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The City of London Law Society Company Law Committee: Response to the consultation on proposed changes to the UK Listing Rules for closed-ended investment funds published on 26 June 2026

Introduction

We set out below our responses to the consultation questions in Consultation Paper CP26/21 (Proposed changes to the UK Listing Rules for closed-ended investment funds) (the **Consultation**) for the FCA's consideration.

The City of London Law Society (the **CLLS**) represents approximately 21,000 City lawyers, through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 22 specialist committees. A link to the list of the individuals represented on the Company Law Committee is set out at the end of this response.

We have also included at the end of this response the members of the working group who were involved in drafting it (the **Working Group**). Any member of the Working Group would be happy to discuss or expand on any of the comments made in this response. Alternatively, please feel free to contact the Chair, David Pudge, whose details are set out below.

1. Overarching comments

There are divergent views among the members of the Working Group involved in drafting this response. Some members of the Working Group are strongly opposed to all of the FCA's proposed changes to the UK Listing Rules other than UKLR 11.4.13AR(2)(a) and (b) and (for some members) UKLR 11.4.13AR(2)(c) and UKLR 11.4.13BR. All members of our Working Group agree that UKLR 11.4.13AR requires amendment, although views differ on what form those amendments should take. Some members consider that UKLR 11.4.13AR(2)(c) and UKLR

11.4.13BR should be removed entirely; others consider that those two provisions should be retained with amendments. We are aware that some law firms whose representatives are members of the Working Group have separately made submissions on their views on the Consultation to the FCA. The Working Group is therefore unable to either unanimously support or disagree with the proposals (whether explicitly or tacitly).

However, in order to be constructive, this response has been prepared with the intention of highlighting certain amendments and improvements that, in our view, will need to be made if the FCA is minded to implement the proposals. On that basis, we have sought to represent the majority view of such changes within the Working Group (assuming that the proposals will be implemented).

The FCA states that the scenario at which these proposals are directed is a narrow ("niche hypothetical") one (the **Scenario**). In particular, paragraphs 1.11 and 2.12 of the Consultation imply that the FCA's proposals may be partly motivated by concerns around low turnout in shareholder votes and the potential difficulties faced by beneficial owners of shares wishing to exercise shareholder rights. We encourage the FCA to take and advocate action to directly address this important issue specifically.

It is important that any changes made as a result of the Consultation should not have retroactive application. Investors in closed-ended investment funds will have made economic decisions based on the rules at the date on which they invested, and to change those rules with retroactive effect could be disadvantageous to them commercially and economically. If investors know that changes are coming, including investors with a holding of more than 20% of the issuer's shares who are within the scope of the Consultation, they will be able to take steps to mitigate any such disadvantage, and we would expect to see a well-publicised transitional period before any changes take effect.

In summary, our principal recommendations are as follows:

- Those supportive of the proposals propose to broaden the non-independence criteria under proposed UKLR 11.4.13AR(2) to capture: (i) directors proposed for appointment by funds, vehicles and accounts under the proposed investment manager's management (although this could be removed if the proposal in the bullet point below is adopted); (ii) directors whose appointment was secured with the support of the aggregate voting power of the proposed investment manager, its connected persons and funds, vehicles and accounts managed by it; and (iii) directors appointed by or whose appointment was secured with the support of non-independent directors. In the view of such respondents, these amendments would make the safeguard provided by UKLR 11.4.13AR sufficient to address the Scenario at which the proposals are directed.
- Consider removing the narrow test of whether the proposed investment manager formally put forward the relevant resolution in favour of a test focused on whether the director's appointment was secured by the proposed investment manager and its connected persons (as described above).
- Broaden UKLR 11.4.13AR to prevent directors who are not independent of the existing investment manager from voting on proposals to remove it as investment manager.
- The proposed ongoing restriction treating directors proposed by a substantial shareholder as not independent for the purposes of the related party and relevant related party transaction regimes seems unnecessary.

- A proposed investment manager should not in our view be treated as a related party on a blanket basis. The non-independence criteria, if formulated appropriately, are sufficient to address the Scenario. Such an appointment should be a matter for the board (subject to the protections mentioned above). To also subject such an appointment to the relevant related party transaction rules in all cases would be disproportionate and may impact a new manager's willingness to be considered.
- Similarly, the proposed voting exclusion under UKLR 11.4.14AR does not seem necessary or proportionate. Any changes to investment policy should be decided on a "one share, one vote" basis. In addition, an investment manager that is also a substantial shareholder should not be regarded as having an automatic conflict of interest. In relation to any funds managed by that investment manager which are a shareholder in the issuer, the investment manager will have duties to its investors in those funds or to the funds which would be paramount in any decision it was making.

