

Mergers & Acquisitions and Market Regulations

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This learning workbook relates to syllabus version 3.0 and will cover exams from **11 July 2026 to 10 July 2027**

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It is estimated that this manual will require approximately 100 hours of study time.



Chapter One
Making Acquisitions

Section 1 Making Acquisitions

Section 2 The Acquisition Process

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1. Making Acquisitions

1.1.1 Be able to evaluate the arguments for and against the use of mergers and acquisitions as a strategy for growth

1.1.2 Be able to apply appropriate criteria for selecting a target for acquisition

1.1.3 Be able to evaluate a potential acquisition target for the following synergies: revenue synergy; cost synergy; financial

1.1.4 Be able to analyse the reasons for an acquisition failing to enhance shareholder value and generate anticipated synergies

1.1.5 Be able to evaluate alternative strategies to mergers and acquisitions for achieving a strategy of growth

This chapter evaluates commercial and financial justifications for acquisitions, starting with a consideration of synergies. It highlights the main motivations for making acquisitions, including motivations not directly connected to enhancing shareholder value. It also looks at the main reasons that acquisitions fail and how growth might be achieved other than by acquisition.

1.1 Synergies

In considering whether an acquisition is appropriate or not, a company should always address the underlying rationale. The key reason given in empirical studies why most acquisitions fail is that they are not planned properly, and insufficient thought is given to the financial benefits likely to arise from the transaction. In all cases, an acquirer should be able to isolate and quantify the anticipated synergies. Value creation arises from purchasing **assets** at a price that enables them to become more valuable under new management and/or in combination with existing assets. Otherwise, the change in **control** amounts to nothing more than constructing a portfolio, and investors are able to do this themselves.
Synergies are the financial benefits arising as a result of a transaction. They are derived from four sources.

- cost savings
- revenue enhancement
- financial, principally one-off cash inflows, and
- real optionality.

1.1.1 Cost Savings

Synergistic cost savings can arise in a business combination from operations, such as eliminating duplication in the merged entity, as well as improvements in the financing structure of the business.

Examples of both types of cost savings are as follows:

- Reducing the headcount in administrative functions.
- Economies of scale leading to improved production efficiencies.
- Gaining critical mass and market dominance, giving ability to set prices and negotiate bulk ordering discounts.
- Eliminating excess production capacity.
- Reducing the group's effective tax rate. The value of this synergy is the **present value** of the tax savings that accrue because of the business combination. Tax synergies could be achieved by:
    - acquiring foreign operations that are taxed at a lower rate than the group's domestic tax rate
    - utilising tax losses across the group, although often such losses will be 'ring-fenced' to prevent acquisitions where the sole motivation is to gain tax losses, or
    - a write-up in the valuation of the assets of the firm being taken over, leading to higher tax savings from **depreciation** in future years.
- Improving **free cash flow**. The acquisition may have the effect of reducing business seasonality, and thus making **cash flow** less volatile. This can lead to an improvement in the entity's credit rating and an overall cheaper cost of debt. It can also increase the overall debt capacity of the enlarged group.

1.1.2 Revenue Enhancement

The combined entity can benefit from the following:

- cross-selling products to two separate customer bases
- common distribution channels, and
- common advertising, sales promotion and warehousing.

Revenue synergies are more difficult to quantify than cost synergies. When companies merge, cost synergies can be relatively easy to assess pre-deal and implement post-deal. Revenue synergies are harder to predict. Companies cannot be certain how customers will respond to the combined business, whether customers will actually value and purchase the broader, integrated set of products and services that the merged company can now offer, or how much of the projected cost savings customers will expect to receive in the form of lower prices. Nevertheless, revenue synergies must be identified and delivered. The stock markets may be content with cost synergies for the first year after the deal, but will also want to see revenue synergies that can deliver growth.

1.1.3 Financial, Principally One-off Cash Flows

Non-recurring **cash** savings arise from the following:

- disposal of surplus assets
- one-off tax credits, and
- disposal of non-core elements of the business.

One-off cash flows can, however, also be cash outflows, from business restructuring and redundancies. In most transactions, there will be one-off negative cash outflows in the early years, particularly while the integration of an acquired company continues.

1.1.4 Real Optionality

Real optionality synergies come from the added flexibility created by the acquisition. Creating the combined entity might establish new opportunities, for example the flexibility to expand into new markets or develop new products. These options would not exist if the businesses were not under common ownership.

1.2 Qualifying Synergies

Once the source of the synergies has been highlighted, it is necessary to estimate the financial effect and the timing of the cash flows. A **discounted cash flow (DCF)** forecast can then be prepared which computes a present value of the synergies. The valuer should also consider the negative impact of the transaction, for example, cash outflows arising due to reorganisation and redundancies or delays in anticipated revenue streams being realised. Quantifying synergies that arise from real optionality requires the use of option valuation models which will include accepting the list of underlying assumptions.

The present value of the synergies amounts to the financial gains expected from the acquisition and will be an important reference point in structuring the deal – in particular in deciding upon the size of the bid premium and the nature of the consideration available to the target company shareholders. This is considered further in chapter 2.

Exercise 1

Shriver plc is looking at a potential acquisition and a member of staff has identified a number of potential synergies that are likely to arise as a result. They now need to allocate the synergies to the most appropriate of three headings: ‘costs’, ‘revenues’ and ‘one-offs’.

Please allocate each of the following to the most appropriate heading.

1. Redundancy entitlements.
2. Sale of non-core operations.
3. Cross-selling opportunities.
4. Elimination of duplicate departments.
5. Improved financial structure post-acquisition.
6. Sale of surplus assets.

The answer to this exercise can be found at the end of this workbook.

1.3 Motivations for Making Acquisitions

Possible motivations for acquisitions that could lead to the realisation of synergies, include the following.

1.3.1 Horizontal Integration

Horizontal integration involves acquiring a company in a similar line of business. This may give access to different geographical markets or new market segments. It could also protect market position by helping eliminate the competition.

1.3.2 Vertical Integration

Vertical integration involves acquiring a supplier or customer. Such integration may enable a company to secure an important source of supply for its business. It may enable a company to obtain supplies more cheaply than its competition. Alternatively, it may enable a company to control its outlets to the final buying public, as with, say, breweries and public houses.

1.3.3 Purchase an Undervalued Company

It may be that the target is currently undervalued by the market and that there is an opportunity to buy it cheaply. If the acquirer thinks that this is the case, then it should have very good justification for its view as opposed to the general view of the market.

1.3.4 Acquire to Gain Expertise

Acquisitions can be undertaken in order to gain technical or other expertise. This should enable a company to seize market share from competitors or retain competitive edge in a sector facing rapid technological change. This is often seen in the pharmaceuticals, telecommunications and technology industries in particular.

1.3.5 Market Penetration

Market penetration means developing new and larger markets for a company's existing products. A market penetration policy will often be used within markets that are becoming more international or globalised. Cross-border mergers and acquisitions can be a means of becoming a major player in such markets.

1.3.6 Acquire for Growth

The quickest way of achieving growth is usually by acquisition. In the short term, it is probably the most expensive of all the **options**. It does, however, enable a company to acquire new expertise, avoid the need to build a market presence gradually and may result in synergies that give extra benefit to the combined entity.

1.3.7 Financial Rationale for Acquisitions

An acquisition could be made in order to generate potential financial benefits for the purchaser, for example:

- Improved earnings quality (consistency of annual profits) through acquiring a more consistently or counter-seasonally profitable business.
- Greater and cheaper access to financing through acquiring a more cash generative **subsidiary**.
- Possible use of tax losses of the target company. However, care must be taken to make sure the tax losses are able to be used post-acquisition. Tax authorities dislike acquisitions which are entered into simply in order to reduce tax, and typically, both companies have to be involved in the same business sector.
- Enhanced asset backing for the bidder's shares after acquisition. This occurs where the bidder has a lower ratio of net assets to share price than the target company. The acquisition would increase the assets available to secure loans, thereby probably improving the terms and amounts of any borrowing.

1.3.8 Some Dubious Motivations for Acquisitions

Diversification

Diversification is achieved by acquiring a business that faces different risks from an entity's existing operations. Diversification may bring benefits to a group, for example by reducing the overall **beta** of the group and thus its **equity** cost of capital.

However, diversification is not, necessarily a sufficient reason for an acquisition. If investors are already fully diversified, then the acquiring company is not bringing any benefits to its shareholders by diversifying its business portfolio. The shareholders have already done this for themselves. With the globalisation of **capital markets**, it is increasingly easy for investors to diversify for themselves rather than relying on companies to do it for them.

In certain circumstances, diversification can be detrimental for a business, where the acquiring company has little or no expertise in the area into which it is diversifying. An inexperienced management may be unable to devote sufficient time, or have the business knowledge, to develop the acquired operations to their best potential.

Inclusion in a larger group that does not understand its business might demotivate a new subsidiary's management and probably result in higher administration and other overheads.

Diversification has become less popular as a motive for M&A, with investors seeking to achieve the required levels of diversification within their portfolios, rather than leaving it to company management. The conglomerate boom from the 1960s through to the 1980s was unwound during the 1980s and 1990s, leading to the break-up of conglomerates such as Hanson Trust, GEC and BAT Industries.

Accounting Considerations

It has been possible for acquisitive conglomerates to achieve growth in **earnings per share (EPS)** solely by acquiring new companies every year. Since accounting earnings are less important than the fundamentals of the business and its cash flows, acquisitions made on this basis cannot be guaranteed to succeed in the long term.

Avoiding a Takeover

The larger the company, the less likely it is to be the subject of a bid itself. However, recent experience has indicated that size is not necessarily a deterrent to a determined bidder, who may see benefits in acquiring the group and breaking it into smaller segments.

Empire Building

Existing management may feel that the existing group is too small for their talents or the nature of the businesses is not interesting enough for them. In such a situation, rather than returning any surplus cash to shareholders by way of dividend, they may reinvest the cash in new businesses to enable them to demonstrate their management skills fully.

Killer Acquisitions

In recent years, a trend has emerged where acquisitions of target companies that pose a threat to the acquirer are undertaken. The target may represent a challenge to the acquirer and eliminate that threat, and maintain market share or industry position, the acquirer may embark on acquiring and then 'killing' the target. This trend has been seen particularly in the technology and telecommunications industries, often involving the acquisition of start-ups.

Exercise 2

Chandler plc designs and manufactures Scandinavian-style furniture that is sold to retail stores. Five potential acquisitions have been identified for Chandler – is the motivation for each acquisition primarily horizontal integration, vertical integration or diversification?

1. Clarke ltd designs and manufactures mock antique furniture.
2. Clarney ltd sells furniture in its own discount warehouses.
3. Crocker ltd runs a successful blog on interior design.
4. Claffin ltd provides a warehousing and delivery service, particularly for household items.
5. Chaffinch ltd is an online sales channel that specialises in furniture.

The answer to this exercise can be found at the end of this workbook.

1.4 Why do Acquisitions Fail?

The success of business combinations can be judged by reference to the returns generated post- acquisition versus those received by the acquirer's shareholders' pre-acquisition. What reasons can be identified where acquisitions fail to generate value?

1.4.1 Diversification into an Area Outside Company Expertise

The acquirer's management may not understand the business they now control and are therefore unable to expand it and maximise possible returns.

1.4.2 Premium Priced Transaction

The acquirer might overpay for the target. Insufficient synergies are generated by the combined entity post- acquisition to justify the bid premium paid. The combination fails to deliver the financial benefits that were quantified prior to the deal completing.

1.4.3 Inappropriate Financing Structure

The **capital** structure put in place to fund the transaction might be inappropriate. In particular, the combined entity post-acquisition may generate insufficient cash flow to service the borrowings necessary to fund the transaction. Borrowings as a source of funding are cheaper for the company than equity, however, borrowings require a fixed cash payment relating to the interest charge for servicing the debt and a repayment of the capital amount outstanding. The greater the **volatility** of the underlying operational cash flows, the more problematic it will be to service the debt finance. Riskier acquisitions should always be funded by a higher proportion of equity, which is a more permanent source of finance. Highly **leveraged** acquisitions are particularly problematic when they take place shortly prior to a period of economic recession and frequently result in restructuring or insolvency as the challenge of servicing the debt increases.

1.4.4 Ineffective Rationalisation

In order to bring two or more organisations together successfully there must be effective integration management and a recognition that any successful integration takes time. Where management is poor or there is an attempt to do too much too soon, potentially successful combinations can fail. Inflexibility in the application of integration plans drawn up prior to the event can be damaging. Once the acquisition has taken place, management must be prepared to adapt plans in the light of changed circumstances or inaccurate prior information.

Poor man-management can be detrimental to successful integration. Keeping staff informed is important. Lack of communication of goals and future prospects of employees, and failure to recognise and deal with uncertainties and anxieties can lead to employees being unclear of what is expected of them. Hostilities may develop between the two groups of staff, with an unwillingness to adapt to new procedures and practices.

1.4.5 Cultural Differences

Allied to ineffective rationalisation is the prevalence of cultural differences that can often derail what would otherwise be a successful acquisition. Invariably, companies and businesses are run by people and when differences in viewpoints, risk appetite, strategic objectives and aspirations arise between the staff of an acquirer and the target, an impact on the operations of the enlarged combination of businesses can arise.

It is not uncommon for such culture differences to feature in failed acquisitions, or at least cause multiple post-acquisition issues – which is why a great deal of the post-acquisition work of management and boards of directors is targeted at the effective integration of staff. It is important that due diligence efforts prior to an acquisition include considerations of the culture of the target and whether there is likely to be a cultural 'fit' post-acquisition. While a focus on financial and valuation aspects of a transaction is important, competent and strong leadership and management is critical to ensure that integration is successful.

1.4.6 Change in Strategy

Sometimes, a target may have been (or may have appeared to be) a strategic fit for the acquirer, but the strategy may require a change by the time of the acquisition, or shortly afterwards. In markets where change takes places at pace (such as in the fast moving consumer goods (FMCG) sector, or technology) it can sometimes be the case that an acquisition target's attractiveness can be lessened (or even become redundant) a short time after the acquisition has completed.

Question 1

Grimes plc is about to make a significant acquisition of an early-stage company for cash that it hopes will broaden, deepen and grow its product offering over time. Grimes will need to raise capital to finance the transaction. Which of the following are likely to be more appropriate sources of capital? Choose all of those that are appropriate.

A. 100% debt finance
B. 100% equity finance
C. A mix with a high proportion of debt
D. A mix with a high proportion of equity

The answer to this exercise can be found at the end of this workbook.

1.5 Attaining Growth by Alternative Methods

The quickest way of achieving growth is usually by acquisition. Acquisition also entails many risks. For example, the acquirer may pay too high a price, may buy a very poor company with hidden liabilities or may buy into an area that it does not really understand, and which becomes a drain on its resources.

Growth can be achieved in different ways. Three alternatives are considered in sections 1.5.1 to 1.5.3, namely organic expansion, licensing and joint ventures.

1.5.1 Organic Expansion

The company may aim to expand its existing operations through increasing production and marketing. If it is aiming to develop a new business area, it may start up from scratch.

The advantage of this approach is that it may be relatively cheap and involve limited investment. However, compared to growth through acquisition, growth will be achieved more slowly. There is also a risk that a start-up in a new business area may not succeed against established competition.

This method of growing the business is most likely to be appropriate in areas where the company already has substantial expertise and a good reputation. In such circumstances, the risk of failure and the costs of the venture are minimised.

In recent years, a number of companies have started 'incubating' start-ups or offering 'start-up labs' within their organisations, allowing and enabling them to support, nurture and steer new (third-party) start-up companies to develop related products or services. While the terms of such arrangements may vary, it is not uncommon for a proportion of the start-up's equity **share capital** to be owned by the hosting company in return for providing the start-up with office space and support.

The benefit of this approach is that if the start-up shows promise and is likely to be successful, the company that has accommodated and supported the start-up will have a head start in either acquiring the entity or increasing its share of ownership.
In some respects, this represents a hybrid approach of organic and opportunistic acquisitive strategy.

1.5.2 Licensing

Licensing involves establishing an agreement with another business in return for a royalty stream, for example selling the license to manufacture a product under an owned brand name. Licensing agreements can also be suitable where alliances are to be forged where, for cultural reasons or historical or national interest reasons, a fully-fledged acquisition is unsuitable.
The advantage of this approach is that it reduces cash outlay, for example, it avoids the need to fund capital expenditure necessary to establish manufacturing facilities. In return, the licenser receives a steady **income** stream at a small proportion of the start-up costs. The main disadvantage is that there may be control issues over the quality and speed of production and it will be necessary to estimate and monitor the level of royalties payable.

1.5.3 Joint Ventures

Joint ventures can be particularly appropriate for large projects or where the company has limited expertise in a specific area. Their benefit is that they spread the costs and the risks of the new venture with other parties. In addition, the other investors can bring their own skills and expertise to the deal, reducing overall risk significantly. The other investor may be a local company in an overseas market or a company that is already involved in a particular industry where the expanding company has little expertise at present.

The disadvantage of joint ventures is that gains are limited due to the existence of a partner, and a partner may simply be seeking and gaining expertise, intending eventually to set up in competition by itself.

Joint ventures can be established using different legal structures.

- The **joint venture** can be an incorporated company, with each party holding 50% of the shares. Such a structure gives limited **liability** for the shareholders, but the entity will be subject to corporate tax on profits generated.
- An **equal partnership** could be set up between two companies. A partnership is not a separate legal entity like a company and so the structure gives flexibility and confidentiality as to the financial affairs and constitution of the operations. However, the partners face unlimited liability and joint and several liability for the debts of the operations.
- A **limited partnership** has the flexibility benefits of a partnership but provides protection for some of the partners in the form of limited liability. However, the limited partners cannot be involved in the day-to-day management of the partnership and at least one partner must be a general partner with unlimited liability.
- A **limited liability partnership (LLP)** offers the flexibility of a partnership with limited liability to all of the partners and it is treated as a body corporate with a separate legal identity from its members. With this structure, the partners are bound like directors running a company and are required to file accounts, but the partnership agreement is a private document.

Case Study 1
Greene plc has taken over Gray ltd in a horizontal integration acquisition for cash. The two companies standalone income statement figures (assuming no acquisition) and combined figures after the acquisition are shown below:

£000s	Greene (assuming no acquisition)	Gray (assuming no acquisition)	Combined (post acquisition)
Revenue	144.0	91.2	288.0
Cost of goods sold	(96.0)	(72.0)	(192.0)
Gross profit	**48.0**	**19.2**	**96.0**
Other variable costs	(12.0)	(4.3)	(14.4)
Other fixed costs	(7.2)	(4.8)	(10.8)
Profit before tax	**28.8**	**10.1**	**70.8**
Tax expense	(7.2)	(2.4)	(9.6)
Profit after tax	**21.6**	**7.7**	**61.2**

Based on the above, please answer the following questions:

i. Were any revenue synergies achieved and how might they have arisen?
ii. Whether any before tax cost synergies were achieved, and how they might have arisen?
iii. Whether any tax savings were realised?

The answer to this exercise can be found at the end of this workbook.

2. The Acquisition Process

1.2.1 Know the key stages in the acquisition of a private company

1.2.2 Know the due diligence process for acquiring private and public companies including: scope of due diligence; vendor due diligence and data rooms; purchaser due diligence

1.2.3 Know the various types of due diligence that may need to be carried out: commercial, financial, people (including management), operational, environmental, legal (including regulatory), IT (including cyber and data security)

This section considers the acquisition process, exploring the various stages of a typical acquisition. The process tends to be similar irrespective of the rationale for the transaction or the type of company (or asset) that is to be acquired, except that if the acquisition is that of a listed company, some differences in the process exist. After a general introduction, this section considers acquisitions of private companies while in section 3, public company acquisitions are specifically addressed.

2.1 Identifying Potential Acquisition Targets

Having decided that the acquisition route is the most effective, a search to highlight suitable companies can commence. It is likely that the directors of the acquisitive company will be able to identify some candidates just by considering their own competitors and through general industry knowledge.

Any such identification of potential targets will necessarily depend first and foremost on what is intended to be achieved – in other words, what strategic aim the acquisition is intended to meet. Once it is clear what strategic objective is being pursued through the acquisition route, target identification and subsequent screening will become easier.

In addition to general industry knowledge and insight from the directors' experience in the market they operate in, information about companies can come from a variety of sources, including the following:

- Financial information services and online databases.
- Industry surveys that have been published.
- Asking individuals with a specialised knowledge of a sector, for example the financial adviser.
- For smaller acquisitions, reference can be made to 'Business for Sale' websites and columns in newspapers.

2.1.1 The Use of AI in Target Identification

Increasingly, technological advancement in the form of generative artificial intelligence (AI) is being used for M&A target identification. AI accelerates and broadens the ability to analyse financial data and market trends to identify companies that operate in growing

markets or possess valuable technologies. AI can also be used to evaluate the financial performance of potential targets and even suggest and quantify possible synergistic benefits.

However, using AI also has drawbacks. AI models rely on data, and in M&A that data can be incomplete (especially for private companies), outdated and inconsistent. This can cause AI models to miss high potential targets and rank target companies incorrectly. Furthermore, AI models may not fully explain why a particular target has been selected and what variables drive the ranking. Used thoughtfully, AI can widen the funnel and increase efficiency. Used blindly, it can narrow vision and create false confidence.

The aim of the initial search is to construct a list of suitable candidates and ensure all relevant possibilities have been considered. The list will then need to be examined to extract a shortlist of target companies.

2.2 Analysis of Targets

The initial analysis of the companies will be brief and only focus on key details. The objective will be to exclude candidates which for some reason or another (for example poor profitability) are unlikely to be satisfactory targets. As such, only summarised information needs to be obtained from a financial database about each of the companies being considered.

Once the initial screening process is over, it is likely that two or three companies will stand out as being attractive. These companies can then be analysed in more depth, drawing on more detailed information from a wider range of sources including national databases of limited companies, deals databases that professional corporate finance advisers have access to, specialist M&A market intelligence databases and advisory networks. Again, utilising AI will speed up this process by quickly scanning and analysing the financial statements and other documents to extract key financial metrics and identify potential risks and opportunities. AI may also uncover hidden patterns that might otherwise be missed.

Such assessment will ensure that the identified companies:

a. match the strategic objectives of the acquirer
b. are, even on a stand-alone basis, financially sound and suitably attractive candidates (in terms of market share, geographic reach, products, services and reputation, among other things), and
c. are a suitable fit (and often with a key focus on cultural fit).

Areas to cover in the analysis will include the following:

- **Financial Analysis** – a detailed analysis of trading, profitability, financial position and cash flows for the last three to four years. This period should be sufficient to give a trend without getting too historic so as to be irrelevant. The information will be available from the annual accounts.
- **Shareholder Information** – relevant information will include the total number of shareholders, an analysis by proportion of shares held and identification of any key stakes, including directors' holdings. Unusual voting or dividend rights and the existence of 'A' shares or **preference shares** should be noted.

- **Information on Directors and Advisers** – the backgrounds of directors and advisers should be noted in case this may afford an easy means of contacting the company through a mutual acquaintance.
- **General Information** – other company information, such as its website and brochures, will help to give an understanding of the company and its business. Premises can be visited discreetly and information obtained from casual conversations. An internet and press cuttings search may also yield results.
- **Initial Valuation** – at this stage, an initial valuation of the company can be prepared using a range of different valuation methods. The most important method will usually be cash flow based. Consideration should also be given as to how the acquisition will make commercial sense for both the acquirer and the vendor to quantify any potential synergies in the valuation. Comparable analysis will also be useful at this stage to determine how the target company trades relative to its peers.
- **Non-Financial Considerations including ESG and Reputational Risks** – Environmental, social and governance (ESG), brand and reputation risk analysis, including by way of screening, social media, and across the internet, has become both customary and a necessity in the digital economy. As already mentioned, the use of artificial intelligence (AI) tools to undertake in-depth screening across the internet, at speeds and depths that were previously unimaginable, allows more rigorous due diligence for reputational risks to be carried out. Both historic and live/real-time analysis of reputational risks, including those relating to ESG matters and ethical and responsible business considerations (such as supply chain factors and workers' rights), enable purchasers to undertake in-depth **due diligence** and unearth issues that they can address with risk mitigation tools and mechanisms which may ultimately include a significant reduction in purchase price or indeed walking away from a deal. Increasingly, buyers are being deterred from deals where concerns have been identified in relation to ESG matters.
- **Operational resilience** – in addition to the above reputational risks, acquiring companies without the ability to withstand disruption could expose the acquiror to significant risks. This includes vulnerabilities in relation to technology including the risk of data breaches and cybercrime. This will be particularly acute where the target's legacy system uses outdated software and weak encryption. To mitigate these risks, companies should conduct thorough due diligence as to how the target can prevent, respond to, and recover from operational disruption.

After this process has been completed, the company should have a good idea as to which company it wishes to approach, how much it is prepared to pay and why the acquisition makes sense. It can then consider how it is going to approach the target and, hopefully, negotiate a successful acquisition.

Where the target company is a public listed company, the due diligence carried out on the acquisition will be largely performed at this stage. For an unlisted company, there will be much less information in the public domain, and a further due diligence process must take place following the initial approach.

It tends to be the case that companies that have a strong track record in being successfully acquisitive, engage in ongoing and systematic searches for acquisition targets. Such a strategy allows for both the forging of relationships with potential targets well in advance of any acquisition as well as the ability to opportunistically take advantage of circumstances when an acquisition offer can be made.

2.3 The Approach

Where the target is a public limited company (plc), the manner and timing of the approach will be governed by City Code on Takeovers and Mergers (often referred to as the Takeover Code). If the acquisition falls under the remit of the Takeover Code, then the rules and principles set out therein must be adhered to.

Even if the Takeover Code does not specifically apply to the transaction, any advisers should conduct themselves in such a way as to follow best market practice and, hence, should remember the main provisions of the Takeover Code. Failure to do so may cast doubt on their integrity and their authorisation by the **Financial Conduct Authority (FCA)**.

Negotiations and processes that are customary for the acquisition of a private company are explored in the remainder of this section, while section 3 explores the considerations that are relevant for offers for public limited companies.

2.4 Approaching the Company

2.4.1 Obtain the Approval of the Target's Board

The approach to any company should typically be to the board of directors. In the case of a small, limited company, it is likely that the directors are significant shareholders and have great influence over the remaining shareholders. It is, therefore, important to convince them of the merits of the offer. This is because the lack of separation between the board and the shareholders means that a hostile bid is unlikely to be successful.

2.4.2 Use of Contacts

The initial approach may be made by one of the directors of the acquirer or by a financial adviser, who will probably have to identify the **principal** in the transaction quickly. It may be the case that a mutual contact between the acquirer and the target can be identified, such as a partner in a firm of solicitors. This will often help to smooth the initial approach.

2.5 Confidentiality

2.5.1 The Confidentiality Agreement

If the target company board is not averse to the initial approach, then negotiations may be taken further. At this stage it is likely that a confidentiality agreement will be signed by both parties. The objective of this is to ensure that any information released as part of the negotiations is not misused by the recipient, although other clauses may also be inserted. For example, the acquirer may attempt to obtain sole negotiating rights with the target for a period of time.

2.5.2 Contents of the Confidentiality Agreement

Typical points that would be covered in the confidentiality agreement include the following.

- The nature of information that will be disclosed by each party.
- Which information amounts to confidential information and which amounts to information that is already publicly available and therefore is not considered confidential.
- To whom the information will be made available in each company and who will not be permitted to see it.
- A prohibition on photocopies or scans being made of information passed over and an agreement to return all originals (and, if necessary, destroy any digital records) should negotiations fail.
- A prohibition on any information made available being used by the recipient for the benefit of their own business, unless they had already received the information from another source.
- Agreement not to disclose the existence of negotiations to other parties and stressing the secrecy of the proceedings.

2.5.3 Enforceability of the Confidentiality Agreement

It is clear that it is difficult to enforce many of these points in practice. However, it does provide some form of safeguard and helps to prevent blatant abuse of any information obtained.

2.6 Due Diligence

The acquirer's accountants, typically their auditors, will usually conduct a detailed investigation of the company to be acquired. This investigation forms what is known as 'due diligence' and the final conclusions are often prepared by the accountants in the form of a detailed due diligence report.

Typically, various types of due diligence will be undertaken including in respect of:

a. **Commercial matters** such as the commercial strategy of the target, its market share, key customers, any significant contracts that they have and their associated terms.
b. **Financial matters** such as the profitability of operations, margins, level of indebtedness and nature and terms of borrowings, and reviews of financial statements.
c. **People matters (including management)** such as the composition of the board of directors, their expertise, terms of engagement, numbers of non-executive directors, tenure and whether they are engaged in any competing business interests that could prove problematic for an acquisition.
d. **Operational matters** such as operational resilience, critical suppliers, integration issues that may arise, location of offices, premises, geographic distribution of operations and whether synergies may exist for the sharing of or streamlining of operations.

e. **Environmental matters** such as whether the target has an appropriate track record of compliance with environmental, social and governance considerations, or operates with due regard for such matters.
f. **Legal matters (including regulatory)** such as checking that the target is a properly constituted company, including a review of incorporation documents, partnership agreements and documents of legal title. Also, ensuring that it has the appropriate licences, permits and intellectual property required for operations. Any pending litigation or arbitration should be identified and considered.
g. **IT matters (including cyber and data security)** to assess whether the target's technology is robust, secure, scalable, and capable of supporting the combined business post transaction. This will include cyber risks – assessing the exposure to breaches, ransomware, or regulatory violations and understanding the target's ability to detect and resist attacks - and data protection and privacy, including compliance with regulations such as the GDPR.

In addition to the above, a due diligence report will normally cover the following areas.

- A detailed examination of the company's products and industry and of how the marketplace has developed and is expected to develop in future. This will include an understanding of the industry size, growth rates and barriers to entry, as well as technological developments that are expected.
- Details of competing firms and an assessment of the acquiree company's competitive position in its marketplace.
- A list of non-current assets including any **intangible** assets such as patents or copyright agreements. Details of premises occupied and **leases**, for example.
- Details of the company's operations in general, including an investigation of the production process, including any capacity constraints and management information systems.
- A detailed examination of supplier and customer contracts, including contract terms and provisions such as warranty claims.
- An analysis of the management team, how effective they are and whether they are essential to the company's success.
- Details of other employees, including identification of any key employees and an organisation chart to understand different roles and responsibilities within the company.
- A historical financial summary of **income statements**, **balance sheets** and cash flows. The accounting policies, along with any proposed or recent changes to these.
- An examination of the internal controls of the company, along with the internal management reporting system.
- An examination of any profit or other forecasts made by the company, considering how reasonable they appear to be. Comparison of forecast and actual position and an assessment of budgetary **variances**.
- An understanding of the **liquidity** position of the business, including working capital management and access to liquidity through committed but undrawn facilities.
- Details of the current financing structure, together with the terms and cost of any borrowings.
- An examination of the tax position, including review of tax returns and an assessment of future tax liabilities.
- Other key contracts of the business, including employment, insurance documentation and relevant government permits.

- Details of any other contingent claims or capital commitments.

This information and analysis will be obtained by examining company documents, where the use of AI tools is increasingly important, and also via meetings with key parties, especially the acquiree company's current auditors. The need to gather information via face-to-face meetings must be counterbalanced with the importance of keeping proceedings secretive at this stage.

The conclusions of the due diligence exercise will be presented in a due diligence report. What the report will cover will depend on the instructions given by the acquirer to its professional advisers/accountants. Typically, the report will be in an 'exceptions only' format, where only those points that are exceptional or differ from the norm, ie, those that are an exception, will be highlighted. Such an approach would ensure focus remains on potential areas of concern. Typical aspects of a business, or customary terms or operations, can then be omitted from such a report as, by their nature of being customary, they need not be of concern to a prospective acquirer.

Any issues identified in the report will be examined. The conclusions of the due diligence exercise may lead the purchasing company to abandon the acquisition or to a reassessment of initial valuation estimates to reflect the new information. Information unearthed through the due diligence exercise serves also to determine key terms of the acquisition beyond the valuation given to the acquisition.

2.6.1 Vendor Assistance

The due diligence report invariably includes a comprehensive review of the financial position and performance of the company. Where a company is undertaking a sales process, offering itself up for sale, it will probably commission its professional advisers to conduct vendor due diligence and prepare a report in advance. A full-scope diligence is performed before any detailed information is provided to external parties, allowing the selling company to identify and address potential risks before they become 'deal breakers'. The vendor due diligence report will then be made available to those potential acquirors that have been shortlisted in the sales process.

The selling company may also use their professional advisors for assistance both in advance of and during a transaction. This broader 'vendor assistance' can include valuation services to provide indicative valuations of the business, preparation of financial information ahead of due diligence, information request handling and other related services to ensure a smoother transaction process. In summary, vendor assistance encompasses a broad range of services by professional advisors to support and enhance the overall transaction outcome for the sellers of the business.

From the perspective of the buyer, assessing the size, experience and reputation of the professional advisors preparing due diligence reports and providing any other vendor assistance will be important.

2.7 Heads of Agreement

If the initial due diligence exercise is satisfactory, then further negotiations will take place between the acquirer company and the directors of the company to be acquired. If negotiations are successful, a preliminary agreement containing the terms of the acquisition will be reached. These will be summarised in the form of heads of agreement (also referred to as ‘heads of terms’ or a ‘letter of intent’). This is not usually a legally binding contract but merely formulates the key terms of the agreement. It is a Memorandum of Understanding (MoU) between the two parties. It will usually be subject to the final contract being agreed, after a detailed investigation of the acquisition target has been completed.

The heads of terms will usually cover the following points.

- The names of the acquirer and the vendor.
- Brief details of what is being sold, specified assets or equity.
- The price to be paid.
- The structure of the consideration (eg, any deferred consideration).
- Any key warranties made by the vendor. A warranty provides a form of protection for the purchaser of the business. It is a statement by the vendor that a particular statement of affairs is correct. For example, the vendor may **warrant** that it has good legal title to the assets of the business (and, therefore, is permitted to sell the assets on to a third party).
- Possible exclusivity provisions (covered in section 2.8).
- Conditions, such as:
    - completion of satisfactory due diligence
    - buyer’s financing being put in place
    - tax clearances being obtained
    - no material contracts terminated or adversely changed in the vendor’s business, and
    - no material adverse change in the vendor’s business.

2.8 Break Clauses and Exclusivity Agreements

The heads of terms may include an exclusivity clause or be accompanied by a separate exclusivity agreement. This will seek to prevent the seller from negotiating with, or soliciting offers from, other parties for a fixed period of time. An exclusivity agreement thereby provides the prospective buyer with a time frame in which to complete its due diligence, negotiate and hopefully complete the proposed transaction, without competition from other parties.

The target company often gets little in return for its grant of exclusivity, other than the (legally unbinding) comfort of the Heads of Agreement document. However, there may be financial penalties for the target if they pull out of the transaction during the period and after the bidder has incurred significant due diligence costs. In such instances, the exclusivity agreements are accompanied by a clause relating to break fees, whereby financial compensation is payable to the potential purchaser by the vendor if the period of exclusivity is not upheld by the vendor, ie, if discussions are entered into with another potential purchaser or the transaction is terminated for some reason. Break fees, otherwise known as ‘inducement fees’, are permitted by the Takeover Code but under strict conditions and

situations, described in Rule 21.2 Offer Related Arrangements. This includes circumstances where there are competing offers and a formal sale process is being undertaken, and that it is less than 1% of the value of the transaction and that consent of the Panel is gained.

2.9 The Sale and Purchase Agreement

2.9.1 Contents

The key contract in an acquisition is the 'sale and purchase agreement' or SPA. It will typically be prepared by the acquirer's solicitors and will be a substantial document, aiming to cover all eventualities. The exact terms may be varied by a process of negotiation between the acquirer and the vendor and their respective legal representatives. Information unearthed through the due diligence exercise can often lead to the terms being amended and negotiated although in large part, the final contract will ultimately reflect the negotiating strength of each of the parties.

The contract will usually contain the following details:

- what is being sold
- the identities of the vendor and acquirer
- the price to be paid, how it is to be satisfied and the exact structure of the deal
- any warranties, representations and indemnities made by the vendor (see 2.10 and 2.11 below)
- a disclosures letter (see 2.12 below)
- any conditions of the contract: both conditions precedent and subsequent (see 2.13 below)
- termination provisions and events on which the deal is conditional would appear in the SPA (although such provisions typically will be set out in a side agreement), and
- the completion date of the contract.

2.10 Warranties and Representations

The purpose of the warranties and representations made in the contract is to protect the acquirer. They are statements given by the vendor of the business to the acquirer, which give greater comfort about the business being bought.

Specifically, the representations are statements about the business given by the vendor, and the warranties are assurances from the vendor that those statements are true and accurate. Representations are wide-ranging and cover the areas focused on by due diligence. A seller will generally not make representations regarding its future financial performance or its prospects.

Warranties are more specific assurances, for example as to:

- completeness of liabilities in the accounts
- good title to assets, particularly properties, and
- warranties regarding the tax position of the company.

Where a warranty is found to be incorrect, the acquirer may sue the person giving the warranty for compensation if the acquirer has suffered losses as a result of the incorrect statement.

There is no such contractual provision to rely on in the case of breach of representations. Most sale and purchase agreements will expressly exclude liability of the seller for innocent or negligent misrepresentation, provided the exclusions are reasonable in the circumstances.

The exception to this is fraudulent misrepresentation in any contract. A misrepresentation will be classed as fraudulent where it is made knowingly by a seller; it is made without belief in its accuracy; it is made recklessly; and it is made with the intention that the purchaser shall act upon it. Care needs to be taken therefore with what representations are made by the vendor.

2.11 Indemnities

Indemnities provide for compensating the acquirer for any losses suffered due to specific liabilities mentioned in the sale agreement. This may include, for example, certain contingent liabilities. They will probably include indemnities in respect of tax liabilities.

Indemnities provide a stronger form of protection for an acquirer than warranties. An acquirer need only prove that the state of affairs envisaged by the indemnity has arisen, without the need to quantify that a loss has been suffered as a result.

Usually, a minimum and maximum indemnity claim is specified, although there may be specific exclusions to this. There can also be a time limit as to when indemnity claims are valid.

As part of the terms of the contract, the acquirer may require the seller to deposit an agreed amount (which can be up to the amount of the maximum indemnity claim) into an escrow account to back up any indemnification claims.

2.12 Disclosures

A disclosure letter is needed to highlight specific exceptions to the warranties. Disclosures are made by the vendor regarding the business to be sold. Ordinarily, where a warranty is found to be incorrect, the acquirer may sue the person giving the warranty if the acquirer has suffered losses as a result of the incorrect statement. However, it is not possible for the acquirer to seek legal redress concerning items included in the disclosure letter. The disclosure letter therefore ‘qualifies’ the warranties provided in the sale and purchase agreement. Its existence helps to mitigate risk that the vendor may otherwise face. In other words, the disclosures letter is the vendor’s opportunity to make ‘disclosures’ against the warranties required by the buyer. For example, if there is a warranty within the sale agreement that the target company is not a party to any litigation, the vendor would need to disclose full details of any current litigation affecting the company.

2.13 Conditions Precedent and Subsequent

Conditions precedent must be met prior to completion of the transaction. Failure by one party to complete a condition allows the other party to walk away from the transaction. Usually, the condition will relate to a specific matter like signing financing documentation, the receipt of regulatory clearances or completion accounts. Once a condition is satisfied, in order to confirm the transaction and make sure that there is a binding agreement between the parties, the matter needs to be documented within the relevant time period.

Conditions subsequent do not need to be fulfilled for the transaction to become binding. They do, however, allow the acquirer to terminate the agreement if the conditions are not fulfilled within a specified time limit.

2.14 Locked Box Mechanism versus Completion Accounts

A locked box is a mechanism whereby the acquisition price of a business is agreed between the acquirer and vendor upfront, before completion, and 'locked' at a point in time. Usually, an acquirer makes an offer on 'a debt-free, cash-free' basis and leaves the final determination of purchase price until completion accounts are available, and the cash, borrowings and working capital position of the business at the completion date is finalised.

With a locked box mechanism, the final price is based on a historic balance sheet, where the amounts of cash, borrowings and working capital are known with certainty. There is thus an agreed up front **enterprise value (EV)** for the business being sold. The relevant date used is often the date of the most recently available management accounts.

A locked box price works in favour of the vendor of the business. The acquirer has the risks and rewards from the locked date. The requirement is removed for the seller to prepare and negotiate completion accounts. It also gives a certain **transaction value** upfront, thereby saving time and cost associated with final price negotiations once completion accounts come through.

A locked box structure will be less suitable for a business with very volatile funding requirements, especially if working capital requirements cannot be estimated with certainty. The locked box mechanism was developed when M&A markets were very active and there were plentiful buyers and not enough good businesses to buy. Potential acquirers were prepared to accept locked box structures, and the additional risk this entailed, in order to get the deal done. It has subsequently remained a popular structure with **private equity** vendors who wish to maintain control over the pricing process.

As part of the locked box structure, the acquirer will negotiate protections in the sale and purchase agreement to prevent vendors extracting value from the business between the locked box date and the completion date when they relinquish control of the business. Such extractions of value could include the payment of dividends, returns of capital paid to the seller, capital expenditure commitments and excessive expenses incurred by the vendor relating to the transaction and any other payments other than necessary for the normal course of business. Indemnities may be put in place to protect the acquirer, covering any non-permitted extractions of value by the vendor.

3. Acquisitions of Public Companies

1.2.4 Know the following aspects of the Takeover Code and their relevance when advising on an acquisition to which the Code relates: when the Takeover Code applies; the structure of the Takeover Code; the spirit of the Takeover Code; the structure of the Panel on Takeovers and Mergers (PTM) and its powers; statutory status; independent advice; irrevocable undertakings; financing arrangements; offers for different classes of shares; concert parties; special deals and management incentives; accuracy and content of documents; the creation of false markets; restrictions and frustrating actions; consideration; mandatory offers; the timetable of an offer; consulting the Panel

1.2.5 Be able to analyse the key stages in the acquisition of a public company via a contractual offer or a scheme of arrangement

1.2.6 Be able to evaluate appropriate strategies for agreed and hostile offers including hostile bid tactics and defence strategies

1.2.7 Be able to evaluate the purpose, scope and contents of different types of legal and other documentation necessary during the acquisition process

This section considers the acquisition process where the target is a public listed company. Considerations that are specific to public companies are explored, and relevant regulatory and legal provisions that govern the acquisition of a public company are explained in the order that they usually appear in a typical acquisition.
However, let's start with a short question that highlights some of the differences between buying listed companies and unlisted, private companies:

Question 2

Conrad plc has identified an attractive target acquisition that is itself a listed company. When will the bulk of the due diligence be carried out?

A. Before the initial approach
B. After the initial approach
C. Once approval is given by the target's board
D. Once a confidentiality agreement is signed

The answer to this exercise can be found at the end of this workbook.

3.1 Facilitating a Takeover

There are two main methods to facilitate a takeover of a public limited company (plc) in the UK: a contractual offer to the shareholders of the target company (or offeree) or a scheme of arrangement. A contractual offer in the UK is made by way of an offer document. The document, constituting an offer to acquire shares, is sent to the target company's shareholders. A scheme of arrangement is a court-sanctioned agreement between the target company to its own shareholders and/or creditors and other parties.

For a contractual offer to be successful, offeree company shareholders (amounting to the specified acceptances level) must vote to accept the offer. For a scheme to be successful, the offeree company shareholders must vote in a general meeting to accept the scheme and the scheme needs court approval.

If successful, both methods will result in the takeover of the offeree by the offeror and both methods are subject to the provisions of the Takeover Code (covered in more detail under sections 3.2 and 3.3 below).
Set out in section 3.1.1 is the overall process of a public company takeover. It also considers how this differs from the private company acquisition process covered earlier in this chapter.

3.1.1 Takeover Offer

The acquisition process for private companies is a collaborative process, with the terms of the transaction worked out in negotiation between the offeror company and the offeree directors and shareholders. With public companies, it is likely that there is a separation between the offeree company directors and offeree shareholders (who have ownership). Offers for public companies thus follow a different process, with the offeror appealing directly to the offeree shareholders who will determine the bid outcome. Offeror shareholder approval is also necessary if the transaction is particularly material for the offeror (required by the **UK Listing Rules**).

Until 3 February 2025, all takeover offers for UK plcs (both listed and unlisted) were covered by the Takeover Code. The scope of the Code narrowed with effect from 3 February 2025. From that date, the Takeover Code only applies to companies with their registered office in the UK, Channel Islands or Isle of Man and whose securities are admitted to trading in the UK, Channel Islands or Isle of Man (referred to as UK-listed companies) or which were previously UK-listed. There is a two year 'run off' period for companies that cease to be listed, and a transitional period of the same time for companies that were within the jurisdiction of the Takeover Code but fall outside the narrowed scope, during which these companies will continue to be subject to the Takeover Code. The transitional arrangements will cease to have effect on 3 February 2027. The Panel does not regulate takeover bids and merger transactions of companies that are registered in any jurisdiction other than the UK, the Channel Islands or the Isle of Man. The Takeover Code contains detailed provisions relating to the main overriding principle that all shareholders of the target company (offeree shareholders) are treated fairly during the offer process and are not denied an opportunity to decide on the merits of a takeover.

