

## UKLA Technical Note

### Sponsors: Conflicts of interest

Ref: UKLA / TN / 701.12 Guidance Consultation

LR 8

#### Identifying and managing conflicts

The principle of identifying and managing conflicts of interest aims to ensure that conflicts of interest do not adversely affect either the ability of sponsor firms to perform their functions properly under Listing Rule 8 or market confidence in the sponsor regime. The principle recognises that sponsor firms may have more than one interest in a transaction and that it should be possible in most cases to identify and manage conflicts. The principle also recognises that there are certain conflicts that cannot be effectively managed and that to provide sponsor services in those situations could have an adverse impact on market confidence in the sponsor regime.

We would encourage sponsors to create a comprehensive conflicts policy that reflects the unique role of a sponsor and the nature and diversity of their firm's operations. In addition to such a policy, sponsor firms are expected to identify and manage any conflicts on a case by case basis. Recognising that the purpose of the principle is also to ensure that conflicts of interest do not adversely affect market confidence in sponsors, firms will need to be alert to this possibility and to ensure they have procedures in place to identify when such a perception of conflict exists.

Where, in relation to a transaction, a conflict cannot be effectively managed, a sponsor must not act. The measure of when a sponsor must decline to act is that, to be able to act, the sponsor must be 'reasonably satisfied' that the organisational and administrative arrangements it has in place will ensure the conflict will not adversely affect its ability to perform its functions under LR 8. Sponsor firms are encouraged to contact the Sponsor Supervision team at an early stage to discuss situations where there is any doubt about a firm's ability to act.

#### *Transactions that may affect market confidence in sponsors*

Set out below are examples of certain limited circumstances when a perception could arise that a sponsor may be unable to carry out its role in a proper manner.

- Listings, capital raisings or disposals which may be perceived as facilitating an exit or realisation for the sponsor's group. The context within which such a transaction takes place will be relevant to determining whether the risk of a perceived conflict remains. For instance, a company subject to a financial rescue may raise concerns about a conflict if the sponsor's group exposure to that company is likely to diminish as a consequence of the transaction.
- Unusual, synthetic or high-risk investment structures developed and promoted by the sponsor for listing. Considerations relevant to assessing whether a perceived conflict exists may include the extent to which the sponsor's group is involved in selecting the management of the investment entity and the accumulation of the investment assets to launch the fund.
- Previous involvement of the sponsor's group in the management or governance of an applicant by virtue of board representation and/or private equity style holdings and the subsequent listing which provides the sponsor's group with an exit (whole or partial).

This list is not exhaustive and firms should contact Sponsor Supervision at an early stage in the transaction if they have any concerns about their ability to act.

### *Systems and controls around conflicts identification and management*

LR 8.6.13AG sets out guidance to assist firms in determining and assessing their internal systems and controls as regards identifying and managing conflicts of interest. Firms should also be mindful of LR 8.3.9R which requires sponsors to put in place and maintain effective organisational and administrative arrangements to manage specific conflicts that arise.

Sponsors are expected to be able to demonstrate the basis upon which they have reached a conclusion on conflicts and should maintain accessible records for this purpose. These records should be sufficiently detailed to enable the firm to explain the conclusion reached.

Please note the revised record-keeping requirements for sponsors published in CP12/25, are effective from 31 December 2012.

### **Sponsor firms that act as agent**

~~Sponsor firms that act as an agent for another sponsor should be aware of the requirements of LR 8.3.13 and LR 8.7.17(2), which require a sponsor that acts as an agent to comply with LR 8.3.7A. A sponsor firm that provides such services should be able to explain the basis upon which it has reached a conclusion on conflicts and, as detailed above, should maintain appropriate records to enable it to do so.~~

### **Provision of finance**

Where the sponsor or sponsor's group has an interest in the issuer (be it, for example, through an existing loan facility or other interest in the issuer) and the issuer is:

- in financial distress and the transaction has a 'rescue element'; or
- taking pre-emptive action with regards to its current financing structure (perhaps seeking to increase headroom or restructuring to meet banking covenants),

we would suggest that a sponsor firm take the following factors into account when considering the application of the guidance and rules in LR 8.3.7AG to LR8.3.12G (inclusive).

