

Technical Note

Sponsors' obligations on no adverse impact

LR 7.2.1R and
LR 8

Under LR 8.4.12R, where a sponsor submits a circular to the FCA on behalf of a listed company, in relation to a transaction that requires a circular under LR 8.4.11R (namely a class 1 circular, a circular that proposes a reconstruction or re-financing, or a circular for the proposed purchase of own shares that is required to include a working capital statement):

'the 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 or the disclosure requirements and transparency rules'.

This technical note is intended to help sponsors understand how we expect them to approach their work in order to comply with LR 8.4.12R(2). This guidance is not exhaustive and a sponsor should exercise professional judgement when it decides what steps it should take to comply with the rule.

The scope of LR 8.4.12R(2)

The sponsor's declaration under LR 8.4.12R(2) is concerned with ensuring that the transaction will not have an adverse impact on the listed company's ability to comply with the listing rules or the disclosure requirements and transparency rules. In order to do this, the sponsor will need to satisfy itself that, after taking into account the impact of the relevant transaction, the listed company has effective procedures, systems and controls in place at the point of completion that will enable it to meet the requirements of Listing Principle 1.

Listing Principle 1 covers all obligations under the listing rules, disclosure requirements, transparency rules and corporate governance rules. This includes the provisions set out in the following chapters:

- LR 9 (Continuing obligations)
- LR 10 (Significant transactions)
- LR 11 (Related party transactions)
- Disclosure Requirements Articles 17-19 of the Market Abuse Regulation (as referred to in DTR 2 and DTR 3)

- DTR 4 (Periodic financial reporting)DTR 5 (Vote holder and issuer notification rules)
- DTR 6 (Continuing obligations and access to information)
- DTR 7 (Corporate governance)

A sponsor should consider other provisions of the listing rules and the disclosure requirements and transparency rules that may impose obligations on the listed company.

Although LR 8.4.12R(2) does not contain a specific reference to the directors' ability to make judgements on an ongoing basis about the financial position and prospects of the listed company and its group, we would expect a sponsor to assess this as an integral part of its work under LR 8.4.12R(2).

Sponsors should be mindful that a sponsor service continues to the point of completion. For some sponsor services, such as a class 1 acquisition or disposal or a reverse takeover, there may be a period of time between the publication of the circular for shareholders to approve the transaction and the completion of the transaction. Under LR 8.3.1AR, for so long as it provides a sponsor service, the sponsor has an obligation as soon as possible to provide to the FCA any information of which it becomes aware that materially affects the accuracy or completeness of information it has previously provided. Therefore, if the sponsor becomes aware of information that compromises the sponsor's declaration given under LR 8.4.12R(2) during the period between making its declaration and completion of the transaction, the sponsor should notify the FCA as soon as possible.

The sponsor's role

Sponsors have a critical role to play in maintaining the integrity of the premium listing regime by providing assurances to us that premium listed companies undertaking certain transactions will continue to be able to comply with their obligations under the listing rules, disclosure requirements and transparency rules.

In respect of LR 8.4.12R(2), it is important to note that the sponsor's role is in addition to that part played by the directors of the listed company and by any adviser such as a reporting accountant and/or firm of lawyers appointed by the listed company or sponsor. As stated in LR 8.3.2AG, a sponsor remains responsible for complying with its responsibilities even where reliance is placed on a listed company, applicant or third party. Further, the sponsor should recognise its unique role among the parties involved in the process by drawing on its experiences of other sponsor service transactions and its interaction with the FCA on matters concerning the application of the listing rules and disclosure requirements and transparency rules.

Typically, a sponsor will be an addressee of a comfort letter provided by the listed company or adviser that effectively mirrors the language of the sponsor declaration required under LR 8.4.12R(2). In our view, reliance on a written confirmation, without an appropriate level of enquiry and challenge by the sponsor, is unlikely to be sufficient evidence to demonstrate that a sponsor has reached a reasonable opinion after due and careful enquiry.

In order to meet its obligations, we expect the sponsor to review and challenge the work done by the listed company and its advisers. In providing its confirmation under LR 8.4.12R(2), we would expect the sponsor to apply its own knowledge and experience of the listed company and take into account other factors that it may consider relevant including. These factors could include the company's operating environment and any particular knowledge or experience the sponsor may have of the approach taken by companies of a similar size, with a similar corporate structure or operating in the same sector.

We would expect to see clear records to demonstrate a sponsor's own enquiries, challenge and action throughout the engagement. This is particularly so when defining the scope of an adviser's work and reviewing its observations and recommendations in order to identify which (if any) procedures, systems and controls require enhancements to be made prior to completion. We would remind sponsors of their record keeping obligations in LR 8.6.16AR to LR 8.6.16CG. Sponsors should refer to UKLA/TN/717.1 for further guidance on the application of record keeping requirements.

A sponsor should be able to demonstrate that a systematic process has taken place. Clearly, a review of a company's existing procedures, systems and controls may highlight a need for enhancements to be made or for new procedures, systems and controls to be put in place. Where this is the case, due consideration must be given to ensure that, at the point of the sponsor declaration, the listed company has appropriate plans to ensure these procedures, systems and controls to be designed, documented, approved and communicated by completion of the transaction.

