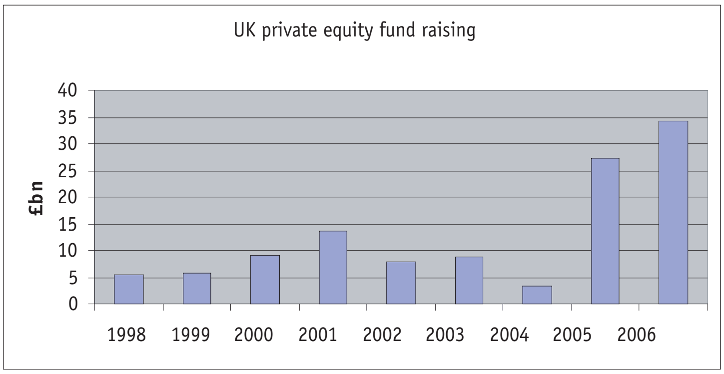


- The UK's contribution to the global markets is of major importance in relation to private markets as well as public markets. The UK has become the largest European centre for the management of private equity investments and funds. The annual survey by EVCA showed that in 2006 the UK accounted for the largest amount of funds raised at 75.0 billion or 66.8% of the European total. The UK market also saw rapid growth in 2006 in terms of funds raised and investments (see Figure 5).

15 Source: The London Stock Exchange

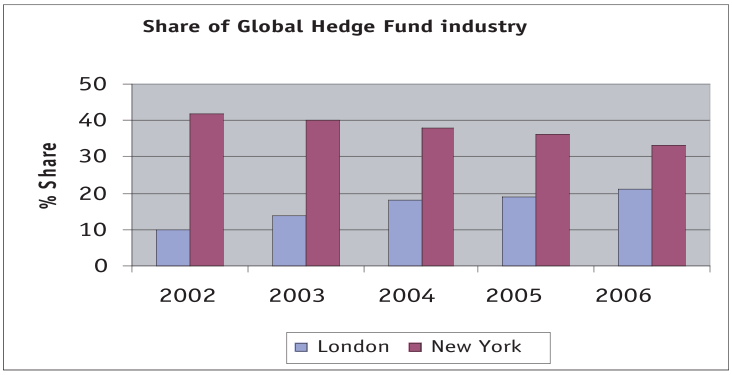
16 The International Monetary Fund's World Economic Outlook, October 2007.

Figure 5[17]



- In 2006 it was estimated that the UK accounted for 79% of the European based hedge fund market based on Assets Under Management (Total European AUM $460Bn not including Fund of Funds and investments from US managed in Europe.) Between 2000 and 2007, London has rapidly grown in importance as a location for hedge fund managers and has closed the gap on New York as a location for hedge fund managers (see Figure 6).

Figure 6[18]

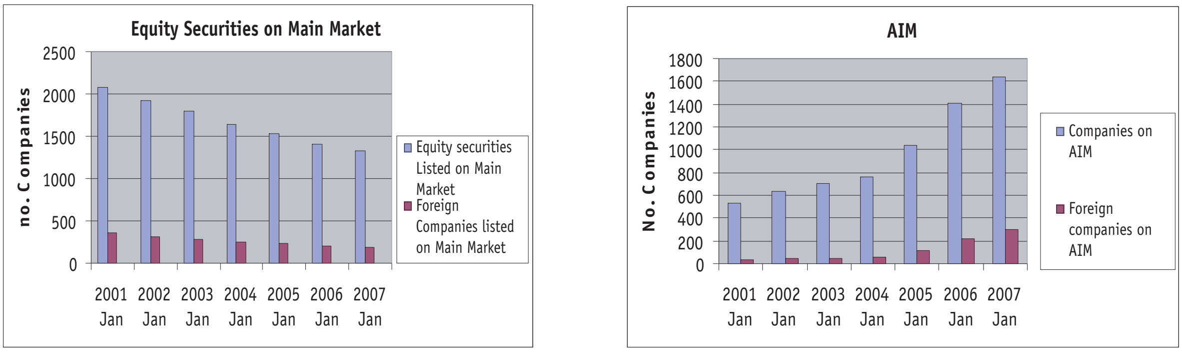


3.11 Although the total of the IPO funds raised in London has increased significantly (see Figure 1), the post-millennium period has witnessed an annual steady decline in the number of companies with their equities listed on the Main Market from 2082 in January 2001 to 1331 in January 2007, an overall decline of 36%. In the same period, the number of overseas companies listing on the Main Market has also declined by 47.5% (from 360 in 2001 to 189 in 2007). The Listing of companies with GDRs initially followed the same trend but this decline was arrested and the number of companies with GDRs listed has risen by about 18% annually since 2004. On the other hand, the UK has witnessed a steep rise in the number of companies seeking admission on AIM, including overseas companies, throughout the period. AIM is of course not a market for listed securities, nor a Regulated Market under MiFID.

17 IFSL Research Private Equity 2007: August 2007 these figures are not comparable with EVCA figures for fund raising as they only include "independent funds" Source BVCA

18 IFSL Hedge funds April 2007 – IFSL estimates based on Hedge Fund Intelligence, Institutional Investor, Eurekahedge & Alternative Asset Centre data.

Figures 7a & b



Source: The London Stock Exchange

3.12 We have also witnessed a change in the composition of companies in our Listing Regime. Most of our overseas incorporated Listed companies were mining companies from South Africa in the 1930s. From the 1960s until the 1990s, there was a wave of companies from developed economies such as U.S. companies as well as European companies seeking a broad shareholder base in London. It was during the latter part of this period that the Secondary Listing segment was created with reduced obligations on the basis that the home regulator was the primary regulator. Since 2000, new additions to the Secondary Listing segment have been few, with companies from a mix of countries.

3.13 In respect of GDRs, we had very little GDR issuance prior to 1990. Over the following decade, a majority of GDR issuers were from Asia during the period from 1990 to 1999 (mostly from India, Korea and Taiwan). In the period 2000-2004, there was a decline in GDR issuance but since 2004, there has been a substantial growth of 63% in GDR issuance in the UK – an average growth of 18% per annum (see figure 3). Issuers from Russia and the ex-CIS formed the largest group of companies issuing GDRs during this period (approximately 32% of new issuers). As well strong growth in the number of issuers, the proceeds raised from GDR issuance have risen spectacularly since 2005 (see figure 9).

Figure 8

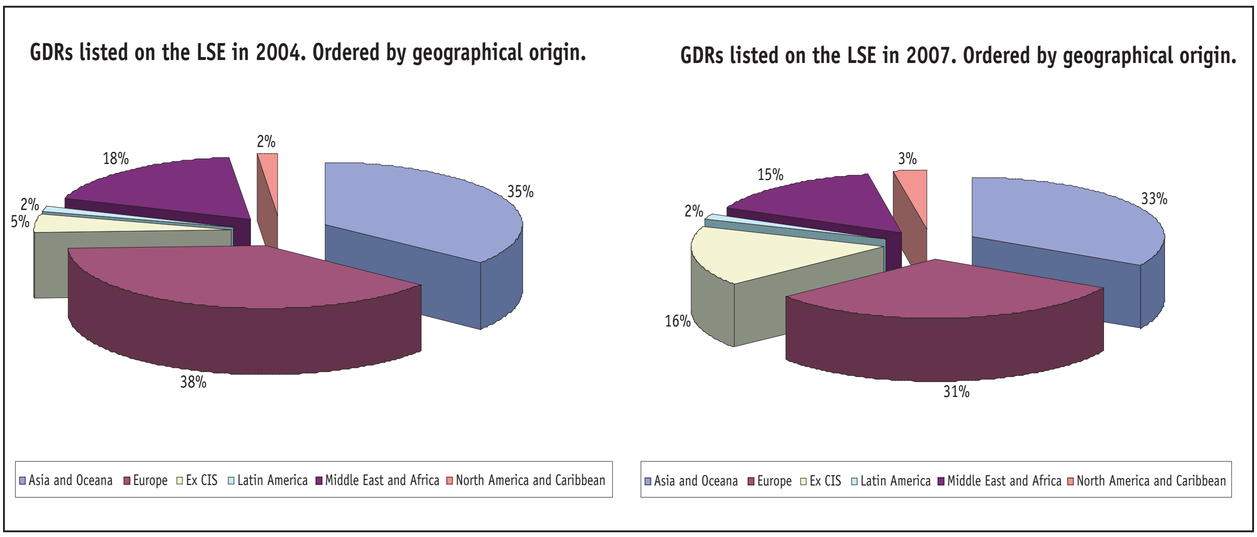
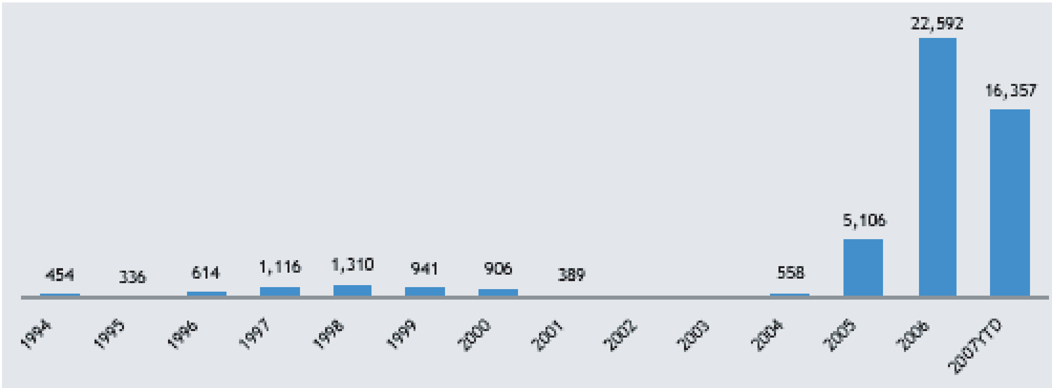


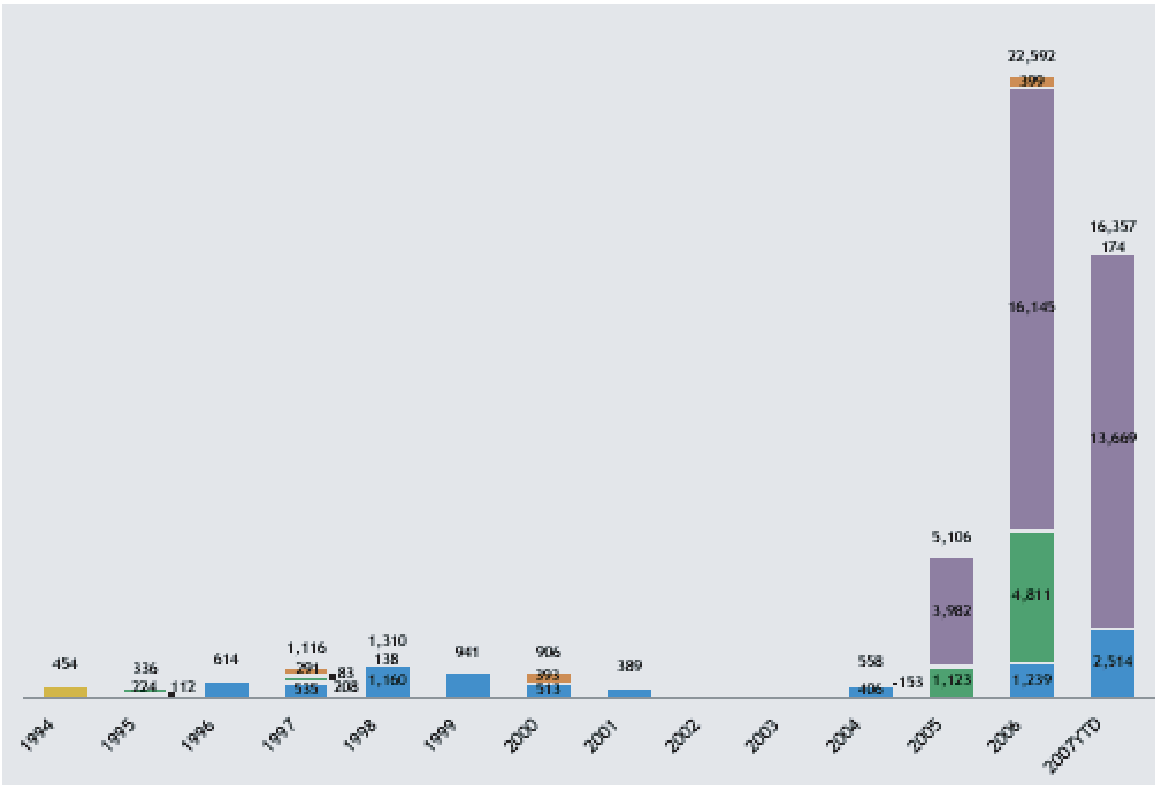
Figure 9



Source: Datastream, October 2007

GDR Issuance by proceeds ($m)

Figure 10



Source: Datastream, October 2007

Annual proceeds raised by ($m) by geography since 1994

RoW Asia Africa CIS Middle East

Conclusions

3.14 These trends illustrate the further development of London as a global financial centre and the shift in the composition of Officially Listed companies in the post-millennium period. The majority of listed equity issuers continue to have a Primary Listing of their equity securities. But the number of companies with either a Primary or Secondary Listing has been in steady decline since 2000. There has been substantial growth in the number of GDR issuers since 2005. There have been no changes in the underlying regulatory standards which explain this pattern. The growth has also coincided with the implementation of the PD and the creation of the Professional Securities Market as well as developments in the global economy, a shift in global output from developed to developing economies and a shift in the method of raising equity capital from public to private equity.