There are six General Principles of the Takeover Code. The existence of the Principles recognises that it is impossible to devise rules that cover every situation. The General Principles assist companies and the Panel in interpreting and applying the spirit of the Takeover Code, which aims to ensure equal treatment for all offeree company shareholders, adequate and timely advice and information, and no false markets.

The six principles are set out below.

1. **General Principle 1 – Equal Treatment for all Shareholders** – states that all holders of securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected.
2. **General Principle 2 – Adequate and Timely Advice and Information** – states that shareholders must have sufficient time and information to enable them to reach a properly informed decision on the bid; where it advises the holders of securities, the board of the offeree company must give its views on the effects of implementation of the bid on employment, conditions of employment and the location of the company's places of business.
3. **General Principle 3 – Offeree Board to Uphold Interests of the Company** – states that the board of an offeree company must act in the interests of the company (as opposed to, for instance, the directors' personal interests). They must allow shareholders the opportunity to consider the merits of the bid. Unapproved frustrating action is not permitted.
4. **General Principle 4 – No False Markets** – states that false markets must not be created in the securities of the offeree company, of the offeror company, or of any companies concerned by the offer, in such a way that the rise or fall of the prices of the securities becomes artificial and the normal functioning of the markets is distorted.
5. **General Principle 5 – Offeror Consideration** – states that an offer should only be announced by an offeror once it can fulfil in full any cash consideration, if offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.
6. **General Principle 6 – No Unreasonable Hindering of Offeree Company's Business** – states that the offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a bid for its securities.

The way an offer is conducted must ensure fair treatment of offeree shareholders and avoid the creation of a false market in offeree company shares during the course of the bid. Offeree directors are required to communicate their views on the offer to the shareholders, but are prevented from undertaking action designed to frustrate the bid. Shareholders must be allowed to decide for themselves on the merits of the bid. In addition, the offeror must treat all offeree shareholders of the same class, as far as possible, equally – so no special deals with significant shareholders are allowed except with the consent of the Panel.

The takeover offer is an invitation by an offeror company to the shareholders of the offeree plc. The offer will include the price and terms of the offer, including the nature of the consideration to be paid. The offer will also incorporate an acceptances condition. The acceptances condition will specify the percentage of share capital which the offeror requires for the offer to be satisfied. This acceptances level can be chosen by the offeror; it must be a minimum of more than 50%, but is usually set at 90% or more. The Takeover Code has a

single unconditional date (which will generally be Day 60) for the satisfaction of all conditions. The unconditional date can be brought forward if a bidder issues an 'acceleration statement'. An offeror must serve an acceptance condition invocation notice (ACIN), if it wants to invoke the acceptance condition and lapse its offer (on or after day 21 and before the unconditional date). A 90% level of acceptance allows an offeror to invoke the compulsory purchase provisions available under the Companies Act 2006, thus gaining 100% ownership of the offeree company. These provisions are otherwise known as the 'squeeze out' provisions as they 'squeeze out' any remaining or dissenting shareholders that have not yet consented to and accepted the acquiror's offer.

The main due diligence exercise carried out by the offeror is undertaken from publicly available information prior to the launch of the offer. Due diligence is limited once the offer process commences. In particular, offeree companies will be mindful of the provisions of the Takeover Code, which state that information given to one offeror or potential offeror must also be given on request to another offeror or bona fide potential offeror, regardless of whether or not their offer is welcome (the Takeover Code, Rule 21.3 Equality of Information to Competing Offerors).

Public company takeovers do not have a sale and purchase agreement, as is used in private company acquisitions. The legal document is the 'offer document'.

Per Rule 13.1:

> *'An offer must not normally be subject to conditions or pre-conditions which depend solely on subjective judgements by the offeror or the offeree company (as the case may be) or, in either case, its directors or the fulfilment of which is in their hands.'*

Per Rule 13.3:

> *'Except with the consent of the Panel, an offer must not be announced subject to a pre-condition unless the pre-condition involves an official authorisation or regulatory clearance relating to the offer and either:*
>
> - *the offeree company agrees to the pre-condition; or*
> - *the authorisation or clearance is a material official authorisation or regulatory clearance.'*

3.1.2 Schemes of Arrangement

A scheme of arrangement is an alternate method to acquire a public company and is usually used for an agreed bid. The main contrast with a normal contractual offer is that shareholders are not asked to accept an offer, but to vote on proposals for a reconstruction of the company, which will have the effect of transferring it into new ownership. A scheme is a statutory procedure, under Part 26 (Sections 895–901) of the Companies Act 2006, which allows a company to make an arrangement or compromise with its shareholders or creditors. Once the scheme is approved by the requisite majority of shareholders or creditors and sanctioned by the court, the scheme is binding on all, whether or not they have voted in favour of it. The requisite majority is 75% in value of members or creditors present and voting at the relevant court meeting, either in person or by proxy.

Schemes can be used to affect a number of processes, including a takeover, an alteration of the rights of creditors, **share buybacks**, a debt restructuring and a compulsory purchase of minority shareholdings.

In a takeover context, the offeree company's shares are cancelled and then reissued to the bidder, in return for which the bidder pays the consideration to the target's shareholders. A scheme of arrangement can really only be used for an agreed bid, because the application to the court must be made by the company whose shares are being reorganised (ie, the offeree).

A scheme does, however, have some advantages for the offeror, particularly that there is a greater finality of outcome – either the scheme will be agreed or not. The offeror does not risk being left with a large stake but not 100% ownership. Once a scheme is sanctioned, the offeror is guaranteed 100% control of the target. Minority shareholders are bought out under the terms of the scheme, whether they like it or not.

The need to seek court approval adds extra complication to a takeover via a scheme, as opposed to a takeover offer. Scheme documentation is lengthy and complex, containing the same information as a takeover offer document, and also the relevant notices for shareholder meetings and the court hearing. As such, a scheme is more expensive to affect in terms of advisers' fees and regulatory costs. A takeover offer would generally be expected to provide the offeror with control of the offeree company quicker than a scheme. However, acquiring dissenting, outstanding minority shareholdings could substantially extend the timetable of the takeover offer beyond that of the scheme.

Schemes are less suitable to use where changes in terms of the offer are expected midway through the process. Changing offer terms (for example because a rival bidder has emerged) requires changing the terms of a scheme midway through the process and is likely to require the parties to go back to court.

There are three main stages to a scheme:

1. **Explanatory statement** – this is dispatched to shareholders and creditors at the same time as a notice convening members' and creditors' meetings. It explains the effect of the scheme, including all information reasonably necessary to enable the shareholder or creditor to decide how to vote. The statement normally takes the form of a detailed document, including a letter from the company's chairman or financial advisers. This includes details of the transaction (in this case, an acquisition), its purpose, its expected outcome, and of any impact on the personal interests of the directors of the company.
2. **Members' and creditors' meetings** – the company, a creditor, the liquidator, or a shareholder must apply to the court for permission for a meeting to be held for each of the classes of the interested parties concerned (ie, creditors, shareholders or different classes of either). The scheme must be approved by a majority in number, and 75% in value, of the creditors or class of creditors or shareholders present and voting, either in person or by proxy, at each meeting.
3. **Court approval** – after the proposal has been approved by shareholders and creditors, an application is made to the court to sanction the scheme. The court will ensure that the arrangement is such that a member of the class concerned, acting in respect of their interest, might reasonably approve the arrangement.

Once the scheme is sanctioned by the court, a copy of the court order must be filed within seven days with the Registrar of Companies. At this stage, the scheme becomes effective, binding on all creditors and shareholders of the class that voted in favour of the scheme, whether or not that individual creditor or shareholder voted in favour. The Articles of Association (AoA) of the company must be updated. If the company has its securities quoted on an exchange, the documentation that has been provided to shareholders, creditors and the Registrar of Companies will also be available through the channels prescribed by the relevant exchange on which its shares are listed.

Takeovers of UK plcs via Schemes of Arrangement are still subject to the provisions of the Takeover Code. Specific rules for Scheme of Arrangement takeovers are in Appendix 7 of the Takeover Code and are further explored in section 3.19 below.

As seen, schemes offer considerable certainty to an offeror as their offer would be binding on all shareholders, thereby avoiding the possibility of minority or dissenting shareholders preventing full control and ownership of the target. Principally because of the certainty schemes provide, their popularity has increased in recent years, a trend which appears to remain strong.

3.2 The Takeover Panel (the Panel)

The Takeover Panel (the Panel) is an independent body whose main functions are to issue and administer the Takeover Code and to supervise and regulate takeovers and other matters to which the Takeover Code applies in accordance with the rules set out in the Takeover Code. As already seen, the Takeover Code is designed to provide an orderly framework within which takeovers are conducted. In addition, it is designed to promote, in conjunction with other regulatory regimes, the integrity of the financial markets.

The Panel comprises up to 34 members, representing a spread of expertise in takeovers, securities markets, industry and commerce. The Chair, Deputy Chairs and up to 20 other Panel members are appointed by the Panel on the recommendation of its Nomination Committee. In addition, ten Panel members are representatives of key financial and business institutions.

The Panel has statutory authority from the Companies Act 2006. In addition, it has the support of regulatory authorities such as the Financial Conduct Authority (FCA), meaning that adherence to the Takeover Code is indicative of best market practice. The FCA requires that all investment businesses follow best market practice, and it may be that anyone who breaches the Takeover Code could have the facilities of the market withdrawn from them (referred to as 'cold shouldering').

The Panel operates via a system of consultation and the Takeover Code requires advisers and parties to a bid to discuss in advance any course of action related to a bid if there is uncertainty as to how the Takeover Code might apply.

There are a number of advantages of the system of regulation administered by the Panel, as follows:

- **Flexibility** – the Takeover Code can quickly be adapted to take account of changing circumstances. The law can only be changed very slowly.
- **Consultation in advance** – the Panel can be consulted in advance to ensure that the rules in the Takeover Code are not going to be broken, albeit unintentionally.
- **Quick decisions** – due to the system of consultation, the Panel can come up with speedy judgements.
- **Focus on principles** – the Panel applies general principles of fairness in making its decisions. Companies must comply with the General Principles which represent the 'spirit' of the Takeover Code. An action can be deemed inappropriate if it does not uphold these principles.
- **Practitioner involvement** – this makes the Takeover Code and its application more realistic, acceptable and effective.
- **Links with other regulatory bodies** – the FCA requires compliance with the Takeover Code and may cold-shoulder people who are severely censured by the Panel.

3.3 When does the Takeover Code Apply?

As seen, the Takeover Panel regulates takeover bids and merger transactions (however effected) of certain companies which have their registered offices in the UK, the Channel Islands or the Isle of Man, ie, companies which are 'UK registered'. The Panel does not regulate takeover bids and merger transactions of companies that are registered in any jurisdiction other than the UK, the Channel Islands or the Isle of Man.

Up until 3 Feb 2025, the Panel regulated offers for UK registered companies if any of their securities were admitted to trading on a UK regulated market or a UK multilateral trading facility, or on any stock exchange in the Channel Islands or the Isle of Man, ie, companies which were 'UK quoted'.

The Panel also regulated offers for: other public companies which were UK registered and certain private companies which were UK registered, which were considered by the Panel to have their place of central management and control in the UK, Channel Islands or the Isle of Man (ie, if the company is 'UK resident').
The private companies were:

- companies which were UK quoted at any time during the ten years prior to the relevant date
- companies in respect of which dealings in securities, and/or prices at which persons were willing to deal in securities, had been published on a regular basis for a continuous period of at least six months in the ten years prior to the relevant date
- companies whose securities had been subject to a marketing arrangement as described in Section 693(3)(b) of the Companies Act 2006 at any time during the ten years prior to the relevant date, and
- companies which had filed a **prospectus** at any time during the ten years prior to the relevant date.

These private companies were referred to as being in the ‘ten-year run-off period’. Since 3 February 2025, the new rules have brought this ‘10-year rule’ to an end, and the Code will also no longer apply to public companies incorporated in, and managed from, the UK, but whose shares are not listed or are listed overseas. Instead, there is now a two-year run-off period for all companies which cease to be UK-quoted, after which the Code will no longer apply to them.

The two-year run-off period runs from 3 February 2025 to 2 February 2027. This transition period is intended to provide time for companies to which the Takeover Code will cease to apply (transition companies), and shareholders in transition companies, to consider what action they may wish to take prior to the Takeover Code ceasing to apply to the company.

3.3.1 Transactions under the Takeover Code

The Takeover Code also describes the transactions that it applies to. The Takeover Code is concerned with regulating changes of control, however effected, including by means of takeover, acquisition, statutory merger or a court-approved scheme of arrangement.
It is also concerned with regulating other transactions which obtain or consolidate control, including offers by a **parent** company for shares in a subsidiary, dual-holding company transactions, new share issues, share capital reorganisations and offers to minority shareholders.

The Takeover Code applies to all takeover and merger transactions, including partial offers for less than 100% of a company’s shares and situations where control of a company is to be obtained or consolidated. However, it does not usually relate to offers for non-voting or non-equity shares.

Control is defined in the Takeover Code as an interest, or interests, in shares carrying in aggregate 30% or more of the voting rights of a company, irrespective of whether such interest or interests give de facto control. While, strictly speaking, control only becomes legally possible when more than 50% of the voting rights are held, the Panel believes that effective control can be achieved at this much lower percentage.

3.4 Structure of the Panel

The Panel comprises members representing a spread of expertise across industry, the financial markets and M&A. Practitioners with acquisitions experience therefore routinely sit on the Panel, ensuring that the Panel’s decisions are in touch with and reflect developments in the acquisitions sector.
The composition ensures that the Panel has breadth of expertise with which to respond to transactions that it regulates.

3.5 The Offer Process

The method in which a company should make an offer is included in the rules of the Takeover Code. This covers how approaches should be made, what announcements are required and what advice should be sought by the offeree board.

3.5.1 The Approach (Rule 1)

Any approach must first be made to the board of the offeree company or to its advisers. The identity of the offeror must be disclosed.

3.5.2 Secrecy Announcements – The Timing and Content of Announcements (Rule 2)

In order to prevent leakage of price-sensitive information, it is vital that absolute secrecy is maintained prior to an offer being announced (Rule 2.1). The advisers to the offeror or offeree should always warn their **clients** of the importance of this. The advisers must draw their clients' attention to the Takeover Code and to highlight the rules restricting share dealings (these rules are detailed later in this chapter). This is to ensure a false market does not develop in the offeree company shares.

3.5.3 When an Announcement is Required

An announcement is required in the following circumstances (Rule 2.2). Consultation with the Panel to clarify whether an announcement is required is encouraged.

a. A firm intention to make an offer has been notified to the offeree board. The offeree board is obliged to make an announcement that it has received the offer regardless of its attitude to the offer.
b. The offeror should make an announcement where an obligation to make an offer has arisen as a result of Rule 9.1 (mandatory offer). The announcement should be made immediately after the obligation has been incurred.
c. Where there is rumour and speculation, or the offeree's share price moves untowardly (for example, by more than 5% in any one day or by more than 10% above the lowest price since an approach was made to the potential offeree), then an announcement may be required as follows:
    - if there has been an approach to the offeree company, in which case the offeree board should make an announcement, and
    - if no approach has yet been made but the potential offeror has reason to believe that its actions are causing the rumours or price changes, in which case the offeror should make an announcement. Where there is any doubt in this respect, the Panel should be consulted.
d. Where negotiations or discussions are being extended to include more than a very restricted number of people outside of those in the company who need to know and their immediate advisers, then the offeree should make an announcement.

e. Where a purchaser is being sought for a holding or aggregate of holdings which have 30% or more of the voting rights in the company or where a company is seeking potential offerors, then the offeree company will be required to make an announcement in any of the following circumstances:
    - the company is subject to rumour and speculation or there is untoward movement in its share price, and
    - the number of offerors being approached is increasing beyond a very restricted number.

3.5.4 Contents of an Announcement of a Firm Offer

Where there is a firm intention to make an offer, a detailed firm intention announcement is required. The announcement should contain details of the terms and conditions of the offer, the identity of the offeror and any existing holdings in the offeree which the offeror (or people acting in concert with them) owns, controls or has options to buy (Rule 2.7).

3.5.5 Contents of an Announcement of a Possible Offer

All possible offer announcements made under Rule 2.4 of the Takeover Code, which commence an offer period, are required to identify the potential bidder. The possible offer announcement, whether released by the prospective offeror or offeree, will trigger an automatic 28 day ‘put up or shut up’ deadline by which time the named bidder must either commit and make a ‘firm intention to make an offer’ announcement, or publicly withdraw from the offer process (Rule 2.6).

3.5.6 Offeror’s Obligations

An offeror should only announce an offer if they know that they have the ability to see the offer through; for example, financing arrangements are in place. After an announcement has been made, an offeror must proceed with the offer (Rule 2.7) unless permitted to withdraw by the Panel. Once an offeror has stated that they do not intend to make an offer, they will normally be bound by that statement for at least six months or until there is a material change in circumstances (Rule 2.8).

The purpose of this rule is to avoid uncertainty and the possibility of vexatious offers, which may create a false market in the offeree’s shares.

3.5.7 Independent Advice (Rule 3)

After an offer has been received, the offeree board must obtain competent, independent advice as to whether the financial terms of any offer (including any alternative offer) are fair and reasonable (Rule 3.1). The substance of this advice must be made known to their shareholders. This is particularly important in the case of a management buyout (MBO), where the MBO directors will have a conflict of interest and will be unable to give advice to their shareholders.

If an adviser receives a fee dependent on the failure of a hostile bid, this will give an impression of a conflict of interest. Such an adviser will normally be disqualified from acting as a Rule 3 adviser. In addition, the Panel will require such arrangements to be disclosed in a defence document.

3.5.8 Reverse Takeovers

A reverse takeover is typically a situation where a listed company makes a share for share offer for an unlisted counterpart. As a result of the offer, the original shareholders of the unlisted company end up owning more than 50% of the shares of the listed company. Effectively, the unlisted company becomes the acquirer and obtains a listing through being taken over in this way.

Where the offer is effectively a reverse takeover or the offeror directors have a conflict of interest, then the offeror must also obtain competent independent advice (Rule 3.2). The basis of this is that in a reverse takeover, the offeror is effectively the offeree.

3.6 The Offer and Defence Documents

3.6.1 General Obligation as to Information

Documents from the offeror and offeree boards are covered in Section J of the Takeover Code. Rule 23 states that shareholders must be given sufficient information and advice to enable them to reach a properly informed decision as to the merits or demerits of an offer. This information must be made available early enough for them to make a decision in good time.

It is worth bearing in mind that in contrast to private company acquisitions where it may be possible for an acquirer to negotiate and influence prospective selling shareholders, in the context of a public company acquisition where several thousand shareholders may potentially need to be persuaded of the merits of an acquisition, the offer document serves as the chief method with which an acquirer may be able to influence shareholders of a target company. The converse also applies. The defence documents serve to dissuade a target's shareholder from accepting any offer that is made to them.

As such, offer and defence documents are sometimes regarded as sales documents to the extent that they seek to influence the outcome of an offer that is made. Great care is often taken to craft letters of recommendation contained within offer and defence documents to persuade shareholders to either accept or reject an offer, as the case may be.

Given the influence such documents, and others, can have over the outcome of a proposed transaction, the Takeover Code sets out a number of requirements that transaction documentation must comply with, as further detailed below.

3.6.2 The Responsibility of the Directors

Any document or advertisement issued in connection with an offer must state that the directors of the offeror or offeree company, as appropriate, accept responsibility for the information contained in the document. It must also state that, to the best of the directors' knowledge, the information is in accordance with the facts and does not omit anything likely to affect the import of the information (Rule 19.2).

If the information relates to another company and has been taken from published sources, then this responsibility is limited to ensuring that the information is correctly and fairly reproduced.

3.6.3 The Offer Document

The offer document must be sent to offeree shareholders within 28 days of the announcement of a firm's intention to make an offer (Rule 24.1), unless the offeror obtains the express consent of the Panel to do otherwise. On the day of publication, the offeror must publish the offer document on a website (usually its own) in accordance with Rule 30.2, and announce via a Regulatory Information Service (RIS) that the offer document has been so published, in accordance with Rule 30.1.

The principal contents are as follows:

a. **The intentions of the offeror with regard to the business, its employees and pension scheme(s) (Rule 24.2)** – this will include any major changes to be introduced and plans for continued employment of employees. The document should also give the long-term commercial justification for the bid.
   Typically, offer documents made rather bland statements concerning the offeror's plans for existing employees. For example, they just stated that the existing rights of employees will be safeguarded. The commercial justification for the offer was typically more fully developed, particularly in a share-for-share offer.
   The introduction of a requirement to more fully explain the intentions of the offeror in relation to an offeree stemmed from a desire by the Panel to deter a recurrence of what arose during a number of high-profile transactions, including Kraft Foods' acquisition of Cadbury's. In that transaction, shortly after the acquisition, a significant number of employees of the offeree company were dismissed, attracting both political and trade union concerns.
   The Panel issued a new Panel Bulletin 7 during 2024 on 'Offeror intention statements' which sets out a reminder of the Takeover Code's provisions which require disclosure by a buyer/acquiror of their intentions with regard to the business, employees and pension schemes of a target company and how such provisions operate in practice. Examples of certain approaches by bidders to address such requirements were included in the bulletin.
b. **Financial and other information on the offeror and offeree company (Rule 24.3):**
   - names of directors
   - nature of the business and the financial and trading prospects
   - the website address where the audited consolidated accounts for the last two years have been published

- the website address where an interim statement and/or preliminary announcement made since the date of the last published audited accounts has/have been published
- for a securities exchange offer, a description of any known significant change in the financial or trading position that has occurred since the end of the last financial period
- a pro-forma statement of earnings and net assets for the offeror
- details of material contracts for the offeror for the two-year period prior to the offer, and
- rating agencies' outlooks and any changes made during the offer period.

c. **The terms of the offer (Rule 24.3d)** – including the consideration offered and how this is to be paid, and any conditions attached to the bid.
d. **Share price comparisons** – the offeree historic share price for the first business day in each of the six months immediately before the date of the offer document and for the last business day before the commencement of the offer period and for the last date before the publication of the offer document (Rule 24.3d).
   It is often the case that the value of the offer is compared to the share price of the offeree. If this is done, there must be a comparison with the offeree share price on the last business day before the offer was announced along with any other comparison that may be made. This is meant to prevent solely unfair comparisons being made (Rule 24.3g). The problem is that the share price of the offeree will often have moved before the announcement in anticipation of the offer. As a result, this share price will already contain an element of bid premium, reducing the validity of the comparison.
e. **How the offer is to be financed (Rule 24.3f)** – there must be details of how the offer is to be financed and the source of any finance. This includes details of any debt instruments entered into in order to finance the offer. Where the offer is for cash or includes an element of cash then the offeror's bankers or another appropriate adviser should confirm that resources are available to satisfy full acceptance of the offer (Rule 24.8).
f. **Details of any relevant shareholdings and dealings (Rule 24.4)** – these include shareholdings in the offeree by the offeror company and shareholdings in the offeror or the offeree company by the offeror's directors or people acting in concert with the offeror. It also includes dealings in derivatives referenced to the shares.
g. Whether and in what manner the emoluments of the offeror directors will be affected by the acquisition of the offeree company or other associated transaction (Rule 24.5).
h. **Responsibility statement (Rule 19.2) –** a statement that the directors of the offeror accept responsibility for the information contained within the document must be included in each document the offeror sends to shareholders.
i. **Fees and expenses (Rule 24.16)** – the offer document must contain an estimate of the fees and expenses expected to be incurred by the offeror, analysed by different fee categories.

3.6.4 The Defence Document (Offeree Board Circular)

The defence document (otherwise known as the offeree board circular) should be sent to shareholders within 14 days of the publication of the offer document (Rule 25.1). On the day of publication, the offeree company must publish the document on a website (usually its own) in accordance with Rule 30.4, and announce via an RIS that the defence document has been so published.

The main contents of the defence document are as follows:

- The views of the offeree board on the offer and their reason for this view. An opinion on the effects of the implementation of the offer on the company's interests, including employment and an opinion on the offeror's strategic plans for the offeree company (Rule 25.2a).
- Substance of the advice received by the board from the Rule 3 independent adviser (Rule 25.2b).
- A description of any known significant change in the financial or trading position of the offeree company which has occurred since the end of the last financial period for which either audited financial information or interim financial information has been published or about which the directors need to give an appropriate negative statement (Rule 25.3).
- Relevant shareholdings and dealings should be disclosed (Rule 25.4). These include shareholdings in the offeror held by the offeree or its subsidiaries and any shareholdings in the offeror or offeree company held by the offeree's directors or people acting in concert with the offeree. It also includes derivatives referenced to the shares.
- Directors' service contracts, including the name of the relevant director and the remuneration payable under the contract (Rule 25.5).
- A responsibility statement (Rule 19.2) is also required.

3.7 Profit Forecasts and Earnings Enhancement Statements

There are specific regulations in the Takeover Code regarding the inclusion of financial forecast information in published documents. The subjectivity associated with making forecasts necessitates clear reporting requirements regarding the forecast and how it has been prepared to ensure shareholders understand the information that has been provided.

The Takeover Panel published Practice Statement No 35 in July 2025 titled '*Profit forecasts, quantified financial benefits statements and investment research*.' According to the Panel, this Practice Statement was introduced to provide formal guidance on how it interprets the rules in relation to this area, particularly regarding the complex 'grey areas' of what counts as a profit forecast.

The Takeover Code distinguishes between 'profit forecasts' and 'quantified financial benefits statements'.

3.7.1 Definition of a Profit Forecast

The definition of a profit forecast is fairly wide-ranging and is covered in Rule 28.2 in particular. A statement that includes no figures, but indicates how the profits have performed may constitute a forecast.

Key factors to consider include whether the statement:

- puts a ceiling or floor on the possible profit, and
- gives information enabling an approximate profit figure to be calculated.

For example, a statement that profits will be higher than last year is likely to be considered a forecast.

Even if the period for which the estimate of profit is being made has already expired, the estimate will still be a forecast. However, preliminary or interim announcements made by companies that comply with the UK Listing Rules requirements for such announcements will not be treated as forecasts. Dividend forecasts will not normally be included unless they are accompanied by an estimate of dividend cover.

Practice Statement 35 (published July 2025) provides specific guidance on when a statement is not a forecast. It states that forward-looking statements for a period ending more than three years from the date they are made are normally treated as 'aspirational targets' to which Rule 28 does not apply.

3.7.2 Requirements Relating to Profit Forecasts

A profit forecast must be compiled with due care and consideration by the directors (Rule 28.3). It must be fairly presented to the highest standards of accuracy. The responsibility for this lies with the directors making the forecast, but the advisers must satisfy themselves that it is the case.

The assumptions upon which the forecast has been based must be stated in the document giving the forecast (Rule 28.4).
Where an offer is solely for cash, then any forecast made by the offeror need not be reported on (Rule 28). In all other cases, the accounting policies and calculations for the forecast must usually be examined and reported on by the auditors for the company. If another financial adviser has been mentioned in the document, then that person must also report on the forecast.

A report by a financial adviser will not confirm that the profit forecast is correct. It will typically state that the adviser has discussed the bases and assumptions relating to the forecast with the directors of the company and that they consider the forecast to have been prepared after due and careful enquiry.

The accountant’s report is likewise fairly limited in its scope. It merely states that the accountant has confirmed that the figures in the forecast have been properly compiled on the basis of the assumptions made by the directors and that the report has been prepared on a basis consistent with the usual accounting policies of the company.

The reports must be published in the document giving the forecast (Rule 28.1). The reports must be accompanied by a statement that those making them have given and not withdrawn their consent to publication. If a company’s forecast is published first in an announcement, it must be repeated in full, together with the reports, in the next document published in connection with the offer by that company.

Exception

Third-party advisers' confirmation reports are not required on profit forecasts made outside an offer period. Instead, a directors' confirmation regime applies (Rule 28.1c).

Directors must confirm that:

- the forecast has been properly compiled on the basis of the assumptions, and
- the basis of accounting used is consistent.

The rationale behind the directors' confirmation regime, which is less onerous than the reporting regime mentioned above, is to encourage listed companies to provide greater guidance to the market about their future expectations, thus improving market transparency and valuations, without the company worrying about the Takeover Code implications on profit forecasts if an unforeseen offer materialises in the future.

If an offer does subsequently arise, any document or announcement published during the offer period which refers to the profit forecast must:

- repeat the forecast and include certain confirmations from the directors, or
- include a statement by the directors that the forecast is no longer valid and an explanation as to why that is the case, or
- include a new forecast for the relevant period, which will then need to be accompanied by the relevant third-party advisers' reports.

However, where a company regularly publishes earnings guidance statements as part of their normal shareholder communications the need for third party reports may not arise. The rules allow that if all parties agree (or the Takeover Panel considers reporting would be disproportionate), the profit forecast need not be reported on and only the directors' confirmations set out above for pre-approach forecasts are required.

The Panel will normally grant a waiver from Rule 28 reporting regimes for a forecast relating to a future financial period which ends more than 15 months from the date of publication. Instead, directors' confirmations must be provided. However, if a subsequent offer document or announcement repeats the forecast, the document must include a profit forecast for the current year and any intervening year and these forecasts are potentially subject to the Rule 28 reporting regime.

Practice Statement 35 clarifies that if an offeree publishes a forecast after unequivocally rejecting an approach, but an offer period subsequently commences (because the offeror returns), the offeree is usually required to obtain full third party reports however, the Panel may grant a dispensation to use the lighter 'directors' confirmation' regime if the forecast was published more than seven days after the rejection.

While Rule 28 reporting requirements will always apply in an MBO scenario (in other words, third-party reports are required and directors' confirmation statements alone are insufficient), dispensations from Rule 28 may however be granted by the Panel in other circumstances if it feels that application of the rule would be disproportionate.

For example, Practice Statement 35 clarifies that if an offeree company provides a private forecast to an offeror (eg, for a US proxy statement required by US securities laws), the Panel will normally grant a dispensation from the reporting requirements. Instead, a prominent warning must be included stating the forecast was not prepared in accordance with the Code.

3.7.3 Quantified Financial Benefits Statements

Where a party makes a statement concerning the expected financial benefits of a takeover or merger (for example, by quantifying the synergies expected to arise), the following disclosures are required (Rule 28.6):

- the bases of the belief supporting the statement (including sources of information)
- reports by financial advisers and accountants
- an analysis and explanation to enable shareholders to understand the statement, and
- a base figure for any comparison drawn.

These requirements also apply to target companies quantifying financial benefits from cost savings and all quantification of financial implications should a bid fail. Those wishing to make quantified financial benefits statements should consult the Panel in advance.

3.8 Restrictions on the Offeror and Concert Parties during the Offer Period (Rule 4.2)

During the offer period, the offeror or persons acting in concert (see section 3.8.1) may not sell securities in the offeree without prior permission from the Panel, and only then after 24 hours' public notice has been given that the sales may take place. If the bid is a mandatory bid under Rule 9 (see section 3.10), then no sales will be allowed at all.

If there is an announcement that sales may be made, then no further purchases of securities will be permitted, and it is highly unlikely that the Panel will permit the offer to be revised. This means that the only way the offeror can acquire shares in the offeree after the announcement will be if shareholders accept the existing offer.

The rationale behind these rules is to prevent an offeror from driving up the price of a target's shares via announcing an offer and then selling subsequently at a profit.

3.8.1 Acting in Concert

Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), cooperate to obtain or consolidate control (as defined in the Takeover Code) of a company or to frustrate the successful outcome of an offer for a company. A person and each of its affiliated persons will be deemed to be acting in concert all with each other. Persons acting in concert (whether they are actually acting in concert or are presumed to be) are, in effect, treated under the Takeover Code as a single person.

In certain cases, people will be deemed to be acting in concert unless it is shown to be otherwise. Whether parties are acting in concert matters because if they are deemed to be, they are considered as a single person and as such, if one party, without knowledge of the others, deals in shares of an offeree, it could potentially trigger a requirement under Rule 9 of the Takeover Code to make a mandatory offer for the offeree.

As per the Takeover Code, the following persons will be presumed to be persons acting in concert with other persons in the same category unless the contrary is established:

1. A company (X) and any company which controls, is controlled by or is under the same control as X, all with each other.
2. A company (Y) and any other company (Z) where one of the companies is interested, directly or indirectly, in 30% or more of the equity share capital in the other, together with any company which would be presumed to be acting in concert with either Y or Z under presumption (1), all with each other.
3. A company's pension schemes, and the pension schemes of any company with which the company is presumed to be acting in concert under presumption (1) or (2), with the company.
4. The directors of a company (together with their close relatives and the related trusts of any of them) with the company.
5. An investment manager of or investment adviser to: (a) an offeror; (b) an investor in a new company (or other vehicle) formed for the purpose of making an offer; or (c) the offeree company with the offeror or offeree company (as appropriate), together with any person controlling, controlled by, or under the same control as, that investment manager or investment adviser.
6. A connected adviser with its client and, if its client is acting in concert with an offeror or the offeree company, with that offeror or offeree company respectively, in each case in respect of the interests in shares of that adviser and persons controlling, controlled by or under the same control as that adviser (except in the capacity of an exempt fund manager or an exempt principal trader).
7. The directors of a company which is subject to an offer or where the directors have reason to believe a bona fide offer for their company may be imminent.
8. A person, the person's close relatives, and the related trusts of any of them, all with each other.
9. The close relatives of a founder of a company to which the Takeover Code applies, their close relatives, and the related trusts of any of them, all with each other.
10. Shareholders in a private company or members of a partnership who sell their shares in that company or interests in consideration for the issue of new shares in a company to which the Takeover Code applies, or who, following the re-registration of that company as a public company in connection with an **initial public offering (IPO)** or otherwise, become shareholders in a company to which the Takeover Code applies.

Not included in the above list is a market-maker, who would normally not be classed as acting in concert with either company in a takeover situation. Where the market-maker is part of an investment bank that undertakes other activities (such as fund manager and corporate finance), then the presence of information barriers will be sufficient for it to be distanced from knowing about the actions or activities that this part of the firm is undertaking for either company.

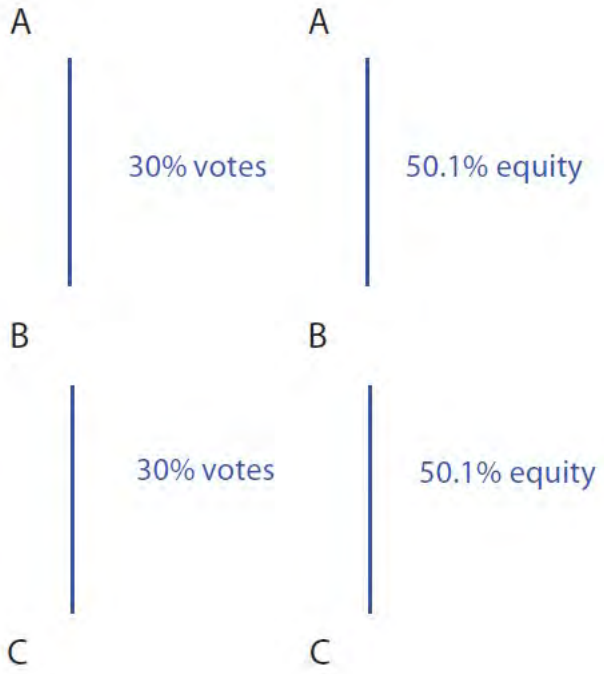
The definition in relation to control is:

> *'A company (or, where appropriate, a fund manager, a principal trader or an adviser) will be regarded as 'controlling' another company if it is interested in: (a) shares carrying 30% or more of the voting rights of that other company; or (b) a majority of the equity share capital in that other company, and references to a company being 'controlled by' or 'under the same control as' another company are to be construed accordingly. (Note that a reference to a company includes any other undertaking (including a partnership or a trust) or any legal or natural person).'*

Additionally, there are clarifications of what may amount to 'acting in concert' in the form of two presumptions from the Panel. These two presumptions apply to voting interests as well as equity interests, include long derivative/options to count towards the 30% threshold, and apply to interests in a fund in the same way as to interests in shares in a company.
The two presumptions are noted below:

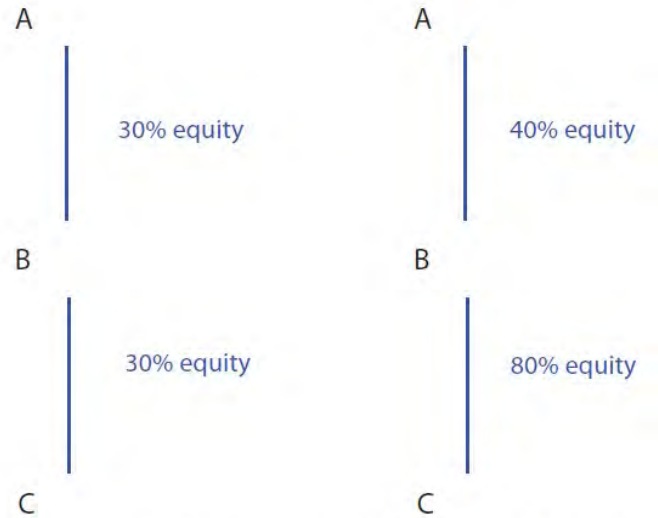
COMPANIES	
Presumption (1)	Presumption (2)
Companies connected by: 1. ≥30% voting rights, or 2. >50% equity share capital (voting and non- voting)	1. Companies connected by ≥30% equity share capital (whether or not the shares carry voting rights), and 2. Companies presumed to be acting in concert with either of them under presumption (1)
Control means that % interests **DO NOT dilute** through a chain of ownership	% interests **DO dilute** through a chain of ownership
FUNDS	
Interests in funds treated in same way as interests in a company's equity share capital	

The practical impact of these presumptions is illustrated in the following examples:
Example 1 – Here are two investment chains:



Under presumption 1, in both cases, A, B and C are all presumed to be acting in concert with each other.

Example 2 is based on the first 'limb' of presumption 2 that relates to equity holdings.



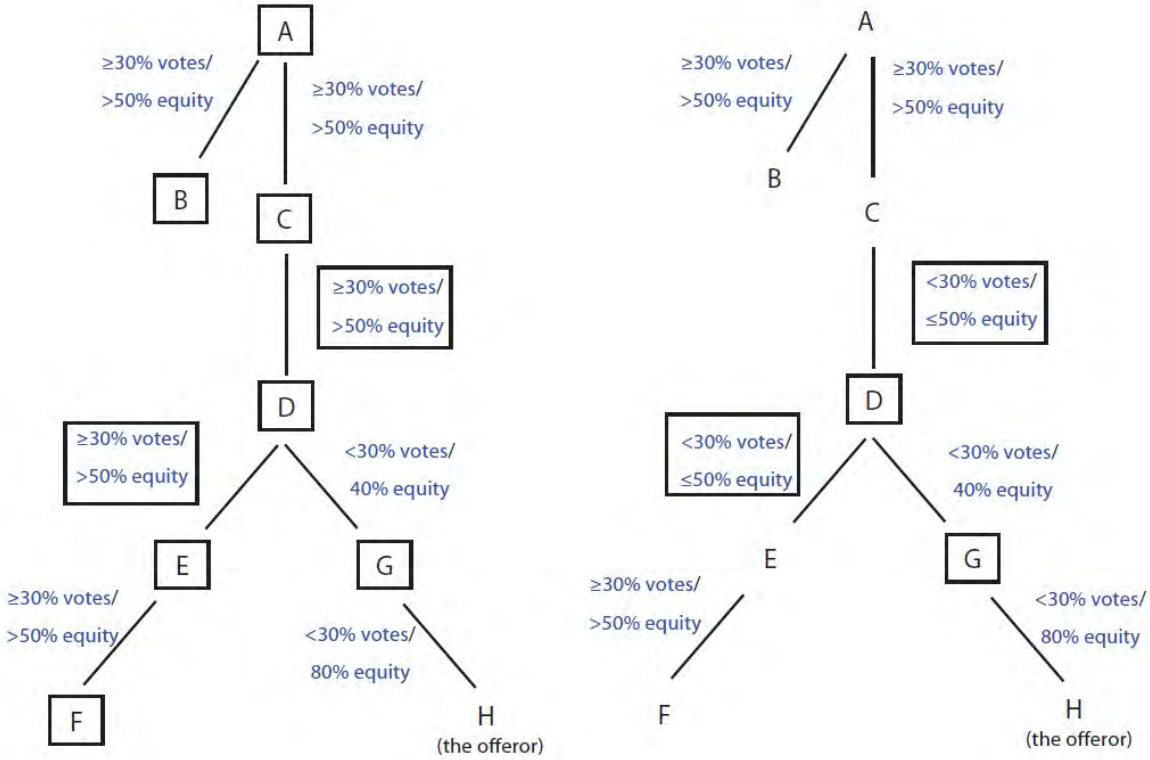
(9% 'see through' interest, based on 30% of 30%)

- A and B in concert
- B and C in concert
- But A and C not in concert

(32% 'see through' interest, based on 40% of 80%)

- A and B in concert
- B and C in concert
- A, B and C all in concert

Example 3 is based on the second ‘limb’ of presumption 2.



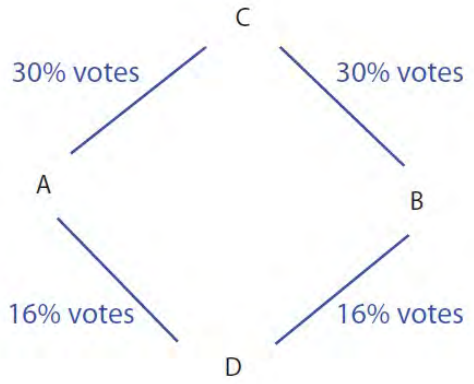
The second limb of presumption 2 catches any company which controls, is controlled by, or is under the same control as, a company subject to first limb of presumption 2.

So, on the diagram to the left, D and G are presumed to be acting in concert with H under the first limb of presumption 2 and A, B, C, E and F are also presumed to be acting in concert with H (the offeror) under the second limb.

On the diagram to the right, only D and G are presumed to be acting in concert with H (the offeror).

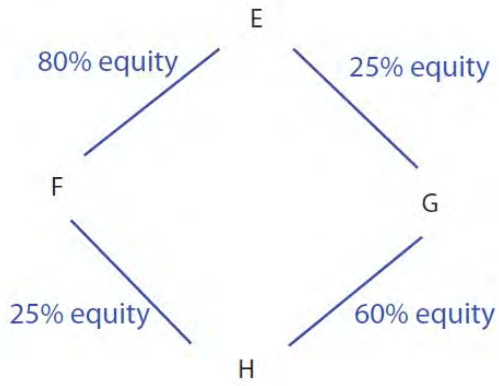
Example 4 – Aggregation of Interests

- C controls A and B
- A and B between them control ≥30% of the votes in D



- A and B (and C) in concert with D under presumption (1) (because C controls A and B)

- E/F and G/H in concert under both presumption (1) and presumption (2)
- E/G and F/H not in concert on stand-alone basis



- E in concert with H under presumption 2 because E has 35% indirect equity interest in H (20% via F based on 80% of 25%; 15% via G based on 25% of 60%) (first limb of presumption 2)
- F is in concert with H because it is controlled by E (second limb presumption 2)

In relation to investment entities, the Takeover Code identifies three key parties:

- The investment entity.
- The investment management/adviser.
- Investors in the investment entity.

The golden rules for investment entities are described below:

1. An investment/fund manager is treated as interested in shares it manages on a discretionary basis. However, a client of an independent fund manager is not treated as interested in shares which the fund manager manages on its behalf.
2. An investment manager/adviser to an offeror (or an investor in a consortium)/offeree (and persons under the same control as the investment manager/adviser) is presumed to be acting in concert with that offeror/offeree.
3. Where a limited partnership (LP) or investment fund:

    - invests in a bid vehicle, or
    - acquires an interest in shares in a Code company,

presumptions 1 and/or 2 will cause an investor in the limited partnership or investment fund to be presumed to be acting in concert with:

- the bid vehicle (in the context of an offer), or
- the limited partnership or investment fund (outside of an offer),

if the investor's percentage interest in the LP/fund means that the presumptions would apply if the LP/fund were a company.

Dealings and interests in securities held by members of concert parties are aggregated for the purposes of the Takeover Code. Thus, an offeror's shareholding in an offeree will be aggregated with that of its investment bank adviser, taking into account all interests held in all parts of that bank, including the fund management arm, the market-makers, and the principal traders. This could impose significant restrictions on principal traders and fund managers, in particular, whose activities are generally segregated from those of the corporate finance advisory arm and who have obligations to perform their roles as fund managers and market-makers. If the Panel is satisfied that effective information barriers (Chinese walls) or other appropriate arrangements are in place, it may grant the fund managers and principal traders exempt status; this provides an exemption from the obligation to aggregate interests in shares with those of the bank's corporate finance clients.

