

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: UKLA Technical Note: TN/701.3 Sponsors: Conflicts of interest

Lead regulator: FCA

Date of assessment: 24 February 2017

Commencement date: 11 May 2015

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? Whole of UK

Brief outline of proposed new or amended regulatory activity

Sponsors

The sponsor regime is a key feature of the FCA's Premium Listing regime. In certain situations companies with or applying for a Premium Listing must appoint a sponsor (such as when a company is contemplating an IPO, or a significant acquisition or disposal of assets outside the ordinary course of business).

Once appointed, a sponsor's role is to guide and help ensure the company meets its obligations under the Listing Rules, the Disclosure Requirements and Transparency Rules. A sponsor also provides important assurances to the FCA in relation to the company, its systems and management.

All sponsors on the list of approved sponsors are formally approved by the FCA. Chapter 8 of the Listing Rules contains the rules applicable to a sponsor..

Proposal

FCA technical note TN701.3 will provide clarificatory guidance to sponsors on the rules and guidance relating to sponsor conflicts of interest in LR8. The TN is an update of our existing TN 701.2 relating to sponsor conflicts and introduces two new concepts which sponsors should take into account when identifying conflicts.

Sponsors approved by the FCA must comply with LR8. LR8 includes rules and guidance relating to the requirement for sponsors to identify and manage conflicts of interest. In identifying conflicts sponsors need to consider circumstances that could create a perception in the market that a sponsor may not be able to perform its functions properly i.e. perceived conflict.

Sponsor firms can have a wide variety of business models. The sponsor list contains large investment banks, accountants, law firms, corporate brokers and independent advisory businesses. The extent to which conflicts of interest may arise for a sponsor varies widely across the sponsor population.

The two new aspects of guidance

1. Materiality metric

A common conflict identified is where large lending banks (a small but active subset of the sponsor population) provide new loan finance alongside performance of a sponsor transaction; for example where a company is entering into a substantial acquisition. Where the proposed loan is large, we currently expect that the sponsor will seek guidance from us as to whether we consider a conflict may exist that could adversely impact the sponsor's ability to perform its functions properly or market confidence in the sponsor regime. Where a conflict is identified, we wish to consider if it is being managed appropriately or whether, irrespective of any conflicts management arrangements in place, a perception of conflict arises that might undermine confidence in the sponsor regime. Although there is relatively well established practice in this area, some sponsors have remained unclear whether they should contact the FCA or not i.e. they are not clear what size of loan should trigger contact with the FCA.

To address this concern, TN701.3 introduces a materiality metric. This will set clear a threshold (based on easily obtainable figures) at or above which a sponsor should contact the FCA. This change will provide certainty to sponsors who will no longer have to discuss internally whether or not a proposed loan is of sufficient size to merit seeking the FCA's guidance. The metric was deliberately set at a level that should not give rise to any increase in the number of times we are contacted in relation to this type of conflict.

2. Perceived conflicts – the reasonable market user

The other area of change in our TN701.3 relates to the subjective judgements sponsors have to make when identifying perceived conflicts. Sponsors may spend time and effort considering whose perception is relevant for this purpose: in other words, is it the sponsor's perception, the FCA's or some other theoretical third party?

In order to assist sponsors identify perceived conflicts, the technical note introduces the concept of a 'reasonable market user'. It explains that we expect sponsors not just to take into account their own view of whether a perception of conflict exists (notwithstanding conflicts management arrangements in place) but also to apply a more objective standard of whether, from a reasonable market user's perspective, a perception remains that the sponsor is unable to perform its functions properly. With this guidance to assist them, sponsors will be able to determine more quickly whether a perceived conflict exists.

Which type of business will be affected? How many are estimated to be affected?

Both changes will only impact sponsor firms. There are currently 45 sponsor firms approved by the FCA. Premium listed companies are not required to retain a sponsor at all times; sponsors are appointed only in relation to certain transactions or situations where the listing rules require their guidance to be obtained.

Materiality metric: The proposal to introduce a materiality metric in relation to large lending conflicts is estimated to apply to approximately 14 sponsors. This is because only a small subset of the firms on the sponsor list are considered to be lending banks that may lend actively alongside their sponsor role. Although these firms lend actively, in the majority of cases the loans are not of material size and do not typically give rise to conflicts concerns.

