

## Primary Market Bulletin No.7: Consultation on new UKLA objectives and sponsor regime and new Knowledge Base guidance published

October 2013

The Financial Conduct Authority (FCA) has published its seventh edition of [Primary Market Bulletin](#) (PMB No.7). The edition clarifies how the FCA, in its capacity as the UK Listing Authority (UKLA), carries out its functions in light of the new strategic and operational objectives conferred upon it since the changes to the regulatory regime on 1 April 2013 (legal cutover). The FCA is also consulting on new guidance on various practical matters and has published final guidance on previously consulted matters which is available in the Knowledge Base.

### New UKLA objectives

In response to the significant changes to the regulatory landscape earlier this year, the FCA has considered how the UKLA should conduct its functions, whilst meeting its new regulatory objectives. Prior to legal cutover, the general objectives of the FSA did not apply to the regulatory responsibilities of the UKLA. Instead, the FSA's regulatory objectives were set by HM Treasury, which were, in turn, subject to a set of factors that the UKLA should 'have regard to' pursuant to the Financial Services and Markets Act 2000 (FSMA).

Under the new regulatory regime, however, the FCA's strategic and operational objectives apply directly to its functions in its capacity as the UKLA. Consequently, PMB No.7 explains how the regulatory changes will impact the UKLA's approach to its functions and further proposes new and amended draft guidance for stakeholders in the light of its new approach and powers. A summary of the UKLA's new approach is set out below.

### Consumer protection

The FCA is required to secure '*an appropriate degree of protection for consumers*'. The definition of 'consumer' is very broad and includes retail and wholesale consumers. FSMA sets out factors to which the FCA must have regard in considering the appropriate protection for consumers. These factors include the level of risk involved in the relevant type of investment and the experience and expertise that different consumers may have for different kinds of investment.

Consequently, the FCA has revised its approach to vetting prospectuses so that it ensures that end consumers are adequately protected. In PMB No.7, the FCA confirms that, when vetting prospectuses, it will tailor its review to take account of the relevant target investors. For example, where prospectuses are targeted at retail investors, the FCA will pay particular attention to the Prospectus Directive requirement that documents should be '*easily analysable*



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*and comprehensible*.

In contrast, the FCA's approach to reviewing a document targeted at wholesale investors will be different given the level of sophistication and knowledge of these consumers. The FCA states that it will view the requirement for prospectuses to be easily analysable and comprehensible 'differently' for wholesale investors, suggesting that the content and presentation of information will differ for wholesale and retail investors. The FCA also expects to raise few comments and review fewer drafts for wholesale investors. The FCA is asking issuers and their advisers to bear this new approach in mind when basing their draft on precedent documents. Draft guidance in a new technical note on the new vetting approach in relation to non-equity retail prospectuses is being consulted on and is summarised below. We assume that the same approach will be taken in respect of retail prospectuses for equity issues.

### **Market integrity**

The FCA acknowledges that the primary information providers (PIPs) and the sponsor regime are key to securing its operational objective to '*protect and enhance the integrity of the UK financial system*'. PIPs must ensure that regulated information is communicated to the market promptly whilst the sponsor regime is integral to ensuring the integrity of the premium listed market. Consequently, the FCA is proposing guidance which specifically deals with sponsors' obligations under the Listing Rules to deal with the FCA in an open and co-operative way. We summarise the content of the technical note below.

### **Competition**

The FCA is also tasked with '*promoting effective competition in the interest of consumers in the markets for regulated financial services or services provided by recognised investment exchanges in carrying on certain regulated activities*'. Again, the FCA recognises the importance of the role of PIPs and sponsors in achieving this objective and, consequently, intends to focus on ensuring that both regimes can operate effectively. The FCA further notes that it has a separate competition duty requiring it to promote effective competition in the interests of consumers when meeting its overarching consumer protection and integrity objectives, which includes monitoring the issuing of securities by issuers to investors.

An interesting point to note is that, as part of the new regulatory framework, the FCA is no longer required to have regard to the international competitiveness of the UK market for listed securities when carrying out its general functions. It is, however, required to have regard to the desirability of sustainable growth in the UK economy in the medium or long term and must follow the principle of ensuring that burdens or restrictions applied by the FCA are proportionate to the expected benefits.