3.15 We recognise that we are operating within the framework of a constantly evolving global and domestic economy and need to revisit periodically how the Listing Regime should be calibrated.

4 The current requirements of the Listing Regime

Introduction

4.1 This section describes in more detail the specific regulatory requirements which attach to the equity and GDR Listing segments. It also sets out, for comparison, the requirements which apply to the non-Listed "directive minimum" Regulated Market segment, noting that these requirements are near-identical to those for a Secondary or GDR Listing. Finally, this section also covers some issues relating to how companies can transfer their Listing between categories, and some technical aspects of the interaction between Listing and trading.

Key requirements for Listing for all companies

4.2 All Listed companies must comply with certain key requirements which are set out in Chapter 2 of the Listing Rules. These requirements relate to incorporation, validity of the company, transferability of the relevant securities, and market capitalisation of Listed companies. These requirements are derived from CARD – the successor to the Listing Particulars, Admissions and Interim reporting Directives.[19] (There are similar, although slightly less detailed requirements in MiFID for admission to trading on a Regulated Market. A company which meets the CARD requirements is deemed to have satisfied the provisions of Article 35 of the MiFID level 2 Regulation). All Listed companies are also required to comply with the Prospectus Rules on admission to the Official List, and the DTRs on an ongoing basis.

19 A vast majority of the provisions in CARD were repealed by MAD, PD and the TD thereby leaving CARD as a skeleton directive relating to the core requirements for Listing.

"Super Equivalent" v "Directive Minimum"

Standards and Key obligations	Primary Listing	Secondary Listing (Ch 14)	GDRs (Ch 18)	Admission to a Regulated Market
Chapter 2: • Requirements relating to incorporation, validity, transferability and admission to trading	√	√	√	X[20]
Chapter 6: • 3 year revenue earning record • Control of an independent business • Unqualified working capital statement	√ √ √	X X X	X X X	X X X
Chapter 7: • Listing Principles	√	X	X	X
Chapter 8: • Sponsors	√	X	X	X
Chapter 9: • Pre-emption rights • Combined Code disclosure • Model Code	√ √ √	X X X	X X X	X X X
Chapter 10: • Substantial Transaction rules	√	X	X	X
Chapter 11: • Related party rules	√	X	X	X
Chapter 12: • Repurchases of securities	√	X	X	X
Prospectus Rules	√	√	√	√
Disclosure and Transparency Rules	√	√	√	√

Key requirements for a company with a Primary Listing of equity securities

4.3 A Primary Listing of equity securities is the most stringent form of Listing in terms of requirements or standards available for companies seeking a Listing on the Official List. It is the only form of Listing available to a UK company wishing to admit its securities to the Official List in London. 'Equity Securities' for the purposes of the Listing Regime means shares and other equity instruments including warrants and some convertibles. A company seeking a Primary Listing of its securities could be a trading company or an investment company.[21]

20 Requirements similar to these are found in MiFID for an admission to a regulated market.

21 The description below relates mainly to trading companies and not investment companies. As we noted on page 8 under the heading, 'Scope', we will not be focussing on investment entities in this DP.

A company seeking a Primary Listing of its equity securities is required to provide for and/or comply with the following requirements:-

- A three-year revenue earning record which has been independently audited without qualification within a period of six months of the prospectus. The earnings must be generated through the control of an independent business. There are exemptions for mineral companies and scientific research-based companies. (Chapter 6[22]);
- Applicants for Listing are also required to provide an unqualified working capital statement. (Chapter 6);
- Prior approval of shareholders before the cancellation of their Listing, as investors bought the shares on the basis of certain protections, and these rights should not be taken away unless done with the investors' agreement. (Chapter 5);
- Compliance with the six Listing principles introduced in 2005 which emphasise director responsibility, adequate systems, integrity towards investors, timely communication, equality of treatment of shareholders and dealing cooperatively with the FSA. (Chapter 7);
- The appointment of a sponsor to advise on key transactions, specifically a company's IPO, any further issue it undertakes and certain transactions for which shareholder approval is required. A sponsor firm is an advisory firm, typically an investment bank, appointed to advise the issuer on the application of the Listing Rules and to provide key confirmations to us under those rules. For instance, prior to an admission to Listing, a sponsor must confirm to us that the applicant company has established procedures which enable the company to comply with both the Listing Rules and the Disclosure and Transparency Rules and has procedures in place which provide a reasonable basis for the company to make proper judgements on an ongoing basis as to the financial position and prospects of the company's group. To act as sponsor, a firm must be accredited as such by us and we maintain (under Part VI of FSMA powers) a specific, tailored system of regulation over and above that set out in the authorisation regime. (Chapter 8);

4.4 Once a company has obtained a Primary Listing of its equity securities, the company is then subject to a number of ongoing obligations, most of which relate to the governance of the Listed company. For example, such companies are required to:-

- Provide various notifications to us and the market about changes in the company; maintain some of the requirements which apply on admission to Listing; include certain information in its annual reports and accounts such as its compliance with the code of corporate governance of its country of incorporation (the Combined Code for UK companies) and information relating to directors' remuneration; and apply pre-emption rights provisions (for UK companies). (Chapter 9);
- Seek the approval of shareholders prior to the disposal or acquisition of businesses or assets which reach a certain threshold. (Chapter 10);

22 These chapters correspond to the relevant chapters in the Listing Rules.

- Seek the approval of shareholders prior to entering into transactions with persons with whom there might be a conflict of interest such as directors and substantial shareholders, otherwise known as related parties. (Chapter 11);
- Observe rules on share buybacks. (Chapter 12);

The key requirements for a company with a Secondary Listing of its equity securities:

4.5 A company seeking Secondary Listing of its equity securities is not required to observe the 'super-equivalent' rules described above which are over and above the minimum we are required to impose under the relevant European directives. Most of the requirements for a Secondary Listing therefore in fact stem from the Prospectus and Disclosure and Transparency Rules reflecting the implementation of European directives.

The principal additional provisions under the Listing Rules are that:-

- The company must satisfy the CARD requirements;
- Applicants for Secondary Listing of equity securities must be overseas companies. Where the company is incorporated in a non-EEA state and the company has no listing its home jurisdiction, we must be satisfied that the absence of a listing in home state is not due to the need to protect investors. However, since 2005 there has been no requirement for an applicant to have a listing in any other jurisdiction including its own jurisdiction.
- The company must publish in the UK all circulars, notices, reports and resolutions and notify an RIS it has done so.

The key requirements for a company with a Listing of GDRs:

4.6 Similarly, most of the requirements for GDRs stem from the Prospectus and Disclosure and Transparency Rules. But in addition, GDRs are also subject to:

- The requirements of CARD that apply to GDRs;
- No requirement for the shares underlying the certificates to be admitted to trading unless they are certificates representing the shares of a UK incorporated company, in which case, they must be admitted to Listing.
- Requirements relating to the depositary. A depositary must be suitably authorised and regulated by us or a financial institution accepted by us and must hold the certificates on trust (or other equivalent legal arrangement) for the sole benefit of the certificate holder.
- Once Listed, issuers of GDRs are also expected to comply with all the continuing obligations of the DTRs if they are admitted to trading on a Regulated Market. Issuers of GDRs admitted to Listing on the PSM (a MiFID MTF) are required to comply with provisions relating to the disclosure and control of inside information (DTR 2) and the dissemination of information (DTR 6.3)

4.7 While we permit investment entities to list GDRs, we would expect them to have their underlying securities listed under chapter 15 of the Listing Rules. This is on the basis that we are about to implement a unitary regime with 'super-equivalent' standards for investment entities in March 2008. As the GDR regime is a 'directive-minimum' regime, we would only permit investment entities to list GDRs on the basis of a chapter 15 Listing. We have set out our proposals for a rule change to clarify this position in our quarterly consultation paper which we published in January 2008[23].

The key requirements for a company seeking admission of its securities to a Regulated Market

4.8 Securities admitted to trading on a Regulated Market, but not to the Official List, are not subject to the requirements of CARD. The conditions for admission – which it is the responsibility of the Regulated Market to ensure are met – are laid out in MiFID, and specifically article 35 of the level 2 Regulation. The PD and the DTRs also apply.

The mechanism for switching between segments

4.9 In CP06/21, we consulted on some detailed Listing categories based upon the current Listing Regime. As we noted in CP07/12, this work has now been superseded by the current work which is the subject of this DP, and is discussed in more detail later. But one of the issues considered in that CP was the mechanism for switching from one Listing segment to another.

4.10 As we noted in Chapter 3 of CP06/21, there is no express administrative mechanism in the current rules for issuers to migrate from one category within a Listing segment to the other. This is important in particular for the Primary Listing of equity securities where a company which began its life as a trading company but during the course of its development may have developed attributes which would resemble more closely an investment company. We therefore set out some clear administrative requirements for switching in CP06/21. Our proposals were mainly accepted by market participants and we will consider whether it is appropriate to implement them when we have concluded this review and determined the structure of the Listing Regime.

Technical aspects of the interaction between Listing and trading

4.11 As noted elsewhere in the DP, the process of admission to the Official List is now separate from the process of admission to trading on an exchange or other platform. However, there remain elements of the Listing Rules, and the FSA's approach to managing the Official List, which involve processes which are arguably more related to trading than to Listing. In the circumstances in which Listing and trading are increasingly understood as separate processes, there could be a case for looking again at how the Listing Rules operate in certain areas. For example, currently, individual securities are admitted to Listing – so that further issues also have to be admitted. An alternative approach may be to admit lines of securities instead.

23 Quarterly Consultation Paper 08/1 (No 15)- Chapter 8

4.12 Another practical issue we will be giving more consideration to is how we approach suspensions (and restorations) of Listing, particularly in the context of MiFID. One of the implications for the UK Listing Regime is that Article 41 of MiFID requires a pan-EU framework for information sharing in relation to decisions to suspend or remove financial instruments from trading, between operators of Regulated Markets, their respective home state Competent Authorities and between such authorities. In addition, where one EU Competent Authority – as opposed to a Regulated Market – has decided to suspend or remove an issuer's securities from trading, it must notify other EU Competent Authorities who are obliged to take similar action for securities admitted to trading on their respective Regulated Markets unless that would be likely to cause significant damage to the interests of investors or the orderly functioning of financial markets.

4.13 We do not expect the implementation of MiFID to change our approach to suspensions of Listing (these powers are in any event separate to the MiFID requirements and are underpinned by LR 5). However, in those circumstances where we act to suspend the trading of a Listed security in response to a suspension of trading initiated by another EU Competent Authority, we will most likely also suspend the Listing of that security in parallel, for as long as the suspension of trading lasts.

4.14 We will continue to review the practical interactions between admission to Listing and admission to trading over the next few months, and may bring forward some proposals for administrative changes at some point, as our thinking takes shape.

5 The role of Listing and the FSA's approach

Introduction

5.1 This section discusses the role of Listing – where the regime now fits in a context of an enhanced EU regulatory regime which does not refer to listing, greater competition and choice, and of some change in the composition of the issuers on the Official List. In that context, this section also summarises the main findings of the theoretical and empirical literature dealing with primary market standards, as well as some specific research on the impact on issuers of switching between Listed and non-Listed markets in the UK. It goes on to discuss the FSA's role and approach in setting standards, particularly for the 'super-equivalent' Primary Listing segment. Finally, it considers the types of platforms which could operate a Listed market.

The UKLA's objectives and approach

5.2 Any discussion about the role of Listing and the optimal structure for the Listing Regime must be had in the light of our statutory responsibilities as the UKLA, and the specific objectives which are set by HM Treasury. Part VI of FSMA[24] tasks us with the general functions of making rules, providing general guidance and determining the general policy and principles by reference to which we perform particular functions under Part VI. As part of the implementation of the FSAP directives, our Part VI obligations have been broadened to encompass securities admitted to trading on Regulated Markets in addition to Officially Listed securities. We therefore not only consider only Listed securities but also those admitted to trading on a Regulated Market when we discharge our responsibilities.

In discharging these functions, we have to have regard to, among other things:

- the desirability of facilitating innovation in respect of listed securities and in respect of financial instruments which have otherwise been admitted to trading on a Regulated Market or for which a request for admission to trading on such a market has been made;

24 Section 73

- the international character of capital markets and the desirability of maintaining the competitive position of the United Kingdom;
- the desirability of facilitating competition in respect of Listed securities and in respect of financial instruments which have otherwise been admitted to trading on a Regulated Market or for which a request for admission to trading on such a market has been made.

5.3 The specific objectives set by the Treasury are to:

(i) provide an appropriate level of protection for investors in Listed securities;

(ii) facilitate access to Listed markets for a broad range of enterprises and

(iii) seek to maintain the integrity and competitiveness of the UK market for Listed securities.

5.4 In discharging our functions, our principal philosophy is to provide appropriate investor protection while facilitating entry into the market for a wide range of issuers. A key element in our approach is to recognise that there is a range of issuers that want to access the markets. We operate a largely disclosure-based regime where market participants are able to make informed investment or issuance decisions depending on their business model, investment strategy and risk appetite. We also operate a risk-based approach to regulation where among other factors, we consider the nature and level of sophistication of investors when determining the level of regulation to impose on a particular Listing segment. The choices we make are of course partly driven by the implementation of the EU FSAP and the directives that underpin this plan. Inevitably, we reassess the Listing Regime with respect to whether our Listing Rules remain appropriate in the light of how the capital markets are developing both in the UK and globally.

