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The Financial Conduct Authority (FCA) continues its work to enhance the effectiveness of the UK Listing Regime. In its new consultation paper [CP 14/2](#), amongst other proposals, the FCA proposes various changes to the sponsor competency regime and initiates market discussion on joint sponsor arrangements. The consultation paper further proposes other amendments to the Listing Rules and the Prospectus Rules. Responses are requested to be submitted by 30 April 2014.

Read on for a summary of the key proposals.

#### Sponsors must be 'experts'

In recognition that sponsors have a crucial role to play in the integrity of the Premium Listing regime and following on from the coming into force of its new statutory disciplinary and supervisory powers last year, the FCA has proposed various amendments to Chapter 8 of the Listing Rules (LRs) which governs the sponsor regime. In particular, the FCA proposes to revise the competency test in order to ensure that all sponsors are 'experts' in applying and interpreting applicable regulation. It is hoped that the proposals will enhance the transparency of the sponsor approval process and boost competition in the sponsor market, both of which should bolster the integrity and quality of a UK Premium Listing.

Consequently, the FCA has proposed a number of changes to the competency test for sponsors. The proposals centre around three key elements:

#### 1) ***Sponsor declaration in the last three years***

Currently, when assessing the competency of a sponsor or applicant, the FCA will look at the firm's recent experience. The FCA considers that recent experience in sponsor transactions indicates that the firm is more likely to be competent in applying and interpreting the relevant rules, as it should also be aware of recent rule and policy changes in both the domestic and European markets. Whilst not articulated in the LRs, the FCA currently adopts an approach which requires firms to have completed sponsor transactions in the previous three years.

In order to improve the transparency of the approval process, the FCA proposes to formalise its existing approach by revising the LRs. The new LRs expressly require that a sponsor, or a person applying for approval as a sponsor, must have submitted a sponsor declaration to the FCA in the previous three years. The FCA believes that the submission of sponsor declarations would be a '*practical and objective way*' of measuring substantive



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sponsor experience, as the declarations require sponsors to make key confirmations required by the Listing Regime. Furthermore, given that sponsors are required to monitor their submission of sponsor declarations, sponsors would be able to assess their compliance with this new rule, using their existing systems and controls.

In respect of new applicants, the FCA will 'look through' to the applicant's underlying employees and consider their relevant sponsor experience. Qualifications are not regarded as a substitute for experience, as the FCA notes that no professional qualification can fully encompass the technical expertise and experience required to be a sponsor in the Premium Listing regime. Similarly, where an existing sponsor cannot prove that it has provided a sponsor declaration within the last three years and it proposes to recruit employees to satisfy this requirement, the FCA may 'look through' to these proposed new individuals, as it proposes to do for a new applicant.

Where an existing sponsor does not comply with this new requirement but can demonstrate compliance with other competence requirements, it may request that the FCA modify or dispense with this requirement under LR 1.2.1.R (which gives the FCA the power to do so). The FCA considers that it would do so only in exceptional circumstances, for instance, where market conditions severely impact the activity of all sponsors. Given that the level of sponsor activity in recent difficult conditions does not appear to have been severely impacted, the FCA considers it will be very unlikely that it will grant such requests.

Currently, the FCA expects sponsors to notify it where they anticipate that they cannot meet the relevant approval criteria. If the FCA believes that the sponsor can meet the relevant criteria in the short term through recruitment, the FCA expects that a sponsor should consider requesting a temporary suspension of its approval whilst the issue is resolved. If there is no realistic prospect of resolving this issue in the short term, the FCA expects that a sponsor should apply for cancellation of its approval.

## **2) Competency framework must be embedded in systems and controls**

In order to demonstrate that it is competent, it is proposed that a sponsor or applicant must show that it meets five key competencies. These competencies should be assessed against an adopted 'competence' framework, which must be embedded in a sponsor's 'systems and controls'.

All staff involved with sponsor services will need to be assessed against this competence framework in order for a firm to demonstrate its competence. It is proposed that sponsors will be required to keep records of the assessments (in addition to its existing general record keeping requirements). Firms must ensure that they have a 'sufficient number' of employees with an understanding of the five 'competency sets'. It is proposed that sponsors be permitted to adopt their own competence framework, provided that it includes, as a minimum, the five 'competency sets' which we outline below. This approach should allow sponsors to make their own assessment on whether staff have the necessary experience and knowledge to demonstrate a particular competency set and, if not, any knowledge gaps should be dealt with either by training or through supervised training experience.

The competency framework must refer to the following five 'competency sets'.

