



Markets Brief

The DFSA Sponsor Regime

Issue No. 4 – January 2013

(Updated 22 October 2014)

Introduction

In this Markets Brief, we examine the Sponsor regime and the role of a Sponsor appointed for the purposes of a DIFC Prospectus Offer. In particular, we look at who may act as a Sponsor in relation to a Prospectus Offer, how a Sponsor is appointed, what experience a Sponsor must have, what the Applicant and Sponsors' responsibilities are, and what issues the DFSA expects a Sponsor to pay close attention to.

This Markets Brief has been produced because, under the DFSA Sponsor regime, the DFSA may impose an obligation on a person who makes a Prospectus Offer to appoint a Sponsor. Therefore, the DFSA wishes to provide issuers and potential Sponsors with some guidelines to assist them in carrying out their responsibilities under the regime.

For the purpose of this Markets Brief, "Applicant" means a Person who applies for admission of its Securities to the Official List of Securities and includes the issuer.

The DFSA Sponsor regime

The Sponsor regime has its basis in Article 49 of the Markets Law 2012 (Markets Law) and is a fundamental pillar to the DFSA listings regime. A Sponsor helps ensure high standards of due diligence at the prospectus stage of a listing of securities and provides essential assistance to companies considering a listing in the DIFC.

The DFSA rules on Sponsors are found in chapter 7 of the Markets Rules (MKT). The rules permit the DFSA to require a person making a Prospectus Offer to appoint a Sponsor in certain circumstances.

What is a Sponsor

The DFSA will require an Applicant to appoint a Sponsor to help ensure high standards of due diligence for a Prospectus Offer. A Sponsor is a professional advisor appointed by an issuer prior to making a Prospectus Offer whose role it is to provide the issuer with specific expertise, drawn from their experience in previous issues, and to help to standardise and streamline processes and practices during the Prospectus Offer.

The role of a Sponsor is to guide the Applicant on the application of the Markets Law and MKT. In particular, to ensure that a prospectus contains all the information which an investor would reasonably require and expect to find for the purposes of making an informed investment decision. A Sponsor will oversee the due diligence and verification processes in the production of a prospectus and is expected to provide an effective challenge to statements made by the issuer. The DFSA will also expect a Sponsor to sign a declaration prior to the approval by the DFSA of the issuer's Prospectus.

While issuers are responsible for compliance with the relevant rules and regulations, Sponsors assist by advising them on their obligations. They also help the DFSA meet its statutory objectives by providing assurances that issuers have complied with the relevant regulations in the Markets Law and the MKT.

Who may be a Sponsor

A Sponsor is typically an investment bank or boutique advisory firm but may also be a firm that provides legal or accountancy services. However, to be appointed as a Sponsor, a person must be able to demonstrate that it possesses:

- a) appropriate knowledge of the relevant rules and regulations, effective systems and controls, and resources to perform the role;
- b) employees with appropriate experience and professional training (at least 5 years of relevant experience);
- c) significant financial services and compliance experience;
- d) a track record in providing similar advice; and
- e) a proactive approach to undertaking appropriate due diligence and verification.

It will be for the Applicant to ensure that the Sponsor that it appoints has the requisite level of

knowledge, experience, qualifications and resources to carry out its obligations as a Sponsor. However, Applicants should note that the DFSA will usually review the proposed Sponsor's suitability to act and may require the Applicant to replace the Sponsor with a more suitable candidate.

Appointment of a Sponsor

The DFSA requires an Applicant to appoint a Sponsor:

- a) when it is making an offer of securities to the public in or from the DIFC or when it is admitting securities to trading on an AMI; or
- b) to assist in the prospectus due diligence and verification process.

The appointment term will normally be effective until the date the securities are admitted to the Official List of Securities (List). However, the DFSA may require the Sponsor to act for a longer term depending on the circumstances.

The Sponsor must demonstrate to the DFSA's satisfaction that it is competent and has the appropriate systems and controls in place to ensure it can carry out its role as Sponsor. See Annex 1 for guidance on the contents of a Sponsor Eligibility Letter.

A Sponsor will generally not be required to be appointed in circumstances where the offer is made wholly to Professional Clients. However, the DFSA may nonetheless require a Sponsor to be appointed for an offer that is made exclusively to Professional Clients if it considers it necessary. Examples include where the initial offer is made to Professional Clients but there is a strong chance that retail clients will buy the securities in the secondary market, or where the offer is of strategic significance to the DIFC markets or where an applicant is in financial distress.