5.5 Clearly we need to strike a balance between these objectives which are often competing. For instance, any attempts to make the Listing Regime too 'UK-centric' may deter international companies from seeking a Listing in the UK and we may end up with a purely domestic market for listed securities – contrary to our objectives. A defining feature of the UK's capital market is its international character which differentiates it from a majority of other EU markets, and is one of the reasons for its attractiveness (besides our proportionate regulatory approach). It would therefore be self-defeating to eliminate this attribute, in particular, in the highly mobile securities market we now operate in. This of course has to be balanced with the need to provide an appropriate level of investor protection through high but proportionate standards of regulation. The London market has thrived from its reputation as a provider of high standards of investor protection and good governance which investors and companies now enjoy and clearly prize.[25]

25 See Annex 2 for full details of the research by our Economics of Financial Regulation Department which supports this proposition to some extent, although with some qualifications.

The role of Listing

5.9 Historically, market participants have viewed Listing in the UK as establishing certain admission and ongoing compliance standards for issuers, in a way which signalled a substantive difference between those issuers and non-Listed issuers, and also, to some extent, between UK-Listed issuers and those listed elsewhere. Listing in London has therefore been considered as a 'badge of quality' or an accreditation, which signifies compliance with certain regulatory standards. This position has become less clear-cut in recent years; in the context of substantial change in global and EU markets.

5.10 When the Listing function was transferred to us in 2000, this effectively established a marked distinction between admission to Listing and admission to trading. At that point, it was admission to Listing where all the substantive regulatory provisions lay, while admission to trading was largely an administrative process, with little regulatory content. However, this balance has been significantly shifted by the introduction of the FSAP directives, which are not referenced to the Official List, but instead use the concept of admission to trading on a Regulated Market. As a result, many of the requirements of the Listing Rules, which previously flowed from CARD, such as the requirements relating to the contents of Listing Particulars or Prospectuses and their publication, and the requirements for the filing and publication of financial information on an ongoing basis, are now found in the new Directives, and are simply referenced to admission to trading. CARD has been left as a skeletal directive which deals with certain constitutional requirements for Listed companies and the transferability of their securities (provisions which as noted earlier are also now mirrored in MiFID in relation to admission to a Regulated Market).

5.11 Now, therefore, the substantive regulatory provisions are split between those which attach to admission to Listing and those which attach to admission to trading (with the balance being weighted to the latter). This is why the "directive minimum" requirements for admission to Listing are virtually indistinguishable from the "directive minimum" requirements for admission to trading, as Chapter 4 shows.

5.12 The most important remaining function of CARD from the UK perspective, is the possibility it gives us to impose the more stringent 'super-equivalent' requirements in respect of Listing. Effectively, the main substantive role that we now provide as competent authority for Listing is the setting of rules in respect of the CARD minimum requirements and more importantly, the setting of 'super-equivalent' standards which apply to a Primary Listing of equity securities. All the other functions we previously had as the competent authority for Listing are mostly now fulfilled under our role as the competent authority for the PD, TD and the MAD, which are not referenced to Listed securities.

5.13 The role of Listing as that which signifies particular standards, which are distinct from those which apply to other primary market segments, strictly only now applies in the case of our 'premium brand', the Primary Listing of equity securities, which provides some additional requirements to the minimum provided by the European directives. For example, they:

- Augment the due diligence process through the engagement of sponsors who provide certain confirmations to us and thereby provide an external source of comfort, which will typically drive the additional due diligence involved in a Primary Listing of equity securities;

- Facilitate shareholder engagement in the governance of the company by offering some key shareholder rights protection such as the requirement to seek the prior approval of shareholders in respect of certain transactions and the restrictions in respect of share buybacks and dealing in the companies' securities by directors. This ensures that any underlying potential information asymmetries that typically exist are minimised, thereby promoting confidence in the market.

5.14 The other Listing segments do not exhibit these attributes. For these segments, Listing can still play a role in signifying particular standards, but not standards which are distinct from those which apply to other primary market segments – in particular, those which apply to the admission of trading on a Regulated Market. For these segments, Listing does not bring much additional regulatory content, or FSA involvement or oversight.

5.15 The Official List provides one option for issuers wanting to bring their securities to a wider market, but it is not the only option. Indeed, companies have a wider range of choices for raising capital than through public equity. We believe that such choice is beneficial, and we do not consider that the regulatory regime should inappropriately skew those choices. As noted above, the FSA has a wider remit under Part VI of FSMA than solely listed markets. The Listed market therefore complements, rather than competes with, the other available choices, particularly in the context of the international competitiveness of UK markets.

The European baseline

5.16 Some market participants note that in several markets in Europe, the stock exchanges are still the competent authority for Listing. However, where exchanges elsewhere in the EU do have responsibility for setting Listing standards, they have not in practice set super-equivalent standards similar to those in the UK.

5.17 It may be instructive, as a possible baseline against which to benchmark the subsequent discussion, to consider how the UK regime might be structured if it were to be more closely aligned with the structure prevailing elsewhere in Europe (assuming that the FSA remained, as now, the competent authority for Listing). On that basis:

- the FSA would set and enforce a Listing Regime that embodied only the directive minimum requirements. There would be no super-equivalent segment;

- UK companies would be able to access the "directive minimum" Listing Regime (in the same way that other EU companies can access a directive minimum regime);

- exchanges would be free to set higher standards than the "directive minimum" standards for admission to trading on their markets.

'Super-equivalent' standards and the FSA's role in setting them

5.18 We previously raised the question of whether the UK Primary Listing segment should embody "super-equivalent" standards in the context of the Listing Review, which we concluded in early 2005. At that time, there was a strong market view in favour of "super-equivalent" standards, which we therefore retained. In order to test the continued validity of that approach, we ask again below whether the market sees continuing value in retaining "super-equivalent" standards.

5.19 On the assumption that super-equivalent standards for Listing are retained, a further issue is with whom the responsibility for setting them should rest. In other areas it regulates, the FSA sets the minimum standards, and leaves the market to set standards over and above those standards. "Super-equivalent" Listing standards could be set, monitored and enforced by the market, for instance by exchanges, as elsewhere in Europe. Another possibility is that the "super-equivalent" standards could be subsumed into the broader corporate governance framework, eg the FRC's Combined Code, and we could enforce a "comply or explain" requirement against those standards, as we do now with the current Code. A "comply or explain" approach could have the effect of weakening the application of the standards somewhat, as the standards currently have the force of FSA rules.

5.20 While we would be interested in views, we believe the market will have a strong preference for us to continue to set the "super-equivalent" standards. The substantive arguments for continuing on this basis are that it is consistent with the objectives set for us by the Treasury in our role as competent authority for Listing; and that it enables us to maintain a strong UK Listing 'brand' which would be beneficial in the long term for the UK market. Furthermore, if exchanges were permitted to set their own standards, this may result in differing standards being set by different exchanges. This fragmentation in standards could lead to confusion in the market and would certainly not assist in strengthening the UK Listing 'brand', to the disadvantage of the UK securities market. It may also, in the long term, lead to a disintegration of these standards. Finally, an independent body with statutory powers to impose strict penalties oversees the setting, monitoring and enforcement of Listing standards removes any scope for or perception of conflict of interests (which might emerge if exchanges had the function).

Summary of the results from the academic literature

5.21 The comparisons across countries and firms made in the academic literature surveyed in the annex suggest that higher corporate governance standards tend to be associated with higher valuation. Studies of firms switching to a lighter regulatory regime show negative returns and liquidity effects around the announcement and/or movement date. However, these studies do not help us to decide at what point the benefits of super-equivalent regulations cease to outweigh their costs. Research on the impact of the Sarbanes-Oxley Act in the US suggests that these costs can be very significant for some firms.

5.22 Research on the effect of compliance with the UK Combined Code on issuers' performance suggests that one size of corporate governance regulation may not fit all and that there is a case for optional standards where investors can distinguish issuers that opt-in from issuers that opt out.

5.23 Overall, the literature is arguably supportive of an approach which offers issuers, whether domestic or overseas, a choice between a super-equivalent and a directive minimum regime, while implementing appropriate measures for minimising the scope for investor confusion of different regimes.

Q1: Do you consider that the UK "super-equivalent" Listing standards should be retained?

Q2: Do you consider that the "super-equivalent" Listing standards should continue to be set by the FSA or should they be determined by the market (exchanges, trade associations or other independent body)?

More flexibility in who can operate a Listed market

5.24 Greater competition between different types of trading platform and the introduction of MiFID raises the issue of whether there are any unnecessary restrictions in the Listing Rules as to who can operate a market for Officially Listed securities, and what type of trading platform they must operate.

5.25 Prior to 1 July 2005, a pre-requisite for a company seeking to admit its securities to the Official List was that it must simultaneously obtain admission of those securities to trading on an exchange. Although not specified in the Listing Rules, it was assumed that the admission to trading must be on a RIE's regulated market. At that time, this was effectively the LSE's Main Market, as the LSE was the only market operator with a market which fitted this description in the UK. The Listing Rules were modified in 2005 to accommodate the Listing of debt securities and GDRs on the Professional Securities Market (PSM), a market for Listed securities for professional investors only. This is not a Regulated Market under MiFID, but an MTF operated by an RIE under a secondary market regime identical to a Regulated market.

5.26 Although there are currently no FSA rules which prevent the admission to Listing of the equity securities trading on a MTF operated by a RIE, equity securities have generally tended to be admitted to trading on a Regulated Market operated by an RIE. Some market participants have questioned whether Officially Listed equity securities may be admitted to an MTF, whether operated by an RIE or investment firm. (Listed equity securities can of course already be traded in the secondary market on such platforms. The issue here is whether MTFs can operate primary markets in listed equity securities).

5.27 Historically, the rationale for the pre-requisite for listed companies to also be admitted to trading on an exchange was that a special regime exists for RIEs that offers a range of protections including the provision of proper information about an issuer and sufficient liquid secondary trading in the securities, and a robust settlement facility. An MTF under MiFID could meet these general requirements.

5.28 There are nonetheless some differences between the regulation of a Regulated Market and a MTF. In the primary market, all the EU FSAP directives that are relevant to the area of securities regulation are hinged upon the concept of a 'Regulated Market'. Therefore, legislation such as the PD, which regulates the disclosure requirements and publication of prospectuses and the TD, which regulates the disclosure of financial information and major shareholdings on an on-going basis would apply to any securities admitted to trading on a Regulated Market, but not to securities admitted (solely) to an MTF. The MAD applies in the UK not only to a Regulated Market but also to particular markets prescribed under FSMA and this would include certain MTFs. Transaction reporting requirements follow the same pattern. In the secondary market, MiFID imposes detailed trade transparency requirements in respect of shares admitted to trading on a Regulated Market. But there are no detailed requirements in respect of equities admitted to trading solely on an MTF.

5.29 Our initial thinking in this area is that we should be open to a more flexible approach to the range of platforms which can operate a market for Listed securities. But we would not want market operators or investment firms to use an MTF to circumvent rules which would otherwise apply to a Listed market. So, for example, the FSAP directive standards mentioned above would need to apply on admission to Listing and where relevant, on an ongoing basis. In the secondary market, we would need to consider whether there was a need to close the "gaps" between the standards applicable to a Regulated Market and those applicable to MTFs.

(See the glossary for the definitions of these terms – RIE, Regulated Market, MTF)

Q3: Should we allow equity securities to be admitted to the Official List if they are only to be admitted to trading on a MTF operated by an RIE or an investment firm and not on a Regulated Market of an RIE? If so, on what basis?

6 Segmentation, Core Standards and Labelling

6.1 This section discusses ways of improving the structure of the Listing Regime in London through a clearer articulation and labelling of the different Listing segments taking into account the changes in the global markets. This section focuses mainly on equity securities and GDRs. The first part examines the appropriate number of segments we should have for equity securities. We then examine what the core standards should be for overseas companies on the Primary Listed segment, and whether it is appropriate to increase the level of regulatory oversight over the Listing of GDRs. Finally, we consider the labels to attach to each segment in order to achieve greater clarity.

Segmentation

6.2 The lack of clarity in the market is often cited only in respect of the segments relating to equity securities and certificates representing such securities (Primary Listing, Secondary Listing and GDRs respectively). This is not surprising as they all relate to the same or similar instruments and naturally the scope for confusion between them will be greater than as between other segments.

6.3 Given our remit and objectives, a major priority for us must be to ensure that London continues to be a pre-eminent global venue for the Listing of equity securities and that investors are able to make informed decisions when investing in UK-Listed securities. Any structure of the Listing Regime going forward should be consistent with that goal. It should also be consistent with the realities of greater competition and choice available today, and recognise the ways in which issuers want, and are seeking, to raise capital.

6.4 The majority of Listed issuers have a Primary Listing of equity securities, and it is in respect of this segment that we have derived our reputation as a pre-eminent global venue for raising capital. It has allowed Listed equity securities in London to command a relatively low cost of capital, and the consequent liquidity has attracted the Listing of other instruments in London. As stated in the previous pages, the overwhelming response of market participants for us to retain the 'premium brand', the Primary Listing of equity securities, following the review of the Listing Regime in 2005, has signalled to us that the market (our stakeholders – both Listed companies and investors) see the added-value in retaining this segment.

6.5 One issue then is how we position that segment against the other segments without blurring the distinction between it and the other segments, inadvertently providing the impression that the other segments have the same attributes as the Primary Listing segment. We acknowledge, as some market participants have suggested, that the Primary Listing of equity securities segment should not be diluted through confusion with other segments in the Listing Regime which do not have the additional 'super-equivalent' standards. As stated in the background to this paper, market participants have expressed concerns that there is a lack of clarity and therefore confusion in the market as to what the different Listing segments represent in terms of regulatory oversight and applicable standards since they are all often loosely referred to as a 'London Listing'. We must therefore ensure that this segment is clearly labelled if we are to preserve the confidence that investors and issuers have in the integrity of this part of the market.

