

UK Sponsor Regime: Rule Changes and Further Consultation

September 30, 2014

The UK's Financial Conduct Authority ("FCA") has issued a new consultation paper (CP 14/21) on sponsor competence. The consultation paper provides feedback and final rule changes in relation to the consultation on sponsor competence launched by the FCA in January of this year (CP 14/2) ([see our Client Memorandum dated February 4, 2014](#)). The changes will take effect from 1 February 2015.

The UK's sponsor regime is set out in Listing Rule 8. In certain circumstances, companies with or seeking a premium listing are required to consult and/or appoint a sponsor to provide guidance on the application of the Listing Rules and to confirm to the FCA that the company has met its regulatory obligations. Sponsors are typically investment banks (although accountants and lawyers can perform the role) and must be approved by the FCA to provide sponsor services. Once approved, the requirement for a sponsor to be 'competent' to provide its services is a continuing obligation. The January consultation paper proposed a number of more specific criteria against which the FCA would assess a sponsor's competence, as well as posing some new questions regarding the role and responsibilities of joint sponsors.

Sponsor competence

The three main elements of the FCA's January proposals were:

- a requirement that in order to demonstrate its competence, a sponsor must have submitted a sponsor declaration to the FCA within the last three years;
- a requirement for a sponsor to staff sponsor functions with a sufficient number of employees meeting prescribed key competency sets; and
- an enhancement of existing rules to introduce specific requirements around the role of the 'key contact' with the FCA.

The FCA's proposals were designed to make the requirements surrounding competence more robust and transparent. Refinements have been made to the original proposals in response to feedback to the consultation.

Final rule changes

Despite some opposition, the FCA has retained its key proposal that a sponsor will not be competent to provide sponsor services unless it has submitted a sponsor declaration to the FCA within the previous three years. It is also retaining its proposal that only sponsor declarations made in connection with an issue or further issue of shares, Class 1 transactions, restructurings, re-financings and transfers from a standard listing to a premium listing will count towards satisfying this requirement. The FCA explains that it chose these transactions as they provide an objective and practical measure of the substantive aspects of the sponsor role, i.e. consideration of disclosures made in public documents; the impact of the transaction on the company in question; and whether the company has sufficient working capital.

However, in response to concerns expressed during the consultation that this requirement was overly prescriptive, the FCA has highlighted its existing ability to modify the requirements in exceptional circumstances – mentioning in particular that aborted transactions may be relevant where a sponsor cannot comply with the three year rule.

The FCA rejects the view expressed by some respondents to the consultation that the requirement for prior sponsor experience would have an impact on the number of firms on its list of approved sponsors, citing various statistics (and the continued ability to act as joint sponsor – see below) to support this.

In relation to its proposals on key competencies, the FCA has amended its proposals significantly in response to feedback. However, in the final draft of the new rules (see amended LR 8.6.7) it has retained the core requirement that a sponsor must demonstrate that it has sufficient employees who understand the following ‘competency sets’:

- the Listing, Prospectus, Disclosure and Transparency Rules, guidance and ESMA publications directly relevant to sponsor services;
- the procedural requirements and processes of the FCA;
- the due diligence process required in order to provide sponsor services in accordance with LR 8.3 and LR 8.4;
- the responsibilities and obligations of a sponsor set out in Listing Rule 8; and
- specialist industry sectors, if relevant to the sponsor services it provides or intends to provide.

However, as a result of the feedback it received, the FCA is no longer proposing to introduce a requirement for a supporting ‘competence framework’. Instead, in the final draft of the new rules the FCA proposes that sponsors must simply retain effective systems and controls to ensure that a sufficient number of employees meet the competency sets. The FCA’s revised proposal will be welcomed by sponsors, as it gives them more flexibility to satisfy the new requirements within the framework of their existing systems and controls.

In relation to ‘key contacts’, the FCA has decided to proceed with its proposal to require a sponsor to have at least two employees who, among others, possess technical knowledge of the rules, guidance and ESMA publications directly relevant to sponsor services and who understand the responsibilities and obligations of the sponsor set out in Listing Rule 8 (see the requirements for key contacts set out in amended LR 8.6.19). However, the FCA has adapted its original proposals slightly, by removing the requirement for a key contact to be proficient in FCA procedural requirements and processes - recognising that this knowledge may sit with other members of the team at the sponsor providing the sponsor service. As before, key contacts are required to be available to answer queries from the FCA between the hours of 7.00 a.m. and 6.00 p.m. (London) on any business day.

Finally, the FCA has decided to proceed with its proposal to allow a sponsor to seek approval to provide a limited range of sponsor services i.e. the ability to provide sponsor services to premium listed investment companies or premium listed commercial companies only, as the case may be. This proposal was met with wide support, as were other minor amendments proposed in the January consultation, which will be implemented as proposed.

