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Primary Market Technical Note

Responsibilities of a sponsor: Specialist due diligence

The information in this note is designed to help issuers and practitioners interpret our UK Listing Rules, Prospectus Regulation Rules, Disclosure Guidance and Transparency Rules, and related legislation. The guidance notes provide answers to the most common queries we receive and represent FCA guidance as defined in section 139A FSMA

Rules and guidance

UKLR 24.2; UKLR 24.2.3G; UKLR 24.2.5G; UKLR 24.2.6R; UKLR 24.4.25R

Introduction

The role of a sponsor is to guide an issuer and provide assurance to the FCA. Sponsors are expected to be knowledgeable in the listing rules, prospectus rules and disclosure requirements and transparency rules (as defined in the UK Listing Rules), and skilful in applying them to transactions where a sponsor is required. As such, the FCA relies on the expertise sponsors bring to a transaction and to the interactions with the FCA. Sponsors are able to apply their knowledge of the rules, their skill in navigating the FCA's regulatory processes and their understanding of the issuer, its business and circumstances to ensure the FCA is presented with relevant information at the

appropriate time and to help ensure that transactions comply with the rules.

Due diligence

In the course of performing a transaction, sponsors will perform due diligence, a process of enquiry and assurance. Typically sponsors will be acting in other roles for the issuer, such as underwriter or adviser.

This process of due diligence will therefore often serve to satisfy a number of requirements, both commercial and regulatory. For example, a sponsor will wish to understand the issuer, its management and its operations as part of managing its own reputational risk. Sponsors will also want to perform financial and legal due diligence to fully understand the risks associated with selling and underwriting share issues. The due diligence a sponsor performs will also help to provide a reasonable basis for it to provide information to the FCA in relation to a listing application and when providing its assurance to the FCA as required by the rules. Indeed, the synergies that exist in relation to this process of enquiry, combined with a requirement to identify and manage conflicts of interest, are helpful in ensuring the sponsor regime remains a cost-effective way for the FCA to obtain information and assurance in relation to a transaction from an objective, authoritative and trustworthy source.

Specialist expertise and the reasonable expectation of a sponsor

The framework of rules and guidance applying to listed companies is necessarily complex and spans a wide range of areas. These include requirements relating to financial reporting, the presentation of financial information and aspects of company and various financial services laws and regulations. The matters that are important to investors when considering investment are also changing. Our rules have evolved to reflect this and now include additional requirements relating to disclosure and transparency on various environmental, social and governance matters.

In addition, the official list is open to a wide range of issuers, including specialist types of issuer and issuers with business and operations focused in specialist industries or markets. In this context, applying the rules expertly demands both an understanding of the rules and also an appreciation of the industry or specialist nature of the issuer. For instance, our rules contain specific requirements in relation to investment companies, mineral companies and property companies.

Understanding an issuer's business and the requirements that apply to it therefore demands a broad skillset and an ability to consider, at a relatively sophisticated level, a range of considerations across a number of technical disciplines. Depending on the complexity of an issuer and its operations, a sponsor must therefore be able to oversee a due diligence process that is suitably focused to the risks and issues presented. The sponsor will need to be able to understand the issuer, its business and operations, including specialist technical information, to the extent that it can be confident that it can provide its opinion that a prospectus or circular relating to a transaction by the issuer meets the requirements of the rules and provides the information that investors require to make an informed assessment for investment or properly informed voting decision.

However, this doesn't mean a sponsor must be an expert in everything. A sponsor's work to support its assurances should involve a sponsor exercising due care and skill in forming reasonable opinions after due and careful enquiry. We expect sponsors to apply common sense judgement when determining the right level of expertise and enquiry required in order to ensure the rules are applied appropriately and that assurances provided to the FCA are reasonable and reliable. Common sense in this context means applying the judgement possessed by a reasonable professional with skill and experience in corporate finance, after assessing information carefully, with curiosity and a sceptical mindset. Members of a sponsor team may wish to challenge themselves, through peer discussions or escalation to those supervising transactions to ensure they are taking a proportionate approach when exercising judgement in this area.

Whilst it isn't possible to prescribe the nature and extent of the assessments a sponsor should make in relation to the specialist or technical information it considers in the course of its due diligence, examples of relevant considerations in ensuring due and careful enquiry include:

- whether sufficient, appropriate evidence has been obtained to support key technical statements in a prospectus. In this context, it will be relevant to consider whether independent sources of evidence or assurance are required where it wouldn't be appropriate to rely solely on management representations

- in the context of a sponsor's work on working capital, considering the basis and preparation of forecasts, historic forecasting accuracy,

the assumptions underlying the financial model, the choice and extent of any sensitivities and the appropriateness of the downside scenarios contemplated

Given a sponsor cannot be an expert in every technical discipline or subject area, it is normal for a sponsor to draw on a wide range of expertise and experience when performing its role. For example, a sponsor may draw on experience from across its firm, using internal sector, country, legal, financial or industry specialists. In cases where deeper technical expertise and/or independent reporting is required, a sponsor may seek to rely on a third-party specialist. In these cases, the sponsor will typically obtain a report that provides it with a reasonable basis for its own opinion. However, a sponsor need not presume that specialist reporting is required in all cases. The decision as to the nature, scope and extent of any additional procedures or reporting required to enable the sponsor to come to its opinion is an important aspect of the sponsor's judgement.

