30 December 2014

Ms Victoria Richardson
Markets Division
Financial Conduct Authority
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Canary Wharf
London E14 5HS

By email: cp14-21@fca.org.uk

CP14/21: Consultation on Joint Sponsor Proposals and Call for views on Sponsor Conflicts

Dear Ms Richardson

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to the consultation on joint sponsor proposals and call for views on sponsor conflicts set out in CP14/21.

AFME represents a broad array of European and global participants in the wholesale financial markets. Our members include the largest and most active of the firms approved by the UKLA to act as sponsor.

We enclose our response to CP14/21 with this letter. We would be happy to discuss our response with you if that would be useful.

Yours faithfully

William Ferrari
Managing Director, ECM & Corporate Finance
The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on FCA CP14/21 on joint sponsors and call for views on sponsor conflicts.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. Our members include the largest and most active of the firms approved by the UKLA to act as sponsor.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

Sponsor Conflicts (Q3)

What, if any, changes to our rules and guidance do you believe may be necessary or desirable?

We welcome the opportunity to respond to the call for inputs on the issue of sponsor conflicts. We agree with the FCA that the sponsor regime plays an important role in maintaining confidence in the integrity of the premium listing regime, and enhancing the attractiveness of the UK premium listing regime as a market for issuers and investors.

In order to consider what, if any, changes to the existing rules or guidance might be helpful, we consider it helpful to examine the issues in the following order:

- What do the current rules require?
- Are the current rules and guidance operating effectively?
- Is there uncertainty about any aspects of the way in which the current regime is operating where additional guidance or clarity would be helpful?

What do the current rules require?

The purpose of the existing rules and guidance is to ensure that conflicts of interest do not adversely affect the ability of a sponsor to perform its functions properly or market confidence in sponsors.

LR 8.3.7BR requires a sponsor to take all reasonable steps to identify conflicts of interest that could adversely affect its ability to perform its functions properly (taking account of circumstances that could create a perception in the market that a sponsor may not be able to perform its functions properly; or compromise the ability of a sponsor to fulfil its obligations to the FCA in relation to the provision of a sponsor service).

LR 8.3.9R requires a sponsor to take all reasonable steps to put in place and maintain effective organisational and administrative arrangements that ensure conflicts of interest do not adversely affect its ability to perform its functions properly under LR 8. If a sponsor is not reasonably satisfied that these arrangements will ensure that any conflict of interest will not adversely affect its ability to perform its
functions properly under LR8, LR 8.3.11R requires the sponsor to decline or cease to provide the sponsor services. LR8.6.12G (soon to be made a rule) and LR 8.6.13AG require sponsors to have appropriate systems and controls in place to identify and manage conflicts of interest.

Accordingly, the existing rules already require sponsors to take all reasonable steps to:

- identify conflicts of interest; and
- put appropriate arrangements in place to ensure conflicts of interest do not adversely impact the performance of their sponsor duties.

It is important to note, by way of context, that this principles-based approach was introduced by the FSA in February 2009, in place of the previous rules on sponsor independence which had included more prescriptive threshold-based criteria for determining sponsor independence. When these rules were proposed in CP08/05, the FSA noted that the new rules were designed to align the approach on sponsor conflicts to the approach to identification and management of conflicts under MiFID, and to modernise the FSA’s approach to the assessment by sponsors of their ability to perform their duties appropriately. It is important to bear this context in mind when considering the concerns expressed by certain stakeholders, as noted in CP14/21.

**Are the current rules and guidance operating effectively?**

We are of the view that, in very large part, the current rules and guidance are operating effectively. We do not believe that the standards to which sponsors are discharging their sponsor duties are being improperly or adversely affected by conflicts of interest, whether arising from relationships with issuers or from the other fees that may be earned by sponsor firms through other roles that they may perform on a transaction. In this context, we note the following:

- **Sponsor firms have sought to put in place robust systems and controls for identifying conflicts of interest that may impact the performance of their sponsor duties.** At the outset of any transaction, a detailed conflict clearance process is undertaken to examine other roles, relationships and interests that the sponsor firm may have which might adversely impact the ability of the sponsor to comply with its LR 8 obligations.

- **The acceptance of the sponsor role is typically considered and decided separately by our member firms from their decision to accept other mandates / roles on a transaction.** This assists in ensuring that consideration of whether there are conflicts which might affect acceptance of the sponsor role is conducted separately from decisions about whether to take on other roles on the transaction. This includes consideration of any potential “regulatory conflict” (i.e. a conflict between the duties owed by the sponsor to the FCA and the interests of the client) as well as any conflicts between the sponsor and its issuer client, or between the issuer and other clients of the sponsor.