6.6 We have therefore set out below two options and a series of sub-options, which reflect our thinking as to how the Listing Regime may be segmented and labelled. The changes reflected in these options are not intended to affect the manner in which capital is raised in London or any changes in the standards or regulatory oversight we have over the securities we regulate. Instead, the intention is to reflect the role of Listing in London in today's environment, in particular bearing in mind the changes introduced by EU legislation. Our aim is to strengthen the Listing Regime by clarifying the regulatory oversight we have in respect of the different routes for raising capital in London so that issuers and investors may make informed decisions.

Option 1: A single Listing segment for equity securities – the 'premium brand' of the official list with 'super-equivalent standards' (currently known as the Primary Listing of equity securities). Secondary Listing and the Listing of GDRs would be removed from the Official List but the FSA would continue to have regulatory oversight over the approval of prospectuses and these securities, as they would continue to be admitted to trading on a Regulated Market.

6.7 A single Listing segment for equity securities would bring the benefits of added clarity to the Listing Regime and would provide a recognisable Listing brand with clearly defined attributes. In the long-term, this option could generate more competition among trading platform providers in the UK, since the 'Listed brand' would be distinct from any RIE and the scope for any confusion between our role and the role of any RIE would be minimised. Securities which are currently Secondary Listed, or are Listed GDRs could no longer be referred to as 'Listed Securities' on the Official List in the UK. They would be 'directive-minimum' securities admitted to trading on a Regulated Market. This would not however affect the regulatory oversight we have over those securities as we would continue to approve the prospectuses and continue to enforce any ongoing obligations required by EU legislation. The RIE would however have the primary responsibility for supervising and enforcing the rules relating to incorporation, validity of the company, transferability and free-float which are derived from CARD and currently in Chapter 2 of the Listing Rules and which are now broadly replicated in MiFID. In the main, there would be no regulatory changes or changes in standards but rather a change in terminology.

6.8 Companies currently with equity securities or GDRs on the Official List would be expected to comply with the standards for Primary Listed companies or otherwise choose to move from the Official List to the 'Directive-Minimum' segment for equity securities. UK incorporated companies would be able to subject themselves to a non-listed 'directive-minimum' regime should they wish to do so (as they can do now, subject to a market operator running a segment for such securities). Our role as the competent authority for the PD, TD and MAD would be the same for UK companies, whether they were Primary Listed, or admitted to a 'directive minimum' segment.

6.9 Some market participants consider that the cachet of being 'listed' in London is one of the determinants of overseas companies seeking to raise capital in London. They argue that this option may deter overseas companies from coming to the UK, because Secondary Listed securities and GDRs would no longer have the 'listed' label, as they would no longer be on the Official List. It would therefore affect the competitiveness of the UK since, internationally, 'listing' is synonymous with admission to trading, and so the 'listed' label would continue to apply in these other jurisdictions.

6.10 We believe there are other drivers for companies coming to London, not least our proportionate, flexible and principles-based approach to regulation. There are other benefits including the status of London as a global financial centre, the wide and deep pool of capital available in London, wide range of institutional investors, broad analyst coverage, relatively cheaper underwriting fees, unparalleled access to international capital markets, time-zone, language all contribute to the attractiveness of London as a venue for raising capital. AIM, which is not a 'Listed' market, has attracted more overseas companies to it than the Primary Listing segment – overseas companies on AIM have increased by tenfold since 2000. Overseas companies with securities admitted to trading on a UK Regulated Market would continue to have similar FSA regulatory oversight as Secondary Listed securities. We would be interested in views on whether a change in terminology would have a major effect on the competitive position of the London market.

6.11 A single Listing segment for equity securities may have some further implications:

- **Investment Mandates:** The first issue is the impact on securities that are currently referred to as listed. Some investment mandates to fund managers are cast by reference to 'Listed' securities. If we no longer segment the market for equity securities or the Listing Regime, this may affect the scope of such investment mandates. Our understanding is that a majority of investment mandates are granted by benchmarking against specific indices and not necessarily directly by reference to Listed securities, although we appreciate that one of the criteria for inclusion in an index will include being Listed but this would only apply to Primary Listed companies. Some fund managers have noted that clarity is long over-due in the area of investment mandates in any event and could encourage the asset-management industry to re-engage with their fund managers. There may also be some regulatory implications; for instance, applying to Insurance firms.

- **Terminology:** Another issue that we need to bear in mind is that we may not be able to control the usage of the term 'Listing' which in some jurisdictions is synonymous with admission to trading in particular where the exchanges are the competent authority for Listing. This however does not preclude the UK Listing Regime from having different attributes where the generic term for admission to trading may differ from the technical term, by reference to the Official List, provided the differences are understood by the market. Indeed, this is the current situation in the market with AIM securities being unlisted securities.
- **Tax:** The options proposed for improving the structure and labelling of the Listing Regime set out in this document represent the start of a discussion on possibilities for change. We, together with HM Treasury (HMT) and HM Revenue and Customs (HMRC), are aware that a number of tax reliefs rely on companies' 'Listed' or 'unlisted' status, and that therefore any changes to the structure of the regime would be likely to affect access to these tax reliefs. Once market participants' initial views have been received on the relative merits of these options, and further consultation on detail and impact is underway, HMT and HMRC will consider the tax implications of the favoured option in more detail. If tax implications are an important factor in determining stakeholders' views on the options outlined here, then we would encourage them to reflect this in their responses and copy them to HMT and HMRC using the contact details given at the beginning of this document.

Option 1	
A single Listing segment for equity securities	
Pros	*Cons*
• Would make the brand more recognisable with less scope for confusion. This would contribute to our market confidence objective as the FSA. • Any reputational risks for the London market that might arise from the confusion will significantly diminish. • A distinctive Listing brand, which is not associated with any particular RIE would generate more competition amongst exchanges in the UK for listed securities.	• May make the UK less competitive for Listing if issuers prefer to have the 'Listing' label. Issuers may seek a listing in jurisdictions where they may refer to securities with EU minimum regulatory standards as 'Listed'. • The potential issues raised as further implications in Paragraph 6.11.

Option 2: The *status quo* of the existing two-tier structure with modernised labels – A tiered regime for equity securities – Two Listing segments consisting of (a) the premium brand with 'super-equivalent' standards as described above and (b) what is currently known as Secondary Listing where the standards are directive minimum but only open to overseas companies together with the Listing of GDRs.

6.12 The other option is to retain the existing tiered Listing Regime for the Listing of equity securities. The existing 'two-tiered' Listing Regime offers choice and is a vital component of the London market which is already successful and respected across the world. There should be a compelling case for any changes to the existing regime. The use of the term 'Listing' is also said to have a significant impact on the attractiveness of London and to the UK's competitiveness. For example, some market participants consider that one of the key elements that attracts a GDR issuer to London is the 'Listing' badge, which is seen as a quality standard. If the "Listing" badge were removed, this could lead to a significant reduction in the numbers of GDR issuers choosing London as their route to the market and this would be detrimental to the recent growth that the GDR market is experiencing.

6.13 In relation to the "directive minimum" tier of Secondary Listing and GDRs, these segments are offered on the same regulatory basis as the "listings" which are available elsewhere in Europe. As long as there is clarity that this is indeed the basis, then arguably there is no case for not continuing to admit these securities to the Official List. As we have noted earlier, the market may not currently have that clarity. This may impact the confidence that investors have in the London market and in the long-term, the reputation and integrity of the market, contrary to our objectives. We discuss later on in this chapter our proposals for labelling the existing structure.

Option 2	
Retain the *status quo* of the existing two-tier structure	
Pros	*Cons*
• Issuers will continue to have the choice they currently have. This will continue to make London attractive and competitive as a venue for Listing where issuers consider that having the 'Listing' label is important in their choice of venue for raising equity capital.	• The possibility that the lack of clarity that is said to exist may persist. This may be alleviated by clearer labelling. • Treats UK companies differently to other classes of companies by restricting them to a single segment but this segment also confers benefits such as i) access to the most liquid LSE trading platforms ii) access to the FTSE UK Index series that are not generally available to secondary listed issuers.

Sub-options

In addition to the basic structural choices set out above, there are two important further questions relating to the structure of the regime which we have set out below;

6.14 **Identical standards for all Primary Listed companies:** In respect of both options, a further issue for consideration is whether overseas incorporated issuers with a Primary Listing should be required to adhere to identical requirements in respect of their corporate governance and pre-emption rights. We have set out the discussion in respect of this issue in paragraph 6.18 onwards.

6.15 **Secondary Listing for UK incorporated companies:** A separate issue in respect of Option 2[26] is whether it is appropriate to make Secondary Listing available to all companies including UK companies thereby providing choice and a level playing field for UK companies. This has the benefit of providing a level playing field so that UK companies are not at any competitive disadvantage vis-à-vis their overseas counterparts. It would also be consistent with our policy for investment entities which provides a unified regime for all issuers. A possible drawback of this option is that having UK companies split across two segments may not enhance clarity.

Implications: The implications for companies with their equity securities admitted to trading on the 'Directive-Minimum' segment in Option 1 or opening up Secondary Listing to UK companies in Option 2 are as follows:

- None of the standards described for Primary Listed companies would apply unless they are mandated through company law;
- These companies would not be eligible for inclusion in the FTSE UK Index series.

6.16 The possibilities described above are clearly not exhaustive as it is possible to configure other options, either as variant to these options or completely different from the ones highlighted above. We have presented the findamental options to make the discussion meaningful. We would therefore invite market participants to suggest other options that they may consider appropriate.

Q4: Which of the options described above do you consider to be optimal? Please provide the reasons for your chosen option.

Q5: What are your views about opening up Secondary Listing for UK incorporated companies?

Core requirements

Core requirements for overseas companies with a Primary Listing of equity securities

6.17 All companies with a Primary Listing of equity securities are required to adhere to identical standards except in respect of the following provisions:

26 This issue does not arise for option 1 which envisages that a non-listed directive minimum regime would be available to UK companies in addition to the super-equivalent regime.

- **Corporate Governance –** The statement in its annual report and accounts as to whether a company complies with the Combined Code and an explanation of reasons of non-compliance – 'the Comply or Explain' statement'. UK companies are required to 'Comply or Explain' against the UK Combined Code whereas overseas companies must disclose whether or not they comply with the corporate governance regime in their country of incorporation. Overseas companies are then required to disclose the significant ways in which their actual corporate governance practices differ from those set out in the Combined Code.

- **Pre-emption rights –** The requirement for issues of equity shares for cash to be offered to existing holders of the class of equity shares and other holders of equity shares who are entitled to be offered the shares, shares in proportion to their existing holdings. This requirement does not apply to overseas companies. Although replicated in the Listing rules, pre-emption rights are derived from the UK company legislation which does not apply to overseas incorporated companies.

6.18 This structure was put in place following the review of the Listing Regime in 2005, on the basis that it may be prejudicial to some overseas companies to comply with regulation which depends on the structure of UK companies where their corporate law regime and structures are different from those of the UK. Furthermore, as we noted in CP05/7, some market participants stated that pre-emption rights are only one of a number of shareholder protections conferred by company law that may or may not be replicated in the laws of other jurisdictions. This does not necessarily mean that the company law regime in those jurisdictions do not offer a comparable level of investor protection as that in the UK.

6.19 In the light of the developments in the market as described in Chapter 3, and the debate surrounding the debate on investment entities, in particular the issue of whether it is sensible for the UK market to treat companies differently based on geographical location and differing domestic requirements, we have decided to revisit the issue of compliance with the Combined Code and pre-emption rights. Furthermore, we have noted the publication of a practice note by the FTSE which states their intention to take into consideration an overseas company's compliance with the UK Combined Code, Takeover Code and pre-emption rights in their decision to include such companies in the FTSE UK series index. If all primary equity issuers were subject to exactly the same requirements, whether they were UK companies or overseas companies, that could give further clarity to the Primary Listing segment, and remove one possible source of uncertainty and confusion.

6.20 In respect of the Combined Code, some market participants (investors) have informed us that the current provisions for overseas companies are not effective. This is on the basis that it is impractical, in a UK context, to engage with the management of overseas issuers on the basis of the code of governance in their own jurisdiction. Moreover, we have noted that some overseas companies have, admittedly with some effort, voluntarily and successfully 'Complied or Explained' against the UK Combined Code. Where it is incompatible with the code in an overseas issuer's jurisdiction, such issuers could explain and provide the reason for non-compliance. This is therefore not an impossible requirement to fulfil. However, arguably this would not be too far from the current position, where we ask overseas companies to state whether they comply with the code in their jurisdiction, and to state how their actual governance practices differ from the UK Combined Code. Overseas companies that value the benefits of a Primary Listing should be willing to incur the costs associated with those benefits. On the other hand, requiring overseas companies to 'comply or explain' against the UK Combined Code may provide false comfort to investors if those companies adopt the procedures/structures recommended in the Code without addressing the underlying governance.

6.21 As part of this debate, we also need to consider the amendments to the fourth and seventh Company Law directives[27] which are due to be implemented in the UK and across the EU in April/May 2008. The requirements of those directives are that all EU companies trading on a Regulated Market in the EU must make a 'Comply or Explain' statement against the corporate governance code of their own jurisdiction or one which the company has voluntarily decided to apply. (As this is a company law directive and not a FSAP directive, we are proposing to implement this directive in the UK so that the scope applies only to UK incorporated companies trading on a Regulated Market in the EU.[28]) This does not preclude us from requiring a company seeking a Primary Listing to 'Comply or Explain' against the UK Combined Code as part of the super-equivalent Listing Rules, but allow issuers (that are within scope) in all the other Listing segments to "Comply or Explain" against the Corporate Governance codes of their own jurisdictions or one which they have voluntary chosen to adopt. Such issuers would therefore still be subject to 'directive-minimum' standards. Obtaining a Primary Listing is a voluntary or optional decision which comes with certain costs, obligations and benefits.