3.8.2 Standstill Agreements

A standstill agreement is an agreement between a company and a shareholder which maintains the status quo, ie, restricts a shareholder's ability to acquire further shares in the company or to sell any shares in the company.

If a standstill agreement is in place, the Panel will not normally consider a concert party to exist between the parties to the agreement, provided that the agreement does not restrict any of those parties from either accepting an offer for the company's shares at any stage or agreeing to accept any offer for the company's shares either before or after announcement (Practice Statement 16).

3.8.3 Dealings by Connected Exempt Principal Traders and Connected Exempt Fund Managers

A principal trader is a person who is:

1. registered as a market-maker with a **UK recognised investment exchange (UKRIE)**, or is accepted by the Panel as a market-maker, or
2. a member firm of a recognised investment exchange dealing as principal in order book securities. An exempt principal trader is recognised by the Panel as exempt for the purposes of the Takeover Code.

An exempt fund manager is a fund manager who deals on a discretionary basis for clients and is recognised as such by the Panel.

Fund managers, who manage investment accounts on a discretionary basis, and principal traders must apply to the Panel to obtain exempt status. Exempt status is only relevant if the sole connection between a fund manager or principal trader is that they are in the same group as a financial adviser or corporate broker to an offeror, offeree or concert party thereof.

The main effect of having exempt status is that the definition of acting in concert will not apply.

Connected, exempt principal traders must comply with Rule 38 of the Takeover Code. A principal trader who is connected with the offeror or offeree must not carry out dealings with the purpose of assisting the offeror or offeree company (Rule 38.1). An offeror and persons acting in concert must not deal as principal with a connected exempt principal trader (Rule 38.2).

If a principal trader or fund manager is connected but not exempt, Rule 7.2 of the Takeover Code applies. On commencement of the offer period both connected principal traders and connected fund managers will be presumed to be concert parties and Code restrictions on dealings will be relevant (Rules 5, 6, 9, 11, 36).

3.8.4 Dealings in Offeree Securities by Financial Advisers of the Offeree (Rule 4.4)

Financial advisers to the offeree, apart from exempt principal traders and exempt fund managers, may **not** do the following during the offer period:

- purchase any securities of the offeree or deal in derivatives and options referenced to the securities during the offer period on their own account
- lend money to others to enable them to deal in the shares other than on normal commercial terms, and/or
- enter into any agreement to induce someone else to deal or refrain from dealing in the shares.

This rule prevents advisers from purchasing shares or adopting other related methods designed to prevent the offeror from obtaining sufficient acceptances to declare the bid unconditional.

3.8.5 Prohibited Dealings by People other than the Offeror (Rule 4.1)

- **Dealing in the shares of the offeree** – any person who possesses confidential price-sensitive information concerning an offer or possible offer is prohibited from dealing in any way in the securities of the offeree, including dealing in options. In addition, they are also prohibited from making recommendations to other people to deal.
- **Dealing in the shares of the offeror** – dealings in the securities of the offeror company will be permitted so long as the offer is not price sensitive to the relevant securities, for example, in a wholly cash bid.
- **Insider dealing** – this rule reinforces the Criminal Justice Act 1993, which broadly states that nobody in possession of inside information may deal in the relevant company's securities.

3.8.6 Summary: Dealings in Offeror and Offeree Securities

The table below summarises the main provisions relating to dealings in offeror and offeree securities in the offer period.

Dealings by	Offeror Securities	Offeree Securities
Offeror	N/A	Sales – prohibited Purchases – allowed subject to Rules 5, 9, 6 and 11
Financial Advisers to Offeree	N/A	Dealings – prohibited
Any holder of Price-Sensitive Information	Dealings – prohibited*	Dealings – prohibited

* Unless the offer is not price-sensitive to the offeror

3.9 Restrictions on Acquisitions

3.9.1 Restrictions on Obtaining Control

The Takeover Code contains restrictions on companies amassing substantial shareholdings in target companies without making an offer for all of the shares. Two Code rules work together here – Rules 5 and 9.

The objective of Rule 5 is to prevent a person obtaining control or consolidating control over a company except in a number of acceptable circumstances. The basic rule states that when a person (including people acting in concert with them) holds shares or rights over shares that carry less than 30% of the voting rights in a company, they may not acquire any shares or rights over shares, which would mean that they would hold 30% or more of the voting rights in the company.

It should be noted that the definition of ‘effective control’ as being control of 30% of the voting rights is essentially arbitrary. The Panel has considered changing this percentage in the past but has concluded that the 30% test has ‘stood the test of time’.

If a person already holds shares or rights over shares with between 30% and 50% inclusive of the voting rights then they may not increase their percentage holding in the company.

3.9.2 Exceptions to the Restrictions

There are a number of exceptions where the basic rule in section 3.9.1 does not apply, allowing a stake of over 30% to be acquired. These are as follows (Rules 5.1 and 5.2).

a. Where a person already holds shares with more than 50% of the voting rights, since they already have legal control (Note 1 to Rule 5.1).

b. Where there is a vote of independent shareholders, ie, excluding the acquirer, which approves the acquisition (Note 4 to Rule 5.1) – a Rule 9 Waiver – see dispensations from Rule 9 in section 3.10.2.
c. Where the purchase of shares or rights over shares is from a single shareholder and it is the only purchase in a seven-day period (Rule 5.2a). Where such a purchase is made, then no subsequent purchases will be permitted unless the situations given below apply (Rule 5.3).
d. Where the purchase is immediately before or at any time after a firm announcement to make an offer or during an offer and either the offer itself or a competing offer will be/has been recommended by the offeree board (Rule 5.2b/c). Where the purchase is immediately before the announcement, it must be conditional on the offer being made.
e. Where an offer has been announced, and Day 21 of the offer or a competing offer has passed (Rule 5.2c).
f. During an offer that is unconditional (Rule 5.2c).
g. Where the acquisition is by way of a shareholder accepting an offer, as opposed to selling in the market (Rule 5.2d).
h. Where the acquisition replenishes a previously held shareholding, as long as it is a very small purchase (less than 1% of issued voting share capital and must not exceed the highest percentage held in the last 12 months) (Rule 9.1, note 11).

3.9.3 Rights Over Shares

It should be noted that Rule 5 refers to shares or rights over shares. This will include options over existing shares but will not include warrants to subscribe for new shares in the company or convertible debt (since the shares are not yet in existence in these cases). Exercise of such warrants or conversion rights would, however, be relevant for the purpose of Rule 5, when they would be treated as an acquisition from a single shareholder. The exercise of options over existing shares would not be relevant, since the options themselves have already been included as rights over shares.

Example of options and warrants being exercised

	Before %	Exercise Options %	Exercise Warrants %
Shares owned	25	29	32
Options over existing shares	4	–	–
Total for Rule 5 purposes	29	29	32
Warrants over shares	3	3	–

Since the options are already included in the Rule 5 total, the exercise of the options has no effect on the holder's position. By contrast, exercise of the warrants increases the shares and rights over shares held and brings the total to 30% or over. This in itself would be permitted by Rule 5, since the exercise of the warrants is treated as a purchase from a single shareholder. However, the restrictions on future purchases outlined above would subsequently apply.

3.10 The Mandatory Offer

The mandatory offer is required by Rule 9 of the Takeover Code. Where a person obtains control of a company, then they must make an offer for the shares of all other shareholders.

This means that other shareholders will not:

- be forced to keep a shareholding in a company where somebody else effectively controls the company's operations and financial policy, or
- have to sell shares subsequently at a lower price that reflects the fact that there is a dominant investor who does not intend to make an offer for the other shares.

3.10.1 When the Mandatory Offer is Required

Acquiring or Consolidating Control

Rule 9 covers two situations, when a person:

- originally acquires effective control of a company (defined as holding 30% or more of the voting rights)
- consolidates control (defined as increasing a holding of between 30% and 50% inclusive of the voting rights by any percentage).

The rule specifically states where:

- a person acquires shares which, when taken in aggregate with their existing holdings and those of people acting in concert, carry 30% or more of the voting rights of a company, or
- a person or people acting in concert already hold shares with between 30% and 50% (inclusive) of the voting rights and the person or people acting in concert acquire shares which result in an increase in their percentage holding, then that person must make an offer to all the holders of any class of equity share, or voting non-equity share in which they or people acting in concert have a holding.

It should be noted that an obligation to make a mandatory offer under Rule 9 may not be satisfied by a scheme of arrangement unless the Panel consents. The factors that the Panel would take into account when considering giving their consent would include the likely timetable and the views of the offeree board and its Rule 3 adviser.

The Panel issued Response Statement 2025/1 in December 2025 titled 'Dual Class Share Structures, IPOS and Share Buybacks'. This addressed the potential issues that might arise in relation to mandatory offers for entities with dual class share structures (ie, a company which has, in addition to voting ordinary shares, a second class of shares (Class B or special shares) with an enhanced level of voting rights or control as compared to the ordinary shares). The framework is primarily applicable to a structure where the Class B shares carry multiple votes per Class B share from the point of issue, and these are extinguished or converted to ordinary shares on particular trigger events, such as a time sunset, the retirement, resignation or death of a Class B shareholder, or the transfer of the Class B shares. The Response Statement clarifies the application of the mandatory offer requirement where a shareholder's percentage of voting rights is increased as a consequence of a trigger event.

Although such an affected shareholder may incur a mandatory offer obligation, the affected shareholder may not be required (in practice) to make a mandatory offer. This is because, on a trigger event other than a time sunset, the Panel will normally grant a dispensation as long as the affected shareholder is an innocent bystander. In the context of a time sunset, the Panel will have the ability to grant a Rule 9 dispensation as a result of the disclosures made at the IPO stage, and/or subject to the disposal of sufficient shares to take the affected shareholder's interests in shares carrying voting rights below the relevant threshold.

The Response Statement also requires an acceptance condition in a contractual offer for a dual class share structure company to be subject to two tests, one that takes account of the voting rights position immediately before the relevant Class B or special shares convert or are extinguished, and another that takes account of the position immediately after the relevant Class B or special shares convert or are extinguished. The acceptance condition must satisfy a two-limb test where an offeror must secure >50% of votes pre-conversion AND >50% post-conversion.

Contrast to Rule 5

Rule 9 links in strongly with Rule 5. There are, however, some important distinctions between the two. Rule 5 basically prohibits purchases that take a holding to 30% or over except in certain circumstances. If a person takes advantage of one of the exceptions, they can purchase the shares. However, they will still be subject to Rule 9 and will be required to make a mandatory offer for the company in question.

A second difference is that Rule 5 refers to shares or rights over shares (such as options) but Rule 9 refers to only shares. Thus, a purchase of options taking a person over 30% would be relevant for Rule 5 purposes, but would not usually be covered by Rule 9, unless the buyer of the option had effectively acquired control of the shares (Note 10 to Rule 9.1). Under Note 2 to Rule 5.1 a person may acquire options, warrants, convertibles or similar that carry rights to acquire voting rights that would result in the person holding 30% or greater of the voting rights if exercised, without triggering a Rule 9 bid. If the options were exercised, however, the resultant acquisition of shares would generally trigger a Rule 9 bid unless a Rule 9 Waiver was granted at the point of the acquisition of rights; such Rule 9 Waiver (see section 3.10.2) cannot be granted subsequent to the point of exercise.

Example of options being acquired and exercised as well as warrants exercised

	Before %	Exercise Options %	Exercise Warrants %
Shares owned (= Rule 9 Total)	25	25	34
Options over existing shares	–	6	–
Total for Rule 5 purposes	25	31	34
Warrants over shares	3	3	–

The purchase of the options has no effect on the total for Rule 9 purposes and hence no mandatory offer is required. It will, nevertheless, be relevant for Rule 5 purposes. If the options are purchased from more than one shareholder, then the purchase would probably not be permitted. If the purchase was from only one person, then it would be permitted but subsequent acquisitions would not usually be possible, in accordance with Rule 5.
The later exercise of the options is irrelevant for Rule 5 purposes, but increases the total of shares to 30% or over. Hence, a mandatory offer will probably be required under Rule 9.

Moving from a Voluntary Offer to a Mandatory Offer

Note that a person may make an offer on a voluntary basis and then purchase shares in the market bringing their holding in the company to 30% or more. This will trigger Rule 9 and mean that the offer will become mandatory. Mandatory offers can only have a limited number of conditions attached and must have a cash alternative (see section 3.10.4).

Should an offeror plan to incur such an obligation, it should consult the Panel in advance (Note 9 to Rule 9.1).

Acquisitions of Shares by People Acting in Concert

The prime responsibility for making a mandatory offer rests with the person who made the purchase that took the total concert party holding to 30% or over and triggered the offer (Rule 9.2). The obligation may, however, be extended to include any other member of the concert party, especially where the person with prime responsibility is a relatively minor member of the group.

Reduction or Dilution of a Controlling Shareholding

It may happen that a controlling stake of between 30% and 50% is diluted as a result of a **new issue** of shares by the company or by a sale of part of the shareholding. In these circumstances, the controlling shareholder (or concert party) is permitted to make limited purchases without incurring a Rule 9 obligation (Note 11 to Rule 9.1).

Such shareholders may purchase up to 1% of the shares in any one year, subject to the proviso that the total percentage owned does not exceed the highest percentage owned in the previous 12 months. As a result, such controlling shareholders will not be able to increase their percentage holdings from one year to the next. They can only reinstate the holding to its previous percentage level. For example, if a holding was reduced from 37% to 36.5%, it could be reinstated to a maximum level of 37% within the next year.

Advisers with Recognised Intermediary Status

Shares held by a recognised intermediary acting in a client-serving capacity will not be treated as interests in shares for the purpose of deciding if a Rule 9 bid is required (Note 1 to Rule 7.2). Note that the shares must be held by the intermediary in a client-serving capacity and as such this exclusion would not apply to shares held by an intermediary for proprietary trading purposes.

If any part of the trading operations of a bank or securities house wishes to be accepted by the Panel as a recognised intermediary, it must apply to the Panel to be granted such status and it will have to comply with any requirements imposed by the Panel as a condition of its granting such status.

3.10.2 Dispensations from Making a Mandatory Offer

The dispensations from Rule 9 give a number of situations when acquiring 30% or more of the voting rights in a company, or increasing a holding with 30% or more of voting rights by any percentage, will not necessarily trigger a mandatory offer. In all cases, the dispensation is not an automatic right but is granted by the Panel.

Rule 9 Waiver

Where there is an issue of new securities by the company as consideration for an acquisition or a cash subscription, and a shareholder is set to acquire 30% or more of a company, no mandatory offer will be required if there is a vote of independent shareholders, ie, not including the person making the acquisition or people acting in concert with them, which approves the shareholding. This type of proposal is known as a 'Rule 9 Waiver'. This will also be given provided there has been a vote of independent shareholders in cases involving the **underwriting** of an issue of shares. A Rule 9 Waiver document (ie, the general meeting (GM) circular to shareholders to approve the transaction) requires the approval of the Panel.

Foreclosure on Security for a Loan

Where a lender forecloses on security for a loan and takes control of 30% or more of the company. This exception will not apply if the lender had reason to believe that foreclosure was likely when the loan was made.

Rescue Operations

Where a person acquires 30% or more of a company as a result of a rescue operation when the company is in financial difficulty. This requires a process essentially similar to a Rule 9 Waiver but subject to such conditions (if any) as the Panel considers appropriate.

Inadvertent Mistake

Where the person made a genuine mistake in incurring an obligation to make an offer. However, the shares must be sold in a limited period of time to people unconnected to the original purchaser.

Where 50% of Shareholders will Not Accept

Where holders of shares carrying 50% or more of the voting rights in the company have confirmed in writing that they will not accept any offer. The Panel will also consider waiving the requirement for a general offer in the case of an issue of new securities where 50% or more who would be entitled to vote on a Rule 9 Waiver resolution have confirmed that they would vote in favour of any resolution to that effect at a general meeting.

This would mean that a mandatory offer would be bound to fail, since it must be a condition of the offer that the offeror and people acting in concert end up with more than 50% of the voting rights (see section 3.10.3).

Enfranchisement of Non-Voting Shares

As clarified in Response Statement 2025/1 the rules regarding the enfranchisement of non-voting shares are as follows: If non-voting shares gain voting rights (enfranchisement) and this pushes a shareholder over the 30% threshold, it is treated as a Rule 9 acquisition. However, the Panel will normally grant a dispensation unless the shareholder acquired the shares having 'reason to believe' enfranchisement was 'imminent.'

Repurchase of Shares

Where a company repurchases its own shares and a person not acting in concert with the directors ends up owning 30% or more of the company as a result. Such a person will not be required to make an offer for the company, unless they acquired the shares with the expectation of the share repurchase taking place (Notes 1 and 2 to Rule 37.1). Note that a director obtaining 30% or more of the company may be required to make a mandatory offer in such a situation, unless there is a Rule 9 Waiver.

3.10.3 Required Conditions for a Mandatory Offer

Except with the consent of the Panel, a mandatory offer must be conditional only upon the offeror having received acceptances in respect of shares which, together with shares acquired or agreed to be acquired before or during the offer, will result in the offeror and any person acting in concert with it holding shares carrying more than 50% of the voting rights in the offeree company. No other conditions are allowed.

3.10.4 Required Consideration to be Offered

The offer must be for cash or with a cash alternative (Rule 9.5). The cash offer must be at a price not less than the highest price paid for shares in the offeree in the last 12 months by the offeror or persons acting in concert with them.

3.11 The Voluntary Offer

A voluntary offer is any offer not subject to Rule 9, Mandatory Offers. There are required conditions for a voluntary offer, and then the offeror may choose to add in additional conditions.

3.11.1 Referral to the CMA and Other Regulatory Clearances

Where an offer comes within the statutory provisions for a referral to the Competition and Markets Authority (CMA) or another regulatory clearance is required, such as to the Investment Security Unit in the Cabinet Office in respect of National Security and Investment clearance, then to the extent that any related review period or assessment period has not ended by Day 37 of a contractual offer, it will normally be possible for the offer timetable to

be suspended under Rule 31.4 (Suspension of offer timetable if an official authorisation or regulatory clearance remains outstanding) pending the outcome of the review and/or assessment.

3.11.2 Acceptance Condition

Rule 10.1 stipulates the requirement for a 50% Acceptance Condition. Any offer which, if accepted in full, results in the offeror holding over 50% must include an acceptance condition that is not capable of being satisfied unless the offeror has acquired or agreed to acquire (either pursuant to the offer or otherwise) shares carrying over 50% of the voting rights (Rule 10).

Although the acceptance condition must specify that the offeror holds more than 50% of the company, it may specify a higher percentage. A typical acceptance condition would state the following:

> *'The offer is conditional upon the offeror acquiring 90% or more of the shares to which the offer relates (or such lesser percentage as the offeror sees fit), so long as the offeror holds more than 50% of the voting rights in the offeree.'*

Response Statement RS 2025/1 ('Dual Class Share Structures, IPOs and Share Buybacks') introduces a mandatory two-limb test for the acceptance condition, codified in Note 9 on Rule 10.1 (for voluntary offers) and Note 3 on Rule 9.3 (for mandatory offers) which applied from 4 February 2026.

The acceptance condition to a contractual offer for a dual class share structure company will be subject to two tests, both of which would need to be satisfied in order for the offer to become or be declared unconditional:

a. first, a 'pre-unconditional' test, ie, whether shares carrying more than 50% of the voting rights immediately before the relevant enhanced voting shares convert or are extinguished have been acquired by the offeror or accepted to the offer, and
b. secondly, and only if the first test is passed, a 'post-unconditional' test, ie, whether shares which would carry more than 50% of the voting rights immediately after the relevant enhanced voting shares convert or are extinguished have been acquired by the offeror or accepted the offer.

This prevents a bidder from exploiting the temporary voting distortion created by Class B shares.

3.11.3 Contrast between Voluntary Offer and Mandatory Offer Acceptance Provision

In a mandatory offer, there is no option to have an acceptance level in excess of 50%.

Note that the offeror in a voluntary offer will be required to control more than 50% of the shares themselves, excluding any people acting in concert. This is a contrast to Rule 9 where the requirement is that the offeror together with persons acting in concert control more than 50% of the shares. If there are reasons why a person acting in concert cannot or will not

transfer the shares to the offeror, this will make it easier for the mandatory offer to succeed than the voluntary offer.

Example
An example of this would be a situation where B plc, an associated company of A plc, owns 29.4% of X plc. A plc wishes to bid for X plc, but to leave at least 10% of the shares in public hands in order to maintain X plc's listing. The problem is that, if A plc makes a voluntary offer, it will have to acquire more than 50% of X plc's shares. This means that a maximum of <20.6% of the shares will remain in public hands, after taking into account A plc's holding of >50% and B plc's holding of 29.4%.

A solution may be for A plc to purchase an additional 0.6% of X plc's shares in the market. Together with the associate's holding of 29.4%, this comes to a total of 30% and incurs a mandatory offer requirement. In this case, it would be possible to acquire only an additional 21% of the shares, since B plc's holding can be taken into account for the purpose of the acceptance condition, leaving well over 10% of the shares in public hands. The deal would of course need to be structured to make it attractive for existing shareholders not to fully accept the offer and leave A plc owning all of the shares in X plc.

In the actual case from which this illustration was drawn, the offeror gave investors two choices as part of the mandatory offer. They could either sell all their shares or they could sell 3/5ths of their holding and retain the other 2/5ths. The second alternative, which was the preferred option for the offeror, would mean that only 3/5ths of the remaining shares would need to be purchased, ie, (3/5 x 70%) 42%, leaving a total of 28% of the shares in public hands.

Note that such an offer may be considered to be a partial offer by the Panel and, hence, be covered by the rules on partial offers, covered in section 3.18.

3.12 Other Possible Conditions

In addition to the above, the offeror can set any conditions they want, provided that the condition does not depend solely on subjective judgements by the directors of the offeror or if the fulfilment of the condition lies in their hands (Rule 13). If this proviso were not in existence, it would be easy for offerors to withdraw their offers at will, and at any time, by setting subjective conditions.

3.13 Minimum Price to be Offered

Where an offeror or people acting in concert have purchased shares in the offeree within the three months prior to the announcement, then the offer price should be on terms no less favourable than for those purchases (Notes 1 and 2 to Rule 6). Note that, even if the purchases are for cash, there is no requirement in these circumstances for a cash alternative.

The Panel may extend the three-month period if it feels that this is necessary to ensure similar treatment to all shareholders, as required in the first general principle (Note 1 to Rule 6). An example of this may be where purchases were made from directors of the offeree company in the fourth month prior to the offer.

Note 6 in Rule 9.5 (in relation to share buybacks, dual class share structures and enfranchisement of non-voting shares) states that where a mandatory offer is required as a result of buybacks, extinguishing enhanced voting rights or enfranchisement, the Panel must be consulted to determine the price at which the offer must be made.

3.13.1 Purchase of Shares in the Offer Period

If the offeror or people acting in concert purchase shares after the announcement of the offer at higher than the offer price, then the offer must be revised to at least the highest price paid for the purchases (Rule 6.2). The revised offer will apply to all offeree shareholders, including those who have already accepted the offer (Rule 32.3). This prevents the offeror arranging a better deal with a particular shareholder by waiting until other shareholders have accepted an inferior offer and then purchasing their shares in the market place. Ensuring that fair and equal treatment of shareholders is achieved is the rationale for these rules.

3.13.2 Requirement for a Cash Alternative

This requirement usually arises where the offeror or people acting in concert have either purchased any shares for cash during the offer period or have purchased for cash shares with 10% or more of the voting rights in the company in the 12 months prior to the announcement of the offer (Rule 11).

Where shares have been purchased for cash during the offer period but the 10% threshold has not been breached, the offer must be for cash or there must be a cash alternative to the offer at a price not less than the highest price paid by the offeror or persons acting in concert during the offer period. Where the 10% threshold is breached, the offer must be for cash or have a cash alternative set at not less than the highest price paid by the offeror or persons acting in concert in the last 12 months.

The Panel may, in addition, require a cash offer or cash alternative in any circumstances where it feels this is necessary to ensure similar treatment for all shareholders. This will be in similar circumstances to those noted above for the minimum price to be offered, eg, where directors have sold their shares for cash.

3.13.3 Requirement for a Securities Alternative

When an offeror has acquired 10% of shares in the last three months in exchange for securities, securities must be offered to all other shareholders.

3.13.4 Similar Treatment for All Shareholders

General Principle 1 of the Takeover Code requires that all holders of the securities of an offeree company of the same class must be afforded equivalent treatment. This principle must be adhered to for all offers, mandatory and voluntary.

In practice, there can be instances where the application of this principle is not entirely straightforward given the differing yet similar voting or economic rights different securities and classes of shares possess. In such circumstances, it is not uncommon for an offeror (or its adviser) to approach and consult the Panel to ensure appropriate compliance with the principle is achieved.

3.13.5 Different Classes of Share Capital and Convertibles

All classes of share capital must be given comparable (but not necessarily identical) treatment (Rule 14.1). In addition, the interests of convertible debt and warrants investors should be safeguarded (Rule 15). Note that Rule 14 was amended in Response Statement 2025/1 to provide the Takeover Panel with greater flexibility regarding offers for companies with multiple share classes (with an implementation date of 4 February 2026). The text of Rule 14.2 was amended to include the phrase 'except with the consent of the Panel' at the beginning of the rule. Previously, the rule strictly mandated that separate offers must be made for each class of share.

The amendment was introduced to allow the Panel to consent to a single combined offer being made for more than one class of shares. This change is particularly relevant for companies with dual class share structures where an offeror is required to make a 'comparable offer' for both the ordinary shares and the Class B (higher-voting) shares under Rule 14.1. By allowing a combined offer, the Panel can reduce administrative complexity in cases where the separation of offers serves no material purpose (eg, where the classes have identical economic rights).

3.13.6 Special Deals with Favourable Conditions

Favourable conditions should not generally be extended to any particular group of shareholders (Rule 16). However, in certain situations, the offeror may wish to retain the services of director shareholders of the offeree and to motivate them by means of an ‘earn out’ deal where they receive a higher price for their shares if the company’s profits hit specified targets.

Such special deals may be permitted as long as relevant details of the arrangements are disclosed and an independent adviser states that, in their opinion, the terms are fair and reasonable. Where the value of the arrangements entered into is significant and/or unusual in the context of industry practice, then the Panel must be consulted and consent to the arrangements be obtained. The Panel may require, as part of this process, that the arrangements be approved at a general meeting of the company’s shareholders (Note 2 to Rule 16.1 and Rule 16.2). Response Statement 2025/1 introduced Note 4 on Rule 16.1, which mandates consultation with the Panel in any offer for a dual class share structure company.

3.14 Summary of Differences between Mandatory and Voluntary Offers

	Mandatory Offer	Voluntary Offer
Nature of Consideration	Cash or cash alternative required	No cash offer required except under Rule 11
Price to be Offered	Highest price paid by the offeror in the last 12 months	Highest price paid by the offeror in the last three months, unless Rule 11 applies
Acceptances Condition	Offeror and concert parties own more than 50% of the voting rights in the offeree	Offeror sets acceptance condition, subject to it being at least owning more than 50% of the voting rights in the offeree
Other Conditions	No	Yes, provided that the conditions are subject to significant regulation and may operate in a limited number of circumstances

3.15 Conduct During the Offer

A takeover bid—especially a hostile or high profile one—is a period of heightened sensitivity, legal risk, and operational uncertainty. Effective stakeholder management protects value, reduces disruption, and helps maintain trust.

Internally, in both the offeror and offeree, all information in relation to the bid needs to be carefully controlled, and those party to sensitive information need to be made aware of the need for confidentiality.

Key operational suppliers to the offeree may be concerned about continuity or payment risk. At the appropriate stage they should be reassured that contracts remain in force and reminded of their confidentiality obligations

High value or strategic customers may need direct, personal engagement reiterating that contracts remain valid, whereas others can be handled through structured communications or account managers.

Press leaks can destabilise staff, suppliers, and markets. The response must be fast, coordinated, and compliant.

3.15.1 Disclosure of Shareholdings

An offeror (Rule 8.1a), an offeree (Rule 8.2a) and a 1% security holder in any party to the offer (Rule 8.3a) must make an Opening Position Disclosure relating to its interests in or rights to subscribe for any relevant securities of any party to the offer. Shares or other

securities of a cash offeror will not be treated as relevant securities for the purposes of Rule 8 (Rule 8, Note 1). The Opening Position Disclosure must be made by no later than 12 noon on the day falling ten business days after the commencement of the offer period or the announcement that first identifies the offeror (Rule 8, Note 2).

3.15.2 Dealings During the Offer Period

As well as the Opening Position Disclosure, announcements are required relating to relevant dealings during the offer period. Public dealing disclosures must be made by certain parties, including:

- the offeror (Rule 8.1b)
- the offeree (Rule 8.2b)
- any person who holds an interest in 1% or more of any class of relevant securities of any party to the offer (Rule 8.3b), or
- any person acting in concert with a party to the offer dealing for their own account or for the account of discretionary investment clients (Rule 8.4).

Shares or other securities of a cash offeror will not be treated as relevant securities for the purposes of Rule 8 (Rule 8, Note 1).

The disclosure is required to be made no later than 12.00 on the business day following the day of dealing (15.30 for any person who holds an interest in 1% or more of any class of relevant securities of any party to the offer).

Both the offeror and offeree are obliged to assist the Panel in identifying those persons interested in 1% or more of any class of relevant securities of the offeror or offeree (Rule 22). The offeror and offeree have a responsibility to send those persons an explanation of their disclosure responsibilities under Rule 8.

3.15.3 Irrevocable Commitments

Irrevocable commitments and letters of intent are commitments to accept, or not to, an offer, and often include a commitment to vote in a certain way relating to the shares. An irrevocable undertaking may be either:

- hard (binding in all circumstances)
- soft (ceases to be binding if a higher offer emerges), or
- semi-hard (ceases to be binding if a higher offer emerges which exceeds the existing offer by an agreed amount).

An irrevocable commitment which relates only to acceptance of an offer will not, in itself, normally result in a shareholder being considered to be acting in concert with an offeror under the definition of ‘acting in concert’ in the Takeover Code.

However, the Panel considers that a shareholder who enters into an irrevocable commitment to accept an offer, which includes a voting undertaking, to be acting in concert with the offeror if the voting undertaking is restricted to the period of the offer, or it is limited to matters which relate to ensuring that the offer succeeds.

During an offer period, if any party to the offer or any person acting in concert with it procures an irrevocable commitment or a letter of intent, the relevant party to the offer must publicly disclose the details in accordance with the Notes on Rule 2.10. The announcement must be made no later than 12 noon on the business day following the date of the transaction.

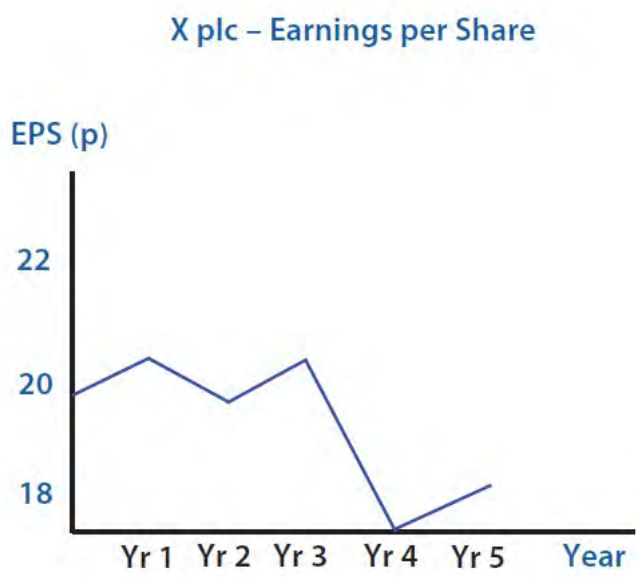
Any irrevocable commitments or letters of intent received before the commencement of the offer period must be disclosed in the Opening Position Disclosure (Rule 2.11 and Rule 8, Note 14).

3.15.4 Standards of Care and Responsibility

Highest Standards of Accuracy and Fair Presentation

Whenever any document or advertisement is issued or any statement is made during the course of an offer, the highest standards of accuracy must be satisfied, and any information must be presented adequately and fairly (Rule 19.1). Parties to an offer or potential offer must take care not to issue statements which, although not inaccurate, may mislead shareholders and the market or create uncertainty (Rule 19.3).

It may be the case that a document is true and correct but nevertheless misleading. Consider the following graph of a company's earnings per share performance.



While the graph may truthfully portray the earnings per share performance of the company, the decision to make 18p the base line of the y-axis means that the presentation may be misleading, giving the impression that the earnings have almost fallen to nil.

Similarly, the selection of the base year when calculating dividend growth rates, for example, must be made with care to ensure that misleading growth rates are not quoted.

The Responsibility of The Directors

Any document or advertisement issued in connection with an offer must state that the directors of the offeror or offeree company as appropriate accept responsibility for the

information contained in the document and that to the best of their knowledge the information is in accordance with the facts and does not omit anything likely to affect the import of the information (Rule 19.2).

If the information relates to another company and has been taken from published sources, then this responsibility is limited to ensuring that the information is reproduced correctly and fairly (Note 2 to Rule 19.2).

3.15.5 Advertisements

In the past, a number of controversial advertisements have threatened to reduce the credibility of the financial services sector in the eyes of the public and to trivialise takeover bids. As a result, advertisements connected with the offer may not be published unless they fall within a number of specific categories (Rule 20.5).

These include:

- product advertisements not bearing on the offer. The advert will need to be cleared with the Panel in advance of publication if in doubt
- corporate image advertisements not bearing on the offer
- advertisements confined to non-controversial information about an offer, eg, a reminder of closing dates
- advertisements comprising preliminary or interim results and their accompanying statements, so long as the statement does not contain argument or invective about the offer, and
- advertisements giving information that is required or specifically permitted to be published by the FCA.

3.15.6 Telephone Campaigns

There is an obvious danger that telephone calls by overzealous sales individuals may result in misleading information being released to offeree shareholders or additional information being made available to some shareholders, but not to others. The purpose of the Takeover Code is to ensure that all callers are properly briefed about their responsibilities under the Takeover Code.

Telephone campaigns should only be conducted by staff of the financial adviser who are fully conversant with the requirements of, and their responsibilities under, the Takeover Code (Rule 20.6). The Panel may consent to other callers being used, but only if they have a prepared script and information from which they are not allowed to depart.

Only previously published information that is still accurate may be used during the telephone call. Shareholders must not be put under pressure and must be encouraged to consult their own advisers.

3.15.7 Interviews and Debates

The unscrupulous nature of some editors in pursuing the art of sensational television leads to risks that fairly ordinary interviews may be rearranged so that they are no longer a fair representation and will appear controversial as a result.

When interviewed, parties involved in the offer should seek to ensure that the sequence of the interview is not broken by the insertion of comments by others not made during the interview (Rule 19.4). Joint interviews and confrontations between the offeror and offeree or competing offerors should be avoided.

3.15.8 Equality of Information to All Shareholders and to Competing Offerors

Information about companies involved in the offer must be made available, as far as possible, to all shareholders at the same time and in the same manner (Rule 20.1). Rule 20.1 reflects General Principle 1, which guarantees that all target security holders are treated equally notwithstanding this, an offeree company can make available information on a confidential basis to a potential offeror or vice versa.

Interviews and Meetings

There is a clear danger that, when meeting with important shareholders, new information may be released that is not yet available to all shareholders. Rule 20 aims to ensure that new information is not released or, if it has been, that it is then immediately made available to all shareholders.

Rule 20 states that great care must be taken during interviews and meetings to ensure that no significant new information is released (Notes to Rule 20.2). If significant new information does emerge, then a circular must be sent to shareholders as soon as possible.

A representative of the company's financial adviser should always attend meetings and confirm in writing to the Panel by 12 noon of the next business day whether in their opinion significant new information was forthcoming at the meeting.

Information to Different Offerors

The board of the offeree company must, on request, equally and promptly provide an offeror or bona fide potential offeror with all the information that it has provided, and that it provides in the seven days following the request, to another offeror or potential offeror (Rule 21.3). Rule 21.3 was amended in 2023 and meant that a competing offeror no longer needed to submit a long list of specific questions to the target company to access information – a general request for information is now sufficient.

Furthermore, once a general request is made, the offeree company's board is required to provide the bidder with all information already provided to any other existing or potential offeror at the time of the request as well as any further information shared with other offerors in the seven calendar days following the initial request.

This system eliminated the need for bidders to make complex daily requests, streamlining the process in a competitive situation.

The objective of making sure that information is disseminated equally is to ensure that all offerors are in a position to make a fair offer. This will ensure that the offeree shareholders are not disadvantaged and forced to accept a lower offer than might otherwise have surfaced.

3.15.9 Frustrating Action

If an offer is in process, or the board of the offeree company has reason to believe that an offer is imminent, then the board must not attempt to frustrate the bid without the permission of the shareholders by any of the following actions (Rule 21.1):

- Issue any authorised but unissued shares or grant options on these shares.
- Issue securities with the right to convert into shares.
- Sell, dispose of, or acquire/agree to sell, dispose of, or acquire assets of a material amount. The Panel will normally consider relative values of 10% or more as being of a material amount.
- Enter into contracts other than in the ordinary course of business.

3.15.10 Inducements

An inducement fee is where the offeree company agrees to pay an offeror a sum of money should certain events cause the offeror's bid to fail. For example, a fee might be payable if the offeree company's directors recommend a competing bid that is higher.

Under Rule 21.2, any commitment by a prospective target to pay the bidder a break fee, or inducement, should a transaction fail, are prohibited under the Takeover Code. There are some very limited exceptions: payments to a 'white knight' coming in to rescue a target from a hostile bidder, or where a potential target puts itself up for auction, or where an offeror has announced a firm intention to make an offer which was not recommended by the board of the offeree company at the time of that announcement and remains not recommended, the Panel will normally consent to the offeree company entering into an inducement fee arrangement with a competing offeror at the time of the announcement of its firm intention to make a competing offer. Both cases are subject to a 1% *de minimis limit*.

Question 3

Under the Takeover Code which of the following would trigger a mandatory offer? Please select all that apply.

Assume all of the companies are UK listed and subject to the Code.

A. A plc holds 0% of E plc and purchases just over 5% in the market
B. B plc holds 0% of F plc and purchases 30% in the market
C. C plc holds 40% of G plc and increases its stake by 2%
D. D plc holds 20% of H plc and increases its stake by 9.99%

The answer to this exercise can be found at the end of this workbook.

3.16 Timetable of an Offer

The following summary highlights the main dates in an offer. These and other important dates are dealt with in more detail below.

3.16.1 Timing and Revision

Once a firm announcement of an offer (to be implemented by means of a contractual offer) has been made, the process becomes subject to a formal bid timetable, with a number of specific deadlines to be met. In outline, an offer must be open for a minimum of 21 days, and all conditions must be satisfied by day 60. All deadlines shown are based on calendar days. Day 60 is the last day for all conditions to be satisfied or waived. An offer must then remain open for a minimum of 14 days after becoming unconditional.

Withdrawal rights from the offeree shareholders will be available from the outset and throughout the offer (until the satisfaction of the acceptance condition), not just from day 42 until day 60.

There is just a single date for which conditions must be satisfied.

If an extension is granted by the Panel, then days 39, 46 and 53 are reset by counting back from the new extended day 60.

Acceleration Statements

The unconditional date can be brought forward by the bidder by making an 'acceleration statement'. Any bidder that does so must waive any and all unsatisfied conditions relating to any official authorisation or regulatory clearance. The new unconditional date must not be set less than 14 days from the acceleration statement date.

Acceptance Condition Invocation Notice (ACIN)

A bidder must give offeree shareholders at least 14 days' notice of any intention to invoke the acceptance condition to lapse its offer if insufficient acceptances have been received.

Rule 12: Long-Stop Date

An offer must have a long-stop date.
The offeror must include a term in the firm offer announcement and in the offer document that the offer will not proceed, will lapse, or will be withdrawn, on a specific date (a long-stop date):

i. if sufficient acceptances have not been received so as to enable the acceptance condition to be satisfied (other than in the case of a pre-conditional offer)
ii. with the consent of the Panel, if a condition or pre-condition relating to an official authorisation or regulatory clearance has not been satisfied or waived, or

iii. if the offer is not recommended by the offeree Board, the Panel must be consulted as to the long- stop date. They will typically require it to be no earlier than the date by which the last condition or pre-condition relating to an official authorisation of regulatory clearance is expected to be satisfied.

Announcement Day

Once a firm offer has been announced, the offeror has 28 days in which to provide the offer document, giving full details of their offer, to offeree shareholders, and to make this available to offeree employees and pension scheme trustees.

Day 0 – Publication Day

The offeror may only publish the offer document within 14 days following the firm announcement with the consent of the offeree company board. The publication day is the day on which the offer document is sent to the offeree's shareholders, which must be no later than 28 days from the firm announcement date. This counts as day 0 for the entire timetable.

No Later Than Day 14 – Target Response Circular/The First Defence Document

In a recommended offer, the offer document includes a letter by the company chairman to the company shareholders, setting out a recommendation that shareholders accept the offer, and including the Rule 3 adviser's opinion. In a hostile offer, however, the offeree board does not cooperate on the production of the offer document, but instead must send a defence document to all shareholders by the 14th day after the publication day, ie, day 14. The defence document contains the directors' response to the offer document, recommending that the shareholders reject the offer, and explaining the reasons why.

Day 21 – Minimum Acceptance Period (first closing day)

An offer must initially be open for acceptance until the later of day 21 and the date on which the offer becomes or is declared unconditional or lapses (Rule 31.2(a)).
The introduction of acceptance condition invocation notices (ACINs) means that offeree shareholders must be given 14 days' notice of any intention to invoke the acceptance condition and lapse the offer if insufficient acceptances have been received.

Business Day Following Day 21 – Acceptance Announcements

Announce the level of acceptances by 08.00 the business day following day 21 and every seven days thereafter (together with selected other key dates (Rule 17)).

Day 37 – Latest Date for Timetable Suspension Due to Outstanding Regulatory Clearance or Official Authorisation

This is the date on which the Panel, at the request of the bidder, or jointly both bidder and offeree, may suspend the offer timetable if an official authorisation or regulatory clearance remains outstanding.

Day 39 – The 21st Day Prior to Day 60 (Rule 31.8) – Last Defence Documents

The offeree board is not permitted, unless with the consent of the Panel, to announce any new information or disclose any material new opinions, after day 39 (21st day prior to day 60) (Rule 31.8). If any such announcement is made, then the day 60 is reset.

Day 46 – The 14th Day Prior to Day 60 (Rule 32.1(c)) – Last Offer Amendment (final revision date)

The offeror may amend its offer up to day 46 – 14 days before day 60 – should they wish to do so. Following this date, the offeror must not buy shares in the market at above the offer price (as this would trigger a revised offer).

Day 53 – Seventh Day Prior to Day 60 (Rules 2.6 (d) and (e))

When an offeror has announced a firm intention to make an offer, and it has been announced that a publicly identified potential offeror might make a competing offer (whether that announcement was made prior to or following the announcement of the first offer), the potential offeror must, by 17.00 on day 53, either:

a. announce a firm intention to make an offer in accordance with Rule 2.7, or
b. announce that it does not intend to make an offer, in which case the announcement will be treated as a statement to which Rule 2.8 applies.

Day 60 – The Final Day: Day 60 and the Unconditional Date

Day 60 means the 60th day following the publication of the initial offer document or such later date as is set pursuant to Rule 31.3.

The new term ‘unconditional date’ is defined as being day 60 or any earlier date specified by an offeror as being the latest date by which all of the conditions to the offer must be satisfied or waived.

Except with the consent of the Panel, all of the conditions to an offer must be satisfied or waived, or the offer must lapse, by midnight on day 60.

An offeror who wishes to specify an unconditional date in the initial offer document which is earlier than day 60 must consult the Panel in advance and will normally be treated as having made an acceleration statement.

Day 74

Assuming the offer is unconditional on day 60, then day 74 is the earliest day on which the offer may close.

Extensions to Day 60

The Panel will normally only extend day 60 beyond the 60th day following the publication of the initial offer document:

- if a competing bidder has been announced
- if the board of the offeree company consents to an extension
- if suspension of the offer timetable has been requested in relation to clearance/official authorisation
- if the target board makes an announcement (trading results) after day 39, or
- if the bidder's receiving agent requests an extension with regard to the certificate stating the number of acceptances.

3.16.2 Settlement of Consideration

Consideration must be sent to shareholders within 14 days after the later of:

- day 21
- the date the offer becomes or is declared unconditional
- after the date of receipt of the shareholder acceptance.

3.16.3 Restrictions Following Offers

According to the Takeover Panel Statement 1990–20:

> *'the effect of this Rule is to restrict the ability of an offeror, whose offer has failed, to return with a new offer within 12 months. The principle underlying Rule 35 is that shareholders' interests are best protected if, after an offer has failed, the target company's management is released from the inevitable dislocation of an offer period.'*

The rule relates to restrictions (except with the consent of the Panel) once an offer has been made. This includes those restrictions relating to an offeror and any concert parties (originally or subsequent to the original offer) in the following circumstances:

Delay of 12 months before making a new offer – Rule 35.1

Where an offer is unsuccessful or an announcement is made that raises the possibility of an offer but no offer is forthcoming within a reasonable period, then the offeror or any person acting in concert with it should not within 12 months (Rule 35.1):

- make an offer for the company
- acquire shares in the company if this would result in an obligation to make an offer under Rule 9.