### **New statutory powers and proposed new guidance**

Since legal cutover, the FCA has new statutory powers which include the oversight of the PIP regime and the ability to supervise and discipline sponsors. In particular, in respect of the sponsor regime, the statutory provisions now allow:

- the restriction or limitation of services performed by sponsors, both on and post-approval;
- a sponsor to request suspension of its approval;
- the suspension of a sponsor's approval or the imposition of a limitation or restriction on the services a sponsor may perform, for such a period as the FCA considers appropriate, in order to advance one or more of the FCA's operational objectives; and
- the FCA to fine, suspend, restrict or limit the services performed by a sponsor for a maximum period of 12 months and/or publicly to censure a sponsor if it has not complied with the Listing Rules relating to sponsors.

The FCA is consulting on two amended technical notes, three new technical notes, one amended

procedural note and one new procedural note to be added to the Knowledge Base to address the practical aspects of furthering the FCA's operational objectives and its new statutory powers in relation to the supervision and discipline of sponsors. A summary of the proposed guidance is set out below.

***Additional powers to supervise sponsors ([UKLA/PN/910.1](#))***

The draft new technical note provides guidance to sponsors on the procedural aspects of the FCA's new statutory powers to suspend, limit or restrict sponsors pursuant to FSMA. In particular, the draft note sets out:

- the process for a sponsor wishing to apply for a suspension of approval (or for the withdrawal of a suspension request);
- the process to limit or restrict sponsor services for new and existing sponsors (or the withdrawal or variation of a restriction or limitation). The guidance provides that the process to limit or restrict sponsor services will be undertaken in parallel with the sponsor application process for new applicants. For existing applicants, the limitation or restriction may be requested by the sponsor or otherwise agreed with the FCA as an outcome of the sponsor supervisory processes; and
- the FCA's power to suspend a sponsor's approval or limit or restrict the services a sponsor can provide in order to advance one or more of the FCA's operational objectives. The guidance provides that the FCA is likely to take such action only in situations where its concerns cannot be '*effectively and promptly resolved*' via the usual sponsor supervisory channels. The effect of the suspension, limitation or restriction of sponsor services can take effect immediately or at some point in the future and can be imposed for the period of time which the FCA considers appropriate.

***Additional powers to supervise and discipline sponsors ([UKLA/TN/712.1](#))***

The draft new technical note provides guidance on how the FCA intends to use its additional statutory powers regarding the supervision and discipline of sponsors. In particular, the FCA clarifies when it would consider restricting or limiting sponsor services.

For example, where the FCA considers that an applicant or existing sponsor does not have the relevant experience or appropriate systems and controls to provide the range of sponsor services it wishes to undertake, it will limit or restrict the scope of services of that sponsor accordingly, rather than refuse an application or seek a cancellation of the sponsor's approval. Furthermore, the FCA will restrict services on a generic basis rather than on a transaction by transaction basis and, has indicated that, it is most likely to consider doing so when, through the usual supervisory processes or upon assessing an application from a sponsor, it has concerns that a sponsor does not have the relevant experience and expertise or appropriate systems and controls to provide sponsor services for a particular type of size of transaction or sector. For example, the FCA states that it may seek to restrict an applicant with experience of providing sponsor services solely to premium listed investment companies or an existing sponsor which predominantly provides such services from providing sponsor services to other premium listed companies. The draft technical note implies that the FCA will take a more granular approach to restrictions on activities post approval. This approach should allow the participation of more sponsors in the market to provide a combined range of services, rather than turning away sponsors for not being able to provide the complete range of services.

The note also explains the circumstances in which the sponsor may wish to consider suspending its approval, rather than cancelling it. Suspension allows the sponsor to take remedial action to ensure it can comply with the approval criteria in the future, as opposed to being subject to the administrative and costly burden of cancelling and subsequently reapplying for an approval. Examples of where a sponsor may request a suspension include where it is undergoing a reorganisation or another corporate event which provokes uncertainty about its future or where there is an unplanned, temporary or permanent loss of experienced staff, which means that the sponsor can no longer meet

its approval criteria.