- **Decisions about whether to take on a sponsor role are ultimately taken by a senior group of individuals rather than by the deal team.** At our member firms this decision is typically taken at a sponsor committee or an equivalent governance forum, and with input and support from Legal, Compliance and subject matter experts.

- **Institutional and organisational arrangements are put in place where necessary to ensure that those responsible for fulfilling the sponsor role are not inappropriately influenced in the performance of their duties by any other parts of the firm that may have other roles / interests in the transaction.** Thus, whilst there will necessarily be some coordination and dialogue between the sponsor team and those responsible for the provision of (for example) debt financing services, the sponsor team, typically overseen by a sponsor committee or an equivalent governance forum, will take independent responsibility for satisfying itself that the firm has discharged its LR8 sponsor obligations.
The experience of our members is that these arrangements operate effectively in practice. We note in this regard that:

- There is typically a very strong alignment of interests between the firm’s obligations as sponsor and other roles it may hold on a transaction (e.g. underwriting and financing), in light of the civil litigation, regulatory and market reputational risks to which the firm may be exposed.
- Quite apart from such alignment, the reputational and regulatory risk associated with non-compliance (or investigation for potential non-compliance) with the LR 8 obligations should not be under-estimated. In our experience, consideration of these risks, which potentially impact across the whole of the relevant business areas for the firm, far outweighs any financial gains that may be made from other roles on a single transaction, and act as a powerful incentive in ensuring that firms adhere to the requirements of the existing rules and guidance.

We strongly disagree, therefore, with the views of some stakeholders noted at §3.4 of CP14/21 that either (a) the fees and commissions earned by the sponsor banks in their non-sponsor roles (whether in and of themselves or as compared to the fees charged as sponsor) or (b) the long-standing relationships between some integrated banks and some of their clients, create a conflict of interest that compromises the ability of sponsors to fulfil their regulatory obligations. Were this to be the FCA’s conclusion, then we would foresee significant risks for the sponsor regime. If either (a) or (b) were thought to give rise to unmanageable conflicts of interest:

- many integrated banks would find it difficult to continue to provide sponsor services (with the result that the FCA, issuers and investors would cease to have the benefit of some of the most experienced and knowledgeable providers of sponsor services);
- those firms that continued to provide sponsor services would no longer have the benefits that long-standing relationships with issuers can deliver in executing a transaction in a timely manner and in undertaking due diligence to a high standard by leveraging the sponsor’s pre-existing knowledge of the issuer, its business and its managers;
- the costs of financial advice and financing would also increase, as different entities would need to be engaged to undertake substantially the same due diligence for different purposes (underwriting, sponsor services), rather than a single firm taking advantage of synergies to undertake the relevant due diligence for multiple purposes.

Each of these consequences would, in our view, be detrimental to the interests of issuers and, ultimately, investors.

In this context, we note and agree with the comments that the FSA made in CP08/05 that "We recognise 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 that could arise where a sponsor or its group undertakes multiple roles. Therefore, our proposals require sponsors to take all reasonable steps to identify and manage conflicts, and to recognise that there may be circumstances where conflict management will not be effective in which event, sponsors should decline to act" (emphasis added), and that "The amendments proposed to sponsor independence are not designed to prohibit integrated banks from acting as a sponsor where the group has more than one interest in a transaction".

We believe that the existing rules already cater for the fact that, as the FSA again noted in CP08/05 “in a very limited number of transactions a perception could arise that a sponsor may be unable to carry out its role in a proper manner leading to significant damage to the reputation of the sponsor, the sponsor regime and the FSA”. We address this specific issue further below.
As well as the views of our own members:

- Our members’ understanding is that their issuer clients are generally satisfied with the operation of the existing regime, and have not expressed significant concerns about conflicts of interest. Issuers (and their boards in particular) are, in our members’ experience, keen to know that an appropriate process of conflict clearance has been undertaken (whether or not a sponsor service is being provided). Issuers have a shared interest with sponsors in avoiding / mitigating any reputational or regulatory risks associated with non-compliance with the existing, broadly-framed rules on conflict identification and management.
- Our members’ understanding from their own experience of dealing with the FCA and acting on sponsor transactions is that, in relation to the large majority of transactions in which they have been involved as sponsor, the FCA has not expressed concerns that the assurances and declarations given to the FCA by sponsors have been compromised or adversely affected by any conflicts of interest, and appears to have been satisfied with the way in which conflicts of interest have been identified and managed.