In these recommendations, we refer to "secured with the support of the proposed investment manager" or "secured with the support of non-independent directors". By that, we mean the appointment would not have been able to be effected but for the vote of the proposed investment manager (and its connected persons) or the non-independent directors, as the case may be.

2. Detailed questions and responses

Question 1: Do you agree that we should not treat a director as independent of a proposed investment manager if they: (i) were appointed as director after being proposed for appointment to the board of directors by the proposed investment manager or its associate; and/or (ii) meet any of the descriptions of persons not being independent, based on the criteria under UKLR 11.2.13R? If not, please explain why. Please also provide any other examples of non-independence that we should consider.

We agree in principle that a director should not be treated as independent of a proposed investment manager where that director meets the descriptions of persons not being independent based on the criteria under UKLR 11.2.13R. However, for consistency with UKLR 11.2.13R(2), UKLR 11.4.13AR(2)(b) should be amended to add the words "(subject to UKLR 11.2.14R)" at the start.

Those members in support of the proposals also agree that a director who was proposed for appointment by the proposed investment manager or its associate should not be treated as independent of that proposed investment manager. Others consider that automatically and permanently treating a director as not being independent of the proposed investment manager is wrong in principle and cuts across the existing considerations in determining independence (in particular, those set out in the UK Corporate Governance Code and the AIC Corporate Governance Code), where boards have more flexibility in determining whether any director is independent. The Consultation does not explain or provide evidence for why a substantive and permanent relationship (giving rise to a conflict of interest) must always exist between a candidate for director and any person who proposes them.

As such, we have a number of concerns with the proposal as currently drafted, which we set out below.

Who is in fact "proposing" the director?

We note that, as currently drafted, the draft rules would apply only where a particular director has been proposed for appointment by the proposed investment manager or its associate. However, in practice, it is unlikely that the proposed investment manager or one of its associates will itself be the beneficial holder of shares in the closed-ended investment fund. Rather, the shareholding is more likely to be held through one or more funds, vehicles or accounts in respect of which the proposed investment manager or its associate provides investment management or advisory services (and even then the shares are likely held by a nominee). It is those funds, vehicles or accounts that are the shareholders, not the proposed investment manager itself. We consider that such funds, vehicles and accounts should be treated as associates of the proposed investment manager for the purposes (and only for the purposes) of UKLR 11.4.13AR(2)(c), so that a director proposed for appointment by any such fund, vehicle or account is treated as not independent of the proposed investment manager.[1]

Furthermore, the rules as drafted would not address a situation in which an unconnected but sympathetic third party puts forward the relevant director for appointment, thereby circumventing the non-independence criteria.

That said, the Consultation does not provide a basis for distinguishing between candidates whose appointment as a director is recommended by the board and those whose appointment is not. Any such recommendation (or not) has no bearing on whether the director has an actual conflict of interest.

What is the status of any directors who have been appointed by non-independent directors?

A further issue arises in relation to the status of directors who are appointed by non-independent directors. In circumstances where a director is not independent of a proposed investment manager (or its associates) under UKLR 11.4.13AR, those directors may in turn vote in favour of appointing additional directors. As currently drafted, UKLR 11.4.13AR would not treat those additional directors as non-independent of a proposed investment manager (or its associates), notwithstanding that directors who are non-independent voted in favour of their appointment (and their votes may have affected the outcome of the board vote). This could be a way of circumventing the proposed independence requirements, and some of our members consider that the FCA should consider addressing this loophole in the final rules. Others suggest that at IPO, all directors of the issuer were, in practice, proposed by the investment manager and those members do not consider those boards incapable of acting independently of their investment manager and certainly do not perpetuate a perceived conflict based on the origin of their appointment.

If you are minded to address the potential circumvention, the non-independence criteria could extend to any director who has been proposed for appointment by a director who is not independent of the proposed investment manager, or whose appointment was approved by

[1] If adopted, this should not extend to any other aspects of the related party transaction rules as this would impede usual portfolio management transactions between funds managed by the same manager. The position advocated elsewhere in this response that the voting rights held by funds under common management should be aggregated for the purposes of determining whether the substantial shareholder threshold is met, is a distinct question from the treatment of those funds as related parties. The suggested aggregation of voting rights for threshold purposes is directed at preventing circumvention of the proposed director voting exclusion regime and should not be taken to imply that funds under common management should be brought within the scope of the related party transaction regime by virtue of that common management alone.

a decision of the board in which a director who is not independent of the proposed investment manager participated (whether by voting or otherwise taking part in the board's consideration of that appointment) instead of recusing themself.