Third party reports

Sponsors may seek third party reports in a number of specialist areas. Examples of third-party reporting that are relied upon by sponsors include:

- Reporting accountant's report on financial information
- Reporting accountant's report on issuer governance, procedures, systems and controls
- Lawyer's report on the verification of statements and disclosures in a prospectus
- Lawyer's legal opinion on specific matters relating to the issuer
- Specialist due diligence expert's detailed background report on issuer or management
- Mineral expert's report
- Surveyor's property valuation report

We are increasingly seeing the involvement of other experts in the preparation of information to support transactions by issuers, including consultation with, or reporting by, environment and climate reporting specialists.

If approached correctly, relying on an expert can provide an important form of assurance to support that the sponsor has acted

reasonably and with care. However, whilst the report of an expert can provide a form of 'back-to-back' comfort, giving assurance on terms similar to those the sponsor is required to provide to the FCA, the sponsor cannot simply delegate its obligations as sponsor to a third party or rely on the assurances of an expert without due care and enquiry. In UKLR 24.2.5G, we provide guidance that a sponsor remains responsible for complying with UKLR 24.2 even where it relies on, amongst others, a third party when providing an assurance or confirmation to the FCA. Further, in UKLR 24.2.3G we clarify that we will have regard, amongst other things, to whether a sponsor has appropriately used its own knowledge, judgement and expertise to review and challenge the information provided by the third party. Thus, we expect to see sponsors taking an active role in determining the nature and extent of expert reporting specific to the transaction in question, and not simply relying on an off-the-shelf assurance product where that may not be wholly appropriate.

Where a sponsor relies on reporting by a third-party expert, we consider that a number of considerations are relevant in assessing whether the sponsor has formed a reasonable opinion after due and careful enquiry and whether the approach of the sponsor is consistent with the principle of due care and skill. For instance, depending on the circumstances, we would expect the sponsor to have:

- Considered the capacity and capability of the expert
- Reviewed and approved the scope of the expert's work to make sure it is sufficient for the sponsor's purposes
- Reviewed and commented on or challenged (where relevant) draft and final reports, with particular regard to matters relevant to complying with the listing and prospectus rules
- Where relevant, discussed the expert's report with the issuer's board and ensured that they are in agreement with its assumptions and conclusions
- Considered if any bring down process is necessary, if there is a gap between the date of the expert's report and the date on which the sponsor will provide its assurance

The records we expect sponsors to keep in relation to third party reporting

The nature and extent of the records a sponsor will need to keep in relation to third party reporting will vary according to the circumstances. Typically, a sponsor should consider at least the

points set out above and keep records accordingly. This might include keeping copies of engagement letters, key correspondence with an expert or in relation to an expert's work, discussions relating to the choice of expert and the scope of its work, draft and final reports and notes of meetings or calls in which the sponsor has questioned or discussed the work of the expert or discussed it with the issuer. Issuers will need to be aware that a sponsor may seek first-hand evidence or confirmation of matters in order to satisfy its ability to demonstrate due and careful enquiry.

However, sponsors will need to exercise judgement so that they keep material records that clearly serve to support important points of detail within their due diligence and to support that they have worked to the requisite standard of care, whilst not keeping everything. For instance, where a report is prepared by an internationally recognised reporting accountant, we would not expect the sponsor to keep separate records recording the capability and capacity of that firm to perform its work. But, if a report is being prepared by a lesser-known accountancy firm or where the sponsor has reason to believe that the use of a particular expert may compromise the quality of the due diligence in some way, it may be appropriate for the sponsor to carefully consider and record its decision if it decides to proceed to place reliance on that expert and to record any other procedures or measures it requires to address any gap in quality. Good practice sees this sort of brief explanation recorded in new business and/or sponsor committee papers, which typically include details of experts engaged to perform consulting or reporting work on sponsor transactions and any considerations relevant to the engagement.

Similarly, where a sponsor has considered and is content with the scope of the expert's work and receives draft and final reports in line with that scope and not revealing matters warranting further discussion or challenge, it will be sufficient to make a brief contemporaneous note of these judgements and the basis for them. We are aware that, in response to our supervisory reviews, some sponsors feel pressure to provide evidence to demonstrate challenge to expert reporting even where they are satisfied with the comfort that the report provides. We do not wish to encourage this practice and ask sponsors to simply exercise, and demonstrate through a contemporaneous record, their judgement when relying on third party reporting.