§3.6 of CP14/21 describes investors (as well as issuers and the FCA) as consumers of sponsor services. It is important to note that sponsors owe their contractual and regulatory duties to the issuer and to the FCA, and not to investors. Investors may be indirect consumers of sponsor services (in the sense that they are participating in a market the standards of which are supported by the sponsor regime), but they are not direct consumers of sponsor services. Moreover, we consider that issuers and the FCA are better placed, as the parties to whom direct legal or regulatory duties are owed, to assess whether those duties have been appropriately fulfilled or whether they have been adversely affected by the existence of any conflicts of interest. We would have significant concerns if the FCA were to determine that the existing regime was not operating effectively on the basis of the views of investors (or indeed other stakeholders) who may not be familiar with the nature of the sponsor regime, the steps it requires sponsors to take under that regime and the consequences that follow in the event of non-compliance.

Is there uncertainty about any aspects of the way in which the current regime is operating where additional guidance or clarity would be helpful?

We believe that there are three main areas of uncertainty or weakness in the current regime where we consider that further guidance would be helpful.

- The perception test;
- The process for discussing and obtaining guidance from the UKLA in relation to transaction-specific conflict issues; and
- The UKLA’s expectations regarding the extent to which contact between a sponsor team and other teams within an institution performing other roles is permissible.

The perception test

As noted above, the existing LR 8 rules on identification and management of conflicts of interest require sponsors to take account of "circumstances that could create a perception in the market that a sponsor may not be able to perform its functions properly" when identifying conflicts of interest. The existing UKLA Technical Note (TN 701.1) sets out certain examples of where such a perception might arise – namely listings, capital raisings or disposals which may be perceived as facilitating an exit; unusual, synthetic or high-risk investment structures developed and promoted by the sponsor for listing; and previous involvement of the sponsor’s group in the management or governance of an applicant through board representation or private equity-style holdings. These problematic situations are fairly well-understood and do not give rise to many difficulties in practice. Guidance is also contained on the factors to be considered where the sponsor or its group has an existing loan facility or other financing interest in the issuer and the issuer is undertaking a transaction which has a rescue element or is in the nature of pre-emptive action with regard to its current financing structure.
The Technical Note states that the guidance is not exhaustive and that firms should contact the UKLA at an early stage in the transaction if they have any concerns.

We and our members accept that the perception test has a valuable role to play in ensuring that sponsors identify those exceptional cases where, despite the arrangements put in place to manage a conflict, there is still an insurmountable perception that the sponsor may be unable to carry out its role in a proper manner. We believe that such cases will, however, be exceptional (to use the words of the FSA in CP08/05, there will be a "very limited number of cases" falling within this category), and it is important that there is a shared understanding between the FCA, issuers and sponsor firms about the "perception test" and how the principles governing how it should be interpreted and applied in practice. There is a danger of excessive ambiguity in the "perception" test generating uncertain and unpredictable outcomes.

The experience of our members is that there is some uncertainty and inconsistency about the way in which the perception test has been utilised by the UKLA. For example, there have been cases where:

- The FCA has sought to suggest in some cases that the provision of new financing should be considered in the same way as where there is an existing finance position (i.e. as set out in the Technical Note), and that it might indeed expose sponsors to more acute conflicts of interest, such as where it involves bridge lending with repayment being contingent on a related transaction for which sponsor services are being provided. Whilst we accept that there is potential for new lending to raise potential conflicts in particular cases, we do not agree that the same considerations apply for new lending and existing financing – new financing is more analogous to an underwriting role, and will not normally be affected by the same considerations around whether the transaction has a rescue element or is pre-emptive in nature, since there is no existing financing position which could potentially affect the sponsor’s performance of its duties unless appropriately managed. We believe that any potential conflicts arising from having a new financing role on a transaction ought in principle to be capable of being managed through appropriate organisational and oversight arrangements.

- The FCA has also suggested that in some circumstances (e.g. where there is a related party transaction and a fair and reasonable opinion is being delivered) the sheer size of fees earned from other roles on a transaction may, in and of themselves, be sufficient to create an insurmountable perception of conflict. We do not agree with this view, and do not agree that there is a materiality/fee threshold above which such a perception should be viewed as arising. We think any fee size-based threshold is likely to be arbitrary and inappropriate. For example, why (and in whose view) would fees of, say, £10 million create an insurmountable perception but fees of, say, £8 million would not? For the reasons set out above, there are powerful duties and incentives on sponsors to perform their obligations appropriately which far outweigh any fees earned on an individual transaction, and no evidence that the size of fees on a particular transaction has compromised the quality or integrity of the performance by a sponsor of its LR8 duties.