What does it mean for a director to have been "proposed" for appointment by the proposed manager or its associate?

The concept of a director having been "proposed" for appointment by the proposed investment manager or its associate is not defined in the draft rules. We would encourage the FCA to clarify the scope of this concept. Given its plain and ordinary meaning, it is very broad. It would cover situations where the proposed investment manager or its associate has requisitioned a general meeting and put forward a resolution for the appointment of a particular director - in such a case, the association between the director and the proposed investment manager is likely to be apparent. However, it could go far beyond this. For example, UKLR 11.4.13AR(2)(c) does not require that the proposer (i) holds any shares in the listed fund at the time of proposal (or subsequently), (ii) puts forward a shareholder or board resolution to appoint the director, or (iii) votes in favour of appointing them.

Questions that the FCA might consider include:

- must a proposal be public, formal or documented?
- does a proposal have to be communicated directly to other shareholders, the listed fund or its directors, or can it be communicated indirectly (e.g. via an open letter, website or press interview or by people passing its substance on)?

This formulation could also be said to capture a scenario in which a proposed investment manager does not itself formally nominate a director, but instead votes in favour of the appointment of a sympathetic director who was not nominated by the existing board.

<u>Alternative proposal</u>

In our view, the test should focus on whether the director’s appointment was secured with the vote of the proposed investment manager and its connected persons, rather than on the narrower question of whether the proposed investment manager formally put forward the relevant resolution. By that, we mean the appointment would not have been able to be effected but for the vote of the proposed investment manager (and its connected persons). By way of example, suppose an investment manager holds (and votes) 20% of the votes and the resolution has 60% of votes in favour of it, the resolution would not have passed without the votes of the proposed investment manager and so the director’s appointment would be secured with the vote of the proposed investment manager. If, however, the resolution has 80% of votes in favour of it, the director’s appointment would not have been secured with the votes of the proposed investment manager because the resolution would have passed without those votes.

Question 2: Do you agree that only directors who are independent of the proposed investment manager should take part in the board's consideration of the transaction or arrangement appointing the investment manager? If not, please explain why.

Subject to our concerns as to the proper scope of the non-independence criteria addressed under Question 1 above, we agree that directors who are not independent of a proposed investment manager based on the criteria in UKLR 11.4.13AR should not participate in the board's consideration of the transaction or arrangement to appoint that investment manager.

Certain members of the working group note, however, that UKLR 11.4.13AR does not prevent directors who are non-independent of the existing investment manager from voting on any transactions with it. They note it appears somewhat inconsistent to only treat a director as having a conflict of interest when their affiliated investment manager wishes to be first appointed, and not when it wishes to resist its appointment being terminated.[2] Any concerns around conflicts of interest appear similar in nature and risk. Appointment starts the flow of investment management fees, and avoiding termination maintains that flow. The proposed new rules seem to introduce an element of inconsistency which could be seen to favour an existing investment manager as compared to a proposed investment manager.

Question 3: Do you agree that any director appointed after being proposed for appointment by a substantial shareholder, or its associates, should be considered as not independent of that substantial shareholder, or its associates? Do you agree that the director should not participate in votes on a related party transaction or relevant related party transaction with that substantial shareholder, or its associates? If not, please explain why.

This proposed ongoing restriction seems unnecessary in addition to the safeguards provided by the proposed UKLR 11.4.13AR (as amended) and (where the proposed investment manager is a related party) the existing relevant related party transaction rules including UKLR 8.2.1R(2). These safeguards, together with provisions typically in articles of association of listed companies, already ensure that non-independent directors are excluded from the board's consideration of the transaction or arrangement to appoint a proposed investment manager. Once those safeguards have operated effectively at the investment manager's point of entry, we struggle to see the rationale for imposing an additional, ongoing restriction on the participation of certain directors in subsequent related party transactions or relevant related party transactions.

We note that proposed new paragraph (1A)(b) of the definition of "associate" captures a substantial shareholder who "acting individually or in concert with other persons" proposes a candidate. What does "acting in concert" mean in this context? Would the FCA seek to apply the Takeover Code definition of "acting in concert" and related guidance despite that definition being designed for a different purpose, or is the intention to refer to the "Acting in concert" wording that appears in the definition of "controlling shareholder" in the Glossary to the FCA Handbook? We would suggest that the FCA clarifies what is meant by "acting in

[2] Terminating an existing investment management agreement (IMA) may be subject to UKLR 8.2.1R(2). It depends on whether any termination fees payable cause the consideration test (the only relevant class test) to exceed the percentage ratios in UKLR 8.2.1R, UKLR 11.5.4R or UKLR 11.5.5R. (The exemption in paragraph 1 of UKLR 8 Annex 1 will not usually apply where the listed fund exercises a discretionary right to terminate under the IMA.) However, a director could vote against terminating the IMA if they are e.g. an employee of the existing investment manager or a director or employee of another company in its group (as UKLR 8.2.1R(2) would not apply).

concert" in the context of the proposed new paragraph (1A)(b) of the definition of "associate", if it is adopted.