- The prevailing circumstances of the issuer and transaction, including:
  - a. the motivation for the fundraising;
  - b. the effect of the use of proceeds of the transaction (for example, does the sponsor's group exposure to the issuer diminish, or does the sponsor's group otherwise benefit as a consequence of the transaction?);
  - c. the significance of the loan to the issuer;
  - d. whether the sponsor or sponsor's group is the only provider of finance to the issuer;
  - e. whether the issuer is at risk of breaching any of its banking covenants; and
  - f. whether interim repayments are required as part of the terms of the loan and whether any such payment is imminent.
- The significance of the loan to the sponsor or sponsor's group, including:

- a. the value of the loan that the sponsor or sponsor's group has with the issuer;
  - b. the materiality of the loan relative to the balance sheet of both the sponsor's group and the specific business area within the sponsor's group that is accountable for the loan;
  - c. if the transaction has a rescue element, the impact on the profit and loss account of both the sponsor's group and the specific business area that is accountable for the loan if the loan was written off;
  - d. whether the loan is syndicated and the priority of the sponsor or sponsor's group within that syndicate; and
  - e. whether the loan is impaired.
- Other exposures (in addition to any loan facility) the sponsor or sponsor group has to the issuer (e.g. other interests or relationships that may create a conflict).

The above list is not exhaustive and sponsor firms should contact the UKLA at an early stage in the transaction if they have any concerns about the application of the guidance and rules in LR 8.3.7AG to LR 8.3.12G (inclusive).

### **Managing the conflict**

A sponsor firm is required by LR 8.3.9R to take all reasonable steps to put in place and maintain effective organisational and administrative arrangements, which ensure conflicts of interest do not adversely affect its ability to perform its functions properly under LR 8. This may, for example, include establishing 'Chinese Walls' between the sponsor team and other areas of the business with an interest in the issuer. In addition, LR 8.6.13AG guides a sponsor firm to have in place effective policies and procedures in relation to managing conflicts of interest. We expect sponsors to maintain appropriate records to support conflict assessments (including the basis upon which the firm has reached its conflict decisions). The revised record keeping requirements for sponsors published in CP12/25 are relevant here.

We accept that the sponsor team will need certain information about the existence of a loan facility provided by its group, to ensure that there is appropriate disclosure in the relevant shareholder circular, Listing Particulars or Prospectus, and to ensure that it is able to undertake due and careful enquiry before reaching a conclusion on working capital. However, we would not expect employees providing or responsible for sponsor services to be apprised of the significance of the loan to the sponsor or sponsor's group, nor to be in contact with colleagues that are accountable for the loan. As a result, Sponsor Supervision would expect to hold detailed conflicts discussions with respect to the significance of the loan to the sponsor or sponsor's group, with the sponsor firm's compliance or legal department.

### **Liaising with the UKLA**

Because of the varied nature of both sponsor firms and the transactions on which they act, we are not able to define a set of criteria for when the UKLA would expect to discuss a conflicts assessment with a sponsor firm. If, after considering the points set out above, a sponsor is comfortable that it can act on a transaction, the UKLA would not necessarily expect to discuss the conflicts assessment process with the sponsor. However, sponsor firms may wish to contact Sponsor Supervision to determine the extent to which conflicts issues and their management should be discussed with the UKLA before providing sponsor services.

We would suggest that a sponsor firm always contact Sponsor Supervision before the submission of a document for vetting by the UKLA if:

- the issuer is in severe financial distress and the transaction provides the sponsor or sponsor's group with an exit, or its exposure to the issuer is significantly diminished as a result of the transaction; or
- there is otherwise any doubt whether the sponsor should act on the transaction.