Partial Offers – Rules 35.2

The above restrictions also apply where a partial offer has been made that could have resulted in a holding of between 30% and 50% inclusive of the voting rights of the offeree, regardless of whether the offer has been successful or not (Rule 35.2).

Dispensations

The 12-month waiting period may be dispensed with if the Panel consents. Circumstances when consent is likely to be forthcoming include where (Notes a and b to Rules 35.1 and 35.2):

- a new offer is to be recommended
- a competing offer has been announced
- a Rule 9 waiver whereby another shareholder will acquire 30% or more of the company without the requirement to make a mandatory offer, is announced
- there has been a material change in circumstances.

Delay of six months before buying shares above the offer value – Rule 35.3

If a person or people acting in concert hold shares carrying more than 50% of the voting rights of a company, then they may not acquire shares in the company or make an offer for it on better terms than those available under a previous offer within six months of the closure of the previous offer which became unconditional (Rule 35.3). Should they do so, then the Panel may require that the better terms are offered to the shareholders who accepted the previous offer.

As with the rules concerning purchases above the offer price during the offer period, the purpose of this is to ensure equality of treatment for all offeree shareholders.

3.17 Conflicts of Interest and Management Buyouts

3.17.1 Independent Advice and Conflicts of Interest

Rule 3.1 states that the board of the offeree company must obtain competent independent advice on any offer. The Panel will not regard as being independent either of the following (Rule 3.3):

- someone from the same group as the financial adviser to the offeror company
- someone who has a significant interest or financial connection with either an offeror or the offeree company so as to create a conflict of interest.

This means that any directors who will continue as part of the management team are unlikely to be able to offer advice to their existing shareholders. In addition, any adviser working for a management buyout team will be unable to give independent advice to the shareholders.

Where the transaction is a reverse takeover or the directors of the offeror company have a potential conflict of interest, then the board of the offeror must also seek independent advice (Rule 3.2).

3.17.2 Management Buyouts

Clearly, a management buyout (MBO) can present a particularly challenging problem in ensuring that shareholders are given a fair deal. There is likely to be considerable information asymmetry between the parties which would be inconsistent with the spirit and general principle of the Takeover Code to ensure equal treatment of shareholders.

Rule 21.4 states that, in an MBO, the offeror or potential offeror must, on request, promptly furnish the independent directors of the offeree company or its advisers with all information that has been furnished by the offeror or potential offeror to external providers of finance, whether equity or debt.

Where there is a competing offer, Rule 21.3 states that information passed by the offeree company to external providers of finance, whether equity or debt, should be given equally and promptly to the competing offeror, even if that offeror is less welcome.

3.18 Partial Offers

3.18.1 Panel's Consent

Offers for Less than 30% of a Company

The Panel's consent is required for any partial offer (Rule 36.1). This will normally be granted if the offer will not result in the offeror holding shares with 30% or more of the voting rights in the offeree.

Offers for 30% or More of a Company

Consent will not normally be granted for offers for 30% or more when the offeror or persons acting in concert have acquired significant numbers of shares in the offeree in the 12 months preceding the application for consent (Rule 36.2).

3.18.2 Share Dealings Around the Offer Period

The offeror and persons acting in concert may not purchase shares in the offeree company during the offer period (Rule 36.3). They are also not permitted without Panel consent to make purchases in the 12-month period after the offer if the offer is successful. Panel consent will normally be granted where the original offer resulted in a holding of less than 30%.

The objective of this is to ensure fair treatment for all shareholders, preventing the offeror from buying all the shares from one shareholder and only making a partial offer to other shareholders.

3.18.3 Offers for between 30% and 50%

Acceptance Condition

Where the offer could result in a holding of between 30% and 50% inclusive, then the precise number of shares offered for must be stated and the offer can only be declared unconditional when acceptances are received for at least the stated number of shares (Rule 36.4).

Shareholder Approval

An offer for 30% or more of the company should be made conditional on shareholders carrying at least 50% of the voting rights not held by the offeror or persons acting in concert indicating that they approve of the offer (Rule 36.5).

3.18.4Tender Offers (Appendix 5)

Fixed and Maximum Price Tenders

A fixed price tender is where the offeror agrees to buy shares for cash at a fixed price of, say, £2.50 per share. People can submit tenders if they believe this price to be attractive. A maximum price tender is where the offeror invites people to submit the price at which they are prepared to sell their shares, subject to a defined maximum price that the offeror is prepared to pay. The final strike price of the tender will depend on the prices submitted by the existing shareholders.

Oversubscription for a Tender

If the tenders received exceed the number offered for, then with a fixed price offer all the tenders must be scaled down pro rata. If a maximum price tender is oversubscribed, then the striking price will be the lowest price at which the number of shares offered for is met. All who tender at or below that price will receive that price. Tenders made at the striking price will be scaled down pro rata if necessary.

Consider the following example where the offeror wants to purchase 1,000 shares in XYZ plc and has specified a maximum tender price of £5.00 per share. The following tenders to sell shares to the offeror are received:

Tendering Shareholder	Number of Shares Tendered	Price at which Tendered
A	400	£2.00
B	500	£4.00
C	500	£4.00
D	200	£5.00

The minimum price at which 1,000 shares can be purchased is £4.00 per share. This becomes the common strike price for all successful tenders. The offeror, therefore, buys 400 shares from A at a price of £4.00, and 300 shares each from B and C at a price of £4.00. D’s offer to sell 200 shares at a price of £5.00 each is not taken up.

Undersubscription for a Tender

If the tender is undersubscribed, then all tenders will receive the maximum or fixed price, subject to the minimum acceptance condition in (D) above.

Code Regulation on Tender Offers

The Panel's consent is required for any tender offer. The Panel's consent will normally be granted where:

a. the tender offer could not result in the offeror and concert parties being interested in shares carrying 30% or more of the voting rights of the company on the closing date of the tender, or
b. the tender offer is by a person holding shares carrying more than 50% of the voting rights of a company, is for less than all the shares carrying voting rights held by the minority, and the Panel believes the circumstances justify the use of a tender offer.

Advertising Requirements

Any tender offer must be published by a paid advertisement in two national newspapers and the advertisement must include the following details:

- the name of the offeror and its broker
- the name of the offeree
- the name of the company whose shares are sought
- the maximum number of shares being offered
- a statement that if tenders totalling less than 1% (or higher if the offeror wishes, but not usually over 5%) of the offeree's voting rights are received, then the tender will be void (no other conditions will be allowed)
- a statement that, subject to the above, a shareholder's tender will be irrevocable
- the fixed or maximum price offered
- details of the offeror's existing holding in the offeree
- the closing day and time for the tender, and
- arrangements for delivery and settlement.

Minimum Duration of a Tender Offer

The minimum period for which a tender offer can remain open is eight calendar days, from the date it is advertised to the date it closes (inclusive).

3.19 Schemes of Arrangement

Thus far, how the Takeover Code applies to takeover offers of a public company has been explored. The Takeover Code also applies to the alternative approach to a public company acquisition, namely a scheme of arrangement.

While some differences in the relevant provisions of the Takeover Code exist between takeovers and schemes, the rationale for the Takeover Code's application in the context of schemes remains unchanged: ensuring equal treatment of shareholders is achieved.

As mentioned under 3.1.2 above, a scheme of arrangement is a transaction effected by means of statutory provisions in the Companies Act 2006. The provisions of the Takeover Code apply to offers effected by schemes of arrangement in the same way as they apply to contractual offers, except as set out in Appendix 7 to the Takeover Code.

The offer document should normally be sent to shareholders within 28 days of the announcement of a firm intention to make an offer (Rule 24.1). This rule also applies to the scheme document. A scheme must include a term that it will lapse if there is a competition reference before the shareholder meetings.

There is no maximum time limit for the holding of shareholder meetings and/or the fulfilment of other scheme conditions in the absence of a competitive situation. So, there is no equivalent to the 60 day limit (Rule 31.6) as there is for contractual offers.

Section 5 of Appendix 7 requires the offeree to make announcements following three key events in a scheme, namely:

a. the shareholder meetings
b. the court sanction hearing, and
c. the date of effectiveness of the scheme.

In relation to the announcement following the shareholder meeting the announcement should specify whether the resolutions had been passed by the requisite majorities, the voting results and, in relation to the court-convened meeting and the number of shareholders who voted for and against the resolution.

Section 10 of Appendix 7 requires consideration to be posted to offeree shareholders within 14 days of the effective date of the scheme. It also requires the terms of the scheme to reflect this, so it may be enforced by offeree shareholders.

An obligation to make a mandatory offer under Rule 9 may not be satisfied by a scheme of arrangement unless the Panel consents. The factors that the Panel would take into account when considering giving their consent would include the likely timetable and the views of the offeree board and its Rule 3 adviser.

There is a specific obligation on an offeror to consult the Panel when it is considering announcing an offer (or possible offer) to be implemented by a scheme, but without first obtaining the support of the offeree board. This requirement is set out in Section 13 of Appendix 7.

3.20 Practice Statements

Practice Statements are issued by the Panel Executive to provide informal guidance to companies involved in takeovers and practitioners as to how the Executive normally interprets and applies relevant provisions of the Takeover Code in certain circumstances.

Practice Statements do not form part of the Takeover Code. Accordingly, they are not binding on the Executive or the Panel and are not a substitute for consulting the Executive to establish how the Takeover Code applies in a particular case.

Tutors' Note

You are expected to be familiar with the content of the Practice Statements for your exam. It is recommended that you read the Practice Statements in full.

The current up-to-date version of the statements can be found on the Panel's website at: https://www.thetakeoverpanel.org.uk/statements/practice-statements

3.21 Agreed or Hostile Bid

Irrespective of whether a private company or a public company is being acquired, transactions can also be classified as either agreed or hostile. In sections 3.21.1 and 3.21.2 below, some of the key considerations for both public and private acquisitions, are set out.

3.21.1 Private Companies

In the case of a bid for an unlisted company, it is highly likely that the bid will need to be approved by the board of the company. This is because the board will probably own a significant number of shares and other shareholders will tend to follow the board's lead. If the board does not approve the bid, then the chances of success are usually so low that it will be best to find a different target.

3.21.2 Listed Companies

A bid for a listed company does not need to be approved, since the directors will probably not own a significant number of shares and the shareholder base is unlikely to have emotional or other attachments to the company.

Instead, it is the fiduciary duty of directors to advise whether the bid is in the best interests of shareholders. If the bid is recommended by directors, it is termed an 'agreed' offer. If directors do not support the bid, then it is 'unrecommended' and, if to proceed, will do so on a 'hostile' basis.

3.21.3 Advantages of an Agreed Offer

Notwithstanding this, there can be advantages in obtaining board approval for a bid, as follows:

- There is a greater chance that shareholders will accept the bid.
- It may act as a disincentive for a hostile bidder to join the fray or persuade them to pull out.
- It will avoid the risk of the bidding company coming out worse in a public relations battle and damaging its reputation.
- More information will be forthcoming on the target company and make for an easier due diligence process.
- Integration of the target into the acquiring company's group may be easier.

3.21.4 Problems with Trying to Achieve an Agreed Offer

Against this, certain disadvantages must be considered:

- If talks fall through, then the bidder will have probably released information about itself to the target.
- It will give the target advance warning of the impending bid and, should the approach fail, enable the board to prepare their defence.

Surprisingly perhaps, obtaining board approval for a bid does not make it any cheaper for the bidder to acquire the company. It is true that, in a hostile situation, the bidder will be obliged to make the price sufficiently attractive to overcome opposition to the bid. However, in an agreed bid, the price will need to be set sufficiently high to deter other bidders from coming in. It will also need to ensure that the bid can be sold successfully to the target's shareholders without accusations of their board negotiating a bad deal.

3.21.5 Hostile Bid Tactics

A number of tactics can be adopted to enhance the chances of a bid's success as follows:

- **Stakebuilding**

  This can either be undertaken gradually or rapidly, via a dawn raid. In the case of the gradual build- up of interests, the danger is that the demand for the shares will be picked up by the company which will use its powers under S793 of the Companies Act 2006 to identify the acquirer. In any case, if 3% or more of the company is acquired, then the acquirer will be legally obliged to notify the company of its interests under the Disclosure Guidance and Transparency Rules (DTR). This regulation sacrifices any element of market surprise.

  In the case of a dawn raid, the company will quickly be identified and may be unable to acquire a significant number of shares if the market becomes aware of what is happening. It can be very time consuming to accumulate shares from daily trading of the free float in the market.

- **Tender Offer**

  A bidder can consider making a tender offer directly to target shareholders. This is an invitation to shareholders to sell their shares to the bidder at a certain price within a specified time frame. In the UK, the Takeover Panel's consent is required for any tender offer. This consent is unlikely to be forthcoming for a tender offer for over 30% of the share capital of the target company. Tender offers have been used extensively in other jurisdictions, for example the United States, as a way to circumvent management and gain control even when managers oppose the takeover.

- **Advertising**

  The Takeover Code prohibits advertising of a controversial nature about the bid (Rule 20.5), but the company's image can be improved by selected and tasteful advertising of a more general nature.

- **Lobbying**

  In order to persuade politicians that the bid will be in the target's and the country's interests and prevent a referral to the Competition Commission or a subsequent blocking of the bid.

- **Public Relations Campaign**

  This may obtain press support and favourable press comment.

- **Investor Relations**

  This may persuade the bidding company's own shareholders of the validity of the bid and assure the target's investors of the bid's advantages.

- **Offer Document**

  In the case of superior performance of the bidder and its management, which will be relevant if the offer is shares and not just cash. It will also criticise the past performance of the target and illustrate the benefits of the bid for the target's shareholders.

- **Offer Price**

It is important to ensure that the price is sufficiently competitive to:

  - make it unattractive for competing bidders to enter the fray or to stay in the frame, if already bidding, and
  - encourage target shareholders to accept.

However, the price should not be so expensive as to result in the company overpaying.

- **White Knight**

A bidder can portray itself as the saviour of the company subsequent to another hostile bidder announcing an offer.

3.21.6 Defence Strategies and Tactics

General Housekeeping Before a Bid

The most effective method of defence is to ensure that the company is not perceived as being a bid target in the first place. The way to achieve this is to ensure that the company is fully and fairly valued by investors. If this is the case, then it is unlikely that any company will be motivated to bid, since there will be no prospect of satisfactory gains to be made from the acquisition. There are various ways of achieving this.

Investor Relations

Effective communication with the company's investor base will ensure that they understand its business and strategy, appreciate the reasons for short-term falls in profitability and will not sell out on the cheap just before results start to improve.

Investor Management

This will ensure that the shareholder base is appropriate for the company, so that they will be happy to stay committed for the longer term and not sell out at the first opportunity. It may be appropriate to develop friendly shareholdings with other companies. The danger of this is that a cross-holding ties up capital and a large shareholder who was originally perceived as friendly may either sell out on a bid or use its stake to launch a bid itself.

Group Strategy

Developing a clear and consistent group strategy will add value to the company and increase the share price. This strategy will, of course, need to be explained and communicated to investors.

Public Relations

The company should ensure that announcements, interim statements and final published accounts are produced in an attractive way that fully emphasises the strengths of the company. In addition, it should ensure that announcements are followed up appropriately with interviews and analysts' meetings.

Dividend Policy

The company should ensure that its dividend policy is suitable for its earnings stream and reflects the investors and stakeholders needs and expectations.

Specific Bid Preparation

In addition to the above points, techniques which can be used specifically to assist in defending against a bid include the following:

- Checking the share register for undesirable investors and identifying trends in share transactions. Powers to investigate shareholdings under S793 of the Companies Act 2006 can be used to identify undesirable shareholders.
- Keeping a draft defence document ready to be tailored to meet a specific bid situation.
- Keeping files of information on possible bidders ready for use.
- Having a contingency plan ready for a bid, to be put into action at a moment's notice. This will include allocation of responsibilities for defence, setting up a defence committee and allocating everyday tasks in managing the business to others who will be less concerned with the bid defence. The details are often maintained in what is commonly referred to as a company's Defence Manual or 'Black Book'.

3.21.7 Bid Defences

After the bid has been launched, the company will only have a limited amount of time (around 60 days) to conduct its defence against the specific bidder. By contrast, the bidder may have spent a substantial amount of time identifying the target and putting together an attractive and feasible bid. This underlies the importance of good housekeeping before a bid to ensure that the company is as prepared as possible. Once the bidder has been identified, possible tactics include the following. There are rules relating to the contents and other matters related to the defence document and profit forecasts released by a company in a potential transaction to which the Takeover Code applies.

Defence Document

It is, of course, vital to have a well-argued and cohesive defence document subsequent to receiving the offer document from the bidder.

Profit Forecast

The company may decide to issue a profit forecast. The danger with this is that it will need to be sufficiently optimistic in order to prevent the bidder's offer from seeming attractive but must not be too ambitious. Otherwise, it will either lose credibility in the short term or act as a hostage to fortune in the longer term, when the company has to achieve those results.

Attack as a Form of Defence

In a share bid, attacking the bidder's management, strategy and accounting policies (used to show improving profits) can be particularly effective.

Public Relations

Lobbying, effective public relations and advertising may assist in turning the tide of investor opinion or may cause the bid to be referred to the Competition and Markets Authority (CMA).

Restructuring

The company may announce an intention to restructure itself, by selling off a major division or demerging the company into separate divisions, each with a listing.

White Knight

The company could encourage a counter bid from a friendly bidder or white knight, although this will mean that the company will lose its independence. An alternative would be the purchase of a large block of target shares by a 'white squire', who does not take control but agrees to vote in alignment with target management. The white squire can disrupt the hostile takeover process and help the company retain its independence.

Dividend Increases

Increases in dividends may pacify investors. However, this may be seen as too little, too late. Also, if the increase is too large, it may beg questions as to why it has only been done now and raise doubts as to whether the larger dividend is sustainable in the future.

Frustrating Action

The Takeover Code prohibits the board of the target company from taking actions which would frustrate a bona fide offer or prevent its shareholders from deciding on the bid's own merits. Therefore, actions such as disposals of significant business assets in the course of a bid will need shareholder approval. In addition, preferential treatment of certain shareholders will go against the basic principle of equal treatment for all offeree shareholders. This means that many frustrating action techniques used in other jurisdictions (eg, the US), would not be possible in the UK.

Examples of frustrating action:

- **Company constitutional document changes** – to limit the ability of a predator to gain control. For example, changes in the voting rights of shares in the event of a hostile bid to effectively block a predator gaining control.
- **Golden parachutes** – granting management generous severance payments if they lose their jobs in the event of a hostile bid.
- **Crown jewels defence** – where key assets are sold from the business prior to a hostile bidder gaining control.
- **Leveraged recapitalisation** – the target company draws down a significant amount of debt and uses it to pay a special dividend to shareholders. This means the bidder acquires a much larger debt burden than expected. Leveraged recapitalisations can be structured to include 'poison puts' whereby the debt becomes immediately repayable on a change of control of the company.
- **Greenmail** – here the target company buys back shares from the bidder at an inflated premium not available to other shareholders. Greenmail will temporarily repel an intruder but will not stop other potential purchasers. Again, under the Takeover Code this is not permitted, as it is against the interests of the other shareholders of the offeree.

Chapter Roundup

Synergies are the financial benefits arising as a result of a transaction. They are derived from four sources:

- cost savings
- revenue enhancement
- financial, principally one-off cash inflows, and
- real optionality.

You should be able to list examples of each and be able to discuss appropriate valuation methods.

This chapter has considered motives for making acquisitions and how these might tie into a value- enhancing strategy. It has also looked at alternative methods to achieve growth.

As a lead adviser on an M&A transaction, you will be expected to run the acquisition process. This chapter has considered the main stages of an acquisition of a private company:

- Identifying potential acquisition targets
- Initial evaluation of targets
- Approaching the target: considerations and best practice
- Due diligence
- Legal documentation
    - heads of agreement
    - break clauses and exclusivity agreements
    - sale and purchase agreements
    - warranties, indemnities, representations and disclosures
    - conditions precedent and subsequent
    - exchange and completion
    - locked box mechanisms versus completion accounts.

It has also considered the main stages of an acquisition of a public company in the UK, for which there are two methods:

- a takeover, and
- a scheme of arrangement.

The outcome of the two methods can be the same – with the offeror company gaining control of the offeree. Whether a takeover or a scheme is undertaken, both methods require compliance with the UK Takeover Code.

This chapter has explored the following provisions of the Takeover Code in particular:

- The structure of the Takeover Code.
- The spirit of the Takeover Code.
- The structure of the Panel and its powers.
- Statutory status.
- Companies to which the Takeover Code applies.
- Independent advice.
- Irrevocable undertakings.
- Financing arrangements.
- Offers for different classes of shares.
- Concert parties.
- Special deals and management incentives.
- Accuracy and content of documents.
- The creation of false markets.
- Restrictions and frustrating actions.
- Consideration.
- Mandatory offers.
- The timetable of an offer.
- Consulting the Panel.
- Schemes of arrangement.
- Practice Statements.

This chapter has also considered the difference between agreed and hostile bids and has examined the defence tactics that can be used by the offeree company to try and thwart a hostile bidder.

It has also explored the key deal documentation involved in an acquisition common to the acquisition of both private and public companies.



Chapter Two
Deal Structuring and Financing

Section 1 Introduction

Section 2 Structuring the Deal

Section 3 Offer Consideration

Section 4 Analysing Deal Effects

Section 5 Sharing of Merger Gains

Section 6 Calculating Control Premia

1. Introduction

This chapter considers the relative merits of acquisition via a share purchase versus structuring the deal as the purchase of assets. It also examines different forms of transaction consideration and why each might be appropriate to use. The chapter finishes by looking at deal effects and how the rationale for a transaction can be substantiated by financial analysis.

2. Structuring the Deal

2.1.1 Be able to evaluate the merits of acquisition via a share purchase versus structuring the deal as the purchase of assets

2.1 Shares versus Assets Purchases

When buying a business in a private deal, it is possible to acquire either the shares of the company that is conducting the business or to buy the business and the related assets from the company.

The factors to consider in deciding which route to follow include the following.

2.1.1 Share Deal

- Purchasing the shares will put the cash directly in the hands of the vendor, whereas purchasing the assets would keep the cash in the company selling the assets. Taking the cash out of the company will involve additional tax charges to the seller. Receiving cash for the shares will only incur capital gains tax liabilities. If the consideration being paid is not cash, but shares or loan stock, then any capital gains tax liability may be deferred.
- The share deal will preserve tax losses in the business being sold, if applicable. Selling the business would mean that the acquirer would probably be unable to use these losses.
- Transferring shares may make it easier to keep the business of the target company intact, eg, preserving long-term contracts with key customers.
- Given the business is transferring intact, the sale and purchase agreement will include detailed warranties and indemnities regarding the nature of the business to be sold.
- Transferring shares will avoid potential problems with loss and clawback of capital allowances that might impact the seller with an asset sale.
- Conceptually at least, a share acquisition is a simpler and less cumbersome transaction than an asset purchase. Simply by the transfer of ownership of shares, an entire company, including all of its assets and liabilities, can be sold by a vendor to an acquirer.

- Furthermore, the acquisition price ascribed for a share purchase transaction will, in some respects, be similarly easier to arrive at than for an asset purchase transaction, as the price will be determined by assessment of market multiples, price/earnings or similar mechanisms. By contrast, the acquisition price for an asset purchase will be arrived at by valuing each asset being bought and taking account of the idiosyncratic characteristics of different assets. Such an exercise can obviously be time consuming and tedious, unless the acquisition is that of a very small number of assets.

2.1.2 Assets Purchase

- The acquirer can pick and choose which business assets they wish to buy. The exception to this is the target company's staff, who will transfer automatically in the UK under 'TUPE' employment regulation – Transfer of Undertakings (Protection of Employment) Regulations 2006.
- The target company's liabilities are not transferred without explicit agreement.
- The business can be put into a 'clean' company and, hence, there is no risk of unpleasant surprises or liabilities in the future. This avoids the need for many of the detailed warranties and indemnities in the sale agreement.
- If the acquirer has previously disposed of certain business assets, such as land and buildings or plant and machinery, then it may be able to claim roll-over relief when it replaces these by purchasing the assets of the target company.
- Purchase of assets will result in different capital allowances being received when compared to the purchase of shares in the company, which may be disadvantageous.
- Purchase of assets will not create **goodwill** in the acquirer's accounts, whereas it will in a share purchase.
- The target company will remain in existence, unless liquidated.
- The vendor effectively is subject to two tax charges: there will be an immediate gain on the asset sale arising in the target company, amounting to the difference between the sales price and the **book value** of the assets. A subsequent gain will arise if the proceeds are distributed to shareholders in the form of a dividend or a liquidation distribution.
- Asset purchase acquisitions can be cumbersome to undertake. Each asset has to be individually transferred. The method by which the transfer takes place depends on the asset in question. In contrast to a share acquisition, an asset purchase can therefore be more time consuming to undertake and conclude, particularly if there are significant numbers of assets with different characteristics and methods of transfer.
- As seen in this section the acquisition price ascribed for an asset purchase will be arrived at by valuing each asset individually. Such an approach can be time-consuming and tedious. It can also be fraught with difficulty if a dispute arises between a prospective acquirer and a seller on the price to be applied to each asset.

2.1.3 Hive Down

A hive down is the term given to a transaction which combines the best elements of a share acquisition and asset purchase. In brief, assets that an acquirer wishes to purchase would be transferred to a new company (newco) set up by the vendor so that the acquirer can then simply purchase the shares of the newco. This ensures that only the assets that are desired are purchased while the acquirer benefits from the procedural advantages that a share acquisition offers. Chapter 3 'Disposals and Demergers', section 3.5 explores hive downs in greater detail.

3. Offer Consideration

2.2.1 Be able to evaluate different offer considerations for an acquisition including cash, loan stock, shares and other relevant forms of consideration

2.2.2 Know the purpose and scope of loan and security documentation in corporate finance transactions

2.2.3 Be able to evaluate the relative merits and demerits of earn outs and deferred consideration as options for financing an acquisition

This section concentrates on how the offer is to be financed. This will usually be a choice between cash or equity.

3.1 Cash Bid

- The vendor's connection with the company is severed. They will, therefore, have little or no concern as to whether the company does well in the future. Cash consideration provides the vendor with an exit route from the business and a way to realise their investment.
- The vendor will have to pay capital gains tax immediately on any gain.
- If borrowings have been raised to finance the purchase then the acquirer's **gearing** will increase. For a group with little debt, this may have the desirable effect of lowering the overall **weighted average cost of capital (WACC)** of the company. For a highly geared company, the increase in financial risk of the entity may have a negative impact on the credit rating and therefore increase the overall cost of capital. In the latter scenario, it may be appropriate to raise the cash via a **rights issue**, termed a 'cash underpinning'.
- The earnings of the acquiring group will be boosted by the profits of the target but reduced by the additional interest expense on increased borrowings or the lower interest income due to reduced cash balances. The net effect is likely to be an increase in earnings per share.
- All the gains from the acquisition after allowing for the cost of the deal will go to the existing shareholders of the acquirer. Their interest in the group has not been diluted through the introduction of additional shareholders.

3.2 Shares Bid

- The fortunes of the vendor are tied in with the acquirer. It is, therefore, in their interest to ensure that the company does well in the future. A bid in the form of shares provides a way for the acquirer to incentivise the existing owners to maximise value in the post-acquisition period. Typically, the vendor of a private company will not be allowed to sell the shares for several years via a lock-in arrangement.
- The vendor will be able to roll over any capital gains tax liability until the shares are disposed of. This will assist in tax planning.
- The gearing of the acquirer may reduce as a result of issuing shares, although this does depend on the level of gearing in the acquired company, relative to the acquirer.

- The earnings of the acquirer will be boosted by the profits of the acquired company, but these will be spread over more shares with the effect on earnings per share being uncertain. Generally, if a company acquires another company on a price to earnings ratio (PE) lower than its own, then the earnings per share subsequent to the acquisition should improve.
- The gains arising from the acquisition will have to be shared with the new shareholders. The interests of the existing shareholders will have been diluted by the issue of new shares to outsiders.
- The total dividend will need to be increased in order to maintain dividend per share after the acquisition.

3.3 Loan Stock

Instead of borrowing from outside providers of finance to fund a cash bid, the acquirer may issue loan stock to the vendor. Loan stock is an IOU from the acquirer to the target company shareholders. Loan stock enables the vendor to defer any capital gains tax (CGT) liability until the loan stock is disposed of. It may also reduce the effective price of the acquisition if the **coupon** on the loan stock is below the market rate of interest.

3.4 Loan Financing Documentation

When an acquisition is to be funded by debt, a key consideration in the structuring of the transaction will be the type of debt that will finance the deal and the terms of such debt. The acquirer will typically fund a transaction by obtaining loan financing from a bank or an alternate debt provider (such as credit funds that specialise in corporate lending).

Debt financing, in the form of a loan or otherwise, ranks above equity in the capital structure of a company. In the event that there is more than one form of debt, it is necessary to understand which type of debt ranks ahead of other types. Broadly, the debt (typically in the form of a loan in relation to acquisitions) may rank as senior, mezzanine or junior in the capital structure of the acquirer/borrower, which in turn will govern the priority the loan will have in the event of the insolvency of the acquirer/ borrower. Furthermore, the loan may be secured or unsecured.

The rate of interest due on the loan will be governed by the seniority of the loan as well as the level of security; the more senior the debt, the ‘safer’ it is in the event of an insolvency and therefore the lower the rate of interest such ‘safe’ debt will be charged at, compared to junior loans where a higher rate of interest will be payable given the higher risk of default such junior loans exhibit.

Additionally, if the loan is secured (as opposed to being unsecured), then the loan will be seen as ‘safer’ and will present lower risk for the lending bank, meaning that the rate of interest charged on the loan will be lower than for an unsecured loan which is considered to be more risky.

The terms of the loan will be set out in a facility agreement (otherwise known as the loan agreement) which will contain the key terms of the loan, including:

- the amount being borrowed
- the purpose of the loan
- the duration of the loan (its term)
- rate of interest
- benchmark base rate
- payment periods
- what will be considered to be an event of default on the loan which may entitle the lender to call in or demand full repayment of the loan
- a negative pledge clause (a clause whereby the borrower agrees not to borrow any additional amounts that rank more senior to the loan)
- notification obligations which require the borrower to notify the lender of any material changes in the borrower's business operations (such as a change of control/change in its ownership structure)
- repayment obligations, and
- whether the loan is to be secured or unsecured.

A secured loan will, by reason of the collateral (ie, security) being made available by the borrower to the lender, allow the borrower/acquirer to borrow at a lower rate of interest than if the loan was unsecured. The terms and conditions of such security will be set out in the security documentation related to the loan. The security documentation will govern when, how and on what basis any security will be provided by the borrower or called upon by the lender.

It will also set out how any such security will be preserved and the mechanics and processes required to register any such security on a register, such as at Companies House where charges (ie, security claims) are typically registered so that any subsequent prospective lender is made aware and put on notice that an existing lender already has a claim on security provided by the acquirer/borrower.

There is a further reason why security documentation exists and is necessary to be reviewed by any corporate finance adviser. As it is not uncommon for a company to be indebted to a number of lenders, the security documentation will also set out which lenders will have priority and a claim over any security, in the event of an insolvency of the borrower company. An intercreditor agreement will set out the provisions of such priority, so as to ensure that if an insolvency situation arises, there is clarity between lenders as to where each ranks in priority.

In other words, the intercreditor agreement sets out the nature of the relationship between the various lenders, and provides a governance structure for the relationship between them.

3.5 Earn Outs and Deferred Consideration

3.5.1 Advantages of Earn Outs

It is possible for a transaction to be structured so that the final consideration for a deal is paid several years after completion and is linked to the profit performance of the acquired company. This is termed as ‘contingent’ consideration or using an ‘earn out’. The obvious advantage for the acquirer is that it ensures that a full price will only be paid if certain financial targets are met in the post-acquisition period. It will also often mean that the vendor will stay on to manage the acquired company for several years. This will ensure continuity of management, enable a smooth transition to be made in terms of management over the period of the earn out and keep in the company an individual who may well be instrumental in the company’s past success.

Deals can also be structured using deferred consideration where there is certainty at the outset as to the total consideration to be paid. However, this is paid in instalments, thus helping the cash flow of the bidding company.

3.5.2 Problems of Earn Outs

- Calculation of profits for the purpose of working out the deferred consideration will need to be exactly defined. The temptation is for both sides to adjust the profits to suit themselves. The vendor, who is still the key director of the acquired company, may argue for reduced provisions for doubtful debtors, whereas the acquirer may seek to impose excessive management charges against the company.
- The level of integration of the subsidiary with the group will need to be established. The group will want to integrate it as fully as possible in order to realise the anticipated benefits of the acquisition. However, it will need to be kept separate for the purposes of profit calculations. If central services are provided by the group, then this will reduce the costs in the subsidiary, but a management charge will be made. Such charges can be difficult to negotiate and be seen as fair.
- The acquiring company’s directors will seek to control the direction in which the subsidiary is heading, for the benefit of the overall group. This may conflict with the desire of the vendor to maximise profits over the period of the earn out. This can make it difficult to ensure goal congruence between the vendor and the acquirer.
- The vendor may find it difficult to operate within the constraints of a large organisation and with budgets imposed from outside. Their ability to run a successful business may have stemmed from the ability to make decisions quickly without reference to any outsiders. Furthermore, the vendor’s status in the company will have changed and this may be hard for them to take.
- Earn outs can work against the long-term good of the business. The managers may be incentivised to focus too much on short-term profit targets and avoid making difficult decisions that have a detrimental impact on profit today but benefit the business as a whole in the long term. For example, if targets are based on a measure of free cash flow, capital expenditure could be put off until after the earn out period has ended.
- Simply put, vendors may be incentivised to prioritise short-term profitability at the expense of long- term sustainability, in order to meet earn out payout targets. To mitigate against such risks as well as others listed above, the terms of the acquisition

may require considerable negotiation, leading to extensive and complex provisions being included in the sale and purchase agreement. Negotiation of such terms can itself be time consuming and costly, sometimes to the extent that it may be to the detriment of the deal being successful

- The benefits of earn outs must therefore be weighed against the disadvantages they may involve.

Question 1

Which ONE of the following is normally considered an advantage of structuring an acquisition with significant contingent consideration?

A. The vendor will be tempted to adjust profit to meet targets
B. The full price will only be paid if financial targets are achieved
C. The acquired company will need to be kept separate for profit calculations
D. Managers may be tempted to focus on short-term profitability and not longer-term sustainability

The answer to this exercise can be found at the end of this workbook.

4. Analysing Deal Effects

2.2.4 Know the impact that variable interest rates have on financing of transactions

2.3.1 Be able to analyse whether a deal has had an enhancing or dilutive effect on the acquirer's earnings per share (EPS)

2.3.2 Be able to analyse the effects of a deal on the financial risk of the acquirer

2.3.3 Be able to analyse the effects of a deal on the relative size of the acquirer with specific reference to net asset per share

2.3.4 Be able to analyse the effects of a deal on the return on capital employed (ROCE)

2.3.5 Be able to analyse the effects of a deal by considering the return on invested capital (ROIC) of the acquirer

2.3.6 Be able to analyse a deal by considering further measures including the size of the bid premium, the post-acquisition P/E ratio and dividend pay-out ratios

When commentators are appraising public company acquisitions, they will look to financial analysis to substantiate the commercial justification for the transaction. Pro-forma numbers are helpful here. Pro- forma numbers calculate key ratios to provide a comparison between a company on a stand-alone basis and as part of a pro-forma merged entity. This makes a direct comparison possible. The latest historical financial results are often used for the calculation to develop some 'what if?' scenarios for consideration.

The most common deal effects that are computed are:

- pro-forma earnings per share
- pro-forma gearing, and
- pro-forma statement of net assets.

In addition to the above, the effects of a deal on the **return on capital employed (ROCE)** and the **return on invested capital (ROIC)** are often considered; section 4.1 below explores these further. Other factors that commentators consider are the size of any bid premium, the P/E ratio post-acquisition and dividend policy.

If the deal is partly funded by borrowing, then the interest incurred on the borrowing in the post-acquisition period will impact the combined entity's profits. Clearly, this will be more predictable for fixed rate, rather than variable rate borrowing. However, the acquiror's expectations of future interest rate movements, the finance term, the spread of fixed to floating rate, and the risk tolerance of the directors of the acquiring company will all be factors in the decision to borrow at a fixed or variable rate. Additional factors would include the combination's existing debt mix, and the liquidity pressures inherent within the business.

4.1 Return on Capital Employed and Invested Capital

4.1.1 Return on Capital Employed (ROCE)

Return on Capital Employed (ROCE) is an investment appraisal technique used by businesses to assess the efficiency and profitability of their capital investments. It measures how effectively a company utilises its capital to generate profits and is also known as 'Return on Investment' (ROI) and 'Accounting Rate of Return' (ARR).

Calculation

For a project/investment with an expected life of several years, ROCE would be calculated based on the estimates of the returns over that time as follows.

ROCE = Average annual profit before interest payable and tax / Capital employed × 100%

Exercise 1

It is estimated that a company will receive income net of direct costs of £100,000 pa over the three-year life of a project/investment, Project/Investment A. An alternative three-year project/ investment, Project/Investment B, will generate £324,000 at the end of the third year.

The initial capital required for either project is £240,000, which will be used to acquire a machine that will be fully depreciated and scrapped at the end of this time.

Using ROCE, which project, if either, should be undertaken on the basis that the alternative use for this cash is to place it on deposit for three years earning compound interest at 10% pa?

The answer to this exercise can be found at the end of this workbook.

Advantages and Disadvantages of ROCE

Advantages:

- ROCE provides a clear and straightforward measure of how well a company generates returns from its capital investments. It is a useful tool for assessing the financial performance of individual projects or the overall company.
- It is a well-recognised measure that investors are familiar with, allowing for ease of comparison and enabling one acquisition of a company or investment to be compared with another.
- ROCE allows for easy comparison of the performance of different projects, business units or companies within the same industry. It helps identify which investments are more efficient at generating returns.
- ROCE emphasises capital efficiency, encouraging companies to use their capital wisely. It helps management identify areas where capital allocation can be improved.
- When factoring in the cost of capital, ROCE implicitly considers the risk associated with an investment. A higher ROCE indicates that the investment is generating returns that exceed its cost of capital, implying a favourable risk-adjusted return.
- ROCE assesses the sustainability of returns over the long term. It ensures that investments not only generate profits but also provide returns that justify the capital employed over the life of the project.

Disadvantages:

- ROCE is based on historical financial data, which may not fully reflect future market conditions or changes in the investment landscape. It is backward-looking and may not capture forward-looking risks and opportunities.
- In the context of an acquisition of a company, over reliance on historical financial data, which the ROCE relies on, may distort appropriate analysis of the acquisition where future prospects would seem to be more important to focus on, not least as non-financial factors and drivers for an acquisition (such as strategic reasons for an acquisition) will not be captured in the ROCE.
- ROCE provides a broad measure of performance but may not provide detailed insights into the specific factors driving investment success or failure. It does not consider the timing of cash flows and the time value of money.
- ROCE relies on accounting metrics such as operating profit and capital employed, which can be subject to manipulation or distortions due to accounting practices. It may not accurately reflect economic reality.
- ROCE focuses solely on financial returns and does not consider non-financial factors such as environmental, social, or governance (ESG) impacts. In today's business environment, these factors can significantly affect investment outcomes.
- Different companies or analysts may calculate ROCE differently, leading to inconsistencies in comparisons. For example, variations in how capital employed is defined can affect ROCE results.
- An acquisition of a company may distort the ROCE as the transaction may have led to a material change in the level of capital employed. As a result, the ROCE measure may be (temporarily) distorted given it takes into account the level of capital employed. Consequently, the effect of an acquisition on ROCE can be to temporarily dilute and reduce the ROCE for an acquiror while for a seller of a business the converse may be the effect; the ROCE may increase as returns will be seen and

measured in the context of a reduced capital employed figure. Such effects may arise whether the acquisition or sale is in respect of assets or a complete entity or company
- ROCE may not be suitable for evaluating certain types of investments, such as start-ups or projects with significant intangible assets. It may undervalue investments with long gestation periods or those with higher upfront costs.
- Acquisitions of start-ups and fledging companies may therefore not be ideal candidates to be analysed through the ROCE measure, as such companies often experience a growth trajectory that does not follow their historic pattern of financial performance. In such cases, it has been argued that the ROCE is an imprecise measure.

4.1.2 Return on Invested Capital (ROIC)

Return on Invested Capital (ROIC) is a measure of the profitability of a company's investments as a percentage of its capital. It aims to assess whether a company is creating value with the investments that it is making, and it is calculated as follows:

Return on invested capital (ROIC) = Net operating profit after taxes (NOPAT) / Invested Capital

For the purposes of the above calculation, NOPAT equals earnings before interest, taxes and amortisation, less taxes while invested capital comprises capital whether in debt or equity form.

Conceptually, a high ROIC would suggest that a company is investing in profitable investment projects. As an acquisition of a company (and, from the perspective of the seller of such company, a divestment) is typically considered an investment project, assessment of its success by computing the ROIC for it may seem to make sense.

There are, however, drawbacks to such an approach.

First, non-recurring events such as an acquisition or restructuring distort ratios, including ratios such as the ROIC, and make comparisons over time less reliable.

But secondly, and more importantly, ROIC is seen as an inappropriate method to evaluate M&A transactions because the benefits (in terms of profit) of such deals almost always take time to come to fruition. An acquisition will typically create value for the buyer over time, and, if the deal is assessed on the basis of ROIC, it is likely that immediately after the acquisition, the ROIC will be poor because the numerator, NOPAT, is likely to be small while the denominator, invested capital, will be large.

In time, typically the NOPAT will increase while the denominator, invested capital, will decrease, especially if considering depreciation of assets. Therefore, over time, the ROIC will increase, other things being equal.

As such, while the ROIC ratio allows for an evaluation of an acquisition investment, drawbacks exist to assess an acquisition on such basis.

Additionally, the effect of an acquisition or divestment may temporarily distort ROIC of companies if it leads to a reduction in operating profit (if, for example, a business division is sold) or an increase in invested capital (for example, to fund an acquisition that has been made). In summary, the effects of an acquisition on measures of returns such as ROIC are dependent on whether the transaction is seen from the perspective of a buyer or seller and whether the measure of returns is calculated shortly after the transaction or some years later.

Consequently, the context of the acquisition transaction, how it has been funded, and when the benefits of it, in terms of additional operating profit, are gained, must all be considered in any evaluation.

4.2 Calculating Pro-forma Earnings per Share

Commentators will want to know if a transaction is earnings enhancing or accretive (EPS is improved) or if it is earnings dilutive (EPS worsens). For an acquisition, this can be determined by comparing the earnings per share of the acquirer on a stand-alone basis, versus the pro-forma earnings per share of the combined entity.

- Where the earnings per share of the acquirer < the earnings per share of the acquirer and target on a pro-forma basis, the transaction is said to be earnings enhancing.
- Where the earnings per share of the acquirer > the earnings per share of the acquirer and target on a pro-forma basis, the transaction is said to be earnings dilutive.

When calculating the pro-forma earnings per share of the combined entity, bear the following considerations in mind:

- The post-tax impact of any synergies should be included. For the EPS calculation, the impact on earnings and thus synergies need to be incorporated on an accruals basis. Remember that synergies can be negative, as well as positive.
- The post-tax impact of the financing structure on earnings needs consideration. For example, the interest on new borrowings should be factored in, as well as the interest receivable lost on the cash consideration paid out as part of the transaction terms.
- The pro-forma number of ordinary shares must take account of the financing structure, ie, any new shares to be issued as offer consideration must be included.

In periods of low interest rates, acquirers find many acquisitions are earnings enhancing, given the poor return that businesses earn on their retained cash and the attractively low cost of borrowing. With higher interest rates, companies tend to be more cautious and less willing to engage in M&A.

For a transaction where the consideration is new acquirer shares, if the target company has a higher P/E ratio than the acquirer, then the transaction will be earnings dilutive. This is because the acquirer has to pay more for each pound of target company earnings than the market currently rates its own earnings. In terms of the calculation, the pro-forma number of shares (denominator) will go up by more than the pro-forma earnings (numerator), causing EPS to decline.

Example

Giant Inc takes over Tiddler Co by offering two shares in Giant for one share in Tiddler. Details about each company are as follows.

	Giant Inc	Tiddler Co
Number of shares	2,800,000	100,000
Market value per share	$4	–
Annual earnings	$560,000	$50,000
EPS	20c	50c
P/E ratio	20x	

By offering two shares in Giant worth $4 each for one share in Tiddler, the valuation placed on each Tiddler share is $8, and with Tiddler's EPS of 50c, this implies that Tiddler would be acquired on a P/E ratio of 16. This is lower than the P/E ratio of Giant, which is 20.