Question 4: Are there unintended consequences that we have not identified? For example, would it materially impede the appointment of directors? If so, could such a risk be mitigated by applying a time limit of, for example, 2 years?

As noted above, we do not agree that the extension of the related party transaction rules is necessary or proportionate.

The breadth of paragraph (1A)(b) of the definition of "associate" may cause unintended consequences. For example, an institutional investor which engages with investee companies in accordance with its stewardship obligations may express a view on the merits of a potential candidate for director should a future vacancy arise (e.g. as part of board succession planning). Depending on exactly what is said, the shareholder may be considered to have "proposed" that candidate (acting in concert with the listed fund or its representatives). If that candidate is ever appointed and the institutional investor ever becomes a substantial shareholder, then that director would be prevented from voting on any related party transaction involving the shareholder and the listed fund.

The lack of any time limit makes this harder to manage. Paragraph (1A)(b) imposes no limits on the time between (a) the initial proposal of the candidate and their appointment, or (b) the candidate's appointment and the related party transaction on which the board must vote. During that time the investor's intentions or investment strategy may change, the listed fund may become a more attractive investment, unexpected opportunities to invest cheaply may arise, or buybacks may increase the investor's percentage shareholding. It seems unfair to penalise an investor which unexpectedly becomes a substantial shareholder following a change in circumstances.

A time limit (e.g. 2 years) may help. This limit could start running from the time the candidate is first proposed, not when they are appointed (which could be much later). The lack of any time limit in UKLR 11.4.13AR(2)(c) raises similar issues.

In addition, some members of the Working Group have particular concerns regarding proposed new paragraphs (1A)(b) and (c) of the definition of "associate", for the same reasons they strongly disagree with proposed UKLR 11.4.13AR(2)(c). In their view, both sets of provisions are based on essentially the same underlying assumptions. Those members also make the following points:

- Associates of directors of all listed companies subject to UKLR 8 raise the same potential conflict risks. Accordingly, there is no justification for defining "associates" differently for directors of listed funds and ESCC companies. The potential conflict risks are the same whether a director is proposed by a substantial shareholder of a listed fund or a substantial shareholder in an ESCC company.
- There is no justification for treating a director as an "associate" (with a conflict of interest) if they are proposed by a substantial shareholder, but not if they are proposed by another type of related party (e.g. an existing investment manager or director). If proposing a candidate creates conflict risks, then similar risks arise in each case. For example, another director could propose a candidate, vote at a board meeting to appoint them and recommend that shareholders re-elect them at the next AGM. An existing investment

manager or director may well have greater influence over a director they proposed, given their roles will necessarily require ongoing interaction with the new director.

- There is no justification for always treating a director as an "associate" of any substantial shareholder who proposed them, but never as an associate of their employer (to whom they owe a duty of fidelity). For example, a director who is an employee of the existing investment manager or a company in its group is not independent under UKLR 11.2.13R. However, such a director is permitted to vote on related party transactions with the existing investment manager (under UKLR 8.2.1R(2)).

Further, certain members of the Working Group consider that the breadth of the proposed provisions covered in Q1 is likely to cause unintended consequences, especially for companies in diversified financial services groups which include investment managers. For example, a director could not vote on the appointment of a new investment manager if another company in its group:

(a) is an institutional investor which engages with investee companies in accordance with the FRC's Stewardship Code, and had prior to that director's appointment suggested them as a potential candidate, or expressed a view on their merits as a potential candidate when asked (e.g. as part of board succession planning). Depending on exactly what is said, the shareholder may be considered to have "proposed" that candidate, even if multiple potential candidates were discussed;

(b) conducts a broking business under which group companies hold the legal title to uncertificated shares in CREST on behalf of investor clients (as nominee or custodian), and at a client's direction had previously requisitioned a general meeting to appoint that director under section 303 of the Companies Act 2006; or

(c) is the existing investment manager, which wishes to transfer its responsibilities to the proposed new investment manager as part of an intra-group restructuring, and that director was appointed after being proposed by the existing investment manager or another group company (e.g. prior to IPO).

