

FCA Provides New Guidance on the UK Sponsor Regime

February 12, 2019

Background

On 7 February 2019, the Financial Conduct Authority (the “**FCA**”) announced, in Primary Market Bulletin **No. 20**, the publication of five new and five amended Technical Notes to be included in the Knowledge Base – the repository of FCA commentary on the UK listing regime that has the status of formal guidance. This follows proposals made by the FCA in Primary Market Bulletins **No. 12**, **No. 16** and **No. 18**.

The focus of this note is the three new Technical Notes relating to the obligations of a sponsor when confirming to the FCA that:

- the directors understand their responsibilities and obligations under the Listing Rules, Disclosure Requirements and the Transparency Rules;
- the directors of a company have established procedures to comply with the Listing Rules, Disclosure Requirements and the Transparency Rules; and
- a transaction will not have an adverse impact on a company’s ability to comply with the same rules, and

the amendments to the Technical Note concerning a sponsor’s obligations with respect to conducting diligence on a company’s financial position and prospects procedures.

A number of interested stakeholders commented on the draft guidance during the FCA’s consultation process. In particular, the Association for Financial Markets in Europe (“**AFME**”) submitted a detailed [response](#) and [mark-up](#) of the drafts of the new and amended Technical Notes in October 2017.

Key Themes

It is possible to identify a number of themes running through the new guidance for sponsors, which broadly reflects other recent guidance by the FCA in respect of sponsor services:

- a sponsor cannot take a ‘one-size-fits-all’ approach and must adjust its focus in response to the specific characteristics of the company it is advising and the nature of the transaction;
- whilst it is not responsible for designing a company’s policies and procedures, a sponsor is required to challenge the company and its advisers on the appropriateness and robustness of such policies and procedures – a sponsor cannot simply rely on the work of others or confirmations from the company;
- a sponsor service does not necessarily end upon the submission of a sponsor declaration to the FCA – a sponsor should be mindful of its responsibilities until the completion of the relevant transaction;
- a sponsor must pay due regard to its record-keeping when providing a sponsor service and ensure that it can evidence not only the diligence it conducted, but the decision-making process it underwent to determine the level of diligence required; and
- a company should be reminded of its obligations to co-operate with its sponsor, suggesting that the FCA seeks to disabuse sponsors of any notion that a company’s unwillingness to assist a sponsor would serve as a defence to any allegation of a breach of sponsor obligations.

Assessing Directors' Understanding of Their Responsibilities

Listing Rule 8.3.4R requires that where, in relation to a sponsor service, a sponsor gives any guidance or advice to a listed company or applicant on the application or interpretation of the Listing Rules or Disclosure Requirements and Transparency Rules, the sponsor must take reasonable steps to satisfy itself that the director or directors of the listed company understand their responsibilities and obligations under those rules and requirements.

When does Listing Rule 8.3.4R apply?

Technical Note [FCA/TN/718.1](#) clarifies that the obligation in Listing Rule 8.3.4R applies to all sponsor services and at all times during any such sponsor service, including where a sponsor has already provided its declaration in connection with the publication of a circular or prospectus, but the transaction has not completed. Whilst this reflects existing market practice, it reminds sponsors to keep under review their assessment of the directors' understanding until conclusion of a transaction.

A change between the draft Technical Note and the final Technical Note is that the final note is less prescriptive as to when this assessment should first take place. The draft Technical Note had stated that this must be at an early stage of the sponsor service, but the final Technical Note now says that the assessment must take place at a "*stage of the sponsor service which will allow sufficient time for the sponsor to carry out any required actions*".

Assessing the directors' understanding

The guidance lists a number of factors that should be taken into consideration by a sponsor when assessing the 'reasonable steps' that should be taken into account when determining the directors' understanding. These include:

- the type of sponsor service being provided – the FCA notes that the guidance required to be given in an IPO will typically be wider in scope than in the context of a class transaction (where directors already have experience of the listing regime);
- the nature and characteristics of the company – for example, where the listed company operates in a specialist sector, is of an acquisitive nature or has multiple related parties, there may be an additional training required; and
- the directors' level of understanding and their experience of complying with their responsibilities and obligations under the relevant rules and requirements.

The Technical Note states that relying on memoranda or training provided by third parties is unlikely to be sufficient evidence to demonstrate that a sponsor has taken reasonable steps. A sponsor (in conjunction with its legal advisers) should review third-party materials to be presented to the issuer's directors to come to a reasonable opinion that the scope and content of these materials is sufficient and has been understood by the directors. A sponsor should also interact directly with the board to determine itself the level of understanding of the directors.