However, the guidance does state that the FCA may seek to cancel an approval of a suspended sponsor if it is unable to take remedial steps to address its ability to comply with the approval criteria. This is because there is a risk that sponsor experience becomes less relevant over time and there will clearly be a gap in the experience of a sponsor during the suspension period which may be significant when the FCA considers lifting its suspension. Consequently, sponsors are required to undertake remedial action as quickly as possible so that the duration of the suspension period does not prejudice eligibility for the reinstatement of its approval.

Finally, the note describes the situations in which the FCA would suspend a sponsor's approval or impose restrictions or limitations on the services a sponsor can provide in order to advance one or more of its operational objectives. The FCA may take such action, for example, where the consumer protection or integrity of the UK financial system would be jeopardised if the sponsor provides sponsor services in certain circumstances. The FCA acknowledges that intervention in this way is likely to be rare, but circumstances where it might use this power include where:

- a sponsor seeks to accept a mandate for which the FCA considers it is unable to meet the relevant competence requirements;
- there are serious concerns that a sponsor's systems and controls are not appropriate to support the proposed sponsor service; or
- there are concerns that the sponsor is unable to manage an actual or potential conflict of interest.

***Sponsors: uncertain market conditions ([UKLA/TN/705.2](#))***

This technical note was published in December 2012 and sets out factors for sponsors to consider if their existing procedures relating to working capital and 'new business take-ons' are robust enough to deal with difficult market conditions. The FCA proposes to amend the existing technical note slightly to include a link to the proposed technical note '*Additional powers to supervise and discipline sponsors*' (UKLA/TN/712.1) outlined above, so that sponsors also consider whether a suspension is necessary in certain market conditions.

***Sponsor transactions: adequacy of resourcing ([UKLA/TN/709.2](#))***

Similarly, the FCA is proposing to amend this existing technical note which sets out factors that the UKLA will take into account when assessing a firm's competence and its systems and controls in order to carry out its role as a sponsor to include a link to draft technical note on '*Additional powers to supervise and discipline sponsors*'.

***Sponsor firms: ongoing requirements during re-organisations ([UKLA/PN/909.2](#))***

The FCA is proposing to amend this existing procedural note to include a further factor for sponsors to consider if they are the subject of a re-organisation. Where the re-organisation is likely to have a short term impact on a sponsor's ability to comply with its approval criteria, the sponsor will be able to request a suspension of its approval, rather than a cancellation, in order to avoid the administrative and financial burden of re-applying to become a sponsor following the cancellation.

***Sponsors: application of principle to deal with the FCA in an open and co-operative manner ([UKLA/TN/713.1](#))***

The new technical note explains the application of the principle in Listing Rule 8.3.5R which requires a sponsor to deal with the FCA in an open and co-operative manner at all times. The guidance notes that the principle may result in a positive duty of disclosure to the FCA in certain circumstances. In particular, the note confirms that the FCA would expect firms to communicate with it at an early stage in relation to the provisions on identification and management of conflicts. If there is any doubt about whether a conflict of interest can be effectively managed, the FCA expects a sponsor to consider

whether it is under a positive duty to disclose the matter to the FCA. Sponsors should also consider Listing Rule 1.2.5G which states that a sponsor should consult the FCA at the earliest possible stage if it is in doubt about how the Listing Rules apply to a particular situation, when interpreting the application of the principle at Listing Rule 8.3.5R.

The guidance further clarifies the implications of the principle on the sponsor's contractual arrangements with third parties. If a sponsor enters into contractual obligations with a third party (for example, a confidentiality agreement in respect of a proposed transaction), it must consider its obligations under Listing Rule 8.3.5R. Whilst the FCA recognises that there are standard carve-outs in confidentiality agreements which allow disclosure required by law, the guidance indicates that the principle should be borne in mind during the sponsor's negotiations of the provisions and emphasises the importance of ensuring that the confidentiality agreement will allow the sponsor to comply with its obligations.