Question 5: Do you agree that this requirement should focus on substantial shareholders, rather than shareholders with stakes of less than 20%? If not, please explain why similar protections would be required in this scenario?

We agree that this requirement should only apply to substantial shareholders holding 20% or more of the voting rights. In our view, the 20% threshold strikes an appropriate balance and there is no clear justification for extending the proposal to shareholders with stakes below that level.

Question 6: If you agree to Q3, do you also agree that the proposed amendment to the definition of 'associate' in the Glossary helps to achieve this? If not, please explain why or provide an alternative suggestion.

As noted in our response to Question 3 above, in our view the proposed ongoing restriction is unnecessary. However, if the FCA is to proceed with this element of its proposals, we do not consider that the proposed amendment to the definition of "associate" in the Glossary is sufficient to achieve the FCA's stated objective for the following reasons:

- The definition of "associate", even as proposed to be amended, does not extend to funds, vehicles or accounts managed by the relevant person (or by persons within the same group). This is a material omission. As mentioned above, in practice an investment manager will not itself be the registered holder of shares in the closed-ended investment fund; rather, its economic interest will be held through underlying funds or accounts under its management. Those funds are not "associates" of the investment manager under the existing or proposed definition. Moreover, the investment manager itself cannot be a "substantial shareholder" because UKLR 8.14.1R(1)(b) expressly provides that voting rights held or controlled by a person in its capacity as investment manager are to be disregarded for the purposes of that calculation.

- This gap creates an opportunity to circumvent the proposed restrictions. An investment manager could distribute its holdings across two or more funds under its management so that no single fund individually meets the 20% substantial shareholder threshold. Because such funds do not individually meet the substantial shareholder threshold, and because the investment manager's own control over the voting rights attaching to the shares held by the individual funds is disregarded under UKLR 8.14.1R(1)(b), no person would qualify as a substantial shareholder for the purposes of the proposed rules, notwithstanding that the investment manager exercises de facto control over the aggregate holding.
- To address this gap, the scope of what constitutes an "associate" of an investment manager or a proposed investment manager should be expanded so as to include any fund, vehicle or account in respect of which that person or its associate provides investment management or advisory services, and the holdings of all such funds, vehicles and accounts should be aggregated for the purposes of determining whether the substantial shareholder threshold is met.
- Arguably, introducing only UKLR 11.4.13AR (as amended) addresses the relevant scenario and obviates the need to deploy the concepts of "substantial shareholder" and "associates" at all, therefore avoiding these issues.

Question 7: Do you agree that a proposed investment manager should be treated as a related party to ensure protections around its fees are consistent before and after the appointment? If not, please explain why.

We do not agree that a proposed investment manager should be treated as a related party on a blanket basis. If the non-independence criteria in the proposed UKLR 11.4.13AR (as amended) are properly calibrated, the Scenario at which this proposal is directed (namely, the risk that a substantial shareholder might secure its own appointment as investment manager on terms that are not fair and reasonable) would already be adequately addressed at the board level.

Where a proposed investment manager is a related party on another basis (e.g. as a substantial shareholder or an associate) then the related party transaction rules already apply.

The extension of the relevant related party transaction provisions to all proposed investment managers would, in our view, be inconsistent with the FCA's move to a largely disclosure-based regime for related party transactions in July 2024 and general deregulatory direction of travel. It would require a sponsor fair and reasonable confirmation (and, where a percentage ratio is 5% or more or uncapped, a shareholder vote) in respect of every new investment manager appointment, imposing material costs on issuers and potentially deterring prospective investment managers from accepting mandates. These costs are not justified from an investor protection perspective where no conflict of interest is present.

The related party transaction regime exists to manage conflicts of interest and to prevent a related party from taking advantage of its position (UKLR 8.1.3G). Where a proposed investment manager is not a related party of the closed-ended investment fund on another basis when its appointment terms are negotiated, there is no identifiable conflict of interest that would justify subjecting the appointment to the relevant related party transaction requirements (which is why the exemption in paragraph 1 of UKLR 8 Annex 1 exists). In the absence of any such conflict of interest, the negotiation of fee arrangements with a proposed investment manager is properly a matter for the board, to whom shareholders have delegated authority and who must act in accordance with their duties as directors (and subject to the applicable conflict of interest provisions). In such circumstances, the board is negotiating at arm's length with an independent counterparty, and the existing protections under company law and the UKLR requirements for board independence provide a sufficient framework for ensuring that fee arrangements are agreed on appropriate terms.