Responsibilities of an Applicant

The Applicant's responsibilities in relation to a Prospectus Offer include:

- a) to take reasonable steps to ensure that the Sponsor has the required knowledge, experience, qualifications and resources (including systems and controls) to carry out its obligations under the MKT;
- b) to take reasonable steps to ensure that the Sponsor and its employees are independent and free from any conflicts of interest;
- c) to take reasonable steps to ensure that it provides the Sponsor:
 - i. with reasonable assistance;
 - ii. access to relevant information which is not misleading or deceptive; and
 - iii. with information which may affect the financial position of the Applicant's business; and
- d) to notify the DFSA of:
 - i. the Sponsor's details;
 - ii. issues relating to independence and conflicts of interest; and
 - iii. termination of a Sponsor's appointment, providing details of any relevant facts and circumstances.

An Applicant is ultimately responsible for ensuring compliance with the rules and regulations which apply to it in relation to a Prospectus Offer.

Responsibilities of a Sponsor

A Sponsor must satisfy itself to the best of its knowledge and belief, after due and careful enquiry, that the directors of the Applicant:

- a) have satisfied all applicable conditions and other relevant requirements under the Markets Law and MKT;
- b) have a reasonable basis on which to make the working capital statement required under;
- c) have put in place systems and controls to enable them to comply with the relevant disclosure requirements of the MKT; and
- d) have put in place systems and controls which provide a reasonable basis for the directors to make a balanced, comprehensive and understandable assessment, on an ongoing basis, as to the financial position and prospects of the Applicant and its group.

In addition, a Sponsor must:

- e) on becoming aware of a breach of the rules and regulations by an Applicant, without undue delay notify the Applicant in order for the Applicant to take remedial action;
- f) exercise a duty of care to the Applicant;
- g) notify the DFSA of:
 - i. the outcome of any remedial action taken pursuant to e) above;
 - ii. the circumstances where the Applicant is being non-cooperative;
 - iii. its resignation; and
 - iv. any breach of its obligations and provide any information that the DFSA may require.

Independence and managing conflicts of interest

MKT Rule 7.1.4 requires an Applicant to take reasonable steps to ensure that the Sponsor and its employees are independent and have appropriately managed any conflicts of interest that may arise.

The principle of independence and 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 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 who do not have one 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.

Where a conflict cannot be effectively managed, a Sponsor must not act. Disclosure alone is insufficient. 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 the MKT.

Adequacy of systems and controls

A listed issuer has a number of systems and controls obligations imposed on it with which it is

required to comply with at all times. These include:

- Corporate Governance Principle 4 in MKT requires that the board of directors must ensure that an Applicant has an adequate, effective, well-defined and well-integrated risk management, internal control and compliance framework.
- Corporate Governance Principle 6 in MKT requires that the directors must ensure that the Applicant's financial and other reports present an accurate, balanced and understandable assessment of the Applicant's financial position and prospects by ensuring that there are effective internal risk control and reporting requirements.
- MKT chapter 8 requires all Applicants to have established, and be able to maintain on an on-going basis, appropriate systems and controls to be able to demonstrate compliance with the Markets Law and the MKT.
- MKT 9 Listing Principle 2 requires an Applicant to take reasonable steps to establish and maintain adequate policies, procedures, systems and controls to enable it to comply with its obligations under the Listing Rules.

A Sponsor is required to confirm to the DFSA, that it has come to a reasonable opinion, after having made due and careful enquiry, that the directors of the issuer have put into place systems and controls to:

- a) enable them to comply with the MKT Rules; and
- b) provide a reasonable basis for them to make a balanced, comprehensive and understandable assessment, on an ongoing basis, as to the financial position and prospects of the issuer and its group.

This confirmation is called the "Sponsor declaration". While we would accept that it is possible, at the time the declaration is given, that some of the necessary procedures will not have

been operated or tested (because they may be event specific), we do expect them to have been designed, approved and communicated to those responsible for their implementation and use at the point of admission to the List.

The Sponsor role is in addition to that part played directly by the directors of the Applicant and by any third party appointed by the Applicant or Sponsor. In order to meet its obligations we expect the Sponsor to review and challenge the work done by the Applicant or any third party involved in a listing (e.g. an expert), drawing on its own knowledge and experience of the Applicant, its operating environment and other companies in its sector.

A Sponsor should be able to demonstrate that a systematic process has taken place in order to come to a reasonable opinion, after having made due and careful enquiry, that all necessary procedures are designed and in place at admission. For this purpose Sponsors may wish to carry out an analysis in the context of the directors' regulatory obligations, which identifies the necessary procedures that should be in place at admission to generate the information required to make proper judgments on financial position and prospects, the quality and extent of those procedures that are already in place and whether there are any gaps. Where there are gaps, steps should be taken to ensure that necessary procedures are designed and in place before admission.