Remedying action

In the event that a sponsor determines that there are gaps in the directors' understanding of the relevant rules and requirements, the sponsor will need to decide upon the most effective way of addressing these gaps. Examples of the steps that could be taken by a sponsor include:

- attending and participating at board meetings where presentations and memoranda are used to educate the directors on their responsibilities and obligations;

- discussing with directors examples of good practice and highlighting pitfalls by referring to FCA publications and guidance, as well as FCA Final Notices in relation to breaches of FCA rules by listed companies;
- working through illustrative scenarios with the directors to assist them in understanding the application of their responsibilities and obligations; and
- carrying out one-to-one training with a particular director if such director has limited knowledge or experience of premium listed companies.

A sponsor should also ensure that directors are provided with the opportunity to ask questions and, where it is apparent that further work is necessary, an appropriate follow-up should take place.

Where a sponsor comes to the view that there are no material gaps in the directors' understanding such that limited (or no) action is required on behalf of the sponsor, the FCA would expect the sponsor to be able to demonstrate how it came to this view (which may be based on previous experience with the individuals on the board).

Determining Whether the Directors Have 'Established Procedures' to Comply with the UK Listing Regime

Listing Rule 8.4.2R(3) requires that a sponsor must not submit to the FCA an application for admission to the premium listing segment unless it has come to a reasonable opinion, after having made due and careful enquiry, that (amongst other things) the directors have established procedures which enable the company to comply with the Listing Rules, Disclosure Requirements and Transparency Rules on an ongoing basis. The rule sits alongside Listing Principle 1, which requires a listed company to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.

Scope of Listing Rule 8.4.2R(3)

Technical Note [FCA/TN/719.1](#) makes it clear that, whilst Listing Rule 8.4.2R(3) encompasses all ongoing obligations, a sponsor should be mindful of Listing Rule 7.2.2G (which provides guidance on Listing Principle 1) which states that listed companies should place particular emphasis on ensuring that they have adequate procedures, systems and controls in relation to identifying whether obligations arise under Listing Rule 10 (Significant transactions) and Listing Rule 11 (Related party transactions) and the timely and accurate disclosure of information to the market.

Assessing the establishment of procedures

Under the new guidance, in order to determine whether directors have established procedures, a sponsor should assess the circumstances and characteristics of the company and take into account factors such as the complexity and geographical spread of its group's operations, whether there is a controlling or substantial shareholder, the company's use of third parties to fulfil its obligations and whether the company has prior experience of being a listed company.

A sponsor should then systematically assess whether the procedures, systems and controls put in place are 'established'. This may be achieved by:

- reviewing documents setting out relevant policies and procedures and assessing the appropriateness of their design and documentation for the company and the requirement of the obligation;
- speaking with relevant management and senior employees of the company to understand how the procedures will be operated on a practical basis or, in some circumstances, it may

be appropriate to examine the effectiveness of procedures by presenting an illustrative scenario and assessing how the procedures would work in practice;

- confirming that the procedures have been approved by the company and communicated to other relevant employees;
- confirming that systems are in place and assessing their appropriateness for the company and the requirement of the obligation; and
- reviewing the controls in place (such as arrangements to review compliance with procedures on a regular basis) and assessing their appropriateness for the company and the requirement of the obligation.

Where a sponsor identifies omissions or gaps, it should take steps to ensure that procedures, systems and controls to address those omissions or gaps will be established prior to admission of the shares.

Ensuring that Transactions Have No ‘Adverse Impact’ on a Company’s Procedures

Listing Rule 8.4.12R(2) requires that for a Class 1 circular or a circular for a reconstruction, re-financing or purchase of own shares (that is required to include a working capital statement), a sponsor must come to a reasonable opinion, after having made due and careful enquiry, that the transaction will not have an adverse impact on the listed company’s ability to comply with the Listing Rules, Disclosure Requirements and Transparency Rules.

When does Listing Rule 8.4.12R(2) apply?

Technical Note [FCA/TN/720.1](#) states that sponsor services continue to the point of completion of the relevant transaction and notes that, for some sponsor services (such as Class 1 transactions or reverse takeovers) there may be a period of time between the publication of the circular (and therefore the sponsor’s declaration under Listing Rule 8.4.12R(2)) and the completion of the transaction.

Assessing the impact of a transaction

In assessing the impact of a transaction, a sponsor should have regard to the type of transaction being undertaken, the circumstances and characteristics of the company and, if applicable, the subject of the transaction, including:

- in the case of a Class 1 acquisition, whether the target is a premium-listed company (or listed in a jurisdiction with similar obligations), the experience of the directors and the complexity and geographical spread of the listed company and target’s operations;
- in the case of a Class 1 disposal, the extent to which the listed company relies on the business, assets or personnel that are the subject of the disposal to comply with its obligations;
- whether the transaction will result in new controlling shareholders, related parties and/or permanent insiders; and
- whether the transaction will result in changes to directors, PDMRs and/or other employees of the listed company who are responsible for performing the procedures, systems and controls for the purpose of Listing Principle 1.