Finally, it is not clear when a person becomes a "proposed investment manager" (as defined). Is this when the listed fund expresses interest in appointing them, when key terms (e.g. price) are agreed, or only when all terms have been successfully negotiated? When does a person cease to be a proposed investment manager if their appointment does not proceed? Is it enough for negotiations to be paused or must they be abandoned? All other categories of related party relationships have a clear start and end, except for a person exercising significant influence.

This matters because UKLR 11.5.3R(2) (as proposed) and the relevant related party transaction rules (UKLR 11.5.4R to UKLR 11.5.6R) do not only apply to transactions relating to the proposed investment manager's fees. They also apply to transactions relating to fees or remuneration payable in connection with services rendered by a member of its group. Where the proposed investment manager is a company in a diversified financial services group, there should be clarity as to whether the relevant related party transaction rules apply to agreements on fees for services to be rendered by another member of its group. This requires clarity on when the proposed investment manager starts and stops being a related party.

Question 8: Are there unintended consequences that we have not identified that we should take into account? If so, please explain what they are.

As noted in our response to Question 7 above, the principal unintended consequence of the proposal we foresee is that the imposition of the relevant related party transaction requirements on every new investment manager appointment (irrespective of whether any conflict of interest exists) is likely to deter prospective investment managers from accepting mandates, given the additional cost, delay and procedural burden involved. In particular, it may be unattractive to prospective investment managers for every appointment to be subject to the uncertainty of a shareholder vote, and they may have legitimate concerns about the commercial consequences of such a process being conducted in public in circumstances where no conflict of interest is in fact present and the incumbent manager at a minimum is likely to have more opportunity to communicate with existing shareholders, i.e. it is not a level playing field.

See also our comments on Question 7 regarding the uncertainty as to when a person is a “proposed investment manager” and the potential impact on agreements regarding fees for services to be rendered by another member of the proposed investment manager’s group.

Question 9: Do you agree that it would be beneficial to address the potential conflicts of interest where a substantial shareholder, or one of its associates, is also a closed-ended investment fund's appointed investment manager? If not, please explain why.

We do not consider that additional measures beyond the existing rules are necessary to address this scenario.

An investment manager and any member of its group are already treated as related parties under UKLR 11.5.3R, with the result that transactions with the investment manager (including in respect of its fees) are already subject to the protections afforded by the related party transaction and relevant related party transaction regimes. The integrity of the board's decision-making is separately safeguarded by provisions typically included in the articles of association of listed companies, the existing majority board independence requirement and UKLR 11.4.13AR (as amended).

In circumstances where the investment manager is also a substantial shareholder, it has committed substantial capital to the fund and has a direct economic interest in the fund's performance that is aligned with that of other shareholders. It has a substantial exposure to the fund’s performance, good or bad. We do not consider that this state of affairs automatically gives rise to a conflict of interest that is not already adequately addressed by the existing regime.

See also our response to Question 10 below.

Question 10: Do you agree with our proposal to exclude: (a) a substantial shareholder that is also a closed-ended investment fund's appointed investment manager, and any of its associates, from participating in a shareholder vote on a material change to the fund's published investment policy? (b) A substantial shareholder whose associate is a closed-ended investment fund's appointed investment manager, from participating in a shareholder vote on a material change to the fund's published investment policy? (c) If not, please explain why or suggest alternative approaches.

We do not agree with this proposal. Any changes to investment policy should be decided on a “one share, one vote” basis. It is important that a listed company’s strategy is supported by a majority of all shareholders. An investment manager which is a substantial shareholder also does not automatically have a conflict of interest (see our response to Question 9).

In addition, the scenario at which the Consultation is directed is a narrow one, being the risk that a person might acquire a substantial shareholding in a closed-ended investment fund, propose new candidates for election to the board, use their voting power towards the appointment of such candidates, subsequently be granted the investment management contract and vote their shares in favour of a material change to the investment policy – where the risk is compounded by low voter turnout, rather than a reflection on the current investment strategy. The proposed UKLR 11.4.14AR goes materially further than is necessary to address this Scenario.

Our objections to the proposed voting exclusion

The effect of the proposed UKLR 11.4.14AR would be to exclude any substantial shareholder that is also the investment manager, together with its associates, from voting on any material change to the investment policy. The proposal operates as a blanket disenfranchisement of a class of shareholder, rather than as a targeted measure directed at an identified conflict of interest.

The existing requirements under UKLR 11.4.14R, which provide that any material change to the investment policy must be approved by both the FCA and by shareholders, already constitutes some safeguard against the risk that an investment manager which is also a substantial shareholder could vote its shares in favour of a change to the investment policy to the detriment of other shareholders. In addition, to the extent that a change of fees is proposed alongside any change of investment policy, this is subject to the relevant related party transaction regime.