The UKLA may request the following confirmations (amongst other things) from a sponsor when considering LR 8.3.7AG to LR 8.3.12G (inclusive):

Employees providing or responsible for the provision of sponsor services have not been in contact with the team responsible for the loan within the sponsor firm or sponsor's group.

Compliance or legal staff at the sponsor have reviewed and signed off on the conflicts assessment and are comfortable for the sponsor firm to act on the transaction.

The sponsor has put in place and will maintain effective organisational and administrative arrangements, which ensure that any conflicts of interest do not adversely affect the ability of the sponsor to perform sponsor services in accordance with LR 8.

Where the UKLA and sponsor agree that a sponsor is able to provide sponsor services on a transaction, we would nonetheless expect the sponsor to notify us as soon as possible should any of the circumstances surrounding the transaction change. Please also be aware that the UKLA may delay providing comments on a document until any conflict queries have been resolved.

### **Approach to conflicts in early or urgent provision of sponsor services**

A sponsor may be asked to provide advice which comprises a sponsor service prior to or in the absence of any formal appointment as sponsor. We expect a sponsor to consider the application of LR 8.3.7AG-LR 8.3.12AG in these circumstances and, accordingly, to take reasonable steps to identify conflicts of interest that could adversely affect its ability to perform its functions properly under LR8, though we appreciate that there can be practical challenges in doing so. Examples of situations which may be problematic include where a sponsor has been asked to:

- provide early stage guidance to an issuer (for instance, initial class test advice or advice on IPO structuring) which falls within the LR definition of "sponsor service" , bearing in mind that this includes "preparatory work that a sponsor may undertake before a decision is taken as to whether or not it will act as sponsor for a listed company or applicant or in relation to a particular transaction"; or
- provide sponsor services outside normal office hours or as a matter of urgency (for example, in a situation such as a rescue or when an issuer is in severe financial difficulty).

We require a sponsor, when carrying out a sponsor service, to take all reasonable steps to identify and manage conflicts of interest that could adversely affect its ability to perform its functions properly under LR 8. However, the precise actions taken by a sponsor to meet our requirements may vary according to the nature of the sponsor service and the circumstances in which the advice is given. From a practical perspective, we consider that a sponsor will need to consider its ability to meet LR 8 conflict requirements prior to such advice being given.

### **Training and guidance**

As set out in LR 8.6.13AG(3), a sponsor is expected to ensure that individuals are appropriately trained to enable them to identify, escalate and manage conflicts of interest. As part of this training, we would expect a sponsor to ensure that relevant employees are aware of when

they may be providing a sponsor service and the point at which that sponsor service begins (as discussed in TN 710.1). We would also expect such employees to be aware of the arrangements in place and the procedures they are expected to follow when a matter is urgent or they provide sponsor services outside of office hours, when they might be unable to carry out full conflicts checks.

### **Reasonable steps**

A sponsor should take reasonable steps to identify conflicts of interest. In the circumstances set out above, we acknowledge that it may be reasonable for a sponsor to conduct less extensive conflict checks, on a temporary basis. Matters which a sponsor might take into account include:

- currently held information on its clients, including any work-in-progress relating to them;
- results of conflict checks carried out by virtue of other pre-existing relationships it has with the issuer (for example, as a corporate broker, financial advisor or from involvement in a recent transaction); and
- negative assurances, given to the best of their knowledge, by those involved in the matter on which advice is being sought (for example, the deal team, direct management, client contacts).

We would expect sponsors to record any steps taken, as envisaged by LR 8.6.16AR(4). In addition, in a situation where only limited conflicts checks have been performed, we would expect full conflicts checks to be performed as soon as practicable in accordance with the sponsor's usual procedures.

Should a sponsor be of the opinion, on conducting a full conflicts analysis, that it cannot provide or continue to provide the sponsor service to an issuer, we would expect that sponsor to cease to act and to advise the issuer of the need to seek advice from or appoint a sponsor which is not conflicted.