If the acquisition produces no synergies, and there is no growth in the earnings of either Giant or its new subsidiary Tiddler, then the EPS of Giant would still be higher than before, because Tiddler was bought on a lower P/E ratio. The combined group's results would be as follows.

	Giant group
Number of shares (2,800,000 + 200,000)	3,000,000
Annual earnings (560,000 + 50,000)	610,000
EPS	20.33c

If the P/E ratio is still 20, the market value per share would be $4.07 (20.33 × 20), which is 7c more than the pre-takeover price.

The process of buying a company with a lower P/E ratio in order to boost your own EPS is known as bootstrapping. Whether the stock market is fooled by this process is debatable. The P/E ratio is likely to fall after the takeover in the absence of synergistic or other gains.

You might think that dilution of earnings must be avoided at all costs. However, there are three cases where a dilution of earnings might be accepted on an acquisition if there were other advantages to be gained.

a. Earnings growth may hide the dilution in EPS.
b. A company might be willing to accept earnings dilution if the quality of the acquired company's earnings is superior to that of the acquiring company.

c. A trading company with high earnings, but with few assets, may want to increase its assets base by acquiring a company which is strong in assets but weak in earnings so that assets and earnings get more into line with each other. In this case, dilution in earnings is compensated for by an increase in net asset backing.

4.3 Calculating Financial Risk – Pro-forma Gearing

Pro-forma gearing ratios assess the change in financial risk as a result of the transaction. A comparison is made between the acquirer's existing gearing ratio, calculated as interest-bearing borrowings divided by shareholders' funds and the pro-forma gearing ratio, which considers the borrowings and shareholders' funds of the enlarged group. If the gearing ratio has increased, the acquirer's shareholders will need to be convinced that forecast cash flows for the combined entity are sufficient to service the levels of borrowings. They will be mindful of the existing operating leverage of the business (how volatile are earnings?) and the current asset-backing. Combining different earnings streams can reduce volatility and therefore the risk appetite of shareholders for debt may increase.

The following considerations impact the calculation:

- The **pro-forma debt** number should be based on the borrowings of the enlarged entity, namely the acquirer borrowings and any borrowings necessary to fund the transaction.
- The **pro-forma equity number** should include any new equity to be issued. In addition, shareholders' funds should be adjusted to include accrued profits in retained earnings, between the balance sheet date and the date of the transaction.
- **Gearing ratios** can be distorted by accounting policy choices and therefore the ratios should be computed eliminating accounting policy differences between the two companies.

4.4 Calculating Pro-forma Net Assets per Share

Pro-forma net assets per share gives an idea of the relative size of the enlarged entity, versus the acquirer. It also provides the basis for other calculations, for example, pro-forma gearing and pro-forma return on equity.

The following considerations are relevant:

- The net assets of the two companies need to be added together, taking account of fair value
- adjustments and aligning accounting policies.
- The net assets need to be adjusted for profit accruals between the last balance sheet date and the proposed transaction date.
- Any goodwill arising on the acquisition should be capitalised as an intangible asset, calculated as the difference between the **fair value** of the acquisition consideration and the fair value of the separable net assets of the business that is to be acquired.

Example

Analysing Deal Effects
Blackbird plc is about to buy Tornado Limited but is concerned about the effect on its earnings per share of the deal it has negotiated. The facts are as follows:

Blackbird	Tornado
3,000,000 shares in issue	100,000 shares in issue
Current share price: £2/share	Purchase price: £1.8m in Blackbird shares
Latest reported net income £600,000	Latest reported net income £120,000

Calculate if the deal will be earnings enhancing for Blackbird. Would your conclusion be different if the transaction was financed by cash instead of shares? Make any assumptions you feel are necessary to do the calculation and state any reservations you have with the calculation.

Solution
Equity Deal
Blackbird's existing earnings per share = 600,000 / 3,000,000 = 20 pence
Pro-forma earnings per share = (600,000 + 120,000) / (3,000,000 + 900,000)
= 18.5 pence

Based on the numbers provided, the transaction will dilute earnings by 7.5% for Blackbird. However, the calculations exclude the impact of any synergies which are expected to arise, and which should be quantified separately. In addition, the calculation is based on historic earnings. Investors may be less concerned about earnings dilution if the deal is expected to be earnings enhancing based on forecast earnings.

Cash Deal
Assuming that the deal is financed from retained cash on the balance sheet of Blackbird.

Assumed rate of return on the cash = 3%. Assumed tax rate = 25%
Pro-forma earnings per share = {600,000 + 120,000 – (£1.8m × 0.03 × 0.75)}/ 3m
= (720,000 – 40,500)/3m
= 679,500/3m
= 22.7 pence

Based on the numbers provided, the transaction will enhance earnings by 13.5% for Blackbird. Again, the calculations exclude the impact of any synergies which are expected to arise, and which should be quantified separately.

4.5 Other Factors

Other factors that commentators consider are the size of any bid premium, the P/E ratio post-acquisition and the dividend policy.

4.5.1 Bid Premium

Where the target company is listed, the acquirer will consider the size of the bid premium. The bid premium is calculated as the percentage excess of the bid price over the pre-announcement share price of the target company. The share price chosen is often the last closing share price prior to a market announcement relating to the transaction. Sometimes, the bid premium is calculated by comparing the bid price to the average of the target's share price over a period of time, often the six months prior to the announcement. This is to ensure the impact of any market rumours is excluded. Once computed, the bid premium can be judged against comparable market transactions to see if it is reasonable.

4.5.2 P/E Ratio Post-Acquisition

A P/E ratio for the combined entity can be calculated by weighting the existing P/E ratios of both companies by their market values. This gives a basic means to assess the market rating of the new entity.

Example

Acquirer market value = \$2.1bn, with a P/E ratio of 9 ×
Target market value = \$250m, with a P/E ratio of 6×
Combined P/E = {(2,100 × 9) + (250 × 6)}/ (2,100 + 250)
= 8.7×

4.5.3 Dividend Pay Out Ratio Policy

Commentators will assess the relative dividend policy by looking at the payout ratios of the two businesses. The payout ratio is calculated as the dividend per share divided by the earnings per share. A view can then be taken on what the likely payout ratio of the combined group will be.

As with bid premium, an analysis of the dividend pay-out ratio over an extended period will lessen any distorting effect of unusual or extraordinary short-term factors or irregular pay outs.

Exercise 2

Company Z acquired Company X on 1 January 2026, financed by issuing new shares of £7.00 each and £50,000 cash. The information in the following table relates to the year ending 31 December 2025.

	Company Z	Company X
Non-current assets	£440,000	£192,000
Current assets	£360,000	£288,000
Interest-bearing borrowings	£240,000	£120,000
Current liabilities	£288,000	£96,000
Number of shares outstanding	200,000	30,000

Immediately before the acquisition, the following information about Company X comes to light:

- The fair value of non-current assets is £72,000 above the book value.
- Inventory amounting to £4,000 is obsolete and must be written down.

In calculating the purchase price, due to expected post-acquisition synergies, an amount of £40,000 in excess of the net asset value of Company X will be paid.

What is the pro-forma net assets per share (to two decimal places) immediately after the acquisition?

The answer to this exercise can be found at the end of this workbook.

Exercise 3

Company ABC took over Company XYZ on 1 January 2026 at a value of £650,000. The deal was financed by issuing 50,000 new shares and 5% five-year bonds. The relevant financial information prior to the transaction is shown below:

	Company ABC	Company XYZ
Market value of shares	£9	N/A
Interest-bearing borrowings	£400,000	£420,000
Non-interest-bearing borrowings	£240,000	£150,000
Shareholders' funds	£880,000	£560,000

What is the percentage proforma debt-to-equity ratio (to two decimal places) immediately after the acquisition?

The answer to this exercise can be found at the end of this workbook.

5. Sharing of Merger Gains

2.4.1 Be able to analyse the share of merger gains accruing to the acquirer and the target company shareholders under different financing scenarios

The financial gains expected to arise from the acquisition will not necessarily all accrue to the acquirer company shareholders. The nature of the acquisition consideration will determine the basis of sharing of merger gains between acquirer and target company shareholders. While it will be the case that the lower the bid premium is, the greater the share of merger gains that accrue to the acquirer, the form of consideration with which the acquisition is financed will also impact the extent to which the seller and target company shareholders may also benefit from the deal.

If the consideration that selling shareholders receive is cash, then they will not be able to participate in any future uplift in the value of the newly combined entity. If, however, the consideration comprises (or is partly) in the form of shares, then any future uplift in the value of the newly combined entity will be shared with such seller shareholders.
This concept is best illustrated by an example.

Example

Africa plc pays €1.2m cash consideration to purchase Botswana plc. The existing market value of Africa is €10m and the existing market value of Botswana is €875,000. Africa has 1 million shares in issue and anticipates that €500,000 merger gains will arise from the transaction.

i. What is the bid premium?
ii. What proportion of total acquisition gains go to Africa shareholders?
iii. What would be the bid premium if the transaction was instead funded by 120,000 new Africa shares?

Solution

i. Total bid premium = acquisition consideration – market value of target (pre-bid)
= 1,200,000 – 875,000
= €325,000

ii. Total acquisition gains for Africa shareholders
= merger gain net of premium paid = 500,000 – 325,000
= €175,000

iii. With equity consideration, Botswana shareholders will now participate in the future gains and losses of the combined entity, effectively increasing the premium paid.

New bid premium = original bid premium + Botswana's shareholders' share of Africa's merger gains
= 325,000 + {(120/1,120) × 175,000}
= €343,750

6. Calculating Control Premia

2.1.2 Be able to evaluate the use of control premia and marketability discounts in arriving at the acquisition price

The per share value for a controlling stake is greater than the per share value for a minority stake. A controlling stake gives the power to decide business strategy, acquisitions and disposals, the level of dividends, who to appoint as a director, how much to pay directors, and which business options to pursue. A minority stake gives only the right to receive dividends and capital gains.

When an acquirer agrees the deal consideration, the acquisition price should include a control premium. A control premium is often quantified by looking at comparable transactions. However, establishing true comparability is very difficult due to differences in individual circumstances caused by different synergies or strategies. In addition, unless the comparable transaction is very recent, comparability is likely to have been eroded by changing market conditions.

The control premium must be justified to the acquirer's shareholders by a quantification of deal synergies. The bid premium should never exceed the present value of the estimated synergistic benefits that are expected to arise.

In practice, the need to apply a control premium to the valuation that is computed, will depend on the valuation method chosen.

The following table provides guidance:

Valuation Method	Control premium?
Comparable company multiples	Comparable company multiples assume a minority holding. A separate control premium must be added on to the valuation
Comparable transaction multiples	Already include a control premium
Discounted cash flow	If using DCF with synergies, no separate control premium is required. If using DCF without synergies, a control premium is required.

6.1 Marketability Discounts

For valuations of unlisted companies, a marketability discount is sometimes applied to the final valuation to reflect the fact that there is not an active market in which to trade the company’s shares. It is therefore harder to value the company and the investment is illiquid. In practice, as markets have become more homogenous and liquid, the marketability of all investments has improved. The appropriate size of a marketability discount is thus getting smaller.

The size of discount in any scenario (if any) is therefore up for individual negotiation. If appropriate, marketability discounts should be applied to valuations computed by both discounted cash flow and multiples methods.

Question 2

Magpie plc took over Blackbird ltd on 1 January 2026, settled by issuing 40,000 new shares and £75,000 cash. The issue price of the new shares was a 7.5% premium to the last trading price. The information on 31 December 2025 is shown below:

	Magpie plc	Blackbird ltd
Number of shares	200,000	40,000
Market value of shares	£6	£7
Net income	£20,000	£8,000

What is the percentage bid premium paid by Magpie plc (to the nearest whole number)?

The answer to this exercise can be found at the end of this workbook.

Question 3

Which of the following valuation techniques require a control premium to be added? Select all that apply.

A. Comparable company multiples
B. Comparable transaction multiples
C. Discounted cash flow with synergies
D. Discounted cash flow without synergies

The answer to this exercise can be found at the end of this workbook.

Chapter Roundup

Chapter 2: Deal Structuring and Financing

This chapter has explored deal structuring, which is concerned with how a transaction is brought about. Put simply, an acquisition is structured by buying the assets or the shares of the target company.

Deal structuring also entails deciding on the consideration package, be it cash, loan stock, shares or alternatives. Consideration can be paid using earn outs, options or deferred arrangements.

The chapter has explored the merits and drawbacks of each deal structure including tax considerations for the vendor and purchaser.

'Deal effects' resulting from a transaction have also been covered, summarising how a particular transaction might be viewed by shareholders and the market generally. Various headline figures are often used to substantiate the merits of a transaction, including:

- Pro-forma earnings per share
- Pro-forma P/E ratio
- Pro-forma gearing
- Pro-forma dividend, and
- Pro-forma net assets.



Chapter Three
Disposals and Demergers

Section 1 Introduction

Section 2 Motives for Disposal

Section 3 Preparing the Business for Sale

Section 4 The Auction Process

Section 5 Demergers

Section 6 Methods of Achieving a Demerger

1. Introduction

This chapter examines disposals and demergers. It will examine both the motives for such transactions and the mechanics of undertaking a disposal.

2. Motives for Disposal

3.1.1 Be able to analyse the motivations for disposal of the following: a subsidiary or division of a public or private company; a private company disposal; a personal disposal of a family business

Having considered the motives for acquisitions, it is appropriate to now consider the motives for disposals. It is important to identify the reasons why a business (or a business segment) may be sold. Once these are known, it will be possible to establish whether the business is actually saleable, and if so, how much it can be sold for and to whom it can be sold.

2.1 Corporate Disposal of a Subsidiary or Division

Corporate disposals should be determined by strategic considerations. The same strategic reasons that determine whether a company should make acquisitions and expand into different areas will be relevant for disposals. The major difference is that the company would usually be disposing of businesses which do not fit into its strategic plans and which are non-core to the group.

Where a company, usually a large group, wishes to dispose of just one part of its business, this can be achieved by a trade sale, spin-off or equity carve-out.

Motivations for disposals can therefore be driven by one or more of the following reasons:

- **Redundant operations** or a business unit that has become surplus, or irrelevant, to the needs of the company. A recent example of this was HSBC's divestment of its Canadian operations, as part of its plans to exit the Canadian market. It sold its HSBC Canada operations to the Royal Bank of Canada, with the motivation for the disposal, as cited in the transaction's announcement to the financial markets, as freeing up capital to invest in core businesses of HSBC.
- **Regulatory requirements** – in the banking sector, for example, following the introduction of the Volcker Rules in the United States (laws that aimed to restrict the extent of proprietary trading being undertaken by banks, as well as to limit the level of ownership of hedge funds and private equity funds by banks, among other things) many banks sought to dispose of their trading and hedge fund/private equity fund operations, despite sometimes being profitable entities, in order to comply with the new regulatory requirements.
- **Exiting market segments or customer markets** – a particular geographic market, product market or customer market may be exited. A recent example from outside

banking can be seen in the energy sector where Shell disposed of its retail energy division, Shell Energy to Octopus Energy. The disposal allowed Shell to exit the domestic energy markets and focus, instead, on business and commercial sectors.

- **Raising funds** – the funds raised from a disposal may support other operations of the selling business. In this regard, the disposal can act a necessary source of funding for the selling business/ parent company to continue to operate. Such disposals will typically (but not always) arise in distressed conditions and amount to 'distressed sales'. Price achieved in such disposals may, however, be discounted as any acquirer will have greater negotiating power given that the seller is in a weaker position and keen to raise funds quickly.

In a trade sale or divestiture, the disposal will be of the division or subsidiary as a whole to one acquirer. This will be of the assets and liabilities of the division as a going concern.

In a spin-off, the shares of the subsidiary company, currently 100% owned by the group parent company and therefore not publicly traded, are distributed to the parent company shareholders in the form of a dividend. No money is exchanged. Before then transaction one firm existed, two exist after the distribution, and they are run as separate businesses with separate management teams. There is now greater transparency of the two different operations and thus the assessment of their value should be easier.

A spin-off can be compared to an equity carve-out. Again, the business to be sold is organised as a separate legal entity but in an equity carve-out the shares in this entity are sold to the public, generating cash for the parent. With a spin-off, shareholders are initially the same, but with a carve-out new shareholders purchase the equity. The sale does not necessarily need to involve 100% of equity; the parent may retain a shareholding in the company.

Question 1

ABC Group wants to raise funds by selling a substantial subsidiary company that it does not consider as 'core'. All of the following would potentially be appropriate EXCEPT:

A. Spin-off
B. Trade sale
C. Equity carve-out
D. Divestiture

The answer to this exercise can be found at the end of this workbook.

2.2 Personal Disposal of a Family Business

A disposal of a business by an individual is unlikely to be motivated by strategic considerations of core businesses and growth areas. It is more likely that the entrepreneur has developed the business over a number of years and now wishes to realise the investment.

The motives of such a vendor may include the desire to:

- realise a cash sum after building up a business
- achieve a level of security
- let the business grow through combining with a larger concern
- obtain status through becoming a director of a listed company
- exit the business due to personal reasons, eg, retirement, or
- get out while the going is good, anticipating the demise of the business.

The motives of the vendor will determine what is a satisfactory form and level of consideration. A vendor who wishes to realise a cash sum and believes that the company is not going to prosper is going to want a cash deal and will possibly be prepared to sell for a smaller sum than would otherwise be the case. A vendor who believes that the company will continue to be successful, wants continued involvement in the business and wants to ensure the continued well-being of their staff, will probably only accept a higher price and may be happy to have an earn out deal and consideration in shares.

2.3 Private Company Disposals

Private company disposals are not governed by stock market considerations. Individual sales processes will thus differ significantly and depend upon the individual objectives of the vendors of the businesses and also the specific circumstances of the businesses to be sold.

To a significant extent, the motivations for a private company disposal will be similar to those encountered in the context of disposals by public companies. Strategic considerations will guide the decision to dispose of a private company, whether as a subsidiary of a private company parent, or as the disposal of specific assets in a private company, either as an asset sale or, more likely, as a share sale or in the form of a hive down.

Common motivations will therefore include the disposal of redundant operations or a surplus business, regulatory requirements, exiting certain customer, product or geographic markets or to raise funds. Each of these have been explored in greater detail in section 2.1 above. Additional motivations may include the retirement of the owners of the private company or due to other personal reasons.

In all cases, the objective of the vendor should be to keep the sales process as controlled as possible. This will be achieved by a ‘rifle shot’ approach to targeting a few selected acquirers rather than contacting and meeting with a large number of possibly interested companies. The more companies that are contacted, the greater the time spent meeting people unnecessarily and the more information that is released to time-wasters who are only interested in seeing the details of the company for sale rather than making a purchase. There are two main methods of negotiation: a controlled auction and a managed bid.

2.3.1 Controlled Auction

A controlled auction, as the name suggests, gives the greatest control to the vendor over the disposal process. This method will usually be applicable where the business for sale is extremely attractive and there are a few, serious potential acquirers.

The potential acquirers are given details of the company for sale and a deadline by which to reply with an offer, subject to final investigation and the final contract being agreed.

The advantage of this approach is that it keeps the seller in control and forces interested companies to make a serious offer upfront. In order to make it work, the sales document will need to be detailed enough to enable the acquirer to make an offer.

2.3.2 Managed Bid

The managed bid is where the vendor arranges to meet potential acquirers prior to their making an offer for the company. No timescale is fixed and the vendor can deal with several potential acquirers at the same time.

This method of conducting the sale takes control out of the hands of the vendor and puts it into the hands of the acquirer to an extent. It allows acquirers to move further down the line before pulling out of the auction. It should only really be used when the company for sale is not sufficiently attractive for a controlled auction to be possible.

3. Preparing the Business for Sale

3.1.2 Know the following aspects of the sale process of a disposal in a given scenario: traditional and alternative disposal methods; identifying and shortlisting purchasers; approaching potential purchasers

There are a number of important issues to be considered to prepare a business for sale. Irrespective of whether the disposal is of a public company's subsidiary, of a private company or of a family business, there are several common features that the process for such disposals share.

3.1 Traditional and Alternative Disposal Methods

Traditionally, the approach to making disposal has involved a seller and prospective acquirer being introduced to each other through a corporate finance adviser (typically an accountant and, sometimes, a legal adviser), or as a result of professional dealings with each other or through pre- existing or new relations that have been formed in a related professional network. Following such an introduction, the parties engage in negotiations to arrive at a contract between them for the disposal by the seller of a business.

A seller of a business may instruct their accountant or corporate finance adviser to find potential purchasers. To be in a position to do so, the accountant or corporate finance adviser will need to undertake an assessment of the business to be sold and, in conjunction with input from the seller, prepare an information memorandum in which key details, including indicative valuations of the business to be sold, will be set out.

The adviser would typically canvas interest from prospective acquirers and seek to broker or develop interest in the business to be sold. Such initial discussions, if fruitful, would be followed by further enquiries being made by any prospective acquirer of the business to be sold, due diligence being undertaken, and the terms of the transaction being subsequently negotiated.

In other words, any such transaction would entail the various stages of an acquisition that were explored in section 2 of chapter 1. Negotiating of the terms of a disposal takes place between the seller and the acquirer, with support from each party's respective legal/finance advisers.

In contrast to this more traditional approach, alternate disposal methods include sales being effected through an auction of a business or company, where bids for the business to be disposed of are invited and the highest bidder will secure the acquisition of the disposed company or business. Such auctions may also necessitate a seller seeking advice and support from a professional adviser whose role will be to advise on, manage and orchestrate the holding of such an auction, including advising the seller on what would amount to a reasonable valuation and sale price.

Again, the professional adviser would provide advice on indicative valuation and market terms, and would assist in facilitating introductions to prospective acquirers who may wish to make bids during the auction. The parameters of the auction and minimum price and valuation ranges would ordinarily be advised on by the professional adviser. If a bid made during an auction is successful and accepted, similar to contractual offers, the auction transaction would also entail the various stages of an acquisition that were explored in section 2 of chapter 1.

More recently, online marketplaces and websites have emerged where companies or businesses for sale can be advertised. This method allows prospective acquirers to evaluate potential companies or target businesses, without involving corporate finance advisers, before taking next steps involved in an acquisition.

Professional advisers may be absent in this method of sale. As such, care has to be taken during all stages of the disposal; transaction management processes would fall on the seller to undertake or on the provider of the market place. As with the traditional approach to disposals and auction bids, the various stages of an acquisition that were explored in section 2 of chapter 1 would need to take place once an offer or bid made on a marketplace has been accepted in principle.

Question 2

Which one of the following is normally considered the 'traditional' approach to selling a company?

A. Using an auction inviting selected purchasers to bid
B. Using on online marketplace to bring sellers and buyers together
C. Using a corporate finance adviser to introduce a potential buyer

The answer to this exercise can be found at the end of this workbook.

3.2 Identifying and Shortlisting Purchasers

Irrespective of whether a traditional or alternative disposal method is adopted, and regardless of whether the sale of a business is that of a public company's business unit or subsidiary, a private company or a family business company, professional advisers often facilitate the identification of potential purchasers.

This may be through introductions that are made through their professional networks, or introductions between clients or by way of research of industry databases which reveals potential acquirers who may be suitable for and interested in the business being sold.

Any such assessment of an acquirer may entail consideration of one or more of the following:

The acquirer's:

- Existing market share.
- Geographic footprint.
- Management team (including expertise that could be necessary for the business being sold to operate).
- Business strategy and plans.
- Technological know-how or expertise (which the business being sold needs or which the acquirer needs and which the business being sold possesses).
- Financial status and ability to fund the acquisition of the business.
- Track record of being acquisitive. It helps to be aware of whether a prospective buyer has made acquisitions in the past and, if so, how the acquisitions have fared.
- Reputation as a purchaser: Is the prospective buyer reliable and well reputed for maintaining their side of a bargain that they enter into? In other words, is the prospective buyer a reliable negotiating party for any disposal.

From a long list of potential acquirers, shortlisting is arrived at by evaluating the above considerations as well as others that are relevant to the disposal's particular characteristics, or the industry in which the company operates. Potential acquirers may then be ranked in order of their appropriateness and candidacy for being a purchaser. Any such ranking and shortlisting exercise may be conducted only after detailed criteria and parameters have been agreed with the seller of the business being disposed of.

Agreement of such criteria and parameters is therefore necessary during the early stages of an adviser being engaged on a disposal. Agreement of criteria can often take time to finalise especially if the seller's strategic motivations for the disposal are unclear or if it is their first disposal (which can often be the case for a family company disposal). In such cases, tactful guidance to sellers from their advisers can help, especially to moderate the seller's expectations on valuation.

Where there is an auction process involving invitations for offers being made by a purchaser, an evaluation of the offers received will be conducted as will a ranking of the offers/bids received, assessed against criteria agreed in advance with the seller.

3.3 Approaching Potential Purchasers

Advisers often broker introductions between sellers and prospective buyers. Prospective buyers will be approached by the adviser to sound out from them whether they have an interest in acquiring the business being sold. If the adviser has a pre-existing relationship with prospective buyers, such discussions will be much easier to conduct.

In any approach being made to a prospective buyer, confidentiality must be key as sensitive commercial information must not be disclosed or leaked. This is particularly the case in the context of disposals of subsidiaries or business units of public companies where the prospect of a disposal may have an impact on the share price of the public company. Knowledge of such a planned disposal may constitute unpublished price-sensitive information, which market abuse and insider dealing regulations govern. As a result, compliance with related market abuse regulations must be carefully considered by advisers in such transactions.

Typically, an adviser will approach senior decision makers, such as directors on the board or strategic/ business development directors of a prospective buyer. In discussions that follow, the willingness of a buyer to consider an acquisition will be explored, as will its strategic plans, to determine whether the business being sold would fit into the buyer's strategy. If it appears that there is potential for a deal to take place, further discussions will ensue, and additional commercial details of the business to be sold will be shared with a purchaser, subject to a confidentiality undertaking first being provided by the prospective purchaser.

Where an auction is contemplated, similar initial approaches to prospective purchasers may be made with an invitation for them to attend and/or submit bids at any planned auction.

Tact, maintaining confidentiality and developing a constructive professional working relationship with any potential purchaser are key in any approaches made.

3.4 Interdependence of Group Companies

One factor to consider is how interdependent individual subsidiaries are in the group. For example, the division to be sold may depend on another group company for provision of a central service. Alternatively, the division may have another subsidiary of the group as an important customer. Yet again, it may itself be a vital customer of another group company.

Such situations will need to be recognised before the business is sold. If the business will lack any vital services, then it will have to plug this gap itself prior to the sale or find a buyer to whom such a deficiency is not important. If the business to be sold has an important trading relationship, then a contract may need to be negotiated to protect the relationship for several years.

3.5 Legal Structure

A business for sale that is already an autonomous legal entity will not present a problem. However, it is possible that the division to be sold is not separate but sits within other divisions in the same subsidiary. In this case a disposal will necessitate a group reorganisation to align the elements of the business that will be divested.

A reorganisation may take many different forms, such as a hive down. As described in chapter 2, section 2.1.3, a hive down combines the simplicity of a share acquisition with the ability to cherry pick assets under an assets acquisition, ensuring the acquirer purchases only the assets that it wants.

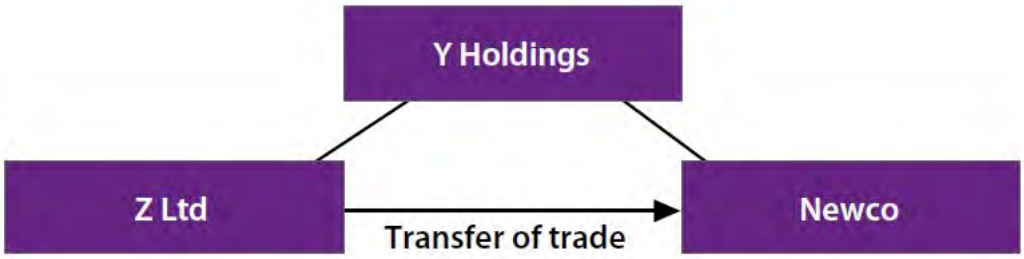
3.5.1 Before

Y Holdings plc is the holding company of a subsidiary company, Z Ltd. Z Ltd has two separate businesses, one of which is for sale.



3.5.2 The Reconstruction

Y Holdings plc creates a new subsidiary (Newco) and transfers the business for sale into Newco.



The business can now be sold as a separate legal entity, Newco.

3.6 Regulatory Requirements

An important factor to consider is whether the sale of the company to a particular acquirer will cause problems with regulatory authorities, such as the competition regulators. It may be possible to restructure the business to avoid this problem by the acquirer agreeing to subsequently sell one part of the business, for example, or by the seller disposing of different parts separately. Advice will need to be sought on the tax position.

4. The Auction Process

3.1.3 Know the stages of the auction process in the following situations: advising on inviting offers; evaluating offers

4.1 No-Names Teaser

Having established the exact structure of the company for sale and to whom it is likely to be attractive, a selling document can be prepared which is accurately targeted to the desired acquirers.

The detailed selling document is preceded by a 'teaser' document. This is prepared by the vendor to provide a potential buyer with outline information on the business to be sold, while at the same time withholding important information, including the company name and details of business operations and customers to protect the confidentiality of the sale. The teaser is used to gauge a potential buyer's interest prior to providing them with more details, in the form of an information memorandum. The document is outline in nature and brief.

The vendor, or more likely the vendor's advisers, draw up a list of potential purchasers and will send out the no-names teaser document to try and provoke a response.

Acquirers can be identified in the same ways as potential vendors can be sought by companies seeking to make an acquisition. The initial approach should be to either the finance director, business development director or managing director of the company. Certain potential buyers may be excluded from the list for competitive reasons and the wish not to disclose information that will give a competitor a strategic advantage.

4.2 Information Memorandum

If a potential purchaser responds to the no-names teaser with a request for more information, the sales process can be developed further. The potential acquirer can apply to receive the full selling document, which is termed the information memorandum (IM). Before the IM is dispatched, potential purchasers must sign a confidentiality agreement, which is a legal document that provides undertakings regarding the use of the information that will be provided.

An information memorandum is like a detailed business plan. It should give a potential acquirer sufficient information to make a decision about whether to buy the business and how much to offer, subject to an accountant's investigation. As an information memorandum, it should portray the business in a compelling light. However, it should be remembered that Sections 89–91 of the Financial Services Act 2012 makes it a criminal offence to make a false statement dishonestly or recklessly in order to induce someone to enter into an investment agreement. It is also an offence to withhold information dishonestly or recklessly for the same purpose. The document should, therefore, be prepared with due care and attention.

The IM will be a detailed document, enabling comprehensive financial analysis and valuations to be undertaken. However, the vendor should be careful not to reveal all confidential details until they are assured as to the seriousness of the acquirer's intent. For this reason, certain details will be omitted, such as terms of key customer contracts.

The key contents will be as follows:

- an overview/executive summary
- sales, marketing and product information
- suppliers
- directors, senior management and employee details
- administration systems and related details
- locations of key premises
- existing shareholders and their percentage holdings
- general company information, such as the registered office and the company registration number
- financial details, including recent income statements, balance sheets and cash flow forecasts (budgets and forecasts for coming years may also be appropriate), and
- suggestions as to how the acquirer can develop and add value to the business.

Potential buyers are given a period of time, usually a few weeks, to assess the memorandum before submitting an indication of interest.

4.3 Inviting Offers

Where an auction process is chosen for the disposal of a business or subsidiary, subsequent to information memoranda being provided, the next stage in the disposal process is to invite offers to be made. As explained in sections 3.3 and 4.1, an adviser will typically approach potential purchasers and after initial discussions to sound out whether they may have interest in making an acquisition, any potential purchasers will be invited to take part in an auction and submit bids in accordance with the terms and parameters of the auction.

To ensure sufficiently detailed and relevant bids are received, in consultation with the seller of the business, an adviser will agree key details and terms of reference that a bid must comply with. Typically, a bid will therefore be submitted in a standardised format. Details provided in a bid will ordinarily include, at the very least, bid price, form of consideration (cash, loan stock, equity in the purchaser's business etc), timing of payment and confirmation of funds being readily available.

The level of detail that a bid offer may contain will also depend on whether the disposal is of a public company's business (where much greater levels of detail may be required), or of a family business (which could be a smaller entity and therefore require a simplified or streamlined auction process) or somewhere in between for disposals of other types of private company. Equally, the level of detail in a bid offer may depend on the industry in which the company/business operates. In heavily regulated industries, for example, confirmation of the existence of regulatory licences, or sufficient capital funding (particularly relevant in the financial services industry) or safety/regulatory approvals (particularly relevant in the pharmaceutical industry) may often be required in any bid offer made.

4.4 Letters of Intent

Bid offers and expressions of interest from potential purchasers will usually take the form of a letter of intent. This is a non-binding letter from potential buyers that reveals how much they are willing to pay for the company, how the purchase will be financed and a description of their experience with making acquisitions. The letters of intent are considered, and the most credible purchasers are identified, by way of a shortlisting process not dissimilar to that described in section 3.2 above. If the process is a competitive one, an adviser can apply pressure on buyers to offer their highest price and maximise value for the seller.

4.5 Evaluating Offers

Each letter of intent will be considered against the criteria that the adviser and seller will have drawn up at the start of the disposal process. Typically, each letter of intent will be evaluated for its price, payment terms, timing of receipt of funds, financing ability of the purchaser, their credibility and track record in making acquisitions and the level of strategic fit that the business being sold presents for the acquirer. Offers will be ranked in order of suitability and their attractiveness.

4.6 Due Diligence

The remaining buyers, perhaps one or two depending on the case, are invited to conduct more detailed due diligence on the acquisition company. Historically, due diligence was conducted at the company's data room: a location where very detailed information on the company is available for potential buyers to view and analyse. Now, physical data rooms have been replaced by documents held online on a secure website for potential buyers to view. The vendor can use these websites to monitor the usage by potential purchasers of this information, for example what information has been viewed and for how long. Based on this due diligence, potential purchasers will submit their final bids.

4.7 Heads of Terms

At this point, final negotiations commence between the vendor and potential purchasers. The outcome of the negotiation is usually a 'heads of terms' document, which sets out the position of both parties as agreed by discussion. The heads of terms will include the purchase price, the purchase consideration, details of what is being sold (ie, assets or shares), conditions of the sale, including warranties, indemnities and representations. The heads of terms document provides the basis for the key contractual document, the Sale and Purchase Agreement.

The Sale and Purchase Agreement for a disposal transaction typically contains similar terms, (including warranties, representations and indemnities) as would be present in any other acquisition transaction. The warranties would be qualified by an accompanying disclosure letter in a similar manner to other acquisition transactions that were explored in chapter 1, section 2.12.

Exercise 1

Please put the following eight documents/activities in the correct order for the auction process, from start to finish:

- Ranking the potential purchasers.
- Heads of terms document.
- No names teaser distributed.
- Letter of intent.
- Final bid submission.
- Sale and purchase agreement.
- Signing a confidentiality agreement.
- Information memorandum shared.

The answer to this exercise can be found at the end of this workbook.

Question 3

Forster Group is holding a board meeting that is discussing the sale of a substantial subsidiary that is facing some challenges. Not disclosing which of the following would be unacceptable?

Select as many as you think are correct.
A. The recent loss of a key customer.
B. The fact that the most recent quarter's sales are substantially below target and prior years.
C. The loss of key member of staff in the sales department holding important customer relationships.
D. A flood that has put a major distribution facility out of action for a considerable time.

The answer to this exercise can be found at the end of this workbook.

5. Demergers

3.2.1 Be able to evaluate the benefits and potential problems associated with a demerger

A demerger is when one large, listed company is split into two smaller listed companies, with shareholders receiving shares in both companies in proportion to their holdings in the original group.

5.1 The Benefits of Demerging

There are a number of possible benefits in demerging a company, which include the following.

5.1.1 Focus on Central Strategy

In the past, there have been trends for companies to diversify their interests. The logic of this was that it reduced the **variability** of the company's earnings stream, and the increased size of the company made it more resilient to takeover. In recent years, this trend has been reversed, with companies returning to their core businesses. The logic of this has been twofold.

Firstly, it is often the case that large conglomerates are not necessarily desirable. Shareholders can diversify their investments themselves to reduce variability of returns if they so desire. Companies that diversify their interests do not therefore perform a service to their shareholders. Indeed, since they may be less effective at managing the acquired businesses than the original owners, they may actually be committing a disservice. Thus, companies should stick with what they know best and concentrate on core businesses and central strategy.

Secondly, it has been seen that size is not necessarily a defence against a takeover when many companies have large war chests, and even small companies can raise substantial amounts of debt to make acquisitions. Since one of the first actions of predators will be to sell off non-core divisions to reduce the cost of the acquisition, disposing of these will make the company less attractive to them.

5.1.2 Elimination of Cross-Subsidies

It may be the case that one profitable part of a group is subsidising the poor performance of another part. Forcing the less profitable division to stand on its own two feet will mean that both divisions can make decisions that fit their own situations – with the profitable division concentrating on growing its market while the less profitable division concentrates on eliminating unnecessary costs and boosting its profitability.

5.1.3 Reduction of Foreign Currency Exposure

If investors seek foreign currency exposure, they can invest in overseas companies directly. Notwithstanding this, it may be that companies can take on foreign exposure more cheaply than investors, meaning that it may be worthwhile for companies to have exposure to the US dollar, for example.

5.1.4 Separating Out Very Different Businesses

It is unlikely that there are significant synergies in combining two very different businesses. It is more likely that central management is more expert in one area than the other, meaning that one division's performance suffers as a result. In addition, shareholders may find it difficult to separate the performance of the two very different parts. As a result, the performance of the more successful of the two divisions may find its stock market rating tarnished by its association with the less profitable division.

Separating out the businesses will enable each to make decisions solely by reference to its own needs and its own strategy. For example, Cadbury demerged into its confectionery and its beverages businesses, while BT demerged its O2 mobile phone operations a number of years ago. More recently, Prudential plc, the insurer, demerged its asset management business, M&G plc. Even more recently, the Indian vehicles giant Tata Motors demerged into two separate listed companies – a commercial vehicles business and a separate passenger vehicles business that includes Jaguar Land Rover.

5.1.5 Capital Market Factors

The company may find it has greater access to capital markets post-divestiture. Investors may decide that the strategy of the company is now more clearly defined and thus fits within their investment objectives.

5.1.6 Defence Against Takeover

As noted above, a raider may acquire a company with the intention of 'unbundling' its different divisions, ie, selling off some of the divisions to reduce the acquisition cost and being left with the core business at a very attractive price. One defence against this is for the target company to unbundle itself.

5.1.7 Motivation of Management

The management of a subsidiary may find it difficult to perform well when dominated by a board largely interested in the other part of the group. Releasing the subsidiary to make its own way in the world may enable management to make better decisions for the benefit of the shareholders.

5.1.8 Cultural Differences

Very different businesses may require very different cultures in order to succeed. Inclusion in the same group where one corporate culture prevails may hold back one of the divisions.

5.1.9 Increases in Market Value

The ultimate reason for a demerger is that the aggregate value of the two separate divisions may be worth more than their value combined. All of the reasons outlined above should give rise to increases in value.

5.2 The Problems of Demerging

5.2.1 Internal Reorganisations

The company will need to reorganise the whole group to enable the demerger to go ahead. For example, the existing legal structure of the group may be geographically based. When the demerger takes place, the different group companies will need to be owned by the relevant holding company. The reorganisation may then give rise to potential tax and legal problems, and that will need to be managed carefully.

5.2.2 Tax

There are potential capital gains tax (CGT) charges arising from the transfer of assets within the group into the subsidiary to be demerged. It is unlikely, pre-demerger, that all assets the parent company wishes to demerge are in a single legal entity. Thus, there may well be considerable intergroup transfers that could crystallise capital gains tax liabilities.

In addition, it is necessary to mitigate in advance CGT for the parent on transfer of the assets to the shareholders, and income tax and CGT for the shareholders themselves.

The tax consequences are affected by the method of demerger which is chosen (see below in section 6).

5.2.3 Size of the Independent Companies

The smaller companies may find that their shares lack marketability and that they are subject to takeover pressures that did not previously exist.

5.2.4 Credit Ratings

The credit ratings of the separate companies may fall substantially, resulting in higher borrowing costs. There is also a risk that existing loan covenants will be breached when the demerger takes place. For example, covenants forbidding disposals of significant business assets or material adverse change clauses may be invoked.

5.2.5 Use of Central Services

Before the demerger, both divisions will probably have used the same central services for treasury and tax, for example. It will be important to establish the length of time both companies will continue to use these services together and how the cost of such services will

be allocated. Additionally, at some time in the future, the divisions will ultimately need to stand alone.

5.2.6 Employees

The interests of employees will need to be protected. For example, pension rights and obligations will need to be established. This is particularly relevant and important where there is a defined benefit pension scheme in place as the capital providers to the demerged company are often reluctant to assume the liability. In the UK, the Pensions Regulator has the power to impose conditions on the demerger in order to protect the scheme's solvency. These pension scheme issues also need to be considered with sales and spin-offs.

5.2.7 Costs

The cost of preparing the demerger, both in terms of management time and professional advice, will be substantial.

Question 4

Which of the following would be considered as potential problems when undertaking a demerger? Select as many as you think are correct.

A. A focus on the central strategy of the group
B. The possibility of a credit rating downgrade
C. A failure to protect the interests of the employees
D. The likelihood of some loan covenants being breached

The answer to this exercise can be found at the end of this workbook.

6. Methods of Achieving a Demerger

3.2.2 Be able to evaluate the use of the following methods of achieving a demerger: dividend approach; scheme of arrangement; liquidation method

The three methods of achieving a demerger are:

- the dividend approach
- by scheme of arrangement, and
- by liquidation.

6.1 Demergers – Dividend Approach

Here, a demerger is achieved by paying shareholders a dividend comprising the shares of the entity being demerged. This is known as a dividend 'in specie'. This means that all shareholders will automatically receive their pro rata share of the division to be demerged.

The parent company instigating the demerger must have sufficient distributable reserves to cover the book value, though not necessarily the market value, of the demerged shares.

The dividend must be declared indirectly to ensure it is classified as a 'scheme of reconstruction', thereby avoiding the capital gains tax charge that the company effecting the demerger would otherwise be liable to. An indirect dividend involves the issue of the shares to the shareholders by the demerged entity itself, as opposed to a transfer by the parent company making the divestment.

The investor receiving the shares will be subject to income tax on the dividend, unless the distribution is classified as an 'exempt' transfer under the Corporation Tax Act 2010. Classification as such requires proof that the transaction is for 'legitimate' commercial purposes (ie, not tax avoidance) and, pre- transaction, the parent owns over 75% of the shares of the subsidiary to be demerged.

If shares of the newly demerged entity are to be listed in the UK, then FCA approval must be gained for their listing. The shares will be listed via an introduction.

6.2 Demergers – Scheme of Arrangement

The scheme of arrangement method is allowed under company law and involves the holding company, the subsidiary and the shareholders coming to an 'arrangement' and redistributing shares based on this. A scheme of arrangement avoids the need for sufficient distributable reserves in the parent company effecting the demerger. Where sufficient distributable reserves do exist, the dividend approach may instead be adopted as the means of effecting a demerger.

Arrangements will be conducted under part 26 of the Companies Act 2006. The key requirements are as follows:

- court approval must be obtained
- shareholders must approve a special resolution, requiring a 75% majority in value of the shareholders voting, and
- creditors must approve.

If all of the above are satisfied, then the arrangement becomes binding on all creditors and shareholders. Necessarily, the scheme of arrangement process entails complying with a court process, submission to court of documents such as a claim form and chairman's report and as such, the process is driven by court-stipulated requirements and time frames.
As with the above dividend approach, the transfer of the demerged shares must be done indirectly to avoid potential CGT charges for the parent.

6.3 Demergers – Liquidation Method

This method arises under the Insolvency Act 1986, principally under s110. The procedure, sometimes referred to as a Section 110 demerger, is that the parent is put into voluntary liquidation and its assets are distributed to two new companies (Newco 1 and 2). Newco 1 and 2 pay for the assets by distributing shares that are given to the shareholders of the liquidated parent.

While a Section 110 demerger does not entail consideration of the level of distributable reserves because a liquidation is instead involved, the problem with this method is that it entails paying off all creditors before assets are sold or reassigning their debts to the new company. The position of employees needs to be resolved, since their old contracts will be at an end. All legal or contractual obligations of the company being liquidated therefore need to be terminated or reassigned, which can be cumbersome and necessitate compliance with several distinct processes for the reassignment of individual assets or contractual obligations. Where numerous assets and liabilities are involved, the Section 110 demerger method can become complex.

Due to these problems, in comparison to the dividend approach and a scheme of arrangement, this method is probably only easy to achieve in the case of a fairly small company with a simplified structure, assets and liabilities.

No income tax charge should arise for investors because of a specific exemption for distributions made on a winding up.

Question 5

Charles Group is planning to demerge into two entities. Which demerger method is most likely to result in the creation of two new companies ('Newco's')?