Reasonable market user: The proposal to introduce a reasonable market user test in relation to assessing whether a perception of conflict exists will apply to all 45 firms. The number of firms practically affected on an ongoing basis is likely to be lower due to the limited opportunities for significant perceived conflicts of interest to arise for some firms. However, it is not possible to reliably estimate the size of this subset and we have therefore assumed that all firms will be affected.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	2017	10	-0.17	0	0

Please set out the impact to business clearly with a breakdown of costs and benefits

Note – for all cost estimates below we have assumed the changes will be applied by experienced compliance staff at an estimated rate of £48/hour. The 2016 Robert Half salary guide estimates that a compliance manager in the risk and compliance function of a financial services company based in London earns between £70,000 and £104,000 per annum. Based on working 8 hours per day for 260 days each year our rate equates to £100,000 per annum and is therefore considered a suitably prudent figure for the purposes of our estimates.

Materiality metric

Familiarisation cost

We expect this change to result in approximately 14 sponsor firms that are also significant lenders amending their sponsor procedures to refer to the technical note and to ensure the firm’s sponsor function applies the metric. These sponsors are also likely to disseminate the change to their deal and compliance teams and may conduct high level, informal training. We estimate the costs to result from the application across 14 firms of 2 experienced compliance team members spending 8 hours each effecting the changes in procedures and communicating changes to staff members at a cost rate of £48/hour. We expect training to be included within existing staff briefing sessions and as such the additional costs are considered to be of minimal significance.

Ongoing cost

On an ongoing basis we expect that these firms will apply the metric when considering very large loans alongside the provision of sponsor services. On average we expect these firms may apply this metric a handful of times each year (4 times). We expect the metric to take very little time to calculate (30 minutes) as the data is readily available. The estimated cost is therefore derived by applying this total 2 hour time cost at an estimated rate of £48/hour across the 14 firms likely to be impacted.

Ongoing benefit

Currently, sponsor firms considering whether to seek the FCA’s guidance in relation to large lending exposures will typically discuss the matter internally and may seek a preliminary view by contacting the FCA. The decision to contact the FCA is one of judgement and it may therefore take several hours to make, for example if the matter is escalated to senior management or a committee for decision. Although difficult to reliably quantify, on a net basis we expect the changes to lead to a reduction in the amount of time taken by sponsors to determine if the FCA should be contacted. This is because the metric is calculated by reference to easily obtainable figures and the decision to be made becomes less subjective.

Reasonable market user assessment

Familiarisation cost

We expect this change to result in all sponsors amending their sponsor procedures to refer to the technical note and the metric. All sponsors are likely to disseminate the change to their deal and compliance teams and they may conduct high level, informal training. We estimate the costs to result from the application across 45 firms of 4 experienced compliance team members spending 8 hours each effecting the changes in procedures and communicating changes to staff members at a cost rate of £48/hour. We expect training to be included within existing staff briefing sessions and as such the additional costs are considered to be of minimal significance*.

Ongoing cost

On an ongoing basis we expect all firms to apply the test when considering whether a perception exists that they cannot perform the sponsor role properly. Due to the widely varying business models of sponsor firms and based on our experience, we expect only a subset of sponsors will need to apply the test. For instance, some sponsors operate an independent adviser business model or have a business model that is highly unlikely to result in circumstances that would give rise to a perceived conflict. However, it is not possible to reliably estimate the size of this subset and we have therefore assumed that all firms will be affected.. We expect the test to be straightforward to apply and to impose little cost. We estimate the costs to result from an estimated 4 annual applications of the new guidance for a period of 30 minutes each by an experienced compliance team member earning £48/hour. The result is applied across all 45 firms.

Ongoing benefit

Currently, decisions in relation to perceived conflicts are likely to be discussed internally by sponsor firms and firms may seek the FCA's preliminary view. The decision to contact the FCA is one of judgement and it may therefore take several hours to make, for example if the matter is escalated to senior management or a committee for decision. Although difficult to reliably quantify, on a net basis we expect the technical note to make the decision around whether a perceived conflict might exist easier and quicker, producing a cost saving for businesses.

* We arrived at the four experienced compliance officer spending 8 hours on reading, digesting and disseminating the information in this Technical note based on our broader supervisory knowledge of how firms respond to such complex Technical Notes and also on supervisory conversations with firms about their procedures relating to this specific issue.

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

Link to Robert Half salary centre

<https://www.roberthalf.co.uk/news-insights/salary-centre-2016>