The Technical Note indicates the following as indicative of the FCA’s expectations for the role of, and steps to be taken by, a sponsor:

- review and challenge by the sponsor of any board memorandum or integration plan prepared in connection with the transaction;

- the sponsor's presence at key meetings where the content of any board memorandum or integration plan are discussed and approved; and
- in the event that not all necessary enhancements required to protect the procedures, systems and controls of the listed company have been effected at the time of the sponsor declaration, the sponsor will have come to a reasonable opinion that the directors have formally committed to implementing the enhancements on a timescale that will ensure that the listed company will, following completion, be in a position to comply with its obligations when required.

In response to feedback on the draft guidance, notably from AFME, the Technical Note clarifies that a sponsor may not be required to carry out the same degree of enquiry as would be necessary to fulfil its obligation in the context of an IPO, because in these circumstances a company will already be complying with its obligations under the Listing Rules, Disclosure Requirements and Transparency Rules. A sponsor is nevertheless reminded that it must notify the FCA should it become aware that a company is failing to comply with its obligations.

Accelerated timetables

The new guidance acknowledges that speed of execution and confidentiality of information can be of paramount importance to the company and accepts that, in such circumstances, a sponsor may not be in a position to perform the same level of due diligence it could otherwise undertake. The Technical Note recommends that, should such a situation arise, it may be appropriate to ensure that the company has interim arrangements in place to ensure that it can comply with its immediate obligations upon completion with particular focus on the procedures, systems and controls relating to identifying whether any obligations arise under Listing Rule 10 (Significant transactions), Listing Rule 11 (Related party transactions) and timely and accurate disclosure of information to the market under the Disclosure Requirements.

Limited access to information

In recognition of the fact that for certain takeovers access to information on the target will be limited, the Technical Note advises that a sponsor should seek out the best information available to it for the purposes of forming its reasonable opinion under Listing Rule 8.4.12R(2). Where no non-public information on the target is available prior to the sponsor making its declaration under Listing Rule 8.4.12R(2), the FCA suggests that the sponsor should consider what due diligence can be undertaken practically and whether it would be sufficient to underpin its declaration under Listing Rule 8.4.12R(2). Examples provided by the FCA of due diligence strategies in such an instance include:

- review of the target's publicly available accounts and comparing them to the listed company's accounting policies, reporting currency, reporting frequency and financial year-end;
- review of any published details on corporate governance arrangements; and
- review of public announcements for adequacy of compliance with the relevant rules.

Ensuring that Financial Position and Prospects Procedures Are in Place

Listing Rule 8.4.2R(4) requires that a sponsor must, before submitting a listing application, come to a reasonable opinion, after having made due and careful enquiry that the directors have established procedures which provide a reasonable basis to determine the financial position and prospects of the company and its group.

A Technical Note providing guidance on the sponsor's obligations in this regard has been available since the implementation of the Knowledge Base in 2012 and was updated in 2015. The FCA has stated that the new Technical Note [FCA/TN/708.3](#) does not seek to change the approach outlined in the previous

guidance (which it considered this workstream well-established and understood by sponsors), but simply to align the language with the other new Technical Notes.

A key concern of AFME with regard the revised wording was the suggestion in the new text that a sponsor was responsible for the design, documentation and communication of the company's procedures, systems and controls. Whilst the FCA has not taken on board all of the suggested amendments proposed by AFME, the drafting of the final Technical Note does make it clear that it is a company's directors, and not the sponsor, who must take the necessary steps to address any deficiencies.

Impact in Practice

As noted above, the new guidance largely reflects market practice and, where different from historic practice, sponsors have already adjusted their approach over the last year or so in light of the draft Technical Notes.

In order to assist sponsors with the satisfaction of their obligations as set out in the new and amended Technical Notes, it is helpful that, in Primary Market Bulletin No. 20, the FCA has sought to reinforce the importance of a company supporting a sponsor's work with proposed amendments to the Technical Note in relation to a company's compliance with the Listing Principles and Premium Listing Principles. These changes, in draft Technical Note [FCA/TN/203.4](#), seek to remind companies that, in order to enable a sponsor to discharge its duties to the FCA, they must co-operate with the sponsor and provide the sponsor with access to relevant meetings with directors and, where applicable, senior management.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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|------------------------|-------------------------|--|
| Simon Witty | +44 20 7418 1015 | simon.witty@davispolk.com |
| Will Pearce | +44 20 7418 1448 | will.pearce@davispolk.com |
| Dan Hirschovits | +44 20 7418 1023 | dan.hirschovits@davispolk.com |
| Jamie Corner | +44 20 7418 1053 | jamie.corner@davispolk.com |

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