As stated earlier, we consider that it will be very rare indeed for there to be circumstances (outside of the specific examples already identified in the Technical Note) where an insurmountable perception of conflict is likely to arise. This assessment will naturally depend on all the facts and circumstances of a particular transaction but it would be helpful if the Technical Note could articulate more clearly any other circumstances or examples (e.g. by way of case study) which the UKLA has in mind (noting that we disagree that providing new equity or debt financing, or carrying out underwriting, bookrunning, financial advice or other similar services, or the size of fees, should fall into this category). The perception test should be objective and should be keyed to the perceptions of market participants who are knowledgeable and experienced in the premium listing and sponsor regime, as opposed to the general public or uninformed investors. Any additional examples or circumstances should, in our view, be the subject of further consultation by the UKLA.
**The process for discussing and obtaining guidance from the UKLA in relation to transaction-specific conflict issues**

Our members understand the need to contact the UKLA at an early stage to discuss potential conflict issues. Given that the conflict identification and management obligations arise from the outset of provision of a sponsor service (including preparatory steps, per the definition of sponsor services) it is important that the process of obtaining guidance and, where appropriate, clearance from the FCA operates swiftly and efficiently. Although in many cases the process has been swift, members have also had experience of some cases where the process has taken several weeks, with a series of iterative questions and answers needing to be posed and answered prior to a decision being reached. Whilst we recognise the importance of ensuring that conflict issues are considered carefully, a lengthy and uncertain process of this nature can cause delay to the transaction timetable and frustration to issuers seeking to receive the sponsor services.

We should therefore be grateful if the FCA could consider (whether through amendments to its Technical Note or otherwise) whether it could provide further clarity to sponsor firms around its expectations in relation to the information and issues that should be addressed by a sponsor firm at the outset of the process of seeking clearance/guidance on conflicts matters. We would also be happy to explore with the FCA any practical suggestions the FCA might have in relation to how this process could operate more swiftly and efficiently in the future. We would also be interested in exploring with the FCA the extent to which a sponsor firm could, in circumstances where formal clearance has not been received from the FCA but the sponsor is satisfied that conflicts can be appropriately managed and the FCA has not expressed concerns, continue to perform the relevant sponsor service pending the outcome of the dialogue with the FCA.

We have considered briefly the threats and safeguards approach utilised in the accountancy profession to assess conflicts of interest. For our part, however, we do not consider that this approach would add materially to the considerations given to conflicts by our member firms under the existing rules and guidance under LR 8.3.7A G – 8.3.12A G and the UKLA Technical Note.

**The existing Technical Note contains commentary in the context of conflict management which has given rise to some uncertainty and confusion. Currently, the second paragraph of the section headed “Managing the conflict” indicates that employees providing or responsible for sponsor services should not 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” (emphasis added). This could be read as indicating that there can be no contact at all between bank employees and those involved in the provision of existing or new finance to the issuer client. We do not think this is what was intended:**

- First, the Technical Note itself recognises that the sponsor team will need information about the loan facility to ensure there is appropriate disclosure and to ensure that it is able to undertake due and careful enquiry before reaching a conclusion on working capital. (Similarly, a sponsor committee or equivalent governance forum is likely to need to be made aware of at least the basic details of the debt financing in order to form a view on internal conflict clearance / acceptance of the sponsor role.)

- Secondly, certain bank employees may simultaneously be part of the sponsor team and part of the debt financing team, or the two teams may be part of a single overall transaction team providing a combination of equity and debt financing as well as a sponsor services. We do not believe this should present a concern as long as the decision-making on key matters for consideration by each team is, where appropriate, kept separate. For example, some integrated banks providing both sponsor services and debt financing to clients would, in certain situations, need a limited number of individuals involved in the sponsor workstream to have visibility of
the debt financing workstream. This would allow those individuals to obtain information about
the debt financing proposals for both prospectus disclosure purposes and as part of its due and
careful enquiry on the client’s working capital position – the same individuals may be involved
in reviewing the debt financing for working capital purposes and for the purposes of
undertaking due diligence prior to recommending the debt financing to the bank’s internal
approval committees. Issuers and sponsor firms may also want key individuals to be involved in
or have visibility over the various workstreams to ensure a consistency of approach and smooth
execution of the overall transaction, especially where those individuals are very familiar with
the business and operations of the issuer.

Provided that appropriate organisational arrangements are made to ensure that any information
sharing is appropriate, that no inappropriate pressure is placed on sponsor team members to approve
the transaction and that those involved in both workstreams are not responsible for making overall
decisions and approvals in relation to the sponsor transaction, we do not consider contact of the type
described above to be inappropriate.