Critically though, the proposed UKLR 11.4.13AR (amended to reflect our suggestions above) would also address the specific scenario identified. That rule excludes non-independent directors from the board's consideration of, and vote on, the appointment of the proposed investment manager, thereby insulating the board’s decision-making process from their influence. There is accordingly no justification for additionally disenfranchising the investment manager at the shareholder level. A substantial shareholder that has committed significant amounts of capital to the fund on the basis of its published investment policy should not be deprived of the right to vote on a proposal to change the terms of the investment policy on which it invested.

This is illustrated by the scenario in which the board, acting independently, proposes a material change to the investment policy with which the investment manager (which is also a substantial shareholder) disagrees. In such circumstances, the investment manager is seeking to preserve the status quo and its interest is entirely aligned with that of any other shareholder who opposes the proposed change. To exclude the investment manager from voting in that scenario would deprive it of the ability to protect its own economic interest as a shareholder, where no conflict of interest exists.

Similarly, a substantial, controlling (30%+) or even majority shareholder in an ESCC company is free to vote on matters with a major impact on the company’s strategy and business, including to approve reverse takeovers and (prior to July 2024) class 1 transactions. This includes where the issuer’s executive directors (CEO and CFO) are the controlling shareholder or persons closely affiliated with it. The major shareholder’s interests are seen as aligned with other shareholders.

The only instances in which the UKLRs currently provide for independent shareholder votes are:

- relevant related party transactions above 5% on a class test (UKLR 11.5.5R). This scenario arguably presents a higher risk for shareholders than a change of investment policy; and
- the election of independent directors of an ESCC company with a controlling (30%+) shareholder (UKLR 6.2.8R). Critically, where the election of an independent director is

not agreed by both the independent shareholders and all shareholders, UKLR 6.2.9R provides for a 90-day cooling off period followed by a vote of all shareholders (including the controlling shareholder) to resolve the deadlock.

We do not think material changes in investment policy should be added to this select list.

Refining the scope of the voting exclusion, if implemented

Without prejudice to our primary position set out above (that no such voting exclusion should be imposed), if the FCA determines to proceed with a shareholder-level voting exclusion on material changes to the investment policy, then we recommend that a deadlock-resolution mechanism should be included, potentially on similar terms to UKLR 6.2.9R.

In addition, the scope of any such exclusion should be significantly narrowed in two ways:

- First, the exclusion should be confined to circumstances in which the proposed material change forms part of, or is associated with, a transaction or arrangement for the appointment of a new investment manager that has been initiated or promoted by a substantial shareholder or its associates.
- Second, even in such circumstances, the exclusion should extend only to the proposed investment manager and its associates, and should not extend to an investment manager after it has been appointed. We consider that, following appointment, an investment manager that holds shares in the fund should retain the right to vote those shares in all circumstances, save where it is disenfranchised under the existing provisions of the UK Listing Rules. To disenfranchise an appointed investment manager in circumstances where it is not the party seeking to exploit a conflict of interest would be neither proportionate nor rational.

In the alternative, if UKLR 11.4.14AR must be introduced, it could apply as set out in the Consultation. That is, it should only apply to a substantial shareholder which is currently the investment manager of the listed fund (and its associates). Such an entity has two types of related party relationship with the listed fund (as substantial shareholder and investment manager), giving it greater influence as recognised in paragraph 3.33 of the Consultation. A proposed investment manager does not have this level of influence, even if it is a substantial shareholder.

See also our response to Question 13 below.

Question 11: Do you consider if it would also be beneficial to extend this proposal to address the scenario where a material change is being made to the investment policy at the same time that a new investment manager is being appointed? If so, please explain why.

As set out in our response to Question 10 above, we do not consider that a voting exclusion on material changes to the investment policy is necessary.

However, if the FCA determines to proceed with such a voting exclusion, we consider the scenario contemplated by Question 11 to be the only scenario in which such an exclusion would be justified, and we would confine the scope of any voting exclusion accordingly.

Question 12: Are there any risks or unintended consequences with this proposal that you think we have not identified? If so, please explain what they are.

Yes. It could result in a listed fund being left with a strategy which is not supported by a majority of all shareholders. That risks encouraging conflict between majority and minority shareholders (and likely also the board of the listed fund, given its role in putting forward resolutions to change investment policy). See also our response to Question 10 above.

The concept of "at the same time" is not defined in the draft rules. If this proposal is pursued, we would encourage the FCA to consider whether "at the same time" means a resolution at the same meeting, or otherwise within a certain defined period.