The Takeover Code

6.22 A further issue is compliance with the Takeover Code (the 'Code'), which is issued and administered by the Takeover Panel (the 'Panel'). Currently, there is no requirement in the Listing Rules for Listed companies to comply with the Code. The Code applies to all offers for companies which have their registered offices in the UK, the Channel Islands or the Isle of Man if any of their securities are admitted to trading on a regulated market in the UK. Furthermore, as a result of the implementation of the Takeovers Directive in the UK, the Panel has 'shared jurisdiction' with supervisory authorities in other EEA member states over offers for certain companies which have their registered offices in another EEA member state whose securities are admitted to trading on a Regulated Market in the UK. However, the Code does not apply to offers for companies which have their registered offices outside of the EEA, even if their securities are admitted to trading on a regulated market in the UK.

6.23 Some market participants have suggested to us that given that our 'super-equivalent' Listing Rules are geared towards the protection of shareholders, we should, through the Listing Rules, require Primary Listed companies which are incorporated overseas (i.e. non-EEA) to provide investors with the protections which shareholders in

27 The Company Reporting Directive (2006/46/EC) amends the fourth and seventh Company law directives (78/660/EEC and 83/349/EEC respectively).

28 The full details of our proposals for implementation are set out in a consultation paper, CP07/24.

companies to which the Code applies enjoy. This suggestion was made in the light of the recent changes made by FTSE to their index criteria. The FTSE Practice Note states that 'for inclusion in the FTSE UK Index series, a company not incorporated in the UK will be required to acknowledge publicly adherence to the principles of …the UK Takeover Code as far as practical'. However, the Code is issued and administered by the Panel and it is not possible for us to extend the application of the Code to new categories of company. In any event, many of the provisions of the Code impose obligations and restrictions on persons who seek to acquire effective control of companies and on offerors, persons acting in concert with them and other market participants. The imposition of a requirement on Primary Listed companies would not therefore have the effect of providing investors with protections equivalent to those set out in the Code because Primary Listed companies would be simply unable to comply with such a requirement.

Q6: What are your views on how the provisions we have described above under core requirements should apply to overseas Primary Listed companies?

Core requirements for GDRs

6.24 **Background:** GDRs are negotiable securities representing a company's equity issued on behalf of a company by a depositary bank. Unlike in the US, where depositary receipts are often issued in respect of the shares of companies from developed jurisdictions, in London, GDRs are typically issued in respect of shares of an overseas company from emerging markets. Overseas companies come to London to broaden their shareholder base, raise capital, enhance their image globally and visibility of their products and services or facilitate M & A activity by creating a desirable acquisition currency. Companies issuing GDRs tend to raise capital on a one-off basis and would not usually undertake a further issue.

6.25 GDRs tend to be purchased by sophisticated or professional investors in the primary market. Invariably, the prospectus for a GDR will contain a bold statement stating that the securities 'should only be bought and traded by investors who are particularly knowledgeable in investment matters'. Furthermore they are traded on the LSE's International Order Book (IOB), a dedicated trading service for GDRs. In contrast to the ordinary shares of companies with a Primary Listing which are denominated in Sterling and settled in Crest, they are typically denominated in US Dollars and are settled on Euroclear Bank, DTC or Clearstream Banking. Generally, retail investors are unlikely to gain access to these securities in the primary market, although it is possible for them to do so in the secondary market. As detailed in Chapter 4 (Current requirements of the Listing Regime), the standards required for Listing GDRs are effectively 'directive minimum' standards. The figure on page 15 shows that the issuance of GDRs is a growth area and may continue to be so for the foreseeable future.

6.26 In view of this growth, some market participants have asked us to ensure that investors are be able to make an informed decision when they purchase GDRs, which may be perceived by some simply as the equity shares of an overseas company with a

‘London Listing’. We believe that clarity is the key to ensuring that investors are able to make informed investment decisions and that provided clear labelling of the different segments exists, there is a clear differentiation between GDRs and the ordinary shares of UK companies in terms of their structure and target investors in the primary market. While GDRs represent the ordinary shares of overseas companies, we believe that the scope for confusion is limited, in particular in the primary market provided that GDRs are properly labelled when compared with a Primary Listing. In the secondary market where GDRs would be sold through broker firms regulated by the FSA, the requirements of the Conduct of Business rules in respect of their suitability for retail investor set out in MiFID would apply when they are offered to such investors. Applying our risk-based approach, we need to balance investor protection considerations against those relating to our competitiveness objective.

6.27 Some market participants have also asked us to consider imposing the sponsor regime on GDRs, presumably in order to align the standards of GDRs more closely to those of the Primary Listing segment. Given the nature of the market for GDRs, we do not believe that imposing an extra layer of regulation would necessarily eliminate the risks associated with GDRs. Furthermore, although the requirement for a sponsor is transaction-specific, a number of sponsor firms have informed us that the relationship is an on-going one which would be difficult to sustain where the management of the company is based overseas. Sponsor firms have suggested that they would find it difficult to make the confirmations required of them where the company is based overseas.

6.28 GDRs are sold to and purchased by investors in other jurisdictions across Europe based on ‘directive-minimum’ standards. There would therefore no bar to UK investors accessing them from other jurisdictions or from their being passported to the UK market and being sold to UK investors. Imposing a sponsor regime could simply encourage regulatory arbitrage and drive the market elsewhere in Europe. We believe that any additional regulatory standards on GDRs over and above ‘directive-minimum’ standards would need to be applied on a pan-European basis and driven by the EU Commission or the Committee of European Securities Regulators (CESR). There could be a case for re-considering those pan-European standards if the current nature of the GDR market as a wholesale market were to change, and there were to be significant retail participation. We do not see that case yet.

6.29 As illustrated in Figure 3 on page 15, we note that this has been a growth area in the past two years. Our approach will be therefore to keep the regulation of GDRs under review. We intend to ensure that GDRs are clearly differentiated from equity securities with a Primary Listing, so that an investor may make an informed investment decision in this area. The substantial growth we have experienced in this area has led us to devote additional regulatory resources to the monitoring of GDR issuers, both on admission and on an on-going basis, and we will continue with this approach.

Q7: Should we require the appointment of a sponsor for a transaction involving the issuance of GDRs? If not, are there any other responses to the significant growth in GDRs that are necessary?

Labelling

6.30 Regardless of whether or not we decide to have a single Listing segment for equity securities, we need to re-label the various Listing segments. The current labels for equity securities – Primary and Secondary Listing – are historical labels based on our pre-July 2005 practice. A Primary Listed company denoted a company with its main Listing in the UK and which complied with the whole of the Listing Rules whereas a Secondary Listing denoted a company with its main listing in another jurisdiction but as the name suggests, with an additional Listing in the UK. There was a pre-requisite for a Secondary Listed company to have a listing in its home jurisdiction and therefore less onerous rules applied to such a company on the basis that the regulator of the home jurisdiction was the primary regulator. This was altered in 2005 in order to allow EU companies to have a Listing in the UK since there was an argument that we could not impose the pre-requisite which we then imposed on Secondary Listing on EU companies[29]. Furthermore, we did not wish to have yet another Listing segment for EU companies and thereby making the Listing Regime overly complex. We abolished this pre-requisite to have a listing in the home jurisdiction as a result. We would therefore seek to change the labels to reflect the current reality in a more meaningful manner.

6.31 We therefore propose to distinguish two tiers of listed securities. 'Tier 1' would be the label for primary equity securities, and 'Tier 2' would be the label for all other Listed segments. So if we choose Option 1 – to have a single Listing segment for equity securities, the concepts of the Secondary Listing of equity securities and the Listing of GDRs would be removed from the Official list, and the other segments, i.e. debt and securitised derivatives, we would label as Tier 2 Listing. If we however choose Option 2 – to continue to segment the Listing of equity securities, then we would re-label what is now currently the Primary Listing of equity securities as a 'Tier 1' Listing and all other "directive minimum" Listings as 'Tier 2' Listing.

The Listing Regime would be re-cast in the following manner:

Option 1[30]

Official Listing

Tier 1 Listing

- Listing of equity securities with super-equivalent provisions.

Tier 2 Listing – Directive Minimum requirements

- Listing of debt securities.
- Listing of Securitised Derivatives.

Regulated Market

Directive Minimum requirements

- The admission to trading of equity securities (overseas and UK)
- The admission to trading of GDRs

29 Article 7 of CARD

30 The options in the boxes correspond to the options provided under the heading 'Segmentation' on page [ ].

Option 2

Official Listing

Tier 1 Listing	**Tier 2 Listing – Directive Minimum requirements**
• Listing of equity securities with super-equivalent provisions.	• Listing of equity securities (overseas companies only) • Listing of debt securities. • Listing of GDRS • Listing of Securitised Derivatives.

6.32 A key part of the success of the labelling exercise will be the education and participation of the market including investors, issuers, exchanges and the media (including information service providers). We have already begun to engage with market participants on steps to take the process forward, and we would expect to set out a more complete strategy in our feedback statement to this DP. We also propose to undertake a revamp of our Official List and may require all companies to insert a ticker symbol adjacent to their name when they appear on any portal belonging to an information service provider. We would also consider whether the detailed Listing categories we proposed in CP06/21 remain relevant in the light of this work and could be incorporated into the outcome of this review as a second layer in this framework.

6.33 We believe that investors have a key role to play in this process by familiarising themselves with the Listing Regime in the UK and its terminology and structure. We aim to keep the regime as simple as we can for the purposes of providing clarity but the whole market including investors would need to work together to make the regime workable.

Q8: Do you have views on the labelling options?

7 The relationship between Listing and the Indices

7.1 One of the criteria for inclusion on the FTSE UK Index series is that the company must be Primary Listed. An index amongst other things represents the most liquid stocks in a market. The changes in the global economy described in Chapter 3 has meant that FTSE has had to reconsider the criteria for inclusion in the indices. FTSE is an independent company owned by The Financial Times and the London Stock Exchange. FTSE indices are used extensively by investors world-wide such as consultants, asset owners, asset managers, investment banks, stock exchanges and brokers. The indices are used for purposes of:

- Investment analysis
- Performance measurement
- Asset allocation
- Portfolio hedging
- Creation of index tracking funds

7.2 The FSA does not play any part in the compilation of the FTSE indices. Whilst we appreciate that the various institutions in the City of London are often interdependent, the FTSE as an independent profit-making organisation organises itself in a manner which takes into account the requirements of its clients.

7.3 We on the other hand, are working within a statutory framework pursuant to powers conferred upon us by legislation. It can be difficult in such circumstances not to allow a company to list which meets with criteria set out by legislation or our rules. The only circumstances in which we could refuse an application for admission to the Official List, if the criteria are met, is where the issuer's situation is such that admission would be detrimental to investor's interests. This would require a case-by-case assessment and could be subjective. We cannot guarantee a risk-free Listing environment but we could assist investors to understand their risks through disclosure based on the standards we have set and this mainly our role as competent authority.

7.4 FTSE recently published a practice note setting out the criteria on which the nationality of a company would be determined for inclusion in the FTSE UK Index series. It stated that a company not incorporated in the UK will be required to 'acknowledge publicly adherence to the principle of the U.K Combined Code, pre-emption rights and the UK Takeover as far as practicable.' This is largely a matter for FTSE since we do not participate in the compilation of indices. We would however seek to continue to work with the FTSE, where appropriate, to ensure that there is clarity in the market.

Next Steps

7.5 We aim to publish the feedback on this DP during the course of Q3 2008 and determine whether a consultation on specific rule changes would be necessary. As part of that consultation, we would seek to set out plans for a revamp of the official list and for the education of investors.

Cost Benefit Analysis

Introduction

1. A cost benefit analysis (CBA) assesses the economic costs and benefits of a proposed policy. A CBA is a statement of the differences between the baseline (broadly speaking, the current position) and the position that will arise if the proposed changes to FSA rules and guidance are implemented.

2. When proposing new rules or general guidance on rules, we are obliged (under section 155 of the Financial Services and Markets Act 2000) to publish a CBA, unless we consider that there will be no significant increase in costs. The CBA should contain an estimate of the costs and an analysis of the benefits arising from the proposals. We seek to give quantitative estimates of the costs, unless it is unreasonable to do so.

3. This Discussion Paper invites views on a number of policy questions. It does not propose fully developed new rules or guidance on rules. Therefore, we do not attempt to offer a detailed cost benefit analysis of the policy options considered in this Discussion Paper. However, we explain in general terms the benefits and costs that could arise from implementing any of these options. Respondents' comments on the analysis contained in this annex will inform possible future CBA work.

Reducing the role of the FSA in London's Listing regime

4. The FSA is the competent authority for the Prospectus Directive, Transparency Directive and the Market Abuse Directive. In addition, the FSA is the competent authority for Listing, with responsibility for super-equivalent Listing Rules. The Discussion Paper asks whether these latter responsibilities should be transferred to market participants, such as exchanges or trade associations.

Benefits

5. Exchanges already have the power to set rules for admission to trading for issuers without an Official Listing (subject to the Exchanges and Clearing Houses Act 2006). We lack evidence for a demand from market participants for a transfer of further responsibilities in relation to super-equivalent Listing Rules (but not the minimum

requirements prescribed by the Prospectus Directive, Transparency Directive and the Market Abuse Directive) from the FSA to exchanges or other organisations. However, we welcome respondents' views on this complex issue.