We consider that the Technical Note could usefully be amended to reflect the more nuanced
position set out above.

Other proposed remedies

We have commented on possible enhancements to the regime above, in the context of our views on the
effectiveness of the regime and potential areas of uncertainty.

In relation to the other potential remedies suggested in CP14/21, we do not consider that disclosure
of transaction fees, in addition to the existing (maximum harmonisation) requirements
embedded in the EU prospectus regime requiring disclosure of aggregate advisor fees and
material contracts, is necessary or appropriate. For the reasons set out above, we do not consider
that the disclosure of transaction fees will enhance the management of conflicts or affect the perception
test. On the contrary, we think that disclosure of transaction fees could be counter-productive as it
would be prone to being taken out of context – for example, it could lead to uninformed comment or the
wrong inferences being drawn from a large overall level of fees, or from the fact that, consistent with
current market practice, no or only a modest fee has been charged in respect of the sponsor role in the
context of the overall fees charged in respect of the transaction.

Instead, given that the perceptions regarding potential conflicts of interest impacting the way in which
sponsors are discharging their LR 8 duties appear to be derived from a lack of understanding amongst
other stakeholders about (a) the nature and purpose of the LR 8 regime; (b) the way in which sponsors
take steps to comply with the regime; and (c) the way in which the FCA supervises and enforces
compliance with the regime, we would suggest that the appropriate remedy should be for the FCA,
issuers and sponsors to work together to ensure a broader and common understanding (e.g.
among investors) of the nature, purpose and effect of the sponsor regime, including the
obligations on sponsors to identify and manage conflicts, and the steps they take to fulfil these
obligations.

We do not consider that this requires amendments to be made to LR 8 or associated guidance. In
particular, we do not consider that standard form disclosures of relationships or conflict management
arrangements in transaction documentation would be illuminating. Rather, we consider achievement of
this better understanding will require a process of shared/consistent dialogue and engagement with
other interested parties to help promote greater awareness and common understanding of the regime.
To conclude, we believe that the current arrangements in relation to the identification and management of conflicts of interest by sponsor firms are generally operating effectively. Our members are happy to work with the FCA to identify areas where the current regime can be refined or clarified, and we have identified some areas of uncertainty where clarification or modifications in the approach might be helpful. We do not believe that fundamental changes are required to the overall approach, however, and consider that changes of this nature (for example to impose an approach to the perception test based on size of fees) would be counter-productive and ultimately prove detrimental to competition in, and the effectiveness of, the sponsor regime.

**Joint sponsors (Q4-Q5)**

Q4. Do you agree with our proposal to amend LR 8.5.3R so that the requirement for only one sponsor to take responsibility for contact with the FCA in respect of the sponsor service applies in respect of administrative arrangements only?

We agree with the proposed amendments to LR 8.5.3R, which are consistent with the views we expressed in our response to Q25 of CP14/2.

Q5. Do you agree that the proposed Technical Note (as set out in Annex 3) provides sufficient guidance to support the proposed amendments to LR 8.5.3R?

We agree with the contents of the proposed Technical Note, but would note the following:

- We would suggested deleting the words “the Principle for Sponsors set out in” from the first paragraph under “Appointment of joint sponsors” as they are unnecessary.
- Whilst the sponsor with responsibility for administrative matters should be responsible for sending comment sheets and similar correspondence to the FCA, we think it would be helpful for the FCA to send comment sheets and correspondence (or at least significant correspondence of a non-administrative nature) to each joint sponsor at the same time, rather than simply to the sponsor with responsibility for administrative matters for onward circulation. We do not consider this would add materially to the administrative burden on the FCA.
- Similarly, whilst we consider that in most cases proactive contact with the FCA can and should be co-ordinated by the sponsor with responsibility for administrative matters, we consider it important the FCA acknowledge in the Technical Note that there may be circumstances in which proactive contact with the FCA (particularly on urgent non-administrative matters) can legitimately be initiated by the other joint sponsor(s). The final section of the Technical Note does not appear to cater for this possibility as presently drafted.

Q6. Do you agree with the proposed new guidance in LR 8.3.15G?

We agree with the proposed new guidance, which is in substantially the same terms as our suggestion on this point made in response to Q25 of CP14/2.

Q7. Do you agree with the proposed amendments to LR 8.3.14R?

We agree with the proposed amendments, although we would suggest that "either of the" is replaced with "the other" in sub-paragraph (1), and that (2) is amended for clarity to read "each sponsor is responsible for complying with its obligations under LR8".

**AFME contacts**

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