### ***Non-equity retail prospectuses ([UKLA/TN/632.1](#))***

The FCA has produced a new technical note in respect of non-equity retail prospectuses. The FCA will treat any prospectus which relates to non-equity securities that have a denomination of less than €100,000 to be a 'retail' prospectus, even if that prospectus is used to issue securities to wholesale or exempt investors. The note sets out a number of key factors for issuers to consider when drafting a retail prospectus so that it is easily analysable and comprehensible to investors. The factors include using appropriate language for retail investors and consequently avoiding legal jargon; ensuring that the prospectus is easy to navigate; appropriately explaining the calculations of an investor's return, the bond holder protections and bond features; and whether or not to include FAQs which are generally considered helpful for retail investors.

### **Finalised guidance published in the Knowledge Base**

The Knowledge Base has been updated with finalised guidance following feedback received on the consultation versions published in Primary Market Bulletin No.5. Click [here](#) for our article on the PMB No.5 consultation. A summary of the changes made to the consultation versions is set out below.

### ***Supplementary prospectuses ([UKLA/TN/605.2](#))***

The FCA has made some amendments to the consultation version following respondents' feedback. In particular, the note has been amended to clarify that:

- whilst the issuer is responsible for the document, the FCA is able to challenge the appropriateness of the information in a supplementary prospectus. This is to ensure that issuers understand that any matter put forward as a significant new factor, material mistake or inaccuracy will not automatically be accepted by the FCA;
- the FCA will take a more purposive approach to assessing whether the supplementary prospectus relates to the securities for which the prospectus was originally drafted. In doing so, it will have regard to factors such as whether the change is a response to external events; the nature of the security; the economic impact of the proposed changes; and whether the changes are purely technical; and
- there are certain circumstances in offer situations, in which the FCA considers it to be best practice for the offer to be suspended between the trigger event requiring a supplementary prospectus and its publication. For example, this would be appropriate where the offer is actively marketed or where securities are allotted immediately such that any investors who complete their purchase before the supplementary prospectus was published would not benefit from withdrawal rights.

PMB No. 7 also states that the FCA is considering the concept of withdrawal rights in more detail before it publishes final guidance on the matter and has indicated that further changes are likely to be made to the technical note following ESMA's submission of draft regulatory technical standards to the European Commission by 1 January 2014 for endorsement. Click [here](#) to read our article on the

consultation.

**Final terms ([UKLA/TN/629.2](#))**

The technical note on final terms has been amended to:

- note that a 'clear demarcation' approach regarding the presentation of information, rather than segregating information, may be more suitable for wholesale investors given their understanding of securities and documents. However, the segregation approach as provided for in the technical note is more suitable for the presentation of information for retail investors; and
- clarify that Prospectus Directive exempt notes can be issued from a document that includes a prospectus, provided that it is clear that those notes are not issued from the approved prospectus contained in the offer document.

**Zero-coupon notes ([UKLA/TN/631.1](#))**

Other than a change to the title of the technical note (which was previously titled 'PD disclosure issues relating to non-equity securities') no changes were made to the technical note which contains guidance on the use of the derivative securities note annex for the issue of issue of zero coupon notes.

**FCA and the PRA**

PMB No.7 summarises the relationship between the UKLA and the Prudential Regulation Authority (PRA) and refers to the Memorandum of Understanding between the two bodies which specifically addresses how they will co-ordinate their functions. PMB No.7 provides that there will be a more 'joined-up' approach by the regulators when dealing with particular types of issuers. The edition provides that the PRA and the UKLA will share information with the other if it is considered that such information will be of material interest to the other body. Consequently, PRA-regulated firms should anticipate that the UKLA will engage with their PRA supervisor when the UKLA is considering a listing, fundraising or significant transaction or the issuer's obligations under the Disclosure and Transparency Rules.

**Next steps**

The proposed guidance includes some practical information for sponsors in a brave new world where the regulator has increased powers to intervene in the sponsor regime. The FCA clearly recognises the importance of the sponsor regime in achieving its own operational objectives and it will be interesting to see whether the use of its new powers will be effective in doing so. Responses to the consultation must be submitted by 19 November 2013.

If you have any queries or comments on PMB No.7, please contact your usual contact or one of the listed contacts.