Costs

6. The FSA is an independent body with statutory powers for the development and enforcement of the Listing Rules. A reduced role of the FSA and an increased role for market participants such as exchanges in setting and enforcing Listing Rules may raise concerns about their quality, coherence and credibility. However, the FSA would in any case retain responsibility for minimum requirements prescribed by the Prospectus Directive, Transparency Directive and the Market Abuse Directive.

7. Any shift of responsibilities from the FSA to the private sector would also lead to a transfer of direct costs, though some net cost savings might be achieved as exchanges are not subject to the same procedural requirements as the FSA.

Admission to the Official List and trading on UK MTFs

8. The Discussion Paper asks whether equity securities admitted to trading on MTFs should be eligible for an Official Listing. It also explores whether MTFs wishing to offer the option of an Official Listing to issuers should be subject to additional mandatory requirements.

Benefits

9. A UK market operator expressed an interest in admitting issuers with an Official Listing to trading. This suggests that there may be some demand amongst UK and possibly overseas issuers admitted to or seeking admission to trading on UK MTFs for an Official Listing, though we lack evidence on its extent. It also suggests that platform neutrality might have some beneficial effects on competition between MTFs and Regulated Markets. However, additional mandatory requirements for MTFs wishing to offer the option of an Official Listing to issuers would make this option less attractive for MTFs (and for issuers, if MTFs can pass on some of the costs of the requirements to their customers) and thus limit its potential benefits.

Costs

10. It is possible that not all investors would be aware of the regulatory implications of platform neutrality. We welcome respondents' views on the risks, if any, this might present to investors and whether these risk would be effectively mitigated by requiring issuers admitted to trading on an MTF to also comply with the requirements of a Regulated Market.

11. To the extent that platform neutrality can increase the volume of applications for an Official Listing, costs to the UKLA would increase.

Extending eligibility for a Secondary Listing to UK trading companies

12. Overseas trading companies are currently eligible for a Secondary Listing in London whereas UK trading companies are required to have a Primary Listing. The Discussion Paper proposes to extend eligibility for a Secondary Listing to UK trading companies.

Benefits

13. While a Primary Listing may reassure investors, a Secondary Listing offers greater flexibility and lower costs. Accordingly, different listing regimes may be appropriate for different companies. Hence, extending the eligibility for a Secondary Listing" to UK trading companies would benefit those UK trading companies (and their investors) which value the greater flexibility and lower cost of a Secondary Listing, but are reluctant to drop down to AIM.

14. It would also remove a potential source of competitive distortions for UK trading companies that prefer a Secondary Listing and compete with overseas trading companies that already have a Secondary Listing. While UK trading companies seeking a less onerous regulatory environment have the option of transferring to AIM, AIM may not be as attractive as a "Secondary Listing" on a regulated market overseen by the FSA.

Costs

15. The costs of this proposal depend on investors' ability to distinguish what is currently referred to as a Primary Listing and a Secondary Listing. Information on issuers' listing status and the FSA's Handbook are publicly available. This should help investors, especially institutional investors, to assess the risks associated with a re-listing of some UK trading companies, especially if the labelling of different Listing segments is clarified (see below). If so, they could demand a compensating greater risk premium for investing in UK trading companies seeking a Secondary Listing or transfer their funds to UK trading companies that retain a Primary Listing. Thus, they would not be disadvantaged by the proposed change in the structure of the UK Listing Rules for UK trading companies.

Re-labelling of Listing segments for equity securities

16. The Discussion Paper invites views on different labelling options. One option would be to reserve the "Listing" label for what is currently called a Primary Listing for equities, while referring to Secondary Listing for equities and GDR Listing as "directive minimum". In any case, new labels are proposed which will distinguish between "Tier 1 Listing" (currently Primary Listing) and "Tier 2 Listing" (corresponding to all the other listing segments which have 'directive minimum' standards).

Benefits

17. A clarification of the labelling of different Listing segments may reduce the scope for misunderstandings by less informed market participants about an issuers' Listing segment and the regulatory implications. The only evidence we have of confusion

between the segments is based on the concerns expressed to us by some institutional investors and our own experience of usage of the term ‘Listing’ in the media.

Costs

18. We lack evidence that market participants would be adversely affected by different possible labelling changes (i.e. either referring to “Tier 1” and “Tier 2” Listing or reserving the term “Listing” to issuers with a Primary Listing). However, this will need to be confirmed in the consultation process, especially in relation to issuers with a Secondary Listing or global depository receipts.

19. The communication of any new labelling by the FSA to the market will have cost implications for the FSA.

Changes to the Listing Rules for overseas equity issuers with a Primary Listing

20. Overseas issuer with a Primary Listing, unlike UK issuers, are currently not required (i) to “comply or explain” against the UK Combined Code, and (ii) to provide pre-emption rights to shareholders. The Discussion Paper explores to what extent they should be required to meet these requirements.

Benefits

21. An extension of the requirements described above would help to better align the treatment of overseas and UK trading companies under the UK Listing Rules. Greater consistency would reduce the risk of misunderstandings by investors about the requirements of the Primary Listing Regime.

22. An extension of these requirements to overseas issues will bring limited benefits where overseas issues already comply with very similar provisions in their own jurisdiction. However, where this is not the case, they may add value. The corporate governance and disclosure provisions in the Combined Code mitigate information asymmetries between firms and investors. Pre-emption rights protect shareholders against the loss of control associated with equity issues.

Costs

23. An extension of any of these requirements would impose some costs on overseas issuers who wish to retain a Primary Listing. Issuers might have to “comply or explain” against two corporate governance code, those of the UK and those of their home state. They would also either incur the administrative and strategic costs associated with shareholder pre-emption rights or else incur some administrative costs when seeking shareholder approval for opting out of this requirement.

24. However, where these costs are considered to be significant, these issuers could opt for a Secondary Listing. This would impose a ceiling on total incremental cost equal to the value these issuers place on a Primary segment relative to a Secondary Listing and the potential administrative costs of transferring between Listing segments.

Extension of the sponsor regime to GDRs

25. The Discussion Paper asks whether we should require the appointment of a sponsor for a transaction involving the issuance of GDRs.

Benefits

26. The sponsor regime serves to give responsibility to sponsors for providing guidance on and/or monitoring compliance with the Listing, Prospectus and Disclosure Rules in certain circumstances. However, the sponsor regime requires a close and ongoing relationship between sponsors and issues and there are geographical barriers to such a relationship in the GDR market. Therefore, it is unlikely that that a sponsor regime could be effectively implemented in this context.

Costs

27. Issuers of GDRs wishing to avoid the super-equivalent requirement to appoint in sponsor for a transaction involving the issuance of GDRs by opting for a directive minimum Listing Regime.

Annex 2

FSA Empirical Research on the UK Listing Rules and Firm Valuation

Introduction and summary of conclusions

1. The FSA has undertaken an empirical analysis to provide insights into two questions. The first is whether the super-equivalent requirements of the UK's Listing Regime can enhance issuers' valuation. On the one hand additional regulatory requirements tend to increase issuers' compliance costs so tending to reduce firms' value. On the other hand, investors may value the fact that issuers meet higher requirements because this reduces the risk that they face as investors. In this case, regulatory requirements will tend to reduce the returns which investors demand of issuers, reducing issuers' cost of capital and so tending to increase issuers' valuations.

2. A second, directly related, question is whether it is beneficial or harmful for issuers to have a choice of Listing Regimes with different standards of regulation. As noted above, there may be a trade-off to issuers between the compliance costs of operating under a more "onerous" regime and the potential benefits in terms of a reduced cost of capital. These trade-offs may be different for different kinds of firm. If so, granting firms a choice between regimes may create benefits for them.

3. Both questions are relevant to the wider debate about the role of the UK Listing Regime, whether it ought to contain provisions which go beyond the minimum requirements of European Directives. The answers to these questions can also help us understand the impacts of the increasing proliferation of options which potential issuers have for Listing[1] and whether this ought to be a cause for concern.

4. There is no perfect methodology for investigating these questions but we believe they can be addressed to some extent by observing the effects of UK issuers' announcements to transfer from the more heavily regulated Main Market of the London Stock Exchange (LSE) to the less regulated Alternative Investment Market (AIM) or vice versa on their share price performance.[2] For example positive returns

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1 For example, Arcot, S., Black J. and Owen G.(2007), From local to global – The rise of AIM as a stock market for growing companies, London School of Economics report commissioned by the London Stock Exchange documents the rise of a number of "junior markets" around the world which present alternatives to the established listing venues while The Banker (1 September 2007) documents the rise of the 144a private placement market in the US.

2 Our analysis is based on UK- incorporated issuers. These firms will have their Primary Listing in the UK and so will be subject to regulatory requirements which go beyond the EU minimum.

for issuers switching from AIM to the Main Market could indicate the extent of the value-added by the additional regulatory requirements of the Main Market.

5. The conclusion of the analysis is, however, that any share price changes which result when issuers announce their intention to switch between regulatory regimes are mainly driven by the markets' expectations of issuers' future growth and profitability rather than the change in regulation or other factors (such as the advantageous tax regime for stocks admitted to trading on AIM). This is not to say that the greater regulation on the Main Market does not add value for the many larger issuers which would not contemplate switching regimes. But for our sample of "switchers" the differences in regulation between the Main Market and AIM do not appear to be a significant factor affecting valuations.

6. This may be because the differences between the regulatory requirements are small. Or it may be that the compliance standards of issuers are driven to a large extent by the market rather than regulation. So, for example, issuers considering switching from AIM to the Main Market may be complying with more than the bare minimum requirements of AIM and may instead already be behaving more like an issuer listed on the Main Market. A third interpretation is that, when issuers switch regimes they do so at a time when the costs to them are in balance with the benefits. So, for example, issuers switching from AIM to the Main Market find that the increased compliance costs of greater regulation are cancelled out by the reduction in the cost of capital they experience. A final explanation could be that the announcements of many switches do not "surprise" the market given the nature of the firms involved and their long-term strategies about which they market may already be well informed.

7. The policy implication of these conclusions is that there may be advantage in allowing issuers to choose the regulatory regime which is right for them.

8. This Annex describes our research methodology and contains our main results. We will publish the full final results of our research in an Occasional Paper in Q1 2008.

The Aim vs Main Market Study – hypotheses and caveats

9. Examining what happens when issuers switch between AIM and the Main Market can tell us something about the impact of different regulatory regimes on issuers. Issuers on the LSE's Main Market operate under the UK Listing Rules which are overseen by the Financial Services Authority. Issuers on AIM operate under rules which are overseen by the LSE itself supported by a set of firms known as Nominated Advisers (Nomads).[3] While these rules are similar to Main Market rules for firms with a Primary Listing in London in important respects (with identical regimes on market abuse), there are a number of differences:

   a. There is no minimum capital requirement on AIM

   b. There is no requirement for firms to have been trading for three years on AIM

   c. There is no minimum free float requirement on AIM

3 see Arcot et al (2007) for a succinct description of the role of Nomads.

d. Shareholder votes are required only for disposals of over 75% of assets on AIM, compared to 25% on the Main Market

e. There is no requirement for shareholder approval of related party transactions on AIM (though there is a requirement for management to consult with Nomads on larger transactions).

f. There is no requirement for firms on AIM to "comply or explain" their non-compliance with the Combined Code on Corporate Governance

Requirements d, e and f above are the main "super-equivalent" aspects of the UK Listing Rules on the Main Market.

10. Observing issuers switching between the Main Market and AIM should allow us to test different hypotheses about the effects of regulation:

a. Positive returns for issuers which announce they intend to switch into the more onerous regime of the Main Market could show that investors place value on the additional regulatory requirements, as could negative returns for issuers switching to the less onerous requirements of AIM.

b. Positive returns for firms switching in either direction could show that issuers benefit from being able to choose the regulatory regime most suitable for them.

c. If switches have no effect on returns this could imply that regulation is not an important factor for investors or that firms chose to switch when the costs and benefits to them are in balance.

11. These are the three hypotheses we have sought to test with our empirical work. In doing so we have been acutely aware of two limitations to our analysis, which we have sought to work around as far as possible:

a. When issuers announce their intention to switch between AIM and the Main Market, it is not only the regulation which changes. We have considered a number of other factors which change including tax, liquidity, the investor base and the markets' expectations of issuers' growth prospects. We have undertaken further analysis which allows us to eliminate some but not all of these factors as drivers of the share price changes we observe.

b. Issuers which switch between AIM and the Main Market are not typical of issuers on either market – they tend to have special characteristics. For example, firms which switch to the Main Market tend to have outperformed the market in the one or two years leading up to the switch. Firms switching to AIM tend to have under-performed the market. So we need to be careful to draw general conclusions about AIM or the Main Market which is not supported by the specific analysis we have undertaken.

Methodology

12. We adopt a standard "event-study" methodology to assess the effect of announcements of firms' switching decisions. Full details of this will be included in our Occasional Paper. This section summarises the main points.

13. The idea behind an event study is that returns behave "normally" before an event and deviate significantly from their normal pattern, either positively or negatively, around and especially after the event date. In our case, the relevant events are announcements of an intention to transfer from the LSE's Main Market to AIM or vice-versa.

14. We rely on statistical models to measure the size of any "abnormal returns" around the time of our events. We use as benchmarks for detecting abnormal returns either the average historical returns of that stock ("the constant mean returns model") or the FTSE small cap index ("the market model"), depending on which benchmark best fits each issuer's historical performance.[4]

15. Formally, the constant-mean-return model can be summarised as:

$$R_{it} = \mu_i + \eta_{it}, \quad E(\eta_{it})=0; \ Var(\eta_{it})= \sigma^2_{\eta_i}. \qquad (1)$$

where R_{it} is the period-*t* return on security *i*, which is equal to a constant, its mean μ_i, plus a disturbance, η_{it}, with mean zero and variance $\sigma^2_{\eta_i}$.