A. The dividend approach
B. A scheme of arrangement
C. Using a 'dividend in specie'
D. The liquidation method

The answer to this exercise can be found at the end of this workbook.

Chapter Roundup

Chapter 3: Disposals and Demergers

This chapter has considered motivations for disposals including disposal as part of a value-enhancing strategy.

The different ways of achieving a private company disposal and which method might be appropriate in a particular scenario were also explored. It has also considered how a vendor might prepare a business for sale, including a reorganisation of the legal structure.

The chapter has looked at the following:

- The sale process:
    - traditional and alternative disposal methods
    - identifying and shortlisting purchasers, and
    - approaching potential purchasers.
- The auction process:
    - no-names teasers
    - confidentiality undertakings
    - the information memorandum, and
    - inviting and evaluating offers.

The chapter concluded by looking at the practical ways to achieve a demerger, namely:

- the dividend approach
- a scheme of arrangement, and
- the liquidation method.



Chapter Four
Main Regulations for Listed and Quoted Companies

Section 1 UK Listing Rules

Section 2 Prospectus Rules

Section 3 Timetable to a Listing

Section 4 The Sponsor

Section 5 Continuing Obligations

Section 6 AIM Rules

1. UK Listing Rules

1.1 The Structure of the UK Listing Rules

4.1.1 Know the following aspects of the UK Listing Rules (UKLR) in a given scenario: the structure, applicability and enforcement of the listing rules; the listing principles; the key requirements for listing

The Financial Conduct Authority (FCA) is the UK's financial services conduct regulator that aims to ensure that financial markets are honest, competitive and fair. It has overall responsibility for regulating the UK stock market.

The FCA sets out the eligibility criteria and the ongoing obligations of listed companies in the UK Listing Rules (UKLR), the Prospectus Rules and the Disclosure Guidance and Transparency Rules which are contained within the FCA Handbook. Furthermore, the UK Listing Rules set out rules for different categories of companies, including equity shares of commercial companies (ESCC), open-ended investment companies (OEICs), closed-ended investment companies, shell companies and overseas companies' secondary listings. Non-equity shares (eg, preference shares and deferred shares), as well as warrants, options and other miscellaneous securities, have additional specific rules.

The **London Stock Exchange (LSE)** operates two markets for equities: the Main Market, for companies admitted to the Official List, and the AIM (formerly the Alternative Investment Market), which is a trading platform for small and medium- sized entities.
To be able to list on the Main Market, a company must have applied to the FCA, had its eligibility approved in respect of one of the listing categories and be admitted to the Official List. The company must additionally satisfy the requirements of the three FCA sourcebooks. In addition, the company will also need to apply to the London Stock Exchange for admission to trading of its shares. The LSE has its own trading rules, which act in conjunction with the FCA's Handbook.

The three **primary markets** sourcebooks in a little more detail are as follows:

- **UK Listing Rules** – comprise general rules for listed companies, including the provisions for listing, overarching listing principles and continuing obligations.
- **Disclosure Guidance and Transparency Rules** – provide rules and guidance for the dissemination of price-sensitive and other information, and run in parallel with the UK Market Abuse Regulation (UK MAR).
- **Prospectus Rules: Admission to Trading on a Regulated Market (PRM)** – contains the rules on prospectuses in relation to admission to trading on a UK regulated market, as well as when a prospectus is required and what it must contain.

1.2 Equity Shares (Commercial Companies)

Following reforms to the UK listing regime, which came into effect on 29 July 2024, a single point of entry to the UK market for UK listings of equity shares in commercial companies was introduced. This new category is named the equity shares (commercial company) or ESCC.

ESCC is defined as a listing of equity shares other than those of:

1. a closed-ended investment fund
2. an open-ended investment company
3. a shell company, or
4. an investment entity that is not a closed-ended investment fund or an open-ended investment company.

The new ESCC simplifies the previous regime, which was considered to be overburdensome and complex.

Note that a number of pre-existing categories continues to exist with the new UK Listing Rules:

- closed-ended investment funds
- open-ended investment companies
- debt and debt-like securities
- depositary receipts
- securitised derivatives, warrants
- options, and
- other miscellaneous securities.

The FCA's UK Listing Rules (UKLR) apply to all listed companies.

The following table summarises the main regulatory requirements for ESCC listings, including highlighting some requirements that were historically required, but were removed in the July 2024 reforms:

Eligibility	
Minimum market capitalisation	£30 million
Historical financial information covering three years	Not required
Three-year revenue track record	Not required
Clean working capital statement	Not required
Free float minimum	10%

Continuing Obligations	
UK Corporate Governance Code disclosure	Required on a comply, or explain, basis
Related party transaction rules	Where a related party is one which has 20% of voting rights in the company, if the transaction with the related party represents a. ≥ 5% value: o the issuer must disclose key details of the transaction o the board must issue a statement considering the transaction to be fair and reasonable and disclose sponsor confirmation o the board (other than conflicted directors) must approve the transaction o no FCA-approved circular or shareholder vote is required b. under 5% value: o no specific requirements exist under the UK Listing Rules.
Significant transaction rules	For significant transactions that represent: a. ≥ 25% value: o the issuer must release one or more prescribed announcements containing key transaction details o no FCA-approved circular or shareholder vote required b. under 25% value: o no specific requirements exist under the UK Listing Rules, although other obligations may exist.
Prospectus/admission document	FCA-approved prospectus required

1.2.1 Listing Principles

The purpose of the Listing Principles (set out in UK Listing Rules 2) is to set out the overall responsibilities of listed companies in maintaining market confidence and ensuring fair and orderly markets – they apply to all listed companies. Six listing principles exist and apply to all issuers.

The Listing Principles state the following:

Listing Principle 1	A listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.
Listing Principle 2	A listed company must deal with the FCA in an open and cooperative manner.
Listing Principle 3	A listed company must take reasonable steps to enable its directors to understand their responsibilities and obligations as directors.
Listing Principle 4	A listed company must act with integrity towards the holders and potential holders of its listed securities.
Listing Principle 5	A listed company must ensure that it treats all holders of the same class of its listed securities that are in the same position equally in respect of the rights attaching to those listed securities.
Listing Principle 6	A listed company must communicate information to holders and potential holders of its listed securities in such a way as to avoid the creation or continuation of a false market in those listed securities.

Notably, the FCA states that Listing Principle 1 is intended to ensure that listed companies have adequate procedures, systems and controls to enable them to comply with their obligations under the UK Listing Rules, disclosure requirements, transparency rules and corporate governance rules. In particular, the FCA considers that listed companies should place emphasis on ensuring that they have adequate procedures, systems and controls in relation to, where applicable:

1. identifying whether any obligations arise under:

    - UKLR 7 (equity shares (commercial companies) (ESCC) – significant transactions and reverse takeovers), and
    - UKLR 8 (equity shares (commercial companies) – related party transactions)

2. the timely and accurate disclosure of information to the market, and
3. the provision of information to the FCA (in accordance with UKLR 1.3.1R) and to their sponsor (in accordance with UKLR 4.5.1R).

Two important considerations in relation to Listing Principle 1 are worth noting, with guidance provided for the interpretation of this principle emphasising the role of directors and the ability of the company to access information when required by the FCA.
For the purposes of Listing Principle 1, directors should take reasonable steps to ensure that adequate governance arrangements are established and maintained at all times to enable the listed company to comply with this principle.

Timely and accurate disclosure of information to the market is a key obligation of listed companies. For the purposes of Listing Principle 1, a listed company should have adequate procedures, systems and controls to be able to:

1. ensure that it can properly identify information which requires disclosure under the UK Listing Rules, disclosure requirements, transparency rules or corporate governance rules in a timely manner, and
2. ensure that any information identified under (1) is properly considered by the directors and that such a consideration encompasses whether the information should be disclosed.

The Listing Principles are designed to ensure adherence to the spirit – as well as the letter – of the rules in the interests of promoting a transparent and fair market.

1.3 Minimum Requirements for Listing

The basic conditions for a listing are given in Chapters 3, 4 and 5 of the UK Listing Rules, while Chapter 6 sets out the continuing obligations that must be complied with by existing issuers.

1.3.1 The Issuer

The applicant must be duly incorporated (LR3.2.1R) as a public limited company (for UK issuers only). Private limited companies (those designated limited or ltd) are not permitted to issue shares to the public. Therefore, a private company must re-register as a public limited company (plc) before it can apply for a listing.

1.3.2 The Shares/Securities

- Securities must conform to the law in the company's place of incorporation (UKLR 3.2.2.R).
- The securities must be freely transferable (UKLR 3.2.4 R). Many private companies' articles stipulate that shares may only be transferred with the approval of the board of directors, and such conditions prevent free transferability and are not permitted for listed companies.
- The securities must have a **market capitalisation** of at least £30 million in the case of shares and £200,000 in the case of **debt securities** (UKLR 3.2.7 R). These limits may be modified if the FCA is satisfied that securities of a lower market value would be adequately marketable, although this would be unusual.
- Convertible securities are only to be admitted to listing if the securities into which they are convertible (or the securities to which they relate) are already, or will be, listed. (UKLR 3.2.12 R).
- A sufficient number of the shares must be in the hands of the public to ensure that the **secondary market** for the shares is sufficiently liquid and the shares are marketable (UKLR 5.5.1 and UKLR 5.5.2). This requirement is known as the 'free float' requirement and will be satisfied where at least 10% of the shares are in public hands. A percentage lower than 10% may be permitted if the shares will nevertheless be sufficiently marketable.

Exercise 1

Match the percentages.

Here is a list of percentage levels:
- 5% or more
- 10% or more
- 20% or more
- 25% or more

And here is a list of requirements under the equity shares (commercial companies) requirements in the Listing Rules.

- Level of voting rights held to classify as a 'related party'.
- Level which means a related party transaction must be approved by the board and disclosed.
- Level at which transactions are considered 'significant' to require one or more prescribed announcements under the Listing Rules.
- Minimum free float – the percentage of shares in public hands to be eligible for listing.

Please match the requirement to the appropriate percentage.

The answer to this exercise can be found at the end of this workbook.

1.4 AIM

1.4.1 AIM Market

The AIM is regulated by the LSE and provides an alternative marketplace for companies to trade their shares publicly. AIM offers similar benefits to a full listing but without imposing the full regulatory burden of listing on the main market. AIM Rules are more flexible and less complex than the UK Listing Rules which apply to the Official List.
An admission to trading on AIM used to be regarded as a stepping stone towards obtaining a full listing. Companies now often choose to remain on AIM rather than progress to the Main Market due to the more flexible regulation and also the tax advantages offered to investors.
AIM company shares will frequently benefit from the following tax benefits:

- They generally qualify as business assets for inheritance tax (IHT).
- Many will qualify for the Enterprise Investment Scheme (EIS) and as qualifying holdings for venture capital trusts (VCTs).
- Dealings are exempt from stamp duty.

Market Data

Since its launch in 1995, over 4,000 companies have raised over £135 billion on AIM. At the time of writing, there were 552 constituents to the FTSE AIM All Share index, with a combined market cap of around £42 billion. Most AIM companies have a market capitalisation below £50 million, although around 15 have a value in excess of £1 billion.

Regulation

All AIM companies must appoint a nominated adviser (termed a nomad) to advise on the company's admission to AIM and then on the ongoing responsibilities of meeting the AIM requirements. The nomad must advise the London Stock Exchange on the company's initial suitability for listing to gain admission to AIM. There are limited initial listing requirements, for example there is no free float threshold nor minimum market capitalisation required; however, the LSE will make a judgement, in consultation with the nomad, on the overall suitability, which could include factors such as free float and market capitalisation. A comparative summary of listing regulation is shown below to help you understand how the AIM requirements compare to those of the main market.

Rule	Main market:	
	ESCC	AIM
Minimum market capitalisation	£30 million	None
Track record required?	No	No
Free transferability of shares required	Yes	Yes
Working capital statement required	No	Yes
Sponsor/nomad required	Yes	Yes (at all times)
Corporate governance requirements	Yes	Yes (QCA Code)
Class tests apply	Yes	Yes (but different and less restrictive thresholds)
Related party rules apply	Yes	Yes (lighter – 5% threshold)
Disclosure rules apply	Yes	Limited
Requirement to announce price-sensitive information without delay?	Yes	Yes
Prospectus rules apply	Yes	Only for public offers, otherwise an admission document is required
Half yearly financial reporting required?	Yes	Yes

2. Prospectus Rules

4.2.1 Be able to apply the Prospectus Rules: Admission to Trading on a Regulated Market sourcebook (PRM) when advising on: when a prospectus is required; the format and contents of a prospectus; the approval of a prospectus by the regulator and subsequent publication; the use of a base prospectus and pricing statement

2.1 When is a Prospectus Required?

On 19 January 2026, the FCA's Prospectus Regulation Rules (PRR) were replaced by a new sourcebook called Prospectus Rules: Admission to Trading on a Regulated Market (PRM). This sourcebook implemented the Public Offers and Admission to Trading Regulations 2024 (POATRs) – part of the UK government's drive to simplify capital raising, reduce costs for issuers, enhance market competitiveness, and broaden retail investor participation, while maintaining robust investor protections.

The POATRs make it an offence to offer securities to the public in the UK unless a relevant exemption is available. The exemptions include offers made in connection with securities to be traded on a regulated market (such as the LSE's main market), or a primary multi-lateral trading facility (MTF) on which retail investors can trade (such as AIM and the AQSE Growth Market), or a public offer platform (POP).

The public offer platforms exemption allows smaller and growing companies to raise £5 million or more on an FCA-regulated public offer platform (POP). POPs must seek authorisation from the FCA and once authorised, must comply with the FCA's Conduct of Business Sourcebook (COBS) which, among other things, prescribes the level of due diligence to be undertaken by a POP on issuers and the offered securities and the information that a POP must provide to investors.

The POATRs specify that all public offers of relevant securities in the UK will be prohibited unless they fall within a specific exception as set out in its Schedule 1.
The definition of relevant securities is slightly broader than the more established definition of transferable securities. Transferable securities are securities that are negotiable on capital markets such as shares, bonds and their derivatives including depository receipts, options and warrants. Relevant securities are transferable securities plus debt instruments that are not traded on capital markets. This latter provision captures unlisted loan notes (often referred to as 'mini-bonds').

The Schedule 1 exceptions from the prohibition on offers to the public include the following:

- An offer of relevant securities to the public where the total consideration for the relevant securities being offered in the United Kingdom cannot exceed £5 million, or an equivalent amount.
- An offer of relevant securities made solely to qualified investors. Qualified investors are defined as legal entities which are authorised or regulated to operate in the financial markets, as well as other entities whose corporate purposes are solely to invest in securities, national and regional governments and central banks.

- An offer of relevant securities made to fewer than 150 persons in the United Kingdom, other than qualified investors.
- An offer of relevant securities whose denomination per unit amounts to at least £50,000, or an equivalent amount.
- An offer of relevant securities made to persons who acquire securities for a total consideration of at least £100,000, or an equivalent amount, per investor, for each separate offer.
- An offer of transferable securities admitted or to be admitted to trading on a regulated market or primary MTF. It is important to note that, under the PRM Rules, offers of shares being made in an IPO, which is described as in contemplation of admission of those shares to trading on a regulated market in the United Kingdom (such as the LSE's Main Market), will require the issuer to prepare a prospectus and have it approved by the FCA.
- An offer to existing holders of shares of either:

    - Shares in substitution for shares of the same class already issued, if the issuing of the new shares does not involve any increase in the issued share capital.
    - Dividends that are paid out to persons who hold shares in the form of shares of the same class as the shares in respect of which the dividends are paid, or in the form of cash under an arrangement under which the persons to whom the dividend is payable may elect for the cash to be applied to the acquisition of further shares of the same class as the shares in respect of which the dividends are paid.

- An offer that is made by or on behalf of a company ('the offeror company') to persons already connected with the offeror company (including existing shareholders and existing or former directors or employees).
- An offer of relevant securities in connection with takeovers.

PRM details when a prospectus is required as well as its contents and format, the processes for approval, publication and advertising, and other relevant provisions. It specifies that, unless an exemption applies, transferable securities can only be admitted to trading after prior publication of a prospectus, approved by the FCA.

Exemptions from the prospectus requirement include those detailed in the POATRs (outlined above) except in the case of an initial offer of shares being admitted to trading for the first time (an IPO) where a prospectus must be made available to the public, and the following exemptions detailed in the PRM:

- Units issued by a collective investment undertaking that is not closed-ended.
- Non-equity securities issued by any of the following:

    i. the government of any country or territory
    ii. a local or regional authority of any country or territory
    iii. a public international body, or
    iv. the European Central Bank or the central bank of any State.

- Money-market instruments.

- Further issuances of securities that are already admitted to trading on the same regulated market, provided they represent, over a 12-month period, less than 75% of the number of those transferable securities already admitted to trading on the same regulated market.
- Conversion or exchange of other transferable securities. In other words, shares resulting from the conversion or exchange of other transferable securities or from the exercise of the rights conferred by other transferable securities as long as the resulting shares are fungible with the shares already admitted to trading on the same regulated market.
- Equity securities issued in connection with a takeover or merger.

Under the Market Conduct sourcebook, offers of shares being made in connection with admission to a primary MTF (such as the LSE's AIM market or the AQSE Growth Market) will require an 'MTF admission prospectus' if an issuer is undertaking an IPO on those markets. Primary MTF operators (the LSE, in the case of AIM) will set the content requirements for an admission prospectus.

2.1.1 The Base Prospectus for Non-Equity Transferable Securities

Issuers, especially frequent issuers of debt securities, structured notes, or derivatives like warrants, can use a base prospectus to streamline issuance. The base prospectus can cover a programme of securities (e.g., a medium-term note programme) and will be supplemented by individual final terms documents for each specific issue. The final terms will incorporate the pricing schedule for the issue.

The purpose of a base prospectus is to enable issuers to pre-approve with the FCA a framework document covering multiple issues, avoiding the need for re-approval each time.

The final terms will contain information specific to each issue such as the price (the pricing schedule) and the identification number (ISIN), the maturity and interest rate.

The base prospectus may need to be added to by a supplementary prospectus if any significant new factors, material mistakes, or inaccuracies arise during the offer period.

A base prospectus must include the following information:

1. a template, entitled 'form of the final terms', to be filled out for each individual issue and indicating the available options to be determined in the final terms of the issue, and
2. the address of the website where the final terms will be published.

Where the final terms are not included in the base prospectus, or in a supplementary prospectus, the issuer must:

1. file the final terms with the FCA and make them available to the public as soon as practicable and, where possible, before the beginning of the offer or admission to trading, and

2. insert a clear and prominent statement in the final terms indicating:

    a. that the final terms have been and must be read in conjunction with the base prospectus and any supplement, in order to obtain all the relevant information, and
    b. where the base prospectus and any supplementary prospectus are published.

2.2 Format of the Prospectus

Prospectus Contents:

The general rule requirement set out in the POATRs requires that:

> *'a prospectus… must contain the necessary information which is material to an investor for making an informed assessment of the assets and liabilities, profits and losses, financial position and prospects of the issuer and of any guarantor, the rights attaching to the transferable securities, and the reasons for the issuance and its impact on the issuer.'*

A prospectus may be drawn up as a single document or as separate documents. A prospectus composed of separate documents consists of a registration document, a securities note and a summary.

The content of a prospectus must be written in English and presented in an easily analysable, concise and comprehensible form, taking into account:

1. the nature of the issuer
2. the type of transferable securities
3. the circumstances of the issuer, and
4. whether transferable securities issued by the issuer have already been admitted to trading.

The content of the component or separate parts of a prospectus (the registration document, the securities note and the summary) must be consistent with each other.

The summary should read as an introduction to the prospectus. When read together with the other parts of a prospectus, whether drawn up as a single document or as component parts, it should aid investors in considering whether to invest in the transferable securities by providing key information on the nature and risks of:

1. The issuer
2. The guarantor
3. The transferable securities that are being admitted to trading.

The summary must be accurate, fair, clear and not misleading. It may contain cross-references to other parts of the prospectus but cannot incorporate information by reference. The summary must be drawn up as a short document written in a concise manner, no longer than 10 sides of A4-sized paper when printed.

It must be presented and laid out in a way that is easy to read, using characters of readable size and be written in a language and a style that facilitates the understanding of the information – in particular, in language that is clear, non-technical, concise and comprehensible for investors.

The summary must be made up of the following 5 sections:

1. **Section 1** – A preliminary disclosure.
2. **Section 2** – An introduction, containing warnings.
3. **Section 3** – Key information on the issuer.
4. **Section 4** – Key information on the transferable securities.
5. **Section 5** – Key information on the admission to trading/proposed admission to trading.

All necessary information must be provided in the documents to enable investors to make an informed assessment. With the exception of the summary, it is also acceptable to incorporate information by reference, meaning that the prospectus could refer potential investors to recently published documents; for example, financial statements.

2.3 Contents of the Prospectus

The PRM (PRM Appendix 1 Annex 2) sets out the minimum information to be included in a prospectus, but this varies according to the type of issuer, the nature of the securities and the size of the issue.

2.3.1 Persons Responsible

There will be a declaration by those accepting responsibility for the document stating that it is in accordance with fact and that there are no material omissions. Primary responsibility for the document rests with the directors of the issuer. This will be accompanied by details of the auditors and any other advisers (eg, the sponsor, bankers or legal advisers) whose statement or report forms part of the prospectus.

2.3.2 Information Relating to the Issuer

The detailed requirements include the following headings:

- Information about the issuer
- Business overview
- Organisational structure
- Operating and financial review
- Capital resources
- Regulatory environment
- Trend information (see 2.3.3 below)
- Profit forecasts or profit estimates
- Administrative, management and supervisory bodies and senior management
- Remuneration and benefits
- Board practices
- Employees

- Major shareholders
- Related party transactions
- Financial information (see 2.3.5 below)
- Material contracts (see 2.3.7 below).

2.3.3 Trend Information

Details of significant historical trends and information about the issuer's prospects in the current financial period. Forecast information does not have to be included but, if it is, assumptions must be detailed and the forecast must be accompanied by an accountant's report.

2.3.4 Risk Factors

There must be prominent disclosure of risk factors that are specific to the issuer or its industry.

2.3.5 Financial Information

- The latest audited three-year historic accounts, accompanied by the audit reports, or such shorter period as the issuer has been in operation.
- Most recent interim results if applicable.
- Pro-forma financial information, to show how the transaction is expected to impact the balance sheet and income statement of the issuer.
- Details of dividend policy.
- Details of any significant change to the trading or financial position from the latest reporting period end.

2.3.6 The Issuer's Share Capital

- Details of issued share capital, and authorised but unissued share capital.
- Changes to share capital in the last three years.
- Details of outstanding convertibles (eg, warrants).

2.3.7 Material Contracts and Display Documents

There needs to be included a summary of all material contracts entered into in the last two years and details of all documents available to be inspected (including the memorandum and articles of association, directors' service contracts and previous years' audited accounts).

2.4 Omission of Information

The FCA permits information to be omitted from a prospectus where the inclusion of it would be against the public interest, or it is of minor importance, or it would be seriously detrimental to the interests of the issuer. Additionally, PRM rules allow omissions of information which is inappropriate to the issuer's legal form, its activity, or the securities concerned. FCA permission to omit must be sought in advance of publication of the prospectus.

2.5 Approval of a Prospectus: 10/20 Day Documents

Where a prospectus is required for an offering of shares, it must be approved by the FCA in advance. In this respect, a wide range of documents needs to be submitted to the FCA in draft form. In a primary (initial) offering, or where there are complex issues involved, the deadline is 20 working days prior to the intended publication of the prospectus Where a company is not a new applicant, but is seeking admission to listing of additional new securities, the drafts need to be submitted ten working days in advance. The documents required must be submitted in searchable electronic format.

They include:

- A completed 'Form A' seeking approval.
- The prospectus.
- Any letter seeking the authorisation of omission of information from the prospectus.
- Contact details for individuals within the issuer's firm who are knowledgeable and available to answer queries (between the hours of 07.00 and 18.00).
- Any other information required by the FCA.
- The fee required for approval of the prospectus.

This information must also then be submitted to the FCA in final form before midday on the day when approval is required to be granted.

2.6 Pathfinder Prospectus

A pathfinder is a 'preliminary offering circular' or draft prospectus which is, broadly speaking, the entire text of the prospectus omitting only the final pricing details. A pathfinder is used to gauge the level of investor appetite for the share issuance that is intended to take place.

In US capital markets, the equivalent pathfinder prospectus is typically referred to as a 'red herring'. 'Pinks' (or 'pink herrings') are an earlier form of preliminary prospectus that are used for very early, pre-marketing testing the waters discussions. 'Blacks' are the final, fully completed statutory prospectus.

The pathfinder enables advisers and salesforce/marketing staff to assess the level of investor interest that may exist, which in turn will inform the issuer of the price at which the issue may be successful. Any indicative price can then be made firm, based on the responses from the market and investors that have been approached.

The PRM Rules permit the approval of prospectuses where the final offer price and amount of securities to be offered remain to be determined.

2.7 Pathfinder Prospectus

Once the prospectus is approved, it must be filed with the FCA and made available to the public as soon as practicable, and before the offer of securities to the public or the admission to trading of the securities.

Question 1

KVC Group is considering listing a substantial subsidiary on the main market of the London Stock Exchange. As a result, a prospectus is being prepared. Which of the following will be required? Please select all that apply.

A. A summary no longer than ten A4 pages
B. Inclusion of all necessary information to enable investors to make an informed assessment
C. Declaration from those accepting responsibility
D. Forecast information covering the next two years

The answer to this exercise can be found at the end of this workbook.

3. Timetable to a Listing

4.1.1 Know the following aspects of the UK Listing Rules (UKLR) in a given scenario: the timetable for listing

The typical stages in a listing are summarised below:

Application for Listing – Summary Timetable	
Time Before Listing	**Action**
24 weeks	Appoint advisers Planning Consult FCA Commence long-form report* ↓
8 to 12 weeks	Draft documents prepared Drafts submitted to FCA Public relations campaign starts ↓
1 to 6 weeks	Draft prospectus Verification Formal submission of documents to FCA ↓

Final week	Approval of documents by FCA Completion meeting Underwriting agreement signed Investment presentations Allocation lists open and basis of allocation is announced Formal application for listing Listing granted Dealing commences

* A long-form report is an expanded form of audit report that is issued by an external auditor.

An issuer will initially appoint a team of advisers. The primary adviser for a listing is known as the sponsor. The sponsor will coordinate with the other advisers, as well as advise the issuer on regulatory issues and ensure the directors are aware of their responsibilities. The sponsor will take the lead in all communications with the FCA. A financial adviser (or advisor) will generally fulfil a similar role; however, this role is not formalised in the UK Listing Rules in the same way.

Where required, the sponsor appointed by the issuer must be independent and on the FCA list of approved advisers – investment banks and similar organisations – with a track record in listings and possessing appropriate expertise. The role of the sponsor is further considered in section 4.

Typically, the advisory team will also contain the following:

- **Broker** – advises on pricing, timing and market conditions, assists in representing the issuer with potential investors, gives guidance on the most appropriate method of marketing the issue, advises on the FCA, stock exchange and any other relevant requirements and ensures that the market for the new issue is liquid.
- **Reporting accountant** – carries out due diligence, prepares the long-form report, and will assist with information required for the prospectus.
- **Lawyer** – carries out the legal due diligence on the company, reviews the issuer's legal status, reviews service contracts, re-registers the issuer as a public company if necessary, completes the document verification process and prepares all other relevant legal agreements. Separate lawyers would normally represent the directors of the company, the issuer and the advisers to the issuer.
- **Public relations (PR) adviser** – advises on the selling of the issue to investors, liaises with the press and analysts and ensures that the marketing tone of any documents is appropriate.

The importance of each of the advisers and the specific role that they adopt will depend on the nature and size of the company to be floated. For example, in a relatively small flotation, the broker can act as the sponsor, lead underwriter and overall coordinator of the listing. Alternatively, a firm of accountants or lawyers may take on a more central role.

The initial planning stage involves preparing a detailed timetable, lists of key documents required, highlighting potential problem areas, and ensuring there is a clear allocation of responsibilities. The FCA must be consulted with at an early stage, to fix the timing and level of disclosure required, and to confirm suitability for listing.

Prior to the listing, a detailed due diligence exercise will be undertaken to ensure that all the regulatory requirements are complied with and that the appropriate information is disclosed in the prospectus. The accountants will prepare a long-form report, which is a very detailed document covering the issuer's past financial performance, current net asset position and an assessment of the reliability of its forecasts. The long-form report will be used by the sponsor to assist in their assessment of the company's suitability for listing and will also be used as a base for much of the information in the prospectus.

Selected contents from the long-form report will be input into the draft prospectus and other documentation must be prepared, including the working capital letter, responsibility letters and derogation letters. The purpose of the derogation letters is to obtain permission from the FCA to omit certain specified information from the prospectus and other documents.

All documents must be verified before they are finalised. Verification is the process of checking on a line-by-line basis that all statements made in the prospectus are fair, accurate and complete, ensuring that the directors have fully discharged their legal responsibilities in respect of the prospectus.

A completion meeting is held to finalise all documents and ratify the final decision to seek a listing for the shares.

4. The Sponsor

4.1.1 Know the following aspects of the UK Listing Rules (UKLR) in a given scenario: obligations of sponsors

4.1 Obligations of a Sponsor

Where required, the sponsor is the primary adviser to an issuer of equity securities in the UK. A sponsor has responsibility for guiding the issuer as to the regulatory requirements in the UK Listing Rules, Prospectus Rules and the Disclosure Rules. The sponsor is required to report to the FCA that the issuer has met its responsibilities under the UK Listing Rules (UKLR 24.2.1 R). The FCA expects the Sponsor to be its main point of contact in relation to the proposed listing (UKLR 24.2.4).

A sponsor is required for an issuer in a number of circumstances, largely relating to listings, major transactions, or when seeking waivers or guidance from the FCA. This includes when:

- an issuer makes an application for listing of equity securities that requires production of a prospectus or equivalent document, then a sponsor submits a letter to the FCA confirming the applicant meets listing criteria
- an issuer produces a circular in relation to a reverse takeover or for related party transaction
- a transfer of listing from one category to another (eg, from equity shares (commercial companies) to closed-ended investment funds), and

- the issuer has breached UK Listing Rules and the FCA decides that a sponsor is needed to advise the company.

A sponsor is needed to report to the FCA in relation to a particular transaction. For example, if a prospectus contains a profit forecast, then a sponsor must confirm to the FCA that the forecast has been prepared after due and careful enquiry.
Issuers are encouraged to retain, on an ongoing basis, a sponsor fully experienced in market practice, but this is not mandatory. For transactions other than those listed above, a sponsor is not required.

4.2 Qualifications for Sponsors

A sponsor must be authorised by the FCA, or a member of a designated professional body. To qualify, a firm must satisfy the FCA that it is competent to act as such, has appropriate systems and controls to carry out its duties, and has a sufficient number of employees with the necessary skills, knowledge and expertise (UKLR 24.4.12).

The FCA will consider a sponsor to be competent if it has a broad range of relevant expertise in providing advice to listed companies and on the UK Listing Rules (UKLR 24.4.16 G).

4.3 Principles for Sponsors

The UK Listing Rules set out principles for sponsors, as follows (UKLR 24.2.6–24.2.19).

- The sponsor is required to provide all of its services, including guidance or advice to an issuer in relation to the rules, with due care and skill.
- A sponsor must, in relation to a sponsor service, act with honesty and integrity.
- Where the sponsor gives advice or guidance to an issuer on the application of the rules, it must take all reasonable steps to satisfy itself that the directors understand the nature and extent of their responsibilities in this regard, and it should provide updates to the issuer where there are major changes to the listing or disclosure rules, or when a new director is appointed to the board.
- It should deal with the FCA in an open and cooperative way, deal with all enquiries raised by the FCA promptly, and disclose promptly to the FCA any material information of which it has knowledge which addresses non-compliance with the UK Listing Rules or Disclosure Rules.
- It should identify and manage conflicts of interest that could adversely affect its ability to perform its role by putting in place adequate organisational and administrative arrangements (eg, Chinese walls). Disclosure of the existence of a conflict is not considered to be an effective organisational arrangement.

4.3.1 Specific Responsibilities for Sponsors

On an application for listing, the sponsor should ensure the following:

- The company has satisfied all conditions and requirements for listing (UKLR 24.3.2 R).
- The directors of the company have established procedures which enable them to comply with the UK Listing Rules and Disclosure Rules on an ongoing basis (UKLR 24.3.2 R).
- In the case of a new applicant, the directors have established procedures to enable them to make proper judgements on an ongoing basis as to the financial position and prospects of the company (UKLR 24.3.2 R).
- The directors have concluded that the company has adequate working capital for its present requirements and the confirmation has been made after due and careful enquiry by the directors (UKLR 24.3.2 R).
- All matters relevant to the application for listing have been disclosed with sufficient prominence in the prospectus (UKLR 24.3.3 R).

Question 2

Which ONE of the following is required to report to the FCA that a listed issuer has met its responsibilities under the UK Listing Rules?

A. The reporting accountant
B. The lawyer
C. The broker
D. The sponsor

The answer to this exercise can be found at the end of this workbook.

5. Continuing Obligations

4.3.1 Be able to apply the UK Listing Rules, the Disclosure Guidance and Transparency Rules (DTR) and UK Market Abuse Regulation (UK MAR) in relation to: announcements to shareholders (including the dissemination of inside information); significant transactions and reverse takeovers, including the need for 'class tests'; related party transactions; directors' obligations

We examine here the obligations of a company once it is listed. We will look at the following areas:

- **Announcements to shareholders** – inside information and when other announcements are required.
- **Significant transactions** – the existence and application of the class tests.

- **Related party transactions** – definition and additional regulatory requirements.
- **Directors' obligations** – directors' statutory obligations and the operation of the Model Code, including prohibited dealings.
- **ESG and related factors** – environmental, social and governance (ESG) factors.

5.1 Announcements to Shareholders

The Disclosure Guidance and Transparency Rules (DTR) provide rules and guidance for the dissemination of price-sensitive and other information, alongside the UK MAR. For AIM, compliance with UK MAR is compulsory, along with certain elements of DTR (more for UK incorporated companies), as well as the rule books for each of the markets.

The overall purpose of the DTR is stated as being to *'promote prompt and fair disclosure of relevant information to the market'* and give guidance on aspects relating to the disclosure of such information, including the circumstances allowing delayed disclosure (DTR 2.1.3 G).

UK MAR sets out most of the rules for the dissemination of information to the market, although certain elements, such as disclosures of major shareholdings (DTR 5) and the publication of financial statements (DTR 4) are set out in the DTR.

5.1.1 Announcements of Inside Information

The primary rule within the DTR is that an issuer must notify a Regulatory Information Service (RIS) as soon as possible of any inside information which directly concerns the issuer (UK MAR Article 17 and DTR 6.3).

Inside information is defined in Article 7 of UK MAR as information that:

- is of a precise nature
- has not been made public
- directly or indirectly relates to one or more issuers, or to one or more financial instruments, and
- if it were made public, would be likely to have a significant effect on the prices of those financial instruments, or on the price of related derivative financial instruments.

In addition, the rules make clear that inside information could include information which that client has conveyed in connection with an order (eg, to a broker). This would be the case where the information indicates circumstances that may exist and is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances on the price of qualifying or related investments.

The rules provide guidance on how issuers should interpret this definition in deciding whether disclosure is required in each circumstance. Disclosure will generally be required, however, where the information would be likely to be used by a reasonable investor and would be likely to have a significant impact on the price of the qualifying investments (known as the 'reasonable investor test' and drawn from UK MAR Article 7(4)). To apply the reasonable investor test, issuers must exercise their own judgement but should take into account the size, status and position of the company concerned in deciding what information would be significant to an investor, while assuming the investor is acting to maximise their

own economic interests. Further, the issuer's directors and advisers should continuously monitor changes in the issuer's position to check whether and when announcements should be made.

Specific factors to take into account include:

- the assets and liabilities of the issuer
- the performance, or expectations of future performance, of the business
- the issuer's financial position
- the course of business of the issuer
- any major new developments in its business, and
- information already disclosed to the market.

Question 3

Norfolk Group is listed on the main market of the London Stock Exchange and is trying to establish whether disclosure is required of some inside information. To require disclosure which one of the following tests applies?

A. The reasonable investor test
B. The gross assets test
C. The consideration test
D. The gross capital test

The answer to this exercise can be found at the end of this workbook.

5.1.2 Dissemination of Inside Information

The prescribed method of dissemination of inside information is that all disclosures should be made as soon as possible (UK MAR Article 17(1)), through an RIS (DTR 6.3.3 R). An issuer's disclosure obligation is fulfilled as soon as the relevant announcement has been forwarded by them to the RIS.

In addition, issuers must publish all inside information disclosed through an RIS, on its own internet site, and this information should be available on the issuer's website for at least five years following the posting (UK MAR Article 7(1)). This is not an alternative to the RIS disclosure, nor should it be posted here in advance of the RIS disclosure.

Where possible, all inside information disclosed should be announced at the same time in all jurisdictions where its investments are traded or listed.

5.1.3 Exceptions

There may be cases where public disclosure of inside information would be detrimental to the legitimate interests of the issuer. This might include impending developments or negotiations in progress, particularly in relation to refinancing. In these circumstances, the issuer may delay the disclosure, provided that the delay would not be likely to mislead the public and that the issuer is able to ensure the confidentiality of the information. Moreover, if any person

(such as an adviser) receives this information, they are regarded as having a duty of confidentiality towards the issuer. However, any decision to delay disclosure of information remains the responsibility of the issuer. UK MAR Article 17(4) sets out the requirements for delayed disclosure of inside information:

a. Immediate disclosure is likely to prejudice the legitimate interests of the issuer.
b. Delay of disclosure is not likely to mislead the public.
c. The issuer is able to ensure the confidentiality of that information.

Delay will not be permissible where the issuer can no longer ensure the confidentiality of the information, including where a rumour explicitly relating to the inside information is sufficiently accurate (UK MAR Article 17(7)). It is also not permissible to delay public disclosure of worsening financial condition, or financial difficulty.

Disclosure and Transparency Regulations (DTR) provide for further exceptions. Under DTR 2.2.9 G, if an issuer is faced with an unexpected and significant event, a short delay may be acceptable if it is necessary to clarify the situation. In such situations, DTR guidance recommends that the issuer make at least a holding announcement pending confirmation of the relevant circumstances if the issuer believes that there is a danger of inside information leaking before the relevant circumstances can be confirmed.

A further consideration for an issue may arise if it becomes the subject of a rumour. Under DTR 2.7, provisions state that if there is, for example, press speculation or market rumour in relation to the issuer, the issuer must consider whether any disclosure obligation arises under MAR Article 17(1). In such a situation, the issuer should consider whether the speculation or rumour has given rise to a situation where it can be said that the issuer has inside information.

Where disclosure is reasonably delayed, the issuer may selectively disclose this inside information to persons owing it a duty of confidentiality, provided that this is in the normal course of their duties; this would include advisers to that transaction (eg, interested regulators).

5.1.4 Control of Inside Information

Issuers have an obligation to have in place effective systems and controls to ensure (DTR 2.6):

- preservation of the confidentiality of the information by preventing unauthorised third parties gaining access to it
- disclosure via an RIS of all inside information revealed to any third party, subject to the exemptions available above
- immediate disclosure via an RIS where it becomes impossible to maintain the confidentiality of the inside information, and
- all persons with access to inside information understand and acknowledge the duties and the sanctions available.

5.1.5 Insider Lists

Under Article 18 of UK MAR and DTR 2.8.1A, both the issuer and any person acting on their behalf or on their account must maintain an insider list. This is a list of those persons working for the issuer, whether employees, advisers or otherwise, who have access to inside information relating directly or indirectly to the issuer, whether regularly or occasionally. The list should show the identities of the insiders, the reason for their being on the list, and the date of the last update. It must be provided to the FCA on request.

Where the company includes an adviser on its insider list, it must record the name of the principal contact at that firm on its own list and make contractual arrangements for the adviser to also maintain a list of those of its staff and associates who are also insiders in relation to that issuer, to be provided to the issuer on request. Persons on the list must be both acting for the issuer and have access to inside information. Moreover, all employees on the insider list must be trained as to the rules in relation to insider dealing.

The list should be updated whenever there is a change to the list and it should be kept for at least five years from when it was last updated.

5.1.6 Other Announcements

The UK Listing Rules and DTR detail a number of specific announcements that must be made by issuers, which include include:

- changes in share capital and capital structure, such as new issues or **redemptions** of equity or debt securities (UKLR 14.3.17R)
- corporate actions, including details of dividends to be paid (UKLR 6.5.2R)
- changes to the company's name, board of directors, details of directors, reporting dates, key advisers or directors' responsibilities (UKLR 6.4.6–6.4.18 R), and
- financial results, including a requirement for interim results to be announced no later than three months from the period end (DTR 4.2.2). The company must publish its annual report and accounts as soon as possible after they have been approved, and in any event no later than four months from the financial year end (DTR 4.1.3 R). The consolidated accounts must be prepared in accordance with IFRS (DTR 4.1.6 R).

5.2 Significant Transactions

Shareholders in listed companies delegate responsibility for the company's day-to-day decisions to directors. However, when the directors wished to enter into a material acquisition or disposal outside the normal day-to-day activities of the company, until the changes introduced by the new UK Listing Rules in summer 2024, certain categories of transactions required separate shareholder approval.

In addition to acquisitions and disposals, outside the ordinary course of business, transactions also include entering into joint ventures.

Transactions were historically classified as either class 1 or class 2 transactions, depending on their size and nature. Class 1 transactions were subject to more stringent requirements, including the publication of a shareholder circular, and gaining shareholder approval. Class 2

transactions were subject to less onerous requirements, generally only requiring an announcement with minimum content requirements.

The new regime replaces the class 1 and class 2 categories with a single category of significant transactions, which are now subject to a uniform set of requirements. These new requirements removed the need for shareholder approval of large transactions (and the publication of an associated shareholder circular), replacing them with a broader disclosure obligation.

Significant transactions are still based on class tests (UKLR 7 Annex 1 The class tests).

5.2.1 The Class Tests

The tests used to determine significant transactions are as follows:

a. **Gross assets** – the gross assets which are the subject of the transaction, divided by the gross assets of the listed company. This refers to the total non-current assets plus the total **current assets** of each of the listed company and of the subject of the transaction, irrespective of the percentage interest being bought or sold.
b. **Consideration to market capitalisation** – the consideration (including the maximum amount of any deferred consideration) divided by the aggregate market value of all the ordinary shares (excluding treasury shares) for the listed company at the close of business on the day before the announcement of the transaction. If no maximum consideration is shown (and either of the other class tests are at least 5%), the transaction is treated as a significant transaction.
c. **Gross capital** – the gross capital of the company or business being acquired compared with the gross capital of the listed company. Note that this test only applies to acquisitions of a company or business. Gross capital for the acquired company is given by the aggregate of the consideration, the value of any shares or debt not being acquired, all other liabilities (excluding current liabilities but including non-controlling interests and deferred tax) and, if applicable, net current liabilities. Gross capital for the listed company is calculated in a similar way, being the aggregate of its shares and debt, all other liabilities and, if applicable, net current liabilities.

5.2.2 Results – Classifying Transactions

Significant Transaction

If any test amounts to 25% or more, the transaction is usually a significant transaction. If the total consideration is not subject to a maximum and any of the other class tests indicate a percentage ratio of at least 5%, the transaction is also treated as a significant transaction.

Related Party Transactions

Chapter 8 of the UK Listing Rules provides additional requirements for related party transactions for ESCC. These are discussed further in section 5.3.

Reverse Takeovers

In the case of acquisitions of unlisted companies, where any of the tests come to 100% or more, the transaction is classed as a reverse takeover.

5.2.3 Other Points

Where an anomalous result would arise due to the application of these tests the FCA has the discretion to substitute other relevant indicators of size.

When considering the class of transaction, the FCA will aggregate all transactions with the same person or with connected persons, or involving a particular business or new business line, entered into in any 12-month period. If the aggregated transactions require shareholder approval, this is required only for the latest transaction.

5.2.4 Significant Transactions and Reverse Takeovers

Following new UK Listing Rules which came into force on 29 July 2024, although the concept of a significant transaction as determined by the above explained class tests has been retained, there has been a reduction in the obligations that apply to such transactions; in particular:

a. Transactions that would have previously qualified as Class 1 transactions no longer require shareholder approval nor a shareholder circular to be published.
b. Listed companies no longer need to disclose what were previously regarded as Class 2 transactions other than in limited special circumstances which are beyond the scope of this workbook.

5.2.5 Contents of the Circular to Shareholders

A listed company must not circulate or publish any of the following types of circular unless it has been approved by the FCA:

1. A reverse takeover circular.
2. A circular which proposes a cancellation of listing which is required to be sent to shareholders under UKLR 21.2.8R(1).
3. A circular that proposes a transfer of listing which is required to be sent to shareholders under UKLR 21.5.6R.