### *(i) Rules, guidance and ESMA publications directly relevant to sponsor services*

Sponsors will need to demonstrate technical knowledge of the regulatory requirements applicable to providing sponsor services to Premium Listed issuers or applicants for Premium Listings. This will include demonstrating an up-to-date knowledge of the Listing Rules, the Prospectus Rules and the Disclosure Rules and the Transparency Rules, as well as any related guidance and relevant ESMA publications (for example, the Prospectus Q&As and ESMA recommendations).

### *(ii) Procedural requirements and processes of the FCA*

Sponsors must be proficient in the FCA and UKLA's processes and procedures (for example, the

UKLA document vetting process). In order to assist sponsors with this obligation, the FCA will continue to maintain and update content in the UKLA Knowledge Base so that sponsors can access the latest information on processes and guidance.

*(iii) Due diligence process required in order to provide sponsor services*

In respect of various sponsor services, sponsors are required to submit declarations to the FCA which require them to come to a reasonable opinion after having made due and careful enquiry in respect of the relevant sponsor transaction. The FCA provides that, in providing these declarations, sponsors should not rely on 'back-to-back' comfort letters provided from third parties, but should be required to conduct the necessary investigations themselves. This will involve ensuring that the scope of the due diligence is appropriate, reviewing third party reports and challenging findings in order to carry out '*due and careful enquiry into such matters with due care and skill*'.

*(iv) Responsibilities and obligations of a sponsor set out in LR 8*

The FCA expects sponsors will need to be aware of their own obligations under LR 8, together with issuers' obligations, when advising their clients. It may be that all employees carrying out its sponsor services may not all *individually* be held to be competent. If this is the case, the FCA will assess the sponsor firm as a whole and would expect sponsors to rely on internal controls, such as escalating relevant matters to those employees who do comply with this competency set.

*(v) If relevant to the sponsor service, specialist industry sectors*

In order to advise clients on the appropriate eligibility requirements and disclosure obligations relevant to an issuer, a sponsor must have an understanding of the industry sector in which their client operates. Consequently, it is necessary for the sponsor to be familiar with the guidance, rules and challenges for specialist industry sectors, which include the property, minerals and investment sectors.

*Systems and controls*

As part of the sponsor approval process, the FCA must be satisfied that a sponsor has appropriate 'systems and controls' in place to ensure that it can carry out its role as a sponsor. The current guidance on what constitutes effective 'systems and controls' in LR 8.6.12G is proposed to take the form of a new LR, given its importance in relation to the supervision of sponsors.

In addition, two further requirements are proposed. Sponsors will be required to have in place effective systems and controls so that '*employees with management responsibilities*' understand and apply the requirements of LR 8. Consequently, the ethos of the new changes must be applied from management level downwards, that is, it should not be limited to the deal execution team. In addition, the LR which requires sponsors to have in place appropriate systems and controls should also require the adoption and application of a competence framework for assessing employees carrying out sponsor services.

**3) Key contacts must be competent**

In its consultation paper, the FCA notes a general decline in the quality of its interactions with sponsors. Given that it places a great deal of importance on the quality of assurances it receives from sponsors, together with the day-to-day interactions in relation to specific transactions, the FCA proposes new requirements in respect of those employees who are given responsibility to liaise with the UKLA. It is proposed that the key contact must be competent in three specific areas (which mirror three of the competency sets mentioned above). Key contacts must:

- possess technical knowledge of rules, guidance and ESMA publications directly relevant to sponsor services;
- be proficient in the procedural requirements and processes of the FCA; and

- understand the responsibilities and obligations of a sponsor set out in LR8.

Sponsors must assess key contacts by reference to their adopted competence framework in respect of these three competencies. Furthermore, key contacts are required to have carried out a sponsor service in the previous three years. The FCA recommends sponsors have at least two key contacts.

### **Limitation or restriction on sponsor approval**

In last year's changes to FSMA under the Financial Services Act 2012, the FCA was given powers to impose limitations or restrictions on the services that a sponsor can provide either at the time of, or following, the grant of an approval. New applicants may also now apply for a limitation or restriction on their approval, if they wish to specialise in providing sponsor services to premium listed investment companies. To address this change, two competence frameworks have been developed: one for a sponsor providing or intending to provide sponsor services to premium listed commercial companies and another for a sponsor providing or intending to provide sponsor services to premium listed investment companies. The two frameworks will enable sponsors to specialise accordingly by staffing their teams with the appropriately experienced and competent personnel.

The FCA's current policy intention is to limit or restrict sponsor approvals to the Premium Listing investment company category only.