The *market model* can be described by the following equations:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}, \quad E(\varepsilon_{it})=0; \ Var(\varepsilon_{it}) = \sigma^2_{\eta_i}. \qquad (2)$$

16. These models provide predictions of "expected returns" which can be compared with the actual returns we see to calculate Abnormal returns (AR_{it}):

17. $AR_{it} = R_{it} - a_i - b_i R_{mt}, \quad t = T_{i1}+1, \ldots, T_{i2},$

18. We compute cumulative abnormal returns (CARs) over an "event window" of 5 days, i.e. the announcement date itself, the two days preceding it and the two days following it. The two days prior to the announcement are included to capture any informed trading by market participants. The two days after the announcement pick up the effect of effect of trading once the whole market is fully informed.

19. The cumulative abnormal return (CAR) for each issuer is the sum of the abnormal returns for the same issuer over the five-day event window. By examining the CARs for issuers which announce they intend to switch to AIM and those which announce they intend to switch to the Main Market we can draw conclusions about the hypotheses mentioned in paragraph 0 above. We are able to identify whether CARs are "statistically significant" at the 10% level given a stock's historical performance using a technique called bootstrapping.[5]

4 The models are estimated over an "estimation window" of 240 trading days ending three days prior to the announcement. We used the constant return model for those events where the p-value associated with the F-statistic for the market model regression applied to data for the estimation window was less that 1%. Modelling returns as following a constant-mean-return model as opposed to a market model did not yield a significant change in results.

5 The market or constant-returns models were used to calculate abnormal returns for the each day in the estimation window. The distribution of CARs for each stock was generated by randomly drawing and summing 5 daily abnormal returns from this sample 10,000 times.

Data

20. Our sample consists of 184 firms switching from AIM to the Main Market and 59 firms switching in the opposite direction in the period 1995 to 2006. These firms were identified on the basis of information downloaded from the London Stock Exchange website. To allow a more meaningful analysis we excluded foreign issuers (which may be subject to regulatory requirements outside the UK) and listed investment funds. We also sought to exclude issuers which made other major news at the same time as they announced their intention to switch between markets, such as of takeovers or profit warnings. However, some of the remaining announcements – often interim or final results statement – may still contain other information, which may "contaminate" our results to some extent.

21. We noticed that a considerable number of issuers (48 firms switching from AIM to the Main Market and 29 firms switching in the opposite direction) announced their intention to switch between markets in conjunction with announcing an equity issue. We analyse these announcements separately as they tell us much about what drives abnormal returns for switchers.

22. We obtained the dates of most announcements of switches from the Regulatory News Service of the London Stock Exchange or other Primary Information Providers (PIPs) which perform a similar function. As firms are legally required to immediately disclose any price-sensitive information, including their intentions to switch to a different trading platform, announcement dates should be reliable.

23. Returns on stocks in our sample were computed on the basis of total return indices downloaded from Datastream.

Main results

24 The table below summarises our main results. We find that on average issuers transferring from AIM to the Main Market experience positive CARs while firms transferring from the Main Market to AIM experience negative CARs. However, as can be seen from the table below these results are driven by those issuers which issue equity at the same time as switching markets.

25. A total of 59 firms switch from AIM to the Main Market. Of these, 29 issue equity and experience CARs of +6.9% when they announce their intention to switch (and issue equity). But the other 30 firms which switch experience on average very small CARs (the mean is -0.8% and the median is +0.4%).

26. Similarly, for the 48 firms which switch from the Main Market to AIM and issue equity CARs are both negative and large – the average CAR is -9.1%. Some 33 of the 48 firms switching to AIM and issuing equity experience negative returns and for 23 of these 33 firms the negative returns are also statistically significant at the 10% level.

27. By contrast firms which switch to AIM without issuing equity experience much smaller abnormal returns. Although the majority of firms (80 out of 136) experience negative returns, the average CAR is -1.5%.

	Event window: -2;+2			
	Main to AIM		AIM to Main	
Number of firms in clean sample	136		30	
Positive reaction	56		16	
thereof significant	7		1	
Negative reaction	80		14	
thereof significant	41		6	
	Average	*Median*	*Average*	*Median*
CAR clean sample	**-1.5%**	**-1.0%**	**-0.8%**	**0.4%**
CAR statistically significant firms	-8.3%	-10.0%	-6.1%	-3.8%
CAR positive reactions	9.2%	4.1%	3.6%	2.6%
CAR negative reactions	-9.0%	-6.7%	-5.9%	-3.8%
Number of equity issues	48		29	
Positive reaction	15		21	
thereof significant	0		3	
Negative reaction	33		8	
thereof significant	23		1	
	Average	*Median*	*Average*	*Median*
CAR equity issues	**-9.1%**	**-6.9%**	**6.9%**	**1.4%**
CAR statistically significant firms	-28.2%	-23.6%	25.2%	16.6%
CAR positive reactions	16.8%	5.6%	11.2%	5.6%
CAR negative reactions	-20.8%	-11.7%	-4.2%	-1.7%

Interpretation of results

28. Our results need to be interpreted with care. It is possible that they reflect the valuation effects of differences in the regulatory environment on the Main Market and on AIM, which we are most interested in. However, it is also possible that other, non-regulatory factors help to explain our findings. First, it is possible that announcing a switch is a "signal" of issuers' expected future performance (the "signalling effect"). For example, small, growing firms may intend to graduate from AIM to the Main Market. When such a firm announces that it is going to switch from AIM to the Main Market, this may be interpreted by investors as confirmation that the management are on target and able to deliver on their growth strategy. This news may be rewarded with an increase in valuation. Second, it is possible that liquidity is affected by a switch as the investor bases for the two markets differ somewhat. Overall demand for the issuers' stock may change because, for example, more institutional money is invested in funds with mandates to invest in Main Market stocks than AIM stocks. Finally, the tax environment differs with AIM stocks eligible for capital gains and inheritance tax advantages which Main Market stocks are not.

29. For switchers which do not issue equity, there is on average no significant impact on share price and so no evidence that investors regard the change in regulation or any of the other factors as very important. The average CAR of switchers to AIM is negative but small. This could be due to any or all of the factors mentioned above other than the tax change – the tax change should benefit AIM stocks – but in practice does not appear to be important. For the switchers to the Main Market the average change is so close to zero that it can be considered both statistically and economically insignificant.

30. For the switchers which issue equity, we observe negative CARs for switchers to AIM and positive CARs for switchers to the Main Market. These CARs are sometimes statistically and economically significant. There is no obvious reason why regulation should be important for firms which issue equity but apparently unimportant for those which do not. Instead, it is likely that performance signalling effects matter more for switchers issuing equity. Firms switching to the Main Market tend to be growing and historic out-performers – firms switching to the Main Market and issuing equity have on average outperformed the market by 197% in the two years before they switch. The fact they are issuing equity could be a positive signal that management believe the firm has many profitable projects to invest in and needs to raise more capital for this purpose.

31. Meanwhile firms switching to AIM tend to be historical underperformers. Firms announcing equity issues when transferring to AIM have on average underperformed the market by 24% in the two years before they switch. The fact they are issuing equity and that additional cash is needed from shareholders could be a negative signal that the firm is in a particularly difficult condition.

32. We have analysed firms' performance after the switch both in terms of share prices and operating performance. We have also analysed changes in the liquidity of firms' shares after the switch. None of this analysis contradicts the conclusion that our results are driven by the market's expectations about future performance rather than other factors such as liquidity.[6]

Next steps

33. We will publish an FSA Occasional Paper in Q1 2008 which will provide full details of the methodology, data and results (including results not reported here) as well as the analysis we have undertaken to ensure our results are robust.

6 We estimated percentage changes in operating performance (return on capital invested, return on sales and ebitda) and liquidity (relative bid-ask spreads) between the year leading up to the announcement and the year following the announcement. We compared the percentage changes in these measures for firms issuing equity and for firms not issuing equity in both samples around the time of the announcement. We found that the differences in the changes in these measures across these groups were insignificant at the 10% level in a one-sided t-test. We will revisit these estimates and publish detailed descriptive statistics in an FSA Occasional Paper in Q1 2008.

Annex 3

The literature review on listing standards

Introduction

1. This Annex surveys the empirical literature that may help to shed light on three related questions about the UK Listing Rules:

   a. What are the costs and benefits of super-equivalent listing requirements?

   b. What are the costs and benefits of giving issuers a choice between super-equivalent and directive minimum listing requirements?

   c. What are the implications of changes to listing requirements for international competitiveness?

2. It is worth noting at the outset that the granularity of the questions addressed in this DP and in the empirical literature on listing requirements often differs. Many of the issues which the FSA has the freedom and desire to review in this DP relate to specific instances of super-equivalence in the Listing Regime. By contrast, empirical studies often focus on major regulatory events or significant variations in regulatory standards across countries and firms. Thus the literature review can only give general indications about the effects of listing requirements.

The economic costs and benefits of listing requirements

3. Capital markets exhibit externalities and information asymmetries between issuers and investors and between buyers and sellers of securities. Regulatory intervention to mitigate these market failures – including super-equivalent requirements – may assure investors, thus reducing firms' cost of raising finance and increasing their valuation. However, regulation also imposes compliance and indirect costs on firms. These costs will also be reflected in firms' valuations. In other words, there is a trade-off between the costs and benefits of Listing Rules.

4. The empirical question of interest therefore is at what point the costs exceed the benefits of further or more stringent requirements. We survey comparisons across countries and firms and studies of the economic impact of regulatory changes and switches between Listing segments that may help to answer this question.

Comparisons across countries and firms

5. A number of studies, including those summarised below, compare corporate governance and firm valuation across countries and/or across firms within a country. A positive correlation might suggest that high corporate governance standards can enhance firm valuation.

6. La Porta et al. (2002) conduct a cross-country study which covers the 20 largest non-financial companies (which have a dominant shareholder with more than 10% of the voting rights) in 27 countries using data from the mid-90s. They construct an index of investor protection, which captures differences in countries' legal traditions as well as specific measures which limit discretionary powers of directors. They find a positive correlation between investor protection and company performance[7] across countries.

7. Deutsche Bank researchers (2005) assess the impact of corporate governance on shareprice performance across firms in the US, the UK and continental Europe. They construct a comprehensive corporate governance index which takes into account board independence, shareholder rights, information disclosure and executive remuneration. They find a positive correlation between the corporate governance standard of a firm and its share price performance in the US, UK and continental Europe. The UK part of the study is based on a large sample of FTSE350 companies. Deutsche Bank researchers assess corporate governance for each company in 2000 and then compare the performance of the corporate governance top quintile companies with the corporate governance bottom quintile companies over five years. The companies with the highest corporate governance standards outperformed the companies with the lowest standards by 34%.

8. Bruno and Claessens (2007) combine the international and the company perspective. They base their analysis on Institutional Shareholder Services (ISS) data on corporate governance (including the composition and independence of boards and committees, the level of shareholders' involvement in the company's decisions, compensation agreements, and relations with the auditors) for approximately 5300 US companies and 2400 non-US companies from 23 countries in the period 2003-2005. Consistent with other studies, they find a positive correlation between the level of corporate governance and firm performance[8]. This pattern is clearest for larger firms able to absorb the costs of better corporate governance and firms in financial difficulty concerned to signal their soundness to the capital markets. Bruno and Claessens also identify the level of shareholder protection at country level and board committees and independence at company level as particularly important for explaining variations in firm performance.

9. In summary, comparisons across countries and firms suggest that high corporate governance standards are valuable. However, we note that establishing a causal link between corporate governance and firm valuation can be challenging in some cross-sectional studies. This requires controlling for a number of country-specific or firm-specific variables, which may be difficult in some cases.

7 This is measured by Tobin's q. Tobin's q is calculated as follows: the numerator of q is (Book value of assets – book value of equity and deferred taxes + market value of equity); the denominator of q is the book value of assets.

8 This is measured by Tobin's q.

Empirical studies of major regulatory events

10. The introduction of the Sarbanes-Oxley Act in 2002 is a recent example of a major regulatory change. There is an increasing amount of literature on the economic impact of the Sarbanes-Oxley Act.

11. Zhang (2007) examines stock price movements around the dates of 17 key legislative events related to the Sarbanes-Oxley Act. She uses concurrent stock returns of non-US-traded forms to estimate normal returns for US-traded firms. Comparing these estimated returns to actual returns for US-traded firms, she finds significant cumulative abnormal returns around legislative events related to the Sarbanes-Oxley Act. Zhang also explores the sources of the costs of the Sarbanes-Oxley Act to firms in a cross-sectional analysis. Her results indicate that non-audit services and governance provisions in particular impose costs on firms. Finally, Zhang examines market reactions to the Security and Exchange Commission's (SEC) announcement of deferring compliance with Section 404, which mandates an internal control test. She finds small firms that obtained a longer extension period experienced significantly higher cumulative abnormal returns around the announcement.

12. Akhigbe and Martin's (2005) analysis of the effects of the Sarbanes-Oxley Act focuses on financial services firms. They find that the introduction of the Sarbanes-Oxley Act was value-enhancing for financial services firms, with the exception of securities firms. This suggests that the market expected improvement in the transparency of financial services firms following the Sarbanes-Oxley Act. Cross-sectional variation in the sample of firms can be explained by disclosure and governance characteristics. Firms with high compliance costs were less favourably affected by the Sarbanes-Oxley Act. Firms with greater motivation and ability of board members to monitor the firm experienced more favourable effects.

13. In summary, the Sarbanes-Oxley Act appears to have had a negative effect on issuers' valuation in most sectors. However, the results vary across sectors and firms, depending on firms' ability to absorb the compliance costs and their potential to benefit from better disclosure and governance standards.