UKLR 10.2.2 R describes the Approval Procedures. The following documents (to the extent applicable) must be lodged with the FCA in final form before it will approve a circular:

1. A sponsor’s declaration for the production of a circular completed by the sponsor.
2. Any other document that the FCA has sought in advance from the listed company or its sponsor.

A copy of the circular and relevant documents (referenced above) in draft form must be submitted at least ten clear business days before the date on which the listed company intends to publish the circular.

UKLR 10.3.1R outlines the content requirements for all circulars sent by a listed company. These are summarised below:

- A clear and adequate explanation of its subject matter, giving due prominence to its essential characteristics, benefits and risks.
- A statement of why the security holder is being asked to vote or, if no vote is required, why the circular is being sent.
- If voting or other action is required, all information necessary to allow the security holders to make a properly informed decision.
- If voting or other action is required, a heading drawing attention to the document's importance and advising security holders who are in any doubt as to what action to take to consult appropriate independent advisers.
- If voting is required, a recommendation from the board as to the voting action security holders should take for all resolutions proposed indicating whether or not the proposal described in the circular is, in the board's opinion, in the best interests of security holders as a whole.
- A statement that, if all the securities have been sold or transferred by the addressee, the circular and any other relevant documents should be passed to the person through whom the sale or transfer was effected for transmission to the purchaser or transferee.
- If new securities are being issued in substitution for existing securities, an explanation of what will happen to existing documents of title.
- A statement that there will be no reference to a specific date on which listed securities will be marked 'ex' any benefit or entitlement which has not been agreed in advance with the RIE on which the company's securities are or are to be traded:

    - if it relates to a transaction in connection with which securities are proposed to be listed, include a statement that an application has been or will be made for the securities to be admitted together with additional information if known (dates, rank, nature, proposed date of issue, treatment of fractions, and other information)
    - if a person is named in the circular as having advised the listed company or its directors, a statement that the adviser has given, and has not withdrawn, its written consent to the inclusion of the reference to the adviser's name in the form and context in which it is included, and
    - if the circular relates to cancelling listing, state whether it is the company's intention to apply to cancel the securities' listing.

5.3 Related Party Transactions

A related party transaction refers to a transaction, or an arrangement, between the company and a related party, other than one of a revenue nature in the ordinary course of business.

A related party is a director (of any company in the group), 50:50 joint venture partner and its subsidiaries, a substantial shareholder (20% or more), or an **associate** of each of these.

An associate is a spouse, a child, a trustee of a trust in which the related party is interested or a company where they (plus spouse and children) own 30% or more of the voting rights or has control of the board.

Where the related party is a joint venture partner, transactions requiring approval include any amendments to the joint venture agreement, exercise of any put or call options in relation to the agreement, and further investment in the joint venture.

5.3.1 Related Party Transaction Announcements

Subject to the exceptions set out in para 5.3.2 below, when a company with equity shares listed agrees to enter into a related party transaction, where any percentage ratio in the class tests is 5% or more, it must:

- obtain board approval before entering into the transaction
- ensure that directors who are related parties or have an association with the related party do not participate in the board's consideration or vote on the relevant resolution
- obtain a written confirmation from a sponsor that the terms are fair and reasonable for the security holders, and
- notify a Regulatory Information Service (RIS) as soon as possible after the terms of the transaction are agreed. This notification must include details of the related party, the transaction's value and a description of the transaction.

Transactions with the same related party within a 12-month period must be aggregated. If the aggregated percentage ratio is 5% or more, the requirements under UKLR 8.2.1R must be met for the latest transaction.

Per UKLR 8.2.2 R, the notification must include:

1. details of the related party transaction, including:

    a. the name of the related party
    b. the value of the consideration for the transaction or arrangement, and
    c. a description of the transaction or arrangement

2. the fact that the transaction or arrangement is a related party transaction which fell within UKLR 8.2.1R
3. details of the nature and extent of the related party's interest in the transaction(s) or arrangement(s)
4. a statement by the board that the transaction or arrangement is fair and reasonable as far as the security holders of the company are concerned and that the directors have been so advised by a sponsor, and
5. the name of the sponsor that provided the written confirmation that the terms are fair and reasonable for the security holders.

5.3.2 Exceptions to the Rule

The PRM related party transaction rules do not apply where:

1. the issuer is not an ESCC issuer, or
2. all applicable class tests for the transaction are below 5%, or
3. the transaction is a normal commercial underwriting transaction.

Case Study 1

Parlour Group is listed on the main market of the LSE and is planning to acquire Bloom ltd, a substantial private company.

i. The group has discovered that news of the planned acquisition has been disclosed inadvertently. What should Parlour Group do?
ii. The transaction represents 21% under the gross assets test, 30% under the consideration test and 17% under the gross capital test. Is it likely to be considered to be a significant transaction?
iii. If Bloom ltd was controlled by a director of Parlour Group what, of anything, would additionally be required?

The answer to this exercise can be found at the end of this workbook.

5.4 Directors' Obligations

The implied duty of a director is as an agent of the company and, therefore, one of skill and care. In exercising their powers, directors must demonstrate fiduciary duties. If directors fail to use their powers appropriately, they can end up finding themselves personally liable for their actions. This liability may fall due to the members of the company (the shareholders, for the negligent use of the company's assets) or indeed may be to third parties where the third party, in dealing with the company, has incurred a loss.

With regard to the liability to third parties, the extent of a director's authority is set out in several key documents:

- Articles of Association
- Service Contracts
- Special Resolutions of a Company.

All of these are publicly available documents.

5.4.1 Directors' Duties

The duties of directors arise from both the common law and statute. Additional obligations apply to directors of listed companies, and these are found within the UK Listing Rules.

Common Law

Under a common law, there is a general duty of skill and care attached to any agent. The level of skill and care required from a director is difficult to define and does depend very much on the director and the firm involved.

The Fiduciary Duties of Directors

Directors have a duty of utmost good faith to the company (not to the shareholders). There are three broad areas where this applies:

- directors are to exercise their powers for the benefit of the company as a whole
- directors are not to make secret profits, and
- directors are to avoid conflicts of interest.

This final point is covered by statute in the form of the Companies Act, which requires directors to state their interests in any contract into which the company enters. The Companies Act has wide powers to excuse directors for negligence, default, breach of duty or breach of trust, provided that the director acted reasonably and honestly.

5.4.2 General Obligations Imposed by the UK Listing Rules

Additional obligations for directors of listed companies include the following key areas:

Board Changes

Changes in the composition of the Board or the significant roles or responsibilities of its members must be notified without delay through the company's RIS (UKLR 6.4.6) and by no later than the end of the following business day following the decision or receipt of notice by the company.

In respect of any new director appointed, or existing director, the company must announce details of (UKLR 6.4.8):

- any directorships held by them in any other quoted company during the last five years, including their current status
- any unspent convictions in relation to indictable offences
- details of any receiverships, administrations, compulsory liquidations etc in relation to companies where the director was an executive director at the time or in the previous 12 months, or for partnerships where they were a partner in the same timescale, and
- details of any public statutory or regulatory criticisms of the director, including designated professional bodies and whether they have ever been disqualified as a director.

The disclosure must be made within five business days of the decision to appoint the new director, or as soon as possible in the case of an existing director.

Disclosure of Directors' Interests

Under the Disclosure Rules, all transactions in the shares of the company by the issuer's senior executives and their close associates, must be disclosed by them to the issuer within four business days of the day of the transaction. The disclosure must show the name of the person and issuer concerned and full details of the transaction in the shares.

Senior executives include directors and also those who are not directors but who have regular access to the company's inside information and the authority to make managerial decisions.

Close associates include any relative who has shared the same household as a director or senior executive in the preceding 12 months and any company connected with a director or a senior executive.

Once an issuer receives such a notification, it is required to disclose it as soon as possible via an RIS, and not later than the end of the business day following the receipt of the disclosure.

5.4.3 General Obligations Imposed by the UK Listing Rules

It is desirable that directors should own shares in their company to align their interests with those of the company that they run. However, due to the privileged level of knowledge possessed by directors, restrictions must be placed on their dealings in shares. It is not sufficient for directors to have integrity in their share dealings; they must also be seen to have integrity.

Listed companies (including those on AIM) are, therefore, required to have internal rules which restrict the ability of directors to trade freely in the shares of that company. Under UK MAR (Article 19), all 'persons discharging managerial responsibilities' (PDMR) and 'persons closely associated' (PCA) are required to only deal in the issuer's securities in accordance with that Article and make the required disclosures. PDMRs and PCAs must notify the company and the FCA promptly and no later than three business days after the date of the transaction.

5.4.4 Prohibitions on Dealing

UK MAR requires that any PDMRs and PCAs of the listed company should not deal in its shares of the company in the following circumstances:

- In the 30 days immediately preceding the announcement of the company's annual results or half year results. This is known as the 'closed period'.
- For companies reporting on a quarterly basis, in the 30-day period prior to the announcement of results. Where relevant this would also be included in the closed period.
- Prior to the announcement of matters involving inside information.
- At any time when in possession of inside information about the shares and hence prohibited from dealing by insider dealing legislation (this, together with the closed period, is known as the 'prohibited period').
- Without notifying the board of their intention to deal and receiving clearance.

5.4.5 Procedures to be Followed on Dealing

Listed companies are required to ensure compliance with UK MAR. This will generally be achieved through the use of dealing codes. While the introduction of MAR invalidated the former FCA Model Code, many companies have adopted the similar but now UK MAR-compliant dealing code that was jointly developed by the Institute of Corporate Secretaries and Administrators (ICSA) together with the Quoted Companies Alliance (QCA) and the GC100 (the association of general counsel of companies that comprise the UK FTSE 100).

If a PDMR or PCA wishes to deal in the company's shares, then typically they must first notify the company (normally the chairperson of the company or a designated director) of their intention to do so and receive clearance in advance of the trade. Clearance or refusal to trade is typically to be given within five business days of the request. Once clearance is given, the restricted person must normally deal within two business days of it being received.

For persons below board level, the company secretary may generally grant or withhold approval to deal.

Clearance should not be given in any situation where the above prohibitions apply, even if the restricted person is not aware of the reason for the prohibition.

The company must keep written records to show that notification was received and clearance was given to the restricted person concerned, and a copy given to the restricted person concerned.

Exceptions to the Rules

The following dealings may be permitted:

- Where the beneficial ownership does not change.
- For dealings in an approved employee share scheme where it is not possible under the terms of the scheme for the dealing to take place outside the closed period.
- In exceptional circumstances (eg, severe financial difficulty).

5.5 Climate-Related Disclosures

The UK Listing Rules (UKLR 6.6.6R) require all listed companies, to make disclosures under the Task Force for Climate-Related Financial Disclosures (TCFD) recommendations. The UK Listing Rules require the following to be included in the company's annual financial report:

A statement setting out:

a. Whether the listed company has included in its annual financial report climate-related financial disclosures consistent with the TCFD Recommendations and Recommended Disclosures.
b. In cases where the listed company has:

i. made climate-related financial disclosures consistent with the TCFD Recommendations and Recommended Disclosures, but has included some or all of these disclosures in a document other than the annual financial report:

   - the recommendations and/or recommended disclosures for which it has included disclosures in that other document
   - a description of that document and where it can be found, and
   - the reasons for including the relevant disclosures in that document and not in the annual financial report

ii. not included climate-related financial disclosures consistent with all of the TCFD Recommendations and Recommended Disclosures in either its annual financial report or other document as referred to in (i):

- the recommendations and/or recommended disclosures for which it has not included such disclosures
- the reasons for not including such disclosures, and
- any steps it is taking or plans to take in order to be able to make those disclosures in the future, and the time frame within which it expects to be able to make those disclosures.

c. Where in its annual financial report or (where appropriate) other document the climate-related financial disclosures referred to in (a) can be found.

5.5.1 TCFD Recommendations

The TCFD recommends that companies make disclosures across four key areas known as the four pillars. These are:

1. **Governance** – the organisation's governance around climate-related risks and opportunities.
2. **Strategy** – the actual and potential impacts of climate-related risks and opportunities on the organisation's business strategy and financial planning.
3. **Risk Management** – the processes used by the organisation to identify, assess and manage climate-related risks.
4. **Metrics and Targets** – the metrics and targets used to assess and manage relevant climate-related risks and opportunities.

Since issuers must also comply with the **UK Corporate Governance Code** (**comply or explain**), this provides new expectations on investment and stewardship. The UK Governance Code incorporates ESG factors within Principle A:

- A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.

The provisions of Chapter 1 (and associated with Principle A) require that the board should:

1. Assess the basis on which the company generates and preserves value over the long-term. It should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company's business model and how its governance contributes to the delivery of its strategy.
2. Understand the views of the company's other key stakeholders and describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making.
3. Keep engagement mechanisms under review so that they remain effective.

5.5.2 ESG in The Strategic Report under the Companies Act Section 172

Within the UK (excluding those reporting under the small companies regime) there are requirements to report on non-financial aspects in the strategic report and directors' report (Sections 414A to 414D of the CA 2006). This includes the provision of the Section 172 (1) Statement for relevant companies.

Listed and AIM-listed companies (with more than 500 employees) are captured by new legislation within the Companies Act regulations, The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2021. It also captures companies with over 500 employees and £500 million of turnover (high turnover companies).

According to the government document, 'Climate-related financial disclosures for companies and limited liability partnerships (LLPs)', the reporting requirements under Sections 414CA and 414CB of the Companies Act 2006, mean that companies and LLPs are required to disclose:

a. a description of the governance arrangements in relation to assessing and managing climate- related risks and opportunities
b. a description of how it identifies, assesses and manages climate-related risks and opportunities
c. a description of how processes for identifying, assessing and managing climate-related risks are integrated into the overall risk management process
d. a description of:

    i. the principal climate-related risks and opportunities arising in connection with the operations
    ii. the time periods by reference to which those risks and opportunities are assessed, and
    iii. the actual and potential impacts of the principal climate-related risks and opportunities on its business model and strategy

e. an analysis of the resilience of the business model and strategy taking into consideration different climate-related scenarios
f. a description of the targets used to manage climate-related risks and to realise climate-related opportunities, and of performance against those targets, and
g. the key performance indicators used to assess progress against targets used to manage climate- related risks and realise climate-related opportunities, and a description of the calculations on which those key performance indicators are based.

Source: Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs

According to the Quoted Companies Alliance, the majority of AIM-listed companies have adopted the QCA Corporate Governance Code.

The QCA Principle 3, 'Take into account wider stakeholder and social responsibilities and their implications for long-term success' is relevant to ESG and diversity matters.

Elaboration of its application is detailed in the QCA Governance Code:

> *'Where matters that relate to the company's impact on society, the communities within which it operates or the environment have the potential to affect the company's ability to deliver shareholder value over the medium to long-term, then those matters must be integrated into the company's strategy and business model.'*

With QCA Principle 6, 'Ensure that between them the directors have the necessary up-to-date experience, skills and capabilities', the Board is expected to be diverse, with an appropriate balance of skills, sector, financial, public markets, personal and other capabilities.

In 2021, the QCA published 'The QCA Practical Guide to ESG'. In this, they explain that:

> *'the QCA Code's principles of taking into account wider stakeholder and social responsibilities; promoting an ethical corporate culture; and building trust through effective communication with stakeholders can all be developed further by companies that embrace, examine and communicate their approach to ESG.'*

They provide a five step approach to improve ESG reporting which dovetails with the QCA Code:

1. Develop a clear purpose statement.
2. Undertake an ESG materiality assessment.
3. Be aware of what others are saying and be prepared to respond.
4. Understand what data you have and what data you will need to gather.
5. Take control – decide what to disclose and where, be proactive in your communication.

Source: 'The QCA Practical Guide to ESG'.

Within point 4, the guide highlights the importance of capturing, monitoring and commenting on non- financial metrics, particularly including ESG matters:

> *'...the disclosures should both dovetail with your identified key ESG issues and your outlined business strategy. The narrative should seek to explain why management of these issues (and metrics) are good for both the long-run health of society and your business.'*

Source: 'The QCA Practical Guide to ESG'.

5.6 Board Diversity Disclosures

The UK Listing Rules (UKLR 6.6.6R(9)-(11)) also require listed companies to disclose whether they have met targets on board diversity. The rules lay down the level of detail that must be disclosed in respect of various categories of diversity.

A statement setting out:

a. whether the listed company has met the following targets on board diversity as at a chosen reference date within its accounting period:

    - at least 40% of the individuals on its board of directors are women
    - at least one of the following senior positions on its board of directors is held by a woman:

        - the chair
        - the chief executive
        - the senior independent director, or
        - the chief financial officer, and

    - at least one individual on its board of directors is from a minority ethnic background

b. in cases where the listed company has not met all of the targets in (a):

    - the targets it has not met, and
    - the reasons for not meeting those targets

c. the reference date used for the purposes of (a) and, where this is different from the reference date used for the purposes of reporting this information in respect of the previous accounting period, an explanation as to why, and
d. any changes to the board that have occurred between the reference date used for the purposes of (a) and the date on which the annual financial report is approved that have affected the listed company's ability to meet one or more of the targets in (a).

6. AIM Rules

4.4.1 Be able to interpret the AIM Rules for Companies

Where a company is quoted or admitted on the AIM market, in addition to the various company law, regulatory and governance provisions described in chapter 5, the company must also comply with AIM rules which govern companies that are listed on the AIM market.

Section 1.4 above described and highlighted a number of the key rules.

While it is outside the scope of this chapter to describe the provisions in detail beyond the summary set out in section 1.4, it should be borne in mind that a listing on AIM (as with a listing on any other exchange) will bring with it additional regulatory and governance obligations which a company must comply with.

Consequently, when acting as a corporate finance adviser, particularly in relation to an acquisition transaction, consideration and due regard must be had of the relevant AIM rules (or those of another exchange on which the company is listed) to ensure that during the transaction there is no inadvertent breach of the rules.

Familiarity with the exchange-related rules is therefore necessary when embarking on a transaction involving a listed company.

Chapter Roundup

Chapter 4: The UK Listing Rules

This chapter provided a detailed introduction to the FCA UK Listing Rules, Prospectus Rules: Admission to Trading on a Regulated Market sourcebook (PRM) and Disclosure and Transparency Rules. You will be expected to be able to apply the regulations and advise your client on the regulatory ramifications of particular courses of action.
The following aspects of the rules were described in particular as they often feature in practice and may consequently do so in any assessment or examination:

- The structure of the FCA rules in relation to listing.
- The minimum requirements for listing.
- Prospectuses.
- Timetable for listing.
- Sponsor's obligations.
- Significant transactions.
- Continuing obligations.
- Related party transactions.
- ESG and Diversity related disclosures.



Chapter Five
Other Regulatory and Ethical Considerations

Section 1 Introduction

Section 2 The UK Regulatory Regime

Section 3 Ethics and Ethical Behaviour

Section 4 Company Law

Section 5 Corporate Governance Codes

Section 6 Financial Promotions and Misleading Statements

Section 7 Other Investment Business Regulations

Section 8 Conflicts of Interest

Section 9 Personal Account Dealing (COBS 11.7)

Section 10 Market Abuse and Insider Dealing

Section 11 Money Laundering and Terrorist Financing

Section 12 Miscellaneous Regulations

1. Introduction

This chapter considers the financial services regulatory structure in the UK and other corporate finance related regulations, including competition law and national security law. Ethical codes of conduct relevant to the work of corporate financiers are also considered, as are corporate governance rules. Additionally, the regulatory frameworks in relation to market abuse, insider trading and misleading statements are explored, together with related laws that tackle financial crime.

2. The UK Regulatory Regime

2.1 Overview

5.1.1 Understand the regulatory environment: UK regulatory infrastructure; the Financial Services and Markets Act 2000; the Financial Services Act 2012; global considerations

5.1.2 Understand the role of the FCA in the regulation of the financial services industry

The Financial Services and Markets Act (FSMA) 2000 introduced a new structure for the regulation of the financial services sector in the UK, which came into effect in 2001. It established a new regulatory regime, replacing a number of self-regulatory organisations with a single statutory regulator, the Financial Services Authority (FSA).

The decade that followed the introduction of the FSMA 2000 was notable for being a period of turmoil for the international financial services sector, stemming in large part from excessive lending by banks, particularly to sub-prime borrowers, and from the 'securitisation' or packaging of mortgages by lenders for selling on to investors who were insufficiently aware of the risks attached to the securities.

In mid-2010, it was announced by the Conservative-Liberal Democrat coalition that there was to be a complete overhaul of the regulation of the UK financial services industry and that the Financial Services Authority (FSA) in its existing form would be abolished. The changes came into force with the enactment of the 2012 Financial Services Act (the FSA 2012), which came into effect in 2013.

The FSA 2012 replaced the single regulator approach which critics claimed hindered the UK's performance in the financial crisis of 2007–08, with a dual regulator approach comprising:

- **The Prudential Regulatory Authority (PRA)** – which regulates banks and building societies (ie, deposit takers), credit unions, insurers and systemically important investment firms.

- **The Financial Conduct Authority (FCA)** – which regulates conduct issues across the entire spectrum of financial services, market supervision, as well as the prudential supervision of firms not supervised by the PRA.

In addition, as part of the measures introduced at the time, the Financial Policy Committee (FPC) was established in the Bank of England, with the responsibility for macro-prudential regulation, or the regulation of stability and resilience of the financial system as a whole.

HM Treasury has overall responsibility for the UK's financial system, the institutional structure of financial regulation and the legislation that governs it.

More recently, further regulatory obligations have been introduced by the Financial Services and Markets Act 2023 (FSMA 2023). Both the FSA 2012 and the FSMA 2023 build on regulatory provisions that were introduced by the Financial Services and Markets Act 2000 and which remain in force to this day.

While the FSMA 2000 (FSMA) introduced a new regime for the regulation of the financial services sector in the UK, replacing a number of self-regulatory organisations (SROs) with a single statutory regulator, the main provisions of the FSA 2012 led to the establishment or vesting of powers in the following bodies:

- **Bank of England (BoE or the 'Bank')** – significant new powers were granted to the Bank. The Bank took on responsibility for identifying potential crises and developing and implementing contingency plans. The Bank was made responsible for ensuring the stability of the financial system and empowered to lead the response in a financial crisis. Responsibility for regulating settlement systems and recognised clearing houses was also transferred to the Bank of England.
- **Financial Policy Committee (FPC)** – established within the Bank, with responsibility for macro-prudential oversight of the regulatory system. The FPC has flexibility regarding appointments of committee members to allow for swift changes in membership. The Government renews the FPC's remit annually. Records of FPC meetings are published in an effort to make its workings transparent and accountable. The FPC publishes two Financial Stability Reports (FSRs) a year, including a summary of its activities and an assessment of the effectiveness of its actions in the period since the last report. (The FPC can exclude confidential or market-sensitive information from what it publishes.) The Role of the FPC is considered further in section 2.2.
- **Prudential Regulation Authority (PRA)** – set up as a subsidiary of the Bank to conduct prudential regulation of firms which manage significant balance sheet risk as a core part of their business. This includes banks, other deposit takers (building societies and credit unions), insurers (including friendly societies) and the more complex investment firms. The PRA has the power to designate firms that should fall within its scope, subject to certain procedural safeguards. The role of the PRA is considered further in section 2.3. It should be noted that the PRA is no longer a subsidiary of the BoE, rather it is part of the Bank of England.
- **Financial Services Authority (FSA)** – legal entity became the **Financial Conduct Authority (FCA)**, which is now responsible for consumer protection in financial services, the regulation of conduct of business (including in firms regulated by the PRA) and market conduct. The FCA specialises in protecting customers and promoting confidence in financial services and markets and promoting competition.

The listing function (hitherto performed by the FSA in its UKLA role) was conferred on the FCA. The role of the FCA is considered further in section 2.4.

The reforms emphasised the need for coordination between the regulatory bodies, as well as extensive coordination with other bodies, such as the Financial Ombudsman Service (FOS) and the BoE.

- **Financial Ombudsman Service (FOS)** – oversees an ombudsman scheme for dealing with disputes between consumers and financial services firms and is one of a range of organisations that has the power to raise with the FCA matters causing significant detriment and the FCA is required to consider appropriate action, which may include consumer redress. The Financial Ombudsman Service is designed to provide quick resolution of disputes, between eligible complainants and their product/service providers with a minimum of formality, by an independent person.
- **Financial promotions power** – the FCA has the power to take regulatory action to prevent consumers from being misled and to publicise the action taken. Safeguards have been introduced to reflect concerns raised by respondents over potential reputation damage to them in the use of this power.
- **Competition scrutiny** – the Government made the competition scrutiny regime, which applies to the PRA and FCA, more up-to-date and effective. The regime allows the competition authorities to monitor the impact of regulatory practices and provisions upon competition in financial services. While the promotion of competition is a key function of the FCA, their primary objective remains as the protection and enhancement of the UK financial system.

The Financial Services and Markets Act 2023 was introduced with the aim of bolstering the UK's position as an open and global financial services centre delivering better outcomes for consumers and businesses in the post-Brexit world. The Act enables the tailoring of financial services regulation to UK markets as the UK adapts to its position outside of the EU and sets out a framework for repealing retained EU law relating to financial services.

The Financial Services and Markets Act 2023 expanded the regulatory architecture with provisions to extend regulations to a wider range of market participants, market infrastructure and developments in the markets, including cryptocurrencies. By way of example, the 2023 Act confers powers on the Bank of England, acting through a new Financial Markets Infrastructure Committee, to make rules for and regulate critical financial markets infrastructure parties and organisations that provide services to financial firms and investors. Financial markets infrastructures enable the clearing, settlement and recording of financial transactions.

The Act also introduced a new 'Designated Activities Regime' which exists in parallel with the framework for regulated activities requiring authorisation under FSMA. It enables designated activities that were previously regulated under retained EU law, or such other activities as HM Treasury decides, to be regulated by the FCA outside the context of authorisation (ie, without requiring the entity performing them to be authorised). Key examples of its use are in market infrastructure and aspects of the prospectus rules outlined in chapter 4.

The 2023 Act also started the process of revoking retained EU law relating to financial services in stages and by doing so, it will enable HM Treasury, the PRA and the FCA to replace EU law with legislation designed specifically for UK markets in a way that builds on the UK's existing approach to financial services regulation.

Both the Government and HM Treasury have acknowledged that the revoking of EU retained laws and rules will be a lengthy process and is being undertaken in a phased implementation approach by the PRA and the FCA.

Furthermore, following the coming into effect of the Financial Services and Markets Act 2023, the PRA and the FCA now have a secondary objective to *'facilitate the international competitiveness of the UK economy and its medium to long-term growth (subject to international standards)'* as a result of which it is expected that greater scrutiny of and comparison with international regulatory regimes may result in further amendments to the UK financial regulatory regime.

2.2 The Financial Policy Committee (FPC)

The creation of the FPC was motivated by the perception that the absence of any effective macro- prudential agency was a major failing in the UK, EU and US before the 2008 financial crisis. This lack was highlighted with the inability of the authorities to deal with asset price bubbles, especially in the property market, and the accumulation of debt and leverage across the financial system.

The FPC usually has 13 members including the Governor of the BoE and the Chief Executive of the FCA. The committee meets four times annually, and when required during times of crises that affect financial stability.

Section 9C Bank of England (BoE) Act 1998 (as amended by FSA 2012) provides that the FPC is to exercise its functions with a view to:

- contribute to the achievement by the Bank of England of the Financial Stability Objective, and subject to that, and
- support the economic policy of the Government, including its objectives for growth and employment.

The BoE's Financial Stability Objective is stated in s2A Bank of England Act 1998 (as amended by FSA 2012). It states that an objective of the Bank shall be: To protect and enhance the stability of the financial system of the UK.

The responsibility of the Committee in relation to the achievement by the Bank of the Financial Stability Objective relates primarily to the identification of, monitoring of, and taking action to remove or reduce, systemic risks with a view to protecting and enhancing the resilience of the UK financial system (s9C(2) BoE Act 1998).

Those systemic risks include, in particular:

- systemic risks attributable to structural features of financial markets, such as connections between financial institutions
- systemic risks attributable to the distribution of risk within the financial sector, and
- unsustainable levels of leverage, debt or credit growth (s9C(3) BoE Act 1998).

Systemic risk here means a risk to the stability of the UK financial system as a whole or of a significant part of that system, whether the risk arises in the UK or elsewhere.

The FPC has the following tools at its disposal:

- setting system-wide cyclical capital requirements, reducing capital buffers required in a crisis while toughening them in more favourable economic times
- altering risk weights, enabling the BoE to force banks to hold more capital against specific classes of assets in apparently frothy markets
- setting limits on leverage as a backstop against excessive lending where changing risk weights might not be effective
- requiring forward-looking loss provisioning to prepare for future losses when lending growth is strong
- setting limits on borrowing, eg, with maximum loan-to-value ratios for mortgages, and
- setting limits on lending through regulation.

The Chancellor of the Exchequer retains the right to overrule the Governor of the BoE in a crisis.

2.3 The Prudential Regulation Authority (PRA)

The PRA is part of the Bank of England and is responsible for the prudential regulation of banks, insurance companies and large investment firms. Following the BoE and Financial Services Act 2016, the Bank of England's functions as the PRA are exercised by the BoE acting through its Prudential Regulation Committee (PRC).

The PRA has a statutory general objective that is fundamentally different from that of earlier regulatory regimes. It has an overall objective to promote the safety and soundness of regulated firms and meets this objective primarily by seeking to minimise any adverse effects of firm failure on the UK financial system and by ensuring that firms carry on their business in a way that avoids adverse effects on the system.

2.3.1 Promoting the Safety and Soundness of PRA Authorised Firms

The PRA meets this objective primarily by seeking to minimise any adverse effects of firm failure on the UK financial system and by ensuring that firms carry on their business in a way that avoids adverse effects on the system.

The PRA focuses on the stability of the system overall, albeit through the mechanism of the supervision of individual firms. This requires close coordination with the FPC whose role is to manage the risks in the system as a whole. The PRA is a key contributor to the information and analysis on which the FPC bases its judgements.

The PRA's supervisory efforts relating to financial stability focuses particularly on large international banks. In the case of UK subsidiaries of overseas banks, links of the UK entity with the group as a whole as well as the group's viability are an integral part of the PRA's supervisory assessment.

In order to deliver its objective of stability of the financial system, the PRA uses a framework to assess risks to financial stability.

2.3.2 Key Elements of PRA Risk Assessment Framework

- Potential impact on the financial system of a firm coming under stress or failing.
- Impact on the viability of a firm's business model of the macroeconomic and business risk context.
- A firm's overall safety and soundness, which may act to mitigate the potential risk a firm poses to financial stability.

2.3.3 Key Mitigants Assessed by the PRA

- Degree of resolvability of a firm (working closely with the Bank's Special Resolution Unit).
- The firm's financial strength (including its ability to generate capital through earnings, its capital held against future risks, the quality of its liquid assets and its liquidity management).
- The quality of a firm's risk management and governance (including the competence of its senior management).

Risks to a firm are identified using:

- baseline monitoring
- investigation and assurance, and
- the macroeconomic and business context.

The PRA takes a forward-looking and judgment-based approach to supervision. Baseline monitoring is undertaken for all firms, including those that can be resolved with minimal disruption to the financial system (eg, credit unions and small deposit takers). This monitoring includes a review of a firm's resolvability (at least) once a year, analysis of a firm's financial position, discussions with senior management and ensuring compliance with minimum prudential standards for capital, liquidity and large exposures, as well as early interventions where necessary.

2.4 The Financial Conduct Authority (FCA)

The Financial Conduct Authority (FCA) is the conduct regulator for the UK financial services sector. The FCA also has responsibility for the prudential regulation of investment exchanges, those investment firms not regulated by the PRA and other financial services providers.

Although set up by statute, the FCA is not regarded as acting on behalf of the Crown. Its members, officers and staff are, therefore, not Crown or civil servants. Like its predecessor – the FSA, the FCA is structured as a company limited by guarantee (the company is the same legal entity as the previous FSA), and is given its powers by the Financial Services and Markets Act 2000 (the FSMA 2000).

The FCA is accountable to His Majesty's Treasury (HMT) and, through the Treasury, to Parliament ultimately.

The FCA is governed by a board that is appointed by the Treasury. The majority of the board members are non-executive. One of the non-executive members is a senior non-executive.

The FCA's board sets the policy of the Authority. Day-to-day decisions and staff management are the responsibility of the FCA's Executive Committee.

The Authority is operationally independent of Government and is funded entirely by the firms it regulates.

The Financial Services Act 2012 gives the Financial Conduct Authority (FCA) a single strategic objective:

> *'Ensuring that the relevant markets function well'*

(s1B(2) FSMA 2000, as amended by FSA 2012)

'Relevant markets' include the financial markets and the markets for regulated financial services. The strategic objective of the FCA is supported by three operational objectives (s1C-E FSMA 2000):

- the consumer protection objective: securing an appropriate degree of protection for consumers
- the integrity objective: protecting and enhancing the integrity of the UK financial system, and
- the competition objective: promoting effective competition in the interests of consumers in the market for regulated financial services and for services provided by a recognised investment exchange.

Following the coming into effect of the Financial Services and Markets Act 2023, the FCA (and the PRA) have a secondary objective:

> *'facilitating, subject to aligning with relevant international standards: The international competitiveness of the economy of the UK (including in particular the financial services sector), and its growth in the medium to long term.'*

The FCA has stated that the new objective will only apply when the FCA is advancing its existing operational objectives (consumer protection, market stability and effective competition). The term 'international standards' means that the FCA will not take action or develop rules that would harm the UK's reputation or standing in the international financial community.

Ensuring that firms put consumers at the heart of their business is central to the work of the FCA, an objective that is underlined by three outcomes that it published:

- consumers get financial services and products that meet their needs from firms they can trust
- firms compete effectively with the interests of their customers and the integrity of the market at the heart of how they run their business, and
- markets and financial systems are sound, stable and resilient with transparent pricing information.

FSMA gives the FCA and the PRA certain duties and objectives in relation to their roles as financial services regulators and establishes the legal powers to enable them to fulfil their roles.

- Broadly, the FCA is responsible for ensuring that financial markets work well so that consumers get a fair deal, while the focus of the PRA is on stability – the safety and soundness of deposit-taking firms, insurers, and systemically important investment firms.
- The regulators' powers are over firms carrying on regulated activities, the exchanges that are used by many of those firms, and individuals carrying out particular functions for firms. In some cases, they also extend to those not currently authorised, for example, formerly authorised firms or firms that ought to have had authorisation, but which have been doing business without it.
- The FCA also has responsibility for:

    - the Financial Ombudsman Service (FOS)
    - the Payment Systems Regulator (PSR)
    - operating the UK securities listing regime, and
    - enforcing the unfair terms requirements in the Consumer Rights Act 2015 in financial services consumer contracts.

- Along with the PRA, it is responsible for the financial services compensation scheme (FSCS).
- The FCA and the PRA are funded entirely from fees paid by the firms which they regulate.
- The FCA is accountable to the government on how it carries out its functions via HM Treasury which in turn is accountable to Parliament.

Specific FCA regulations that are pertinent to corporate finance transactions including, in particular, acquisitions, are highlighted in subsequent sections of this chapter.

2.4.1 The Consumer Duty

The Consumer Duty was finalised by the FCA in 2022 and reflects a significant change. Frequently described as treating customers fairly (TCF) with teeth, the Consumer Duty is designed to set a higher standard than current Principle for Businesses 6 that says:

> *'a firm must pay due regard to the interests of consumers and treat them fairly'.*

The Duty focuses on consumer outcomes rather than processes and has been substantially in place since 31 July 2023.

There are three aspects to the Consumer Duty:

- The introduction of a new principle for businesses.
- Cross-cutting rules.
- The 'four outcomes'.

The Consumer Principle has been added to the previous 11 principles as a further Principle 12:

> *'A firm must act to deliver good outcomes for retail clients'.*

The cross-cutting rules are designed to support the Principle 12. The cross-cutting rules present three overarching requirements that explain how firms should act to deliver good outcomes.

- Firms must act in **good faith** towards retail customers. (Acting in good faith is a standard of conduct characterised by honesty, fair and open dealing, and acting consistently with the reasonable expectations of retail customers).
- Firms must **avoid causing foreseeable harm** to retail customers.
- Firms must **enable and support retail customers to pursue their financial objectives**.

The four outcomes are a suite of rules and guidance setting more detailed expectations for firm conduct in four areas that represent key elements of the firm-consumer relationship:

- the governance of products and services
- price and value
- consumer understanding, and
- consumer support.

The FCA's expectations of firms under the Duty are to:

- Put consumers at the heart of their business and focus on delivering good outcomes for customers.
- Provide products and services that are designed to meet customers' needs, that they know provide fair value, that help customers achieve their financial objectives and which do not cause them harm.

- Communicate and engage with customers so that they can make effective, timely and properly informed decisions about financial products and services and can take responsibility for their actions and decisions.
- Not seek to exploit customers' behavioural biases, lack of knowledge or characteristics of vulnerability.
- Support their customers in realising the benefits of the products and services they buy and acting in their interests without unreasonable barriers.
- Consistently consider the needs of their customers, and how they behave, at every stage of the product/service lifecycle.
- Continuously learn from their growing focus and awareness of real customer outcomes.
- Ensure that the interests of their customers are central to their culture and purpose and embedded throughout the organisation.
- Monitor and regularly review the outcomes that their customers are experiencing in practice and take action to address any risks to good customer outcomes.
- Ensure that their board or equivalent governing body takes full responsibility for ensuring that the Duty is properly embedded within the firm, and senior managers are accountable for the outcomes their customers are experiencing, in line with their accountability under the regulators' Senior Managers and Certification Regime (SM&CR).

2.5 Ongoing Reforms

In December 2022, the UK Government, via HM Treasury, published a package of reforms to financial services regulation – referred to as the 'Edinburgh Reforms'. These measures were designed to build on the UK government's vision of an open, sustainable and technology-driven financial services sector.

Together with the Financial Services and Markets Act 2023, they set the UK regulatory agenda and focus. The reforms included, but were not limited to:

- Replacing packaged retail and insurance-based investment products (PRIIPs) rules and replacing the related regime with an alternative retail disclosure framework that better suits the UK market.
- Designing a new UK Short Selling Regime.
- Review of the Senior Managers & Certification Regime (SM&CR).
- Enhancing the remit of the PRA and FCA with a focus on international competitiveness.

Linked to the proposed reforms, and following the Public Offers and Admissions to Trading Regulations 2024 (POATRs) were the new prospectus regulations introduced by the FCA and covered in Chapter 4.

According to CP24–12, the aim of these changes was to:

> *'reduce the costs of listing on UK markets, make capital raising easier on UK listed markets and remove barriers to retail participation. They dovetail with recent reforms we have undertaken of the listing regime, which aim to encourage companies from around the world, many of which start up and are incubated in the UK, to list and raise capital here and to help UK-listed companies be more competitive globally.'*

Exercise 1 – Unravelling the Acronyms

Here is a list of acronyms relevant to the UK regulatory structure. Identify what each acronym stands for, and its place in the financial regulatory system in the UK.

UK Financial Services Regulatory Regimes
BoE, FCA, FOS, FPC, FSA 2012, FSA, FSMA 2000, FSMA 2023, HMT, POATR, PRA, PSR

The answer to this exercise can be found at the end of this workbook.

2.6 International Regimes

Most financial regulatory regimes have similar objectives to the UK's, although the structure of regulations and the extent to which oversight and regulatory powers rest in related regulators differ.

In the US, among its various regulators that form part of its regulatory regime, the most prominent regulator is the Securities and Exchange Commission (SEC). The mission of the US SEC is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. The laws and rules that govern the securities industry in the US derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment. The SEC oversees the key participants in the securities world, including securities exchanges, securities brokers and dealers, investment advisers and mutual funds. The SEC is concerned primarily with promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud.

It is the responsibility of the SEC to:

- interpret federal securities laws
- issue new, and amend existing, rules
- oversee the inspection of securities firms, brokers, investment advisers, and ratings agencies, and
- oversee private regulatory organisations in the securities, accounting, and auditing fields, and coordinate US securities regulation with federal, state and foreign authorities.

In addition, the Financial Industry Regulatory Authority (FINRA) is the largest independent regulator for all securities firms doing business in the US. FINRA touches virtually every aspect of the securities business – from registering and educating industry participants to examining securities firms; writing rules; enforcing those rules and the federal securities laws; informing and educating the investing public; providing trade reporting and other industry utilities; and administering the largest dispute- resolution forum for investors and registered firms.

In Europe, the European Union (EU) works towards a single European market in various trade sectors, finance being one of the most important. The aim is to remove barriers to inter-state trade by, among other things, ensuring that similar regulatory rules are in place. From a financial services perspective, this should mean that, in terms of investor protection, it makes no difference to a customer whether they buy a financial product from a provider in their home state or from another member state.

A single market in financial services has long been an objective of the EU. In a single market, financial institutions authorised to provide financial services in one member state are able to provide the same services throughout the EU, competing on a level playing field within a consistent regulatory environment (also known as ‘passporting’).

In the wake of the 2007–08 financial crisis, the European Union adopted a series of structure changes to secure financial stability within the EU. The European System of Financial Supervision (ESFS) was introduced in 2010 and consists of the following:

- European Systemic Risk Board.
- Three supervisory authorities:
    - The European Insurance and Occupational Pensions Authority (EIOPA)
    - The European Banking Authority (EBA)
    - The European Securities and Markets Authority (ESMA).

In Asia, the main bodies responsible for regulating financial services include:

- **In mainland China** – the China Securities Regulatory Commission (CSRC), the National Financial Regulatory Administration (NFRA) and The People’s Bank of China (PBOC).
- **In Hong Kong** – the Securities and Futures Commission (SFC), Stock Exchange of Hong Kong (SEHK), Hong Kong Futures Exchange (HKFE) and the Hong Kong Monetary Authority (HKMA).
- **In Japan** – the Financial Services Agency (FSA) and self-regulatory organisations (SROs), such as the various Japanese securities exchanges and the Japan Securities Dealers’ Association (JSDA).
- **In Singapore** – Monetary Authority of Singapore (MAS)
- **In Australia** – Australian Securities and Investments Commission (ASIC) and Australian Prudential Regulation Authority (APRA)
- **In India** – Securities and Exchange Board of India (SEBI) and Reserve Bank of India (RBI)
- **In South Korea** – Financial Services Commission (FSC) and Financial Supervisory Service (FSS).

Exercise 2 – International Regimes: Unravelling the Acronyms

Here is a list of acronyms relevant to selected overseas financial services regulatory regimes. Please attempt to identify what each acronym stands for, and the country it relates to.

Overseas Financial Services Regulatory Regimes
ASIC, CSRC, EBA, EIOPA, ESFS, ESMA, ESRB, FINRA, FSA, HKFE, HKMA, JSDA, MAS, NFRA, SEHK, SEC, SEBI, SFC

The answer to this exercise can be found at the end of this workbook.

2.7 Regulation of Market Structures

5.1.3 Know how regulated market structures are regulated: exchanges; trading venues (multilateral trading facilities and organised trading facilities); systematic internalisers

A large proportion of trades in financial instruments are carried out via established exchanges, such as the London Stock Exchange (LSE). However, increasingly trades are taking place on other forms of trading venues (ie, multilateral trading facilities (MTFs) and organised trading facilities (OTFs)). The FCA is responsible for recognising and supervising both.

2.7.1 UK Recognised Investment Exchanges (UK RIEs) and Designated Investment Exchanges (DIEs)

A UK recognised investment exchange (UK RIE) is an investment exchange which is recognised by the FCA under FSMA S.290. Any body corporate or unincorporated association may apply to the FCA for an order declaring it to be a UKRIE. The FCA will seek to establish whether the applicant is fit and proper to operate as an exchange, including whether it has sufficient financial resources to properly carry out its activities. The applicant must be willing and able to share information with the FCA, and to promote and maintain high standards of integrity and fair dealing, including laying down rules for activities on the exchange. It must record, monitor and enforce compliance with these rules.

Once recognised, these exchanges are subject to supervision and oversight by the FCA. Being granted recognised status relieves the organisation of the requirement to be an authorised person to conduct financial services business. UK RIEs can be UK- or overseas-based; in the latter case, they are often referred to as recognised overseas investment exchanges (ROIEs). An example of a UK RIE is the LSE. The LSE is the largest formal market for securities in the UK. It facilitates deals in shares, **bonds** and some derivatives.

ROIEs, in contrast, are based outside the UK, but carry on regulated activities within the UK (for example, by offering electronic trading facilities to members in this country) and, to this extent, are regulated and supervised by the FCA. They do not have physical UK operations (except some support representation), so they are necessarily electronic marketplaces. An

example of an ROIE is the Nasdaq, established in the US. Over 30 ROIEs exist and are listed on the FCA register, including Deutsche Börse AG, Cboe Europe B.V., Chicago Board of Trade and SIX Swiss Exchange AG. A list of all the ROIEs can be found on the FCA's website within 'the financial services register'.

Designated investment exchanges (DIEs) are, like ROIEs, overseas-based, but unlike ROIEs they do not offer membership and access to participants based in the UK. Instead, the designated status indicates that the exchange is regulated and supervised to standards that the FCA believes meet certain criteria in terms of protection for investors dealing on it. An example of a DIE is the New York Stock Exchange (NYSE).