Determining due and careful enquiry

In assessing the impact of the transaction on the listed company's ability to comply with the listing rules or the disclosure requirements and transparency rules, the sponsor should have regard to the type of transaction being undertaken. It should also have regard to the circumstances and characteristics of the listed company and, if applicable, the subject of the transaction as well as the listed company's experience of undertaking transactions of a similar nature. This will allow the sponsor to determine the due and careful enquiry required to form its reasonable opinion. For example, the sponsor may determine that the due and careful enquiry required to come to its reasonable opinion in relation to the purchase by a listed company of its own shares (where a working capital statement is required) or a class 1 disposal of non-core assets

is materially different to the due and careful enquiry that would be required when a company is undertaking a different class 1 acquisition.

Factors that may be relevant for a sponsor to consider could include:

- in the case of a class 1 acquisition:
 - whether the target is a premium listed company (or listed in a jurisdiction with similar obligations) and therefore has established procedures, systems and controls to comply with Listing Principle 1 (or the equivalent) on a standalone basis
 - whether the directors of the listed company have experience of integrating businesses or assets of a similar size and nature
 - the degree to which the listed company and the target have complex operations, operate in a specialist industry sector (such as property or mineral companies), have significant operations overseas and/or are part of a large or complex group of companies
- 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
- 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

We would expect the sponsor to record its assessment and retain any documentary evidence it has relied upon.

Appropriate procedures, systems and controls

In carrying out its work for LR 8.4.12R(2), the sponsor should first understand the listed company's existing procedures, systems and controls in order to assess the extent to which they will be impacted by the transaction. If the transaction involves the acquisition or disposal of a company or business, then the sponsor should also understand the relevant procedures, systems and controls of the subject of the transaction in order to assess the impact it may have on the listed company.

We recognise that the nature of the assurance required under LR 8.4.12R(2) for an existing listed company is different than the assurances required for a new applicant. This is because a listed company will already be complying with its obligations arising from the listing rules, disclosure requirements and transparency rules. Therefore, in gaining an understanding of the listed company's existing procedures, systems and controls, a sponsor may not be required to carry out the same degree of enquiry

as would be necessary to fulfil its obligations under LR 8.4.2R(3) and LR 8.4.2R(4). However, a sponsor should be mindful of its obligations under LR 8.3.5AR to promptly notify the FCA should it become aware that the listed company is failing or has failed to comply with its obligations under the listing rules, the disclosure requirements or the transparency rules.

We would expect to see evidence that the content of the listed company's board memorandum or integration plan has been reviewed and challenged by the sponsor. This includes defining the scope of these documents to ensure that they deal with issues that might arise in relation to the listed company's ability to comply with all aspects of the listing rules or the disclosure requirements and transparency rules. We would also expect the sponsor to be present at key meetings with the listed company where the content of the documents are discussed and approved.

We accept that it is possible, at the time the sponsor declaration is given, that not all necessary enhancements to procedures, systems and controls will have been effected. If this is the case, we would expect the sponsor to have formed a reasonable opinion that the directors have formally committed to implementing the enhancements on a timescale that will ensure the listed company will, following completion, be able to comply with its obligations when required. The commitment should be appropriately detailed such that the directors have identified, for each enhancement to be made, the individual at the listed company who will be responsible for its implementation, a plan of action and a timetable for when the enhancement will be completed. The sponsor should review the listed company's commitment and plan in order to form a view on whether it is sufficient for the purpose of enabling the sponsor to meet LR 8.4.12R(2).

Takeovers with accelerated timetables

Takeovers may be subject to accelerated timetables where there is a short period of time between the listed company approaching the target and the publication of the circular for shareholders to approve the takeover. We recognise that transactions are often conducted in circumstances where speed of execution and confidentiality of information is of paramount importance. In such circumstances a listed company may have not yet formed a detailed integration plan and the sponsor may not be able to perform the same degree of due diligence that it could otherwise undertake.

The listed company should be mindful of its obligation to comply with Listing Principle 1. It may be appropriate to put into place interim arrangements with the target to ensure that it can comply with its immediate obligations upon completion, with full and formal integration occurring at a later date. In this event, we would expect the sponsor to have particular focus on the operational effectiveness of the interim arrangements. In particular this should include those procedures, systems and controls relating to identifying whether any obligations arise under LR 10 (Significant transactions) and LR 11 (Related party transactions) as well as the timely and accurate disclosure of information to the market under the Market Abuse Regulation (as referred to in DTR 2).

Takeovers with limited access

In certain types of takeovers, access to information regarding the target will be limited. In this instance, we would expect the sponsor to seek out and assess the best information available to it for the purpose of forming its reasonable opinion with respect to LR 8.4.12R(2).

In some instances, no access to non-public information on the target will be given to the listed company and its advisers prior to the sponsor making its declaration. When this occurs, the sponsor should consider what due diligence can practically be undertaken and whether this is sufficient for the purpose of meeting LR 8.4.12R(2). For example, this could include:

- reviewing the target's published accounts and comparing them with the listed company's accounting policies, reporting currency, reporting frequency and financial year-end
- reviewing any published details on corporate governance arrangements
- reviewing public announcements for adequacy of compliance with the listing rules, disclosure requirements and transparency rules

In forming its reasonable opinion, the sponsor may also wish to take into account any relevant factors outlined above under 'Determining due and careful enquiry'.

The sponsor should be mindful that, even where it has no access to non-public information on the target, it must be comfortable that it has had access to sufficient information to satisfy its obligation under LR 8.4.12R(2).