Proposed Technical Notes

As a result of the revised approach to competency sets and competence frameworks, the FCA is consulting on two new technical notes.

The first technical note (*‘Sponsors: Guidance on the competence requirements set out in the Listing Rules’*) provides sponsors with a description of the types of skills, knowledge and expertise that the FCA expects to consider when assessing whether they understand each of the ‘competency sets’ – effectively replacing the more prescriptive competency framework proposed in the January consultation with more general guidance.

The second technical note (*'Sponsors: Practical implications of competence requirements for sponsors and applicants'*) is designed to answer some of the questions that sponsors may have when considering the practical application of the new rules. In particular, the note deals with the situation where a sponsor is coming to the end of a three year period without having submitted a relevant sponsor declaration, and how the sponsor can demonstrate its ability to comply with the requirements of the competency sets. The technical note clarifies that the FCA does not expect sponsors to perform a detailed assessment of each individual's understanding of each competency set, but rather expects to see evidence of how the relevant team at the sponsor as a whole is competent to provide sponsor services with reference to each competency set.

The consultation in relation to guidance on sponsor competence will close on 7 November 2014. The changes relating to sponsor competence, including the two new technical notes, will take effect from 1 February 2015.

Joint sponsors

In its January consultation, the FCA included a discussion on joint sponsors. A company is currently permitted to appoint more than one sponsor, but must ensure that one of the sponsors it appoints has primary responsibility for contact with the FCA. The FCA has asked market participants whether they are in favour of retaining the joint sponsor regime and if so, what refinements or amendments would improve the regime. Given the overwhelming support for the joint sponsor regime, the FCA plans to retain the ability for a company to appoint more than one sponsor. However, in order to address the principal concern that sponsors wish to be the 'lead' sponsor so as to have access to (and the relationship with) the FCA, it is proposing to clarify the rules to make it clear that all appointed sponsors will be able to participate in calls and meetings with the FCA. The exception to this is administrative matters, where the FCA proposes to communicate with only one of the appointed sponsors. On this basis, the FCA does not propose to introduce a two tier regime of lead sponsor and junior sponsor.

The FCA has proposed a new technical note (*'Sponsors: Joint Sponsors – communication with the FCA'*) to provide guidance on communications between the FCA and joint sponsors. The note suggests that sponsors should assess on a case by case basis whether it is appropriate for all sponsors to participate in calls with the FCA, bearing in mind that multi-participant calls and meetings can raise practical issues for the FCA. Apart from guidance clarifying that the FCA expects joint sponsors to cooperate with each other in relation to the provision of the sponsor services, including by establishing arrangements for the sharing of information, these matters will be for joint sponsors to determine between themselves as appropriate.

The consultation in relation to guidance on the role of joint sponsors will close on 30 December 2014.

Sponsor conflicts

A new consultation has been launched in relation to sponsor conflicts, partly as a result of unsolicited comments made on the topic by market participants in response to the January consultation. Currently the sponsor conflicts regime is based on the premise that sponsors must seek to identify and manage conflicts of interest that could adversely impact their ability to carry out their functions and the FCA requires sponsors to have appropriate systems and controls in place to enable them to do so.

A number of stakeholders have expressed concern to the FCA about the fees and commissions earned by sponsors in their non-sponsor roles (for example, as underwriter) and the fact that the sponsor role is, by comparison, largely unpaid or performed for a *de minimis* amount. Stakeholders have also expressed concern about the effect of longstanding relationships between sponsors and companies.

The FCA has therefore invited views on sponsor conflicts and whether the current rules and guidance remain fit for purpose. In particular, the FCA asks whether sponsors should be required to disclose their transaction fees, whether they should be required to disclose their relationships with the relevant company, their conflicts and how they are being managed and whether there should be enhanced rules and guidance to provide greater detail on the conflicts analysis carried out by sponsors. In this context, the FCA has said that it is mindful of its three operational objectives which are: to secure an appropriate degree of protection for consumers; to project and enhance the integrity of the UK financial system; and to promote effective competition in the interest of consumers.

The consultation in relation to sponsor conflicts will close on 30 December 2014.

Practical impact for sponsors?

Over the last 10 years, the regulatory approach to the UK sponsor regime – particularly in relation to the competence of a party to act as sponsor and the management of conflicts – has moved from the prescriptive rules-based approach adopted in July 2005 at the time of implementation of the EU's Financial Services Action Plan, to the more principles-based approach adopted in February 2009, following a review of the operation of the sponsor regime. Over the last 18 months, with the changes to the regime relating to duties of sponsors, communications with the FCA and record keeping that came into force at the end of December 2012 (see CP 12/2 and CP 12/25) and these proposed changes, the regime is tighter but remains principles-based.

Over the coming months, compliance teams at sponsors will need to review sponsor and other compliance manuals, related systems and controls and the composition of the teams that provide sponsor services to ensure compliance with the FCA's new requirements and related guidance.

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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