Furthermore, we would not expect a Sponsor to submit its declaration without an Applicant having formally documented, approved and appropriately communicated those procedures that it has committed to implement on a timely basis.

Adequacy of working capital

MKT Rule A1.2.1 requires the directors of an Applicant to state that in their opinion the working capital of the issuer is sufficient to meet its present requirements or, if not, how it the Applicant proposes to provide the additional

working capital if needed. Working capital should be considered as the Applicant's ability to access cash and other liquid resources in order to meet its liabilities as they fall due. A prospectus may be valid for up to twelve months and therefore present requirements should be considered to be a minimum of twelve months from the date of the prospectus.

A Sponsor is required to confirm to the DFSA that it has come to a reasonable opinion, after having made due and careful enquiry, that the directors of the Applicant have a reasonable basis on which to make the working capital statement.

A Sponsor is required to apply its judgement, experience, knowledge and expertise on the MKT Rules when deciding whether an Applicant has a reasonable basis on which to make the working capital statement. To do this the Sponsor must have regard to the Applicant's circumstances and the context of the transaction.

This role is in addition to the part played directly by the directors of the Applicant or by a third party appointed by the Applicant in the working capital exercise. This is not to say that third party work cannot be used to help a Sponsor come to a reasonable opinion that the directors of the issuer have a rational basis on which to make the working capital statement.

However, reliance on third party work alone will not be sufficient evidence that a Sponsor has discharged its obligation to make due and careful enquiry. Specifically, the Sponsor must review and challenge the work done by the Applicant and third party and, through its own knowledge and experience of the Applicant and its operating environment, ensure that the conclusion reached on the Applicant's working capital position is the right one under the circumstances (see below for reliance on third parties).

Applicants should ensure that there is very little risk that the basis of such a statement is subsequently called into question. The procedures adopted by issuers in making a statement are expected to be very similar to those adopted by

issuers in concluding that the annual accounts should be drawn up on a going concern basis.

When carrying out due diligence in an environment characterised by changeability and companies in financial distress, Sponsors need to carefully consider how they assess working capital. In particular, the inherent unpredictability of the business environment could make assessing forecasts, assumptions, sensitivities and bank facilities more difficult.

When giving a working capital statement Applicants are expected to have undertaken appropriate procedures to support the statement that is being made. Such procedures would normally include:

- preparation of unpublished, supporting prospective financial information in the form of internally consistent cash flow, profit and loss and balance sheet information flowing from the company's latest audited financial statements;
- business analysis covering both the cash flows of the business and the terms and conditions and commercial considerations associated with banking and other financing relationships;
- consideration of the strategy and plans of the business and the related implementation risks together with checks against external evidence and opinion; and
- assessment of whether there is sufficient margin or headroom to cover reasonable worst case scenario (sensitivity analysis).

Where there is insufficient headroom between required and available funding to cover reasonable alternative scenarios it will not be possible for the Applicant to make a clean working capital statement. In these circumstances if the issuer is to give a clean statement it will need to reconsider its business plan or to arrange additional financing.

Reliance on third parties

While we are aware that it is customary for Sponsors to rely upon third parties, for example, reporting accountants, to assist them when discharging their obligations, we recognise that the scope of a third party's engagement and its deliverables will vary, reflecting the fact that these are ultimately private contractual matters between the third party, new applicant and Sponsor.

Although the third party's involvement may vary, we would expect to see clear records to demonstrate a Sponsor's own enquiries, challenge and action at all stages of the engagement. This is particularly so when defining the scope of the third party's work and reviewing the third party's observations and recommendations in order to identify which procedures should be designed and in place before admission.

In addition, it is not uncommon for a Sponsor firm to rely on comfort letters provided by third parties that effectively mirror the language of the Sponsor declaration. In the DFSA's view, reliance on a written confirmation designed to give 'back to back' comfort, as with any such confirmation from a third party adviser is, without an appropriate level of Sponsor enquiry and challenge, insufficient evidence to demonstrate that a Sponsor has reached a reasonable opinion after due and careful enquiry.

Guidance

Please note that the contents of this communication are not intended to be Guidance as contemplated by the Regulatory Law 2004 and the contents should neither be interpreted, nor relied upon, as Guidance. You should refer to the DFSA Rules for Guidance or contact the DFSA if you require individual guidance.