Empirical studies of movements between listing regimes

14. A number of empirical studies explore the reasons why firms switch between listing regimes and how the switch affects their valuation and the liquidity of their shares. These studies may give us an indication of the costs and benefits of different listing regimes.

15. Macey et al. (2005) analyse mandatory delistings from NYSE due to breaches of listing requirements. Their sample consists of 55 companies which deregistered their shares with the SEC, moving from NYSE to the Pink Sheets market. Companies in the sample are very heterogeneous, including large and high profile companies like Enron and Betlehem Steel as well as many other bankrupt firms. The costs of delisting are generally high. The stock price is considerably (ca. 50%) lower on the Pink Sheets than on NYSE. Bid-ask-spreads and volatility also tend to increase after delisting. The effect on trading volume is less marked.

16. Leuz et al. (2007) analyse the performance of 480 companies that voluntarily deregister their shares in the period 1998-2004 and thus cease to be subject to SEC reporting requirements. The number of deregistrations increased significantly once the Sarbanes-Oxley Act implementation rules were proposed in October 2002. In February 2004 a change which provided relief for smaller companies was introduced and deregistrations occurred less frequently after this date. Consistent with other studies, Leuz et al. also find evidence that firms that deregister tend to have weaker corporate governance and worse prospects than firms which do not.

17. In summary, firms switching to a lighter regulatory regime tend to suffer negative return and liquidity effects around the announcement and/or movement date. However, the price change around the move to the lighter regulatory regime may reflect a signal about the prospects of the firm rather than the effect of lighter disclosure regulation.

Optional and mandatory listing requirements

18. Different corporate governance standards may be suitable for different forms. If so, opt-in standards may be beneficial because they allow individual firms to choose a level of corporate governance that is suitable for them. However, investors may find it difficult to distinguish between firms that opt in and firms that opt out. If so, compulsory standards that apply to all firms may provide greater assurance to investors than opt-in standards.

19. We located two empirical studies that highlight the benefits of mandatory and optional listing requirements in different circumstances. As will emerge, the conclusions of these studies can be reconciled by carefully analysing the information available to shareholders.

The "comply or explain" requirement of the Combined Code

20. Companies with an Official Listing are not legally obliged to comply with the Combined Code, but have to explain their degree of compliance in their Annual Report. Arcot and Bruno (2007) explore the effect of different degrees of compliance with the UK Combined Code on firms' performance.

21. They collect data on code compliance for 245 non-financial FTSE 350 companies in the period 1998 – 2003. To achieve the separation between highly and badly compliant companies, they construct a corporate governance index based on the degree of compliance with the Combined Code. The degree of compliance is measured in two different ways:

    a. "tick-box compliance": companies are ranked according to the number of code provisions they comply with.

    b. "comply or explain": companies that can give a reasonable explanation for deviating from provisions of the Combined Code are treated as if they were compliant.

22. Arcot and Bruno then compare the performance of a portfolio of highly compliant companies with that of the least compliant companies over more than five years. They find that the companies in the high-compliance portfolio outperform those in the least compliant portfolio only when the "comply or explain" measure of compliance is used, and not if the "tick-box compliance" measure is used. These results suggest that "embracing" the spirit of corporate governance by explaining compliance choices is better for shareholders than purely ticking the boxes of the Combined Code. The results also highlight the merits of granting firms discretion over compliance with provisions of the Combined Code.

Reputational effects of the SEC's 1999 Disclosure Requirements

23. Bushee and Leuz (2005) look at the impact of the introduction of SEC disclosure requirements in 1999 on firms trading on the OTC Bulletin Board. They distinguish three categories of firms: "non-compliant" firms choosing to move down to the Pink Sheets[9] to avoid the SEC disclosure requirements, "newly compliant" firms choosing to comply and to stay on the OTC Bulletin Board and "already compliant" OTC firms which did not need to change their practices to comply with the new SEC disclosure requirements.

24. Bushee and Leuz compare the effect of the regulatory change on the abnormal returns (and liquidity) of firms' in the three categories. They find that newly compliant firms suffered negative abnormal returns (and somewhat increased liquidity) around the date of introduction of the SEC disclosure requirements, reflecting significant compliance costs which exceeded the benefits to investors. Non-compliant firms experienced sustained periods of lower returns and lower liquidity after the regulatory change. Interestingly, already compliant firms who did not have to change their practices enjoyed positive abnormal returns after the announcement of the regulatory change. This suggests positive externalities as the reputation of their market segment as a whole was enhanced by other firms' compliance with the new mandatory disclosure requirements.

25. In summary, corporate governance requirements affect firms differently. Studies on the Combined Code in the UK highlight the potential benefits of granting firms discretion over compliance with regulatory requirements. However, there is also some evidence that requiring all firms in a sector to comply with corporate governance standards can have positive spillover effects on the valuation of firms that voluntarily adopted these standards already before they became compulsory.

Implications of regulatory differences for international competitiveness

26. The introduction of the Sarbanes-Oxley Act in 2002 has sparked a debate on the implications of regulation on international competitiveness. This issue has also attracted academic attention. Specifically, the following questions have been explored:

9 The Pink Sheets are an OTC platform with lower disclosure requirements than the OTC Bulletin Board.

a. Has the pattern of listing in New York and London changed after the Sarbanes-Oxley Act?

b. Is there a premium for cross-listings in NY and in London and has this premium changed following the Sarbanes-Oxley Act?

27. Piotroski and Srinivasan (2007) analyze foreign listings in the UK and the US in the period June 1995 to June 2006. No distinction is drawn between companies with a Primary Listing and companies with a Secondary Listing which are also listed in their country of origin. The term “listing” is also understood broadly to encompass Official Listing and mere admission to trading.

28. Traditionally access to (US or UK) capital markets was cited as the main reason for a direct listing or cross-listing on a foreign exchange. With the increasing integration of capital markets this might have become less relevant. Instead, the primary motivation for listing in the US or the UK might be the reputational effect, especially for companies from emerging markets. Thus a foreign listing is a credible signal that a company adheres to high corporate governance standards (the so-called “bonding effect”). This may be reflected in higher valuation.

29. The implementation of the Sarbanes-Oxley Act may increase the benefits of the bonding effect, while also increasing the cost of listing in the US. Thus a change in the number of foreign listings in the US (and/or a change in the number of foreign listings in the UK) could be an indication of the costs and benefits of the Sarbanes-Oxley Act for issuers.

30. Piotroski and Srinivasan note that there are more listings in London and less in New York after the Sarbanes-Oxley Act. This effect is marked for smaller firms (comparing NASDAQ and AIM), but less significant for larger firms (comparing NYSE and the London Stock Exchange’s main market). This finding remains unchanged when Piotroski and Srinivasan control for firm-, industry-, country- and exchange-specific factors.

31. Piotroski and Srinivasan also compare the characteristics of firms choosing to list in the UK or the US. Firms predicted by their control model to list in the US in the absence of the Sarbanes-Oxley Act but actually listed in the UK following the Sarbanes-Oxley Act tend to be smaller and less profitable than firms that list in the US. However, a small number of large and profitable firms from emerging markets actually listed in the US following the Sarbanes-Oxley Act although the control model predicted that they would list in London. This suggests that the bonding effect of foreign listing might be more valuable for a listing in the US than in the UK.

32. Doidge et al. (2007) focus on the frequency of cross-listings in New York and London and the cross-listing premia before and after the Sarbanes-Oxley Act. Unlike Piotroski and Srinivasan (2007), Doidge et al. (2007) do not identify a real shift between New York and London. They argue that cross-listings decrease on NYSE, NASDAQ and the LSE’s main market. The shift towards London occurs only because of the large rise of admission to trading of foreign companies on AIM. According to them this is no indication for a less attractive US “stock exchange environment” because firms trading on AIM are normally too small for a listing on NASDAQ.

33. Moreover, when analysing cross-listing premia, Doidge et al. find that there is a cross-listing premium for a US listing whereas there is no such premium for a UK Listing. This is true for the periods before and after the Sarbanes-Oxley Act. In their view differences in cross-listing premia in the UK and the US reflect differences in regulatory standards. However, they do not support this hypothesis with tests of the empirical data. Thus the nature of these differences and to what extent they are relevant to valuation is a matter of debate. In addition to corporate governance and disclosure standards, differences in enforcement activities may also matter (Coffee (2007)).

34. In summary, the evidence on the impact of financial regulatory differences between the UK and the US on the attractiveness for issuers is not clear-cut. However, it appears that the option of admission to trading on AIM in the UK is valued by many overseas firms.

Conclusion

35. This literature review focused on three issues. First, we were looking for evidence that may help to assess the economic benefits of higher listing standards. Comparisons across countries and firms suggest that higher corporate governance standards tend to be associated with higher valuation. Studies of firms switching to a lighter regulatory regime show negative return and liquidity effects around the announcement and/or movement date. However, these studies do not help us to decide at what point the benefits of super-equivalent regulations cease to outweigh the costs. Research on the impact of the Sarbanes-Oxley Act in the US suggests that these costs can be very significant for some firms.

36. Second, we were interested in the relative merits of mandatory and opt-in standards. Two studies we reviewed are noteworthy. Arcot and Bruno's (2007) research on the effect of compliance with the UK Combined Code on issuers' performance suggests that one size of corporate governance regulation may not fit all and that there is a case for optional standards where investors can distinguish issuers that opt-in from issuers that opt out. Bushee and Leuz (2005) research shows that firms which already voluntarily adopt higher corporate governance standards benefit from regulation that forces other firms in their market segment to follow their example. This points to reputational spillover effects where investors lack information about the practices of the firms they invest in. Both studies confirm that investors' ability to assess and price in the standards adopted by issuers is crucial when deciding whether regulatory requirements should be optional or mandatory.

37. Third, we wanted to explore the implications of the extent and segmentation of the UK's Listing requirements on international competitiveness. The evidence for a shift in listing from the US to the UK following the Sarbanes-Oxley Act is not clear-cut. Instead, the availability of a range of regulatory regimes, particularly the option of admission to trading on AIM, appears to have contributed to the attractiveness of London for foreign issuers.

38. Overall, the literature is arguably supportive of the FSA's preferred approach of offering issuers, whether domestic or overseas, a choice between a super-equivalent and a directive minimum Listing Regime while implementing appropriate measures for minimising the scope for investor confusion of different listing regimes.

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Next steps

34. We will publish an FSA Occasional Paper in Q1 2008 which will provide full details of the methodology, data and results (including results not reported here) as well as the analysis we have undertaken to ensure our results are robust.

Glossary of terms

CARD – Consolidated Admissions and Reporting Directive

Directive 2001/34/EC of the European Parliament and of the Council on the admission of securities to official stock exchange listing and on information to be published on those securities. The successor to the Listing Particulars, Admissions and Interim Reporting Directives.

Directive Minimum requirements

The relevant minimum standards set from the directives of the European Parliament and Council.

Financial Services Action Plan (FSAP)

The FSAP was published by the EU in May 1999 as a key step in the evolution of the EU internal market. The FSAP focuses on the freedom to provide financial services across the EU, so that capital can be raised more easily by European companies and the demand for capital can be matched more easily with supply. The MAD, PD, TD and MiFID are some of the 42 measures of the FSAP.

Market Abuse Directive (MAD) (2003/6/EC)

Directive of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse).

Multilateral Trading Facility (MTF)

a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract in accordance with the provisions of MiFID Title II "Authorisation and operating conditions for investment firms"

Transparency Directive (TD) (2004/109/EC)

The TD replaces and updates parts of existing EU legislation the 'Consolidated Admissions and Reporting Directive' (CARD). The Directive is designed to enhance transparency on EU capital markets by establishing minimum requirements on periodic financial reporting and on the disclosure of major shareholdings for issuers whose securities are admitted to trading on a regulated market in the EU. The TD also deals with the mechanisms through which this information is to be stored and disseminated.

Prospectus Directive (PD) (2003/71/EC)

The PD replaced the Public Offer (PO) Directive and some parts of the Consolidated Admission and Reporting Directive (CARD). It sets requirements for the drawing up and the publication of prospectuses when securities are offered to the public and/or admitted to trading on a regulated market in the EU. It is a maximum harmonization directive in relation to the contents and format of prospectuses and as such, member states may not require disclosure provisions in addition to those required by the PD

Recognised Investment Exchange (RIE)

An investment exchange which is declared by a recognition order under the Financial Services and Markets Act 2000 to be a recognised investment exchange.

Regulated Market

A multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments - in the system and in accordance with its non-discretionary rules - in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance regularly and in accordance with the provisions of Title III of MiFID.

Super Equivalent

Standards set by the UKLA over and above the directive minimum standards.

Annex 5

List of questions

Q1: Do you consider that the UK super-equivalent Listing standards should be retained?

Q2: Do you consider that the super-equivalent Listing standards should continue to be set by the FSA or should they be determined by the market (exchanges, trade associations or other independent body)?

Q3: Should we allow equity securities to be admitted to the Official List if they are only to be admitted to trading on a MTF operated by an RIE or an investment firm and not on a Regulated Market of an RIE? If so, on what basis?

Q4: Which of the options described above do you consider to be optimal? Please provide the reasons for your chosen option.

Q5: What are your views about opening up Secondary Listing for UK incorporated companies?

Q6: What are your views on how the provisions we have described above under core requirements should apply to overseas Primary Listed companies?

Q7: Should we require the appointment of a sponsor for a transaction involving the issuance of GDRs? If not, are there any other responses to the significant growth in GDRs that are necessary?

Q8: Do you have views on the labelling options?

PUB REF: 001175

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