Question 13: What are your views on the alternative options also discussed? If you consider one of these to be a more effective approach, please explain why.

As set out in our response to Question 10 above, we do not consider that a shareholder-level voting exclusion on material changes to the investment policy is necessary. Accordingly, we do not consider that any of the alternative options are required.

If the FCA decides to proceed with UKLR 11.4.14AR, then we would support limiting it to permit voting up to 20% of total voting rights (i.e. the first alternative in paragraph 3.38 of the Consultation). As drafted, UKLR 11.4.14AR would allow an investment manager which holds 19.9% of the listed fund's shares to vote all those shares. However, the rule would prevent an investment manager which holds 20.1% of the listed fund's shares from voting any shares. This does not seem proportionate.

We do not support the second alternative in paragraph 3.38 of the Consultation (only apply the proposal where one or more directors are not independent of the investment manager). A listed fund must have a majority independent board (UKLR 11.2.12R). We do not see why the application of UKLR 11.4.14AR should depend on whether some or none of the minority directors are non-independent of the investment manager as they are still a minority.

We do not support the third alternative in paragraph 3.38 of the Consultation (apply a double majority approach). The only situation where the UKLRs require this is UKLR 6.2.8R, which is critically subject to UKLR 6.2.9R. If the FCA decides to explore this option then it should include a deadlock-resolution mechanism similar to UKLR 6.2.9R. See our comments on this issue in our response to Question 10.

Question 14: Do you agree with our proposed approach to implementation? For example, does a 4-week gap between the rules being finalised and coming into force allow enough time to complete any transactions or arrangements under the current rules?

See our comment above that any changes made as a result of the Consultation should not have retroactive application. Provided that this is agreed to, we agree with the proposed approach to implementation, including the 4-week gap.

Becoming a major or substantial shareholder in a listed fund requires a large investment (up to 20% of market cap), and investments are made on the basis of the rules in force at the time. Sufficient time should be provided to digest the new rules and complete any transactions in progress.

Question 15: If not, what are the practical issues that may justify a different approach to implementing any final rules?

N/A

Question 16: Do you agree with our proposed clarification to make it clearer that UKLR 8.1.11R(4), regarding 'associates' of related parties, also applies to the extended definition of related parties under UKLR 11.5.3R, regarding a closed-ended investment fund's appointed investment manager? If not, please explain why.

We do not consider it to be clear that this proposal constitutes a clarification of the existing rules, as opposed to a substantive rule change in its own right. UKLR 11.5.3R currently provides that a related party includes "…*any investment manager of the closed-ended investment fund and any member of such investment manager's group*". If the definition of "associate" already had the effect of treating members of the investment manager's group as related parties by virtue of their association with the investment manager, the express inclusion of the words "*and any member of such investment manager's group*" in UKLR 11.5.3R would be, and would always have been, redundant. The fact that those words were included in the existing rule suggests that the definition of "associate" was not understood to apply to the additional related party category for the purposes of UKLR 11 of an investment manager and any member of its group, and that the proposal to extend the definition of "associate" to capture such persons is therefore a substantive extension of the scope of the related party regime rather than a clarification of it.

Having said that, we have no objection to this change. It seems logical for an associate of an investment manager to be a related party, just as an associate of a substantial shareholder, director or person exercising significant influence is a related party under UKLR 8.1.11R(4). However, if this change is made then the words "and any member of such investment manager's group" in UKLR 11.5.3R(1) should be deleted as they will be redundant.

If this change is adopted, the FCA should clarify, for the avoidance of doubt, that the amended definition does not have the effect of treating funds managed by the same investment manager as related parties of one another (to the extent that they may otherwise meet the definition of "associate"). Please see the discussion of the association / aggregation principle re funds, vehicles or accounts in respect of which a proposed investment manager or its associates provide investment management or advisory services in our response to Question 1 under "*Who is in fact "proposing" the director?*".

Question 17: Do you have any comments on our Cost Benefit Analysis?

While we do not have specific comments on the methodology or assumptions on which the FCA's Cost Benefit Analysis is based, we consider that the concerns about proportionality, breadth and unintended consequences of the FCA's proposals which we have raised in our responses above are relevant to such analysis. We are concerned that additional costs (including compliance costs) could be imposed on closed-ended investment funds, their shareholders, directors and investment managers in circumstances where no corresponding investor protection benefit arises.

Point of contact

Should you have any queries or require any clarification in respect of our response, please feel free to contact our chairperson or any of the members of the Working Group set out below.

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https://clls.org/committees/company.html