Technical explanations given in this brief are for illustrative purposes and should not be considered or relied upon as a legal advice. We recommend that independent legal advice is obtained if you

are unsure about any aspect of the DFSA markets regime which may apply to you.

Defined terms are identified in this brief by the capitalisation of the initial letter of a word or each word in a phrase and are defined in the Glossary Module of the DFSA Rulebook.

Questions and answers

How should I approach the DFSA with a new transaction?

Submit a **Sponsor Eligibility Letter** setting out the following:

- a brief outline of the transaction, drawing attention to potentially difficult issues or significant matters;
- the eligibility of the Person proposing to be the Sponsor under MKT 7; and
- an indicative timetable for listing.

See Annex 1 for guidance on the contents of a Sponsor Eligibility Letter.

Submit a **Listings Eligibility Letter** setting out the following:

- a brief outline of the transaction, drawing attention to potentially difficult issues or significant matters;
- the eligibility of the Applicant to be listed under MKT 9.3; and
- an indicative timetable for listing.

See Annex 2 for guidance on the contents of a Listings Eligibility Letter. For additional information on the eligibility process, see the Markets Brief on Eligibility for listing.

What is involved in the review and approval of a prospectus?

Please refer to Markets Brief No.1 which can be found on the DFSA's website.

What is my liability if I breach the Markets Law or MKT?

If a person breaches DFSA legislation or any rules made for the purpose of such legislation, the DFSA may take enforcement action which may include the imposition of a fine, a public censure, or the use of injunctive powers among other remedies.

Arabic edition

Every Markets Brief is produced in both English and Arabic and is available on the DFSA website.

Recommended reading

- The Markets Law
- The Markets Rules
- The Sponsor Declaration Form
- Policy Statement 1/2012 on the Appointment of a Sponsor
- European Securities and Markets Authority recommendations for the consistent implementation of the European Commission's Regulation on Prospectuses No. 809/2004
http://www.esma.europa.eu/system/files/05_054b.pdf

Contact us

Visit the DFSA website www.dfsa.ae for:

- previous editions of the Markets Brief;
- access to DFSA-administered legislation and the DFSA Rulebook; and
- full text of the Markets Law 2012 and Markets Rules.

For enquiries:

- Telephone +971 4 362 1500
- Email markets@dfs.ae

Feedback

We appreciate your feedback and welcome any suggestions that you may have. Please email us at markets@dfsa.ae

Annex 1 – Contents of a Sponsor Eligibility Letter

A Sponsor Eligibility Letter should contain information that demonstrates to the DFSA that the Person proposing to act as a Sponsor to a transaction has the appropriate systems and controls in place to ensure that it can carry out its role in accordance with MKT 7.

The following is an example of the type of information that we would normally expect to find in a Sponsor Eligibility Letter:

- a brief outline of the transaction, drawing attention to potentially difficult issues or significant matters;
- information demonstrating that a Sponsor possesses:
 - i. appropriate knowledge of the relevant rules and regulations, effective systems and controls, and resources to perform the role;
 - ii. employees with appropriate experience and professional training (at least 5 years of relevant experience);
 - iii. significant financial services and compliance experience;
 - iv. a track record in providing similar advice; and
 - v. a proactive approach to undertaking appropriate due diligence and verification.
- information identifying any potential matters relating to the independence of the Sponsor firm and its employees and how any potential conflict of interests that may arise will be managed;
- an indicative timetable for listing; and
- a copy of the letter from the Applicant appointing the Sponsor (which may be subject to DFSA approval).

Annex 2 – Contents of a Listings Eligibility Letter

A Listings Eligibility Letter should contain information that demonstrates to the DFSA that the Applicant satisfies the relevant listing eligibility requirements and considerations set out in MKT 9.3.

The following is an example of the type of information that we would normally expect to find in a Listings Eligibility Letter:

- a) a brief outline of the transaction, drawing attention to potentially difficult issues or significant matters;
- b) information demonstrating that the Applicant meets the relevant eligibility requirements set out in MKT 9.3:
 - i. Incorporation;
 - ii. IFRS compliant audited financial statements (3 years);
 - iii. Working capital sufficiency (Shares only);
 - iv. General suitability for listing;
 - v. Management experience and expertise;
 - vi. Controlling shareholder (Shares only);
 - vii. Conflicts of interest (Shares only);
 - viii. Validity and transferability;
 - ix. Market capitalisation (Shares only);
 - x. Shares in public hands (Shares only);
 - xi. Whole class of Securities to be listed;
 - xii. Settlement;
 - xiii. Warrants; and
 - xiv. Depositary receipts.
- c) an indicative timetable for listing.