### **Proposed procedural and technical guidance**

The FCA is also consulting on draft guidance to be inserted in the UKLA Knowledge Base to complement the suite of proposals. A new procedural note sets out further practical implications of the competence requirements for sponsors and applicants, whilst a new technical note provides more detail on the competence frameworks for the assessment of employees carrying out sponsor services. The drafts can be found at Annex 1 of the consultation paper.

### **Debate on joint sponsor arrangements**

In CP 14/2, the FCA has initiated a market discussion on joint sponsor arrangements. The FCA invites feedback from all market participants on these arrangements, with the aim of reviewing and, if required, revising the relevant LRs in this area.

Initial feedback from informal market soundings reveals both benefits and drawbacks with the joint sponsor arrangements. For example, appointing joint sponsors may bring a variety of sector expertise or the addition of a particular geographical presence to a particular transaction which is beneficial to the issuer and is likely to provide additional comfort to investors. The joint sponsor arrangements also open up more opportunities for firms to become involved in a wider range of transactions, thereby increasing opportunities to become experienced and boosting competition.

Equally, these arrangements have their drawbacks. Whilst both sponsors are severally liable in respect of their obligations as sponsor on a transaction, only one sponsor takes primary responsibility for liaising with the UKLA throughout the sponsor service. This may lead to a perception that there is a 'lead' sponsor, whilst the other is perceived to be junior, thereby discouraging firms from taking part in a joint sponsor arrangement where it might not be the primary contact for the UKLA. In addition, there is concern around an apparent lack of any formal or informal agreement between the relevant firms as to how the arrangement is to work in practice. Any breakdown in communication or process may lead to a disparity of information between joint sponsors which could affect their abilities to meet their respective obligations under the LRs. In addition, there is concern that joint sponsor arrangements trigger greater costs for issuers and investors.

## ***Proposed changes to the Listing Rules and the Prospectus Rules***

### **Other amendments to LR 8**

The FCA is also proposing to make a number of other amendments to LR 8 which include:

- amending the definition of a class 1 circular so that it covers circulars required in connection with transactions that must comply with class 1 transaction requirements. This captures reverse takeovers where class 1 requirements are applied;
- extending the current requirement for premium listed companies to appoint a sponsor when they submit a class 1 circular to the FCA, to also applying where any supplementary circular is to be submitted to the FCA; and
- removing the ability for sponsors to delegate certain functions to another sponsor (on the basis that this ability has not been used to date).

### **LRs – 28 day circular**

In respect of a hostile takeover or a takeover for which the premium listed bidder company does not have access to due diligence information on the target at the time the class 1 circular approving the bid is published, a premium listed company must under the current LRs publish a circular which updates the working capital statement within 28 days of the offer becoming unconditional. The FCA proposes to delete this requirement on the basis that the additional 'updating' information is not relevant, given that shareholders have already consented to the takeover and consequently, the subsequent disclosure is unnecessary.

### **Prospectus accuracy**

Whilst FSMA imposes penalties for incomplete, misleading or untrue information in a prospectus, there is no explicit obligation on a relevant person to prepare a compliant prospectus in the LRs or the Prospectus Rules. Consequently, in order to align itself with current market and regulatory practice in Europe, the FCA is proposing to introduce new Prospectus Rules which impose separate obligations on an applicant to submit a compliant and factually accurate prospectus.

### **More regulation or helpful clarification?**

The sponsor regime has a key role to play in the FCA's ongoing work to enhance the effectiveness of the UK Listing Regime. The proposed additional measures to ensure that sponsors are competent to advise premium listed companies are clearly intended to protect the interests of investors and the smooth operation of the market. Whilst the proposals may not significantly change the way in which the majority of sponsors operate currently, they should provide transparency in the sponsor approval process and clarify what the FCA expects from sponsors, whether as advisers to issuers, or when liaising with the UKLA. For most sponsors, the proposals may only impact how they structure and evidence their current competence frameworks to the FCA.

Meanwhile, the new debate on joint sponsor arrangements is an opportunity for all market participants to influence future policy in this area. Our own market soundings suggest that the market's views are more mixed than the FCA's initial market soundings indicate, and that the combination of the FCA's increased focus on the sponsor regime and the lack of clarity as to which joint sponsor is responsible for which aspects of the sponsor role increases the risk that a sponsor may be held by the FCA as not having properly performed its role. If joint sponsor roles are here to stay, there may be a need for further guidance from the FCA in this area, particularly on how it expects sponsors to implement these arrangements. If guidance is required, we would expect that the FCA will seek stakeholders' views on how best to formulate it.

If you have any queries or comments on the consultation paper, please contact your usual contact or one of the listed contacts.