2.7.2 UK Multilateral Trading Facilities (MTFs)

A UK MTF is described by the FCA as follows:
An investment firm or market operator that operates a multilateral system in accordance with non-discretionary rules.

> *A 'multilateral system' means, 'any system or facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact'.*

Examples include firms such as Brokertec, MarketAxess, Tradeweb, Creditex and Bloomberg. A UK MTF is sometimes considered and described as 'exchange lite', as they do not have a listing process or the ability to change the regulatory status of a security.

2.7.3 Organised Trading Facilities (OTFs)

An OTF is a multilateral system that is not a regulated market or an MTF.

Within an OTF, multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in a way that results in a contract. Equities are not permitted to be traded through an OTF. MTFs and OTFs are similar multilateral systems that bring together third-party buying and selling interests in financial instruments in a way that results in a contract.

The requirements that apply to OTFs and their transactions are generally the same as the requirements for MTFs. As with MTFs, OTFs must establish clear rules and processes around trading. OTFs are also subject to the same transparency requirements as regulated markets and MTFs, and are required to establish and maintain effective arrangements and procedures to enable the regular monitoring of compliance by the members.

2.7.4 Systematic Internalisers (SIs)

A systematic internaliser (SI) is an investment firm which on an organised, frequent, systemic and substantial basis, deals on own account when executing client orders outside a regulated market, MTF or OTF without operating a multilateral system.

Typically, SIs are investment banks, although any firm can be a SI in a particular security or financial instrument if relevant thresholds are met.

Exercise 3 – Market structures: Unravelling the Acronyms

Here is a list of acronyms relevant to selected overseas financial services regulatory regimes. Please attempt to identify what each acronym stands for and explain its meaning.

Overseas Financial Services Regulatory Regimes
DIE, LSE, MTF, NYSE, OTF, RIE, ROIE, SI

The answer to this exercise can be found at the end of this workbook.

2.8 Regulation of Takeovers and Mergers

5.1.4 Know the roles of the relevant bodies involved in takeovers and mergers

2.8.1 The Takeover Panel (the Panel)

As encountered earlier, the Takeover Panel (the Panel) is an independent body, whose main functions are to issue and administer the Takeover Code (also known as the Code) and to supervise and regulate takeovers and other matters to which the Takeover Code applies in accordance with the rules set out in the Takeover Code. Its statutory functions are set out in Chapter 1 of Part 28 of the Companies Act 2006.

In all cases, the Panel's function is to ensure that the shareholders of an offeree company are treated fairly and are not denied an opportunity to decide on the merits of a takeover, and that offeree shareholders of the same class are afforded equivalent treatment by a bidder (referred to in these rules as an offeror).

The Takeover Code is not concerned with the financial or commercial advantages of a takeover, which it considers to be matters for the offeree company and its shareholders. Wider questions of public interest are dealt with by the Department for Business and Trade (DBT).

The Panel's role in takeovers is threefold, to:

- provide advice and guidance on the application and interpretation of the relevant rules to offerors, offerees, advisers and, where relevant, other market participants
- monitor the progress of an actual, or contemplated, takeover bid for breaches of compliance with the relevant rules, and
- enforce the Code through decisions on issues arising, or seeking enforcement through the courts.

Where necessary, the Panel may impose sanctions, generally through private warnings, public censure and/or reference to other regulators as appropriate. It also has the power to 'cold-shoulder' offenders, ie, to ensure that the facilities of the market are withdrawn from them with respect to takeover activity, for a period of time, by publication of a statement that an offending party is, in the opinion of the Panel, not likely to be a party that will comply with the Code. FCA authorised persons, such as banks and corporate finance advisers, are not permitted to act for or represent parties that are the subject of such a cold-shoulder statement in relation to any transaction for which the Code applies.

In addition to the Panel, competition regulators routinely regulate and approve of (or block) takeover and mergers, as described in greater detail in section 2.8.2.

Question 1

Which of the following are included in the role of the Takeover Panel for takeovers and mergers? Please select all that apply.

A. Issuing the Takeover Code
B. Administering the Takeover Code
C. Assessing the commercial merits of a takeover
D. Enforcing the Takeover Code

The answer to this exercise can be found at the end of this workbook.

2.8.2 Competition and National Security Regulations

UK Competition Regulation

The UK competition authority is the Competition and Markets Authority (CMA). The CMA's primary duty is to seek to promote competition, both within and outside the UK, for the benefit of consumers. Part of this responsibility is to investigate mergers between organisations to ensure that they do not result in a substantial lessening of competition.

The UK merger control regime is established under the Competition Act 1998, together with the Enterprise Act 2002 which replaced a number of the provisions of the Competition Act, and in turn, substantially updated again in the Enterprise and Regulatory Reform Act 2013, which saw the Office of Fair Trading (OFT) and the Competition Commission (CC) replaced by the CMA.

In 2021, the CMA published its '***Merger Assessment Guidelines***' document, whose purpose is to provide appropriate guidance to business considering entering into transactions which may have an impact on competition in the UK. If the CMA finds that a relevant merger situation has been created (or arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation), it must decide whether the creation of that situation has resulted, or may be expected to result in, a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

More recently, the CMA significantly updated its merger control framework. Key revisions to the jurisdiction and procedure guidance (CMA2) and merger remedies guidance (CMA87) now reflect the CMA's '4Ps' approach, focusing on pace, predictability, proportionality, and process. Additionally, the updates provide critical clarifications on the material influence and share of supply tests used to establish jurisdiction.

The CMA has also introduced new key performance indicators (KPIs) for merger reviews, including an aim to complete pre notification within 40 working days and to issue straightforward Phase 1 decisions by the 25th working day.

Under the Act, the CMA has a function to obtain and review information relating to merger situations, and a duty to refer for an in-depth 'Phase 2' investigation any relevant merger situation where it believes that it is, or may be, the case that the merger has resulted, or may be expected to result, in a substantial lessening of competition in a UK market.

A relevant merger situation occurs where the following three criteria are met.

First, either, two or more enterprises must cease to be distinct, or there must be arrangements in progress or in contemplation which, if carried into effect, will lead to enterprises ceasing to be distinct, and second, either:

- the UK turnover associated with the enterprise which is being acquired exceeds £100 million, or
- the enterprises which cease to be distinct, supply or acquire goods or services of any description and, after the merger, together supply or acquire at least 25% of all those particular goods or services of that kind supplied in the UK, or in a substantial part of it. The merger must also result in an increment to the share of supply or acquisition

and third, either:

- the merger must not yet have taken place, or
- it must have taken place not more than four months before the day the reference is made.

As part of the Digital Markets, Competition and Consumers Act 2024, two further changes to UK merger control were introduced:

- A new acquirer focused jurisdictional threshold, capturing transactions where one party has UK turnover exceeding £350 million and holds at least a 33% share of supply (or purchases) in the UK (or a substantial part of it), and the other party has a UK connection.
- A statutory 'de minimis' exemption, removing CMA jurisdiction where each party has UK turnover below £10 million, even if the share of supply test would otherwise be met.

As noted, after starting an investigation, the CMA is, in most cases, required to decide whether the test for reference is met within a timetable of 40 working days. Furthermore, the CMA has a KPI that seeks to resolve straightforward Phase 1 decisions by the 25th working day.

The CMA must bring to the attention of the Secretary of State any merger it is investigating at Phase 1, which it believes raises a material public interest consideration.
The public interest considerations that the Secretary of State may take into account are those relating to:

- national and public security
- newspaper and other media mergers, and
- the stability of the UK financial system.

The Secretary of State has the power to add further public interest considerations.
UK Government ministers are also able to intervene in transactions for ‘relevant enterprises’ which include companies active in and of the following: military or dual-use goods which are subject to export control, computer processing and quantum technology. Added to this list in 2020 were artificial intelligence (AI), cryptographic authentication and advanced materials. The UK turnover for these relevant enterprises needs to be £1 million or greater (rather than the £100 million or greater in the general threshold) for intervention to occur.

In May 2025, the UK government published its 'strategic steer' to the Competition and Markets Authority. In this publication, it reaffirmed the independence of the CMA whilst encouraging it to exercise its discretion (eg, in case selection, investigations, remedies, and engagement) in ways that align with the government's growth-focused priorities:

- promotes growth
- encourages investment
- supports innovation
- reduces regulatory friction, and
- delivers swift, more predictable and proportionate outcomes.

European Competition Regulation

Under the EU Merger Regulation, the European Commission (EC) has jurisdiction over those mergers that have an EU dimension. While the UK is no longer subject to the EU Merger Regulation since 1 January 2021, many UK companies will remain within their remit due to the EU dimension. The terms of the EU–UK Trade and Cooperation Agreement (agreed as part of the Brexit arrangements) also include ‘level playing field’ clauses that may have longer term implications in this area.
Mergers that are deemed to be concentrations under the EU Merger Regulation fall under the jurisdiction of the Commission where they have an EU dimension, that is where they satisfy one of two alternative sets of jurisdictional thresholds:

either

- the combined aggregate worldwide turnover of all the undertakings concerned is more than €5 billion, and
- the aggregate EU wide turnover of each of at least two of those undertakings is more than €250 million

or

- the combined aggregate worldwide turnover of all the undertakings concerned is more than €2.5 billion
- in each of at least three Member States, the combined aggregate turnover of all those undertakings is more than €100 million
- in each of at least three of the Member States included for the purposes above, the aggregate turnover of each of at least two of the undertakings concerned is more than €25 million, and
- the aggregate EU wide turnover of at least two of the undertakings concerned is more than €100 million

unless

- in relation to either situation above, each of the undertakings concerned achieves more than two- thirds of its aggregate EU wide turnover within one and the same Member State.

2.8.3 The National Security and Investment Act (NSI)

In recent years, protectionist legislation has re-emerged across the world, including in the UK. Designed to protect national security interests, the legislation adds a further consideration to be taken account of in an acquisition, irrespective of whether it is a transaction structured as a share purchase or an assets purchase.

The National Security and Investment Act (NSI) came into force on 4 January 2022 and gives the government powers to scrutinise and intervene in business transactions, such as takeovers, to protect national security. There are 17 sensitive areas of the economy known as ‘notifiable acquisitions’ for which there is a legal requirement to inform the government or make a ‘mandatory notification’ if an acquisition is to be made.

The sensitive areas are:

- Advanced Materials
- Advanced Robotics
- Artificial Intelligence
- Civil Nuclear
- Communications
- Computing Hardware
- Critical Suppliers to Government
- Cryptographic Authentication
- Data Infrastructure
- Defence
- Energy
- Military and Dual-Use
- Quantum Technologies
- Satellite and Space Technologies
- Suppliers to the Emergency Services
- Synthetic Biology
- Transport.

2.8.4 The Foreign Influence Registration Scheme (FIRS)

The Foreign Influence Registration Scheme (FIRS), introduced under the UK National Security Act 2023, is not an M&A specific regime, but it has direct implications for corporate transactions – particularly where a buyer, seller, investor, or strategic partner may be linked to a foreign power or a specified foreign entity.

The scheme is designed to increase transparency of foreign influence, not to block investment. But for transactions involving foreign state linked entities, it can create new disclosure, compliance, and reputational considerations.

FIRS is a two tier registration scheme intended to ensure transparency around arrangements with foreign powers, covering:

- **Political Influence Tier** – registration required where a foreign power directs political influence activities.
- **Enhanced Tier** – wider registration obligations for dealings with specified foreign powers or entities assessed as posing a risk to UK national security.

State linked entities are not automatically designated as 'foreign powers' – the test focuses on whether the entity acts at the direction of a foreign power.
FIRS can become relevant in acquisitions where:

a. The acquiring party is a foreign power or state controlled entity. Deals involving sovereign wealth funds, state owned enterprises, or politically directed investors may be captured under the enhanced tier, if the foreign government is one specified by regulation.
b. The target company has arrangements with a foreign power. If the company being acquired has:

    - contracts
    - memoranda of understanding
    - partnership agreements, or
    - lobbying or political communications work that are directed by a foreign power, these may be registerable arrangements.

c. Joint ventures or partnerships involving a foreign power - sector specific guidance for business explicitly notes that joint ventures with companies from a government specified country may fall within scope.
d. The buyer will undertake political, government facing, or regulatory engagement in the UK on behalf of a foreign entity – any activities intended to influence political matters in the UK that are conducted under direction of a foreign power must be registered.

3. Ethics and Ethical Behaviour

3.1 Ethics

5.2.1 Be able to apply their professional body's relevant code of conduct (eg, CISI's Code of Conduct and/or the ICAEW's Code of Ethics) in a given scenario

Ethics are the moral principles that govern a person's conduct. Ethical behaviour in the financial services sector has come under scrutiny in recent years, particularly in light of a series of financial scandals and business collapses which have turned the spotlight on the way the financial services sector operates.

Poor ethical standards clearly have detrimental effects. They pose risks to market confidence and consumer protection. They can increase the scope for financial crime and have a negative impact on public awareness and confidence.

Behaving ethically in a business scenario can run counter to personal interest. A finance professional is in a position of trust with the client, employer and general public. Consequently, the highest standards of professional behaviour are expected. Written codes have been formulated in an attempt to systematise standards of ethical behaviour and provide practical examples of the ethical dilemmas that could arise.

3.1.1 Ethics – CISI Code of Conduct

Members of the Chartered Institute for Securities & Investment (CISI) are required to meet the standards set out within the **CISI's Code of Conduct**.

	The Principles		Stakeholder
Personal Accountability	1	To strive to uphold the highest levels of personal and professional standards at all times, acting with integrity, honesty, due skill, care and diligence to avoid any acts, either in person, in a remote working environment or digitally which may damage the reputation of your organisation, your professional body or the financial services profession.	**Self, Clients, Regulators, Colleagues, Market Participants, Firm, Profession, Society**
Client Focus	2	To put the interests of clients and customers first by treating them fairly, being a good steward of their interests, never seeking personal advantage from confidential information received and utilising client data only for a defined purpose.	**Clients**

	The Principles		Stakeholder
Conflict of Interest	3	Being alert to and actively manage fairly and effectively any personal or other conflicts of interest, obeying legislation and complying with regulations to the best of your ability, ensuring you are open and cooperative with all your regulators, challenging and reporting unlawful or unethical behaviour.	**Clients, Market Participants, Regulators**
Respect for Market Participants	4	To treat all counterparties and business partners with respect, to observe proper standards of market integrity, good practice, conduct and confidentiality required to maintain the highest level of mutual trust.	**Clients, Market Participants**
Professional Development	5	To strive continually for professional excellence, committing to continuous professional development (CPD) and promoting and supporting the development of others.	**Profession, Clients, Colleagues**
Awareness of Capabilities	6	To decline to act on any matter about which you are not competent or qualified unless you have access to such advice or assistance to carry out the work in a professional manner, taking into account the nature of the individual mandates given by your customers and counterparties.	**Clients, Profession, Market Participants**
Respect Others and the Environment	7	To treat everyone fairly and with respect, supporting opportunity for all, embracing diversity and inclusion and ensuring that the environmental impact of your work is considered.	**Society, Colleagues, Clients, Regulators, Market Participants, Profession, Professional Body**
Speak up & Listen up	8	To be active in speaking up and encouraging others to do so by listening up, promoting a safe environment for all and recognising the responsibilities you have to the communities in which you operate.	**Society, Colleagues**

The CISI states that material breach of the Code of Conduct would be incompatible with continuing membership of the CISI and may result in disciplinary action.

Members who find themselves in a position which might require them to act in a manner contrary to the Principles are encouraged by the CISI to:

1. discuss their concerns with their line manager
2. seek advice from their internal compliance department
3. approach their firm's non-executive directors or audit committee, and
4. if unable to resolve their concerns and, having exhausted all internal avenues, contact the CISI for advice.

3.1.2 Ethics – ICAEW Code of Ethics

Updated on 1 July 2025, the Institute of Chartered Accountants in England and Wales (ICAEW) 2025 edition of its Code of Ethics is based on the 2024 version of International Ethics Standards Board for Accountants (IESBA) Code and is used with permission of the International Federation of Accountants (IFAC).

There are five fundamental principles of ethics for professional accountants:

1. **Integrity** – to be straightforward and honest in all professional and business relationships.
2. **Objectivity** – to exercise professional or business judgement without being compromised by:

    i. bias
    ii. conflict of interest, or
    iii. undue influence of, or undue reliance on, individuals, organisations, technology or other factors.

3. **Professional competence and due care** – to:

    i. attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation, and
    ii. act diligently and in accordance with applicable technical and professional standards.

4. **Confidentiality** – to respect the confidentiality of information acquired as a result of professional and business relationships.
5. **Professional Behaviour** – to:

    i. comply with relevant laws and regulations;
    ii. behave in a manner consistent with the profession's responsibility to act in the public interest in all professional activities and business relationships, and
    iii. avoid any conduct that the professional accountant knows or should know might discredit the profession.

The most recent update in 2025 refined the application material and conceptual framework of the five fundamental principles with a focus on technology, conduct and clarity of expectations:

Integrity

- Encourages an inquiring mind and ethical awareness.

Objectivity

- Adds technology as a threat to objectivity
- Reinforces scepticism and bias awareness.

Professional Competence and Due Care

- Requires digital literacy and tech risk management
- Emphasises mindset and diligence.

Confidentiality

- Expands scope to cover tech-enabled confidentiality risks .

Professional Behaviour

- Adds behavioural expectations: no bullying, harassment
- Clarifies breach reporting and documentation
- Aligns independence rules with IESBA and FRC standards.

3.1.3 Ethics – FCA's Ethical Framework

The Financial Services and Markets Act (FSMA) 2000 and the FCA's principles and commitments embody a framework of core values. In summary they can be seen as:

- being open, honest, responsive and accountable
- being committed to acting competently, responsibly and reliably, and
- relating to colleagues and customers fairly and with respect.

The following questions were set out in the FCA paper '*An Ethical Framework for Financial Services'*, published in 2002. The questions are designed to help practitioners recognise, apply and balance values in everyday decisions and actions.

Open, Honest, Responsive and Accountable

- Who is left out or kept in the dark? Why?
- How happy are we to be associated with our decisions/actions?
- Are we listening or just hearing?
- What can we learn? How do we help others to understand us?
- How do we recognise and deal with conflicts of interest?

Relating to Colleagues and Customers Fairly and with Respect

- Do we treat everyone as we would like to be treated?
- Do we deal with people with respect and without prejudice?
- How do we keep rights and obligations in balance and proportionate?
- When do we hold to our commitments and resist ‘fudging’?
- Who benefits and who loses out? Should they?

Committed to Acting Competently, Responsibly and Reliably

- Do we do what we say we will do?
- Under pressure do we swap cooperation for coercion?
- Do we dither or delay? How is error treated?
- Do people trust us? If not, why not?
- Can we meet our commitments and plans?

This 2002 paper reflected the FCA’s early thinking on ethics, values, and decision making. It has since been superseded by a more formalised, outcomes based, and accountability driven regulatory framework that reflects a number of key developments:

1. **Principles for Businesses (PRIN): expanded from 11 to 12 Principles**

The ethical baseline for firms was expressed through the 11 Principles for Businesses introduced by the FSA in 2001. These Principles set expectations around integrity, skill and care, fair treatment, conflicts, market conduct, and relations with regulators. In 2023, the FCA introduced the Consumer Duty, adding Principle 12: ‘A firm must act to deliver good outcomes for retail customers’.

2. **The Consumer Duty: a shift from the 'Treating Customers Fairly' regime**

The Consumer Duty focuses on customer outcomes, requiring firms to:

- avoid foreseeable harm (PRIN 2A.2.8)
- support customers in achieving their financial objectives (PRIN 2A.2.14)
- ensure products, communications, and customer support meet higher standards (PRIN 2A.3 to 2A.6)

3. **SM&CR and personal accountability**

The Senior Managers & Certification Regime embeds ethical responsibility at the level of individual decision makers. Senior managers must demonstrate:

- reasonable steps
- effective governance
- a culture that supports good conduct

4. **Culture as a supervisory priority**

The FCA now treats culture as a root cause of misconduct. Supervisory messaging emphasises:

- psychological safety
- diversity of thought
- leadership competence
- effective challenge
- governance and risk culture

5. **Non financial misconduct (2025–2026 reforms)**

Based on the FCA's Policy Statement PS25/23 (confirmed in December 2025), the regulation of non-financial misconduct (NFM) is being explicitly codified into the Handbook from 1 September 2026.

The FCA has expanded COCON and FIT to treat bullying, harassment, discrimination, and similar behaviours as regulatory misconduct. Ethical expectations now explicitly include personal behaviour and workplace culture.

6. **Data driven and outcomes based supervision**

Within its Strategy 2022–2025 (launched in 2022), the FCA articulates how its increasing use of data, behavioural insights, and firm level metrics to assess whether ethical expectations are being met in practice. The Consumer Duty rules (PS22/9) provide for outcomes-based supervision.

3.2 Ethical Behaviour in Corporate Finance

Some key themes can be developed out of the above codes of conduct that impact particularly on corporate finance work.

3.2.1 Conflicts of Interest

Conflicts of interest prevent an adviser acting objectively, or, as importantly, being perceived to be acting objectively. Conflicts of interest can arise between the adviser and the client or between two different clients of an adviser.

Conflicts between the Adviser and the Client

A conflict can exist due to some arrangement which an adviser has entered into which might prevent them giving a client unbiased and objective advice. An example might be an arrangement whereby the adviser receives commission from introducing the client to a third party, or from performing some other service. Any such arrangements must always be disclosed to the client.

Conflicts between Two Different Clients of an Adviser

If the interests of two clients are in dispute with each other (for example different sides of a takeover bid) the objectivity of the adviser may be perceived to be impaired. Conflicts can sometimes be managed via internal arrangements, for example, by using separate advisory teams and proper record keeping, but if a material conflict exists an appointment should be declined. The Takeover Code requires that offeree shareholders be represented by an independent (Rule 3) adviser and a material conflict of interest would prevent the adviser being perceived as independent. A disclosure to the client that a conflict of interest exists is not always sufficient to ensure that the perception of objectivity is upheld.

3.2.2 Confidentiality

A corporate financier is privy to much confidential information about a client. This information should not be disclosed without express consent from the client, unless there is a legal duty to disclose the information, for example, if breaches of the law come to light. Confidential information acquired in the course of professional work should neither be used nor appear to be used for personal advantage or for the advantage of a third party. In some situations disclosing confidential information can be a crime; legislation exists in respect of insider dealing and market abuse.

Corporate financiers are often dealing with price-sensitive information. The Takeover Code sets out the importance of secrecy relating to all matters concerning a bid prior to initial announcement to prevent false markets in the company's shares.

3.2.3 Fee Arrangements

Fee arrangements with clients must not be designed in a way that might be perceived to detract from the impartiality and objectivity of the advice that is given. Fee estimates should be set out in advance of work being undertaken and should specify the scope of work that is expected. It is acceptable to charge differential fees with different rates for different services that are to be undertaken. It is acceptable to charge fees on a percentage or contingent basis. However, contingent fees may give rise to a self-interest threat to objectivity. The significance of this threat should be evaluated and safeguards considered. Success fees payable to advisers are likely to prevent an adviser being seen as 'independent' under Rule 3.2 of the Takeover Code.

Question 2

Which of the following are generally considered to be key in relation to ethical behaviour in a merger and acquisition context? Please select all that apply.

A. Managing conflicts of interests
B. Structuring fee arrangements
C. Continuing professional development
D. Maintaining confidentiality

The answer to this exercise can be found at the end of this workbook.

4. Company Law

4.1 The Companies Act

5.3.1 Be able to interpret the key provisions relevant to the following areas of the Companies Act as they relate to corporate finance transactions: Section 793 notices; company meetings; alterations to capital structure; financial assistance; company investigations; minority shareholder protections; duties of directors in relation to conflicts of interest

The Companies Act 2006 includes the following key provisions, which can impact corporate finance transactions:

- Requiring information about interests in a company's own shares.
- Company meetings.
- Alterations to capital structure.
- Financial assistance.
- Company investigations.
- Minority shareholder protections.
- Duties of directors in relation to conflicts of interest.

4.1.1 Requiring Information About Interests in Own Shares

In the UK, all shares are issued in registered form. However, the use of nominee names and delays in the settlement process may result in companies being unaware of the ultimate owner of particular shares. Section 793 of the Companies Act 2006 gives a public company the power to require shareholders to give information regarding their shareholding.

Under Section 793 of the Companies Act 2006, a UK public company is able to send a written notice to any person that the company knows or suspects to be a shareholder and ask them to confirm whether they are holding any shares. The notice requests details of that shareholder's total interest in the company.

The notice can also request details of past shareholdings held at any time in the last three years and, when the interest is a past interest, details of the identity of the person to whom the shares were sold if that is known. However, it is rare for such a notice to be sent by the company registrar to an individual shareholder. These letters are usually sent to the nominee companies that appear on the register. A nominee company is the legal owner of shares on behalf of another beneficial owner.

The letter is sent to the company secretary of the nominee company, requesting details of the true beneficial owner of the securities. Section 793 enables identification and confirmation of someone using the nominee company to hide their identity and accumulate a substantial holding without anyone being aware.

Notices under Section 793 require a written response from the recipient within a reasonable time as may be specified in the letter. If requests are persistently ignored, the company can apply to court to have the shares held frozen. This means the shareholders would lose their rights to vote on those shares, lose their entitlement to dividends and be unable to sell them. The company is required to keep a record of the Section 793 letters that have been sent, and the information received, in a separate part of its register of shareholders.

Similar disclosure and transparency requirements have been implemented in many other jurisdictions.

The investigation notice can be sent to existing shareholders asking them to reveal the ultimate owner of any shares held in their names. It may also be sent to a particular individual asking whether they have, in the last three years, been an owner of shares in the company, either directly or through concert parties. If the shareholder has sold their shares in the last three years, they should identify the person they sold them to.

In the absence of a response, companies may remove the voting/dividend rights of defaulting shareholders during the course of an investigation. If false information is provided the person is liable to a minimum penalty of two years in jail and/or an unlimited fine.

4.1.2 Company Meetings

While directors are responsible for making decisions regarding the day-to-day running of the business, decisions which affect the structure of a company or the rights of members are decided upon in a meeting of the shareholders.

Types of Meetings

The Companies Act provides general provisions as to the conduct and structure of company meetings which will apply in the absence of any provisions to the contrary in the company's Memorandum and Articles.

The two varieties of meeting are annual general meetings (AGMs) and general meetings (GMs). Because the latter are often dealing with pressing and urgent matters, they are often referred to as Extraordinary General Meetings (EGMs). AGMs must be held by public companies within six months of the end of the company's financial year. A GM/EGM may be held at any other time as required. The Companies Act 2006 removed the requirement for private companies to hold AGMs. All private company meetings are now on 14 days' notice (unless the Articles say otherwise) and it requires 90% of voters to agree to hold meetings at shorter notice.

Public Companies

All members and directors of a public company must be informed in writing (which includes posting on a website) in advance of the meeting and of the nature of the business to be transacted. This notice differs according to the type of meeting. An AGM requires 21 calendar days' notice, whereas an EGM requires 14 calendar days. The notice may be reduced, and an AGM held on short notice, if 100% of members entitled to attend a meeting vote in favour. This figure becomes 95% of members in the case of reduced notice for an EGM. Short notice is not available if the company's shares are publicly traded.

Members may require the company to circulate a statement regarding business at the meeting of up to 1,000 words provided that it is requested by either:

- members representing at least 5% of voting rights, or
- at least 100 shareholders holding at least £100 paid up shares each.

Resolutions

Decisions are made at company meetings via resolutions. Ordinary resolutions require only a simple majority (>50%) of votes cast at the meeting to be carried. Special resolutions cover more unusual matters, such as changes to a company's constitution or structure. Any meeting voting on special resolutions requires a 75% majority of votes cast to be passed. Unless specified to the contrary in the company's constitution, each member will be entitled to one vote in respect of each share held.

Resolutions may be proposed by the members provided they are legal and not defamatory, frivolous or vexatious. The request must be from members representing at least 5% of voting rights.

Meeting Conduct

Directors normally call the meeting and send out the required notice. However, members holding at least 5% of a company's voting shares may requisition that the directors call a GM. Directors must send out notice within 21 days of such a request, thereby convening a meeting. In exceptional circumstances, the courts may order that a meeting be held.

A meeting can only validly pass resolutions if it is quorate, a quorum is two members. Any member so elected may act as chairperson at any meeting.

Proxies

Any member entitled to attend and vote at a company's meeting is entitled to appoint another person (who may not be a member) as their proxy to attend and vote in their place. In a public company, a proxy may attend and vote, but may not exercise the member's right to speak.

4.2 Alterations to Capital Structure

The funds which a company raises from the issue of shares are generally maintained within the company as a permanent source of finance rather than being returned to shareholders. This concept of capital maintenance is of great importance within the Companies Act. However, there are various exceptions contained within the Companies Act whereby capital may be reduced.

A company may carry out a reduction of share capital, provided the Articles of Association permit it and a special resolution is passed in favour of the reduction. Private limited companies complete a solvency statement and plcs need confirmation by the court.

It can be done for any reason, but the Act specifically mentions three instances:

a. Extinguish or reduce the liability of shareholders or shares which are not fully paid up.
b. Cancel share capital which has been permanently lost and is thus no longer represented by assets.
c. Return capital to shareholders which is in excess of the company's needs.

4.3 Financial Assistance

Section 678 of the Companies Act 2006 provides that it is illegal for a public company directly or indirectly to give financial assistance for the purchase of its own shares (or those of its holding company). The reason for this is the principle of capital maintenance. Particularly relevant for corporate finance transactions, if a company provides financial assistance to allow a third party to buy its shares, by allowing its assets to be pledged as security for the bidder/acquirer's acquisition financing, it reduces its own assets without receiving compensation in exchange, and potentially reduces its ability to meet its debts as they fall due.

Financial assistance would include:

- a gift
- provision of a guarantee, security, indemnity, release or waiver, or
- any other form of assistance, whereby the company's net assets are reduced to a material extent.

Thus, many transactions are caught under these definitions, not just direct cash payments.

4.3.1 Consequences of Contravention

Any financial assistance in contradiction of these rules is void. In other words, all contracts in connection with it have no legal effect.

The company and its officers may be liable to a fine and/or two years' imprisonment.

Directors who are in breach of their duties are liable to the company for any losses.

4.3.2 Exceptions

There are various exceptions when transactions that would satisfy the definition of financial assistance are permitted. Such as:

- if the principal purpose of the transaction is not the provision of financial assistance
- if the financial assistance is an incidental part of a larger purpose
- when the assistance is lending in the ordinary course of business, or
- where a loan is made to employees as part of an Employee Share Scheme.

Furthermore, it should be noted that the financial assistance provisions relate only to public companies and not private companies, unless the private company is a subsidiary of a public company.

4.4 Company Investigations by Inspectors

The Companies Act gives members the right to apply to the Department for Business and Trade (DBT) to provide an inspector to investigate the company's affairs.
An inspector may be appointed by the DBT on application of:

- at least 200 members or holders of at least 10% of issued shares, or
- the company itself, if it has passed an ordinary resolution approving such an action.

Any applicant must provide £5,000 security for costs and must furnish the DBT with evidence to support their claim.

The Companies Act also gives the DBT the power to exercise their investigative powers at their discretion in the following three circumstances:

- the company has been conducting its affairs with intent to defraud auditors or in a manner prejudicial to members, or for unlawful or fraudulent purposes
- the promoters or managers have been guilty of fraud or any other act of misconduct, and
- the company has failed to provide proper information to the members.

The DBT has no obligation to warn the company or reveal the circumstances which led to the investigation.

The inspectors have very wide powers to obtain and require disclosure of information. They may also question any person on oath, obtain a warrant to search premises and finally inform the Secretary of DBT of any matters coming to their attention during the investigation.

The Secretary of State has the power to:

- give directions to an inspector as to the subject matter to be investigated (eg, area of operation, specific transactions or a period of time)
- terminate an investigation where criminal offence matters have been passed to a prosecuting authority, and
- set requirements for the contents and time limit of the inspector's report.

4.5 Minority Shareholder Protections

Sections 994–996 of the Companies Act 2006 make provisions for the protection of members against unfair prejudice. If members believe that their company or large shareholders are taking action against their interests, they may seek redress through the courts. This may result in the courts ordering the majority shareholder to buy out the minority shareholders at a fair price.

There are also specific provisions under s974–985 of the Companies Act 2006 which relate to situations following a takeover of a company and provide minority shareholders with an exit opportunity in certain circumstances.

If a bidder is successful enough to secure a total of 90% or more of the voting rights of a company, then under s979 they can compulsorily purchase ('squeeze out') the remaining minority shares. Section 983 also protects a minority in such circumstances by giving them the right to insist that the successful bidder buys them out – known as a 'sell out'.

4.6 Duties of Directors in Relation to Conflicts of Interest

A company's directors have a duty under s175 of the Companies Act 2006 to avoid situations which bring about a conflict of interest between the directors and the company, either directly or indirectly. Where the situation would not be regarded as likely to give rise to a conflict of interest or the dealings have been authorised by the directors, then this duty will not be considered to have been breached.

Examples of where such a conflict may arise include:

- A director having an interest such as a shareholding in a competitor whose interests conflict with the company with whom they hold the directorship.
- A director in company A, also holding the position of director in company B, whose services are used by company A. This would present possible conflicts of interest.
- Where the director offers services to the market in a personal capacity in direct competition to the company for whom they act as a director.

Generally, where there is doubt as to whether a conflict of interest exists or is likely to arise, the best practice is to disclose and declare any potential conflict of interest in the interests of transparency and so that no inadvertent breach of s175 occurs.

5. Corporate Governance Codes

5.1 The 2024 UK Corporate Governance Code

5.2.2 Be able to apply the main principles of the UK Corporate Governance Code and the QCA Corporate Governance Code in a given scenario

5.2.3 Know the similarities and differences between the principles of the UK Corporate Governance Code and the Disclosure Guidance and Transparency Rules (DTR)

Corporate governance is the system by which companies are directed and controlled. In the UK, the UK Listing Rules require companies listed in the commercial companies category or the closed-ended investment funds category to comply with the 2024 UK Corporate Governance Code (the Code), which applies regardless of where the companies are incorporated. Boards of directors are responsible for the governance of their companies.

The shareholder's role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The 2024 UK Corporate Governance Code is the latest version of the UK Corporate Governance Code that was first adopted into the UK Listing Rules in 1994.

Under the UK Listing Rules, commercial companies and closed-ended investment funds must apply the principles of the UK Corporate Governance Code and comply with, or explain against the provisions.

Corporate Governance is not only important for the largest companies, all companies should have appropriate systems, policies and practices in place, and consequently, many companies that are not required to follow the UK Corporate Code choose to do so voluntarily. While the UK Corporate Governance Code does not apply to private companies, large private companies that are in scope of The Companies (Miscellaneous Reporting) Regulations 2018 are required to disclose their corporate governance arrangements.

5.1.1 The Main Principles and Provisions of the Code

The UK Corporate Governance Code is not part of the UK Listing Rules. It is published by the Financial Reporting Council (FRC) and consists of principles (divided into five sections) and provisions. The principles are the core of the UK Corporate Governance Code and adherence with these ensures that companies adopt the spirit of the UK Corporate Governance Code.

As seen above, the UK Listing Rules require companies listed in the commercial companies category or the closed-ended investment funds category to apply the principles and to report to shareholders on how they have done so.

Each of the five sections of the UK Corporate Governance Code sets out the principles applicable and the provisions which help demonstrate how the principles should be applied. The principles provide guidance for companies, together with detailed provisions on the matters such as the design of performance-related remuneration, the duties of non-executive directors (NEDs), and disclosure of corporate governance arrangements. In addition, there are guidance and good practice suggestions. The UK Listing Rules do not require companies to comply with the provisions, but it is recognised that in most cases, the best corporate governance practice will be to adhere to the letter of these provisions.

The UK Listing Rules require disclosure of compliance throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code. If all provisions have not been complied with, then the company needs to set out:

- those provisions, if any, it has not complied with
- in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions, and
- the company's reasons for non-compliance.

The corporate governance system, therefore, is set up around a ‘comply or explain’ approach. Such an approach enables an alternative to complying with a provision. This also takes into account that it may be an approach that is beneficial or necessary for a company in particular circumstances based on a range of factors, including the size, complexity, geography and ownership structure of it.

The ‘comply or explain’ regime therefore offers flexibility, and it encourages companies to choose bespoke governance arrangements most suitable to their particular circumstances in both the short- and long-term. When departing from the UK Corporate Governance Code, companies should explain how their chosen alternative arrangement is more appropriate and beneficial in upholding high standards of governance.
The five sections of the UK Corporate Governance Code are detailed in the following text. The main principles are set out, and each include a summary of relevant guidance provisions.

5.1.2 Section 1 – Board Leadership and Company Purpose

Main Principles

- A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.
- The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.
- The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enables risk to be assessed and managed.
- In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.
- The board should ensure that workforce policies and practices are consistent with the company’s values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.

Guidance on Section 1

The provisions here focus on the business model and risks, company culture, regular engagement with shareholders, addressing and engaging with shareholder opposition and ensuring concerns are recorded in board minutes.

5.1.3 Section 2 – Division of Responsibilities

Main Principles

- The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates

constructive board relations and the effective contribution of all NEDs, and ensures that directors receive accurate, timely and clear information.

- The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no individual or small group of individuals dominates the board's decision-making. There should be a clear division of responsibilities between the leadership of the board and the executive leadership of the company's business.
- NEDs should have sufficient time to meet their board responsibilities. They should provide constructive challenges, strategic guidance, offer specialist advice and hold management to account.
- The board, supported by the company secretary, should ensure that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.

Guidance on Section 2

Except for smaller companies, at least half of the board should comprise independent NEDs. Independent non-executive directors must be identified in the Annual Report. The following factors are provided as circumstances which might suggest that a director is not independent. The individual:

- has been an employee of the company or group within the last five years
- has, or has had within the last three years, a material business relationship with the company
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme
- has close family ties with any of the company's advisers, directors or senior employees
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies
- represents a significant shareholder, and/or
- has served on the board for more than nine years from the date of their first election.

It should be noted that the independence of a director is referenced by other current or recent connections to the company or its executive directors such as employment, shareholdings, commercial arrangements or familial relations.

The provisions in this section focus on the independence of the chair and the NEDs, that half the board should be independent led by a senior independent director, that the NEDs have the prime role in appointing and removing executive directors, that the written responsibilities of the board and committee are clear, that there is sufficient time for the board to fulfil its responsibilities and that all directors have access to the company secretary.

5.1.4 Section 3 – Composition, Succession and Evaluation

Main Principles

- Appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan should be maintained for the board and senior management. Both appointments and succession plans should be based on merit and objective criteria and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.
- The board and its committees should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the board as a whole and membership regularly refreshed.
- Annual evaluation of the board should consider its composition, diversity and how effectively members work together to achieve objectives. Individual evaluation should demonstrate whether each director continues to contribute effectively.

Guidance on Section 3

The provisions in this section are focused on the use of effective board committees for nominations and remuneration, that all directors are subject to annual re-election, the tenure of the chair should not remain beyond nine years, the use of open advertising and external search for the appointment of the chair and NEDs, rigorous assessment of performance and suitability of the board, committees, the chair and individual directors and full disclosure of the nomination committee work.

5.1.5 Section 4 – Audit, Risk and Internal Control

Main Principles

- The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself with the integrity of financial and narrative statements.
- The board should present a fair, balanced and understandable assessment of the company’s position and prospects.
- The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

Guidance on Section 4

The provisions in this section focus on the establishment and effectiveness of the audit committee in performing its various roles and responsibilities – including its advice as to whether the annual report and accounts are fair, balanced and understandable, and any disclosures on significant issues, the directors’ responsibility statement for annual report and accounts, the robust assessment of emerging and principal risks, monitoring of risk management and internal control systems and the going concern and viability statement.

5.1.6 Section 5 – Remuneration

Main Principles

- Remuneration policies and practices should be designed to support strategy and promote long- term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company's long-term strategy.
- A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration should be established. No director should be involved in deciding their own remuneration outcome.
- Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances.

Guidance on Section 5

The various provisions in this section are centred around the establishment of the remuneration committee and its role in setting remuneration which must be linked to long-term performance and should address key issues including clarity, simplicity, risk, predictability, proportionality and alignment to culture, reporting on any use of remuneration consultants, the independence of the remuneration committee (including its ability to override formulaic outcomes), that pensions are based on basic salary, that notice or contract periods should be kept to less than one year where possible, and that the work of the remuneration committee is described in the annual report.

5.2 QCA Corporate Governance Code

Companies quoted on AIM are required to follow a recognised corporate governance code on a 'comply or explain' basis.

The Quoted Companies Alliance (QCA) introduced the QCA Corporate Governance Code 2023, which is specifically tailored for smaller, growing companies whether already traded on a public market or privately owned. The QCA code is available on the QCA's website (**www.theqca.com**) and is intended to be a simpler alternative to the UK Corporate Governance Code.

While similar in its broad approach to the UK Corporate Governance Code, the QCA Code is somewhat less prescriptive and based on ten principles:

Principle 1	Establish a purpose, strategy, and business model that promotes long-term value for shareholders.
Principle 2	Promote a corporate culture based on ethical values and behaviours.
Principle 3	Seek to understand and meet shareholder needs and expectations.

Principle 4	Take into account wider stakeholder interests, including social and environmental responsibilities, and their implications for long-term success.
Principle 5	Embed effective risk management, internal controls and assurance activities, considering both opportunities and threats throughout the organisation.
Principle 6	Establish and maintain the board as a well-functioning, balanced team led by the chair.
Principle 7	Maintain appropriate governance structures and ensure that, individually and collectively, directors have the necessary up-to-date experience, skills and capabilities.
Principle 8	Evaluate board performance based on clear and relevant objectives, seeking continuous improvement.
Principle 9	Establish a remuneration policy which is supportive of long-term value creation and the company's purpose, strategy and culture.
Principle 10	Communicate how the company is governed and is performing by maintaining a dialogue with shareholders and other key stakeholders.

It should be clear where these communication practices are described (annual report or website).

5.3 Overlap with the FCA Disclosure Guidance and Transparency Rules

The Disclosure Guidance and Transparency Rules are a subset of FCA rules that appear in and are part of the FCA's Handbook.

Broadly, the purpose of disclosure rules is to promote prompt and fair disclosure of relevant information to markets and to set out circumstances when disclosure can be delayed or kept confidential, while the purpose of transparency rules is to ensure there is adequate transparency of, and access, to information in the financial markets.

The following table shows the overlap between the Corporate Governance Code and requirements in the FCA's Disclosure Guidance and Transparency Rules relating to corporate governance matters. Evident from the table (which is in summary form) is the extent of the rules and the extent to which consideration must be given by a company (and its advisers) to ensure appropriate disclosure is made, and compliance with the Corporate Governance Code is achieved.

References to the source rules are provided for information.

	UK Corporate Governance Code	FCA Disclosure Guidance and Transparency Rules
Composition of the audit committee	The board should establish an audit committee of independent NEDs, with a minimum membership of three, or in the case of smaller companies, two. The chair of the board should not be a member. The board should satisfy itself that at least one member has recent and relevant financial experience. The committee as a whole shall have competence relevant to the sector in which the company operates (Provision 24).	A majority of the members of the relevant body must be independent. At least one member of the relevant body must have competence in accounting or auditing, or both. The members of the relevant body as a whole must have competence relevant to the sector in which the issuer is operating. (DTR 7.1.1 R)
Responsibility of the audit committee	The main roles and responsibilities of the audit committee should include: • monitoring the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, and reviewing significant financial reporting judgements contained in them • providing advice (where requested by the board) on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy • reviewing the company's internal financial controls and internal control and risk management systems, unless expressly addressed by a separate board risk committee composed of independent NEDs, or by the board itself • monitoring and reviewing the effectiveness of the company's internal audit function or, where	An issuer must ensure that, as a minimum, the relevant body must: 1. monitor the financial reporting process and submit recommendations or proposals to ensure its integrity 2. monitor the effectiveness of the issuer's internal quality control and risk management systems and, where applicable, its internal audit, regarding the financial reporting of the issuer, without breaching its independence 3. monitor the statutory audit of the annual and consolidated financial statements, in particular, its performance, taking into account any findings and conclusions by the FRC under article 26(6) of the Audit Regulation 4. review and monitor the independence of the statutory auditor in accordance with paragraphs 2(3), 2(4), 3 to 8 and 10 to 12 of Schedule 1 to the Statutory Auditors and Third Country Auditors Regulations 2016 (SI 2016/649) and Article 6 of the Audit Regulation, and in particular the appropriateness of the provision of non-audit services to the issuer in

	there is not one, considering annually whether there is a need for one and making a recommendation to the board • conducting the tender process and making recommendations to the board, about the appointment, reappointment and removal of the external auditor, and approving the remuneration and terms of engagement of the external auditor • reviewing and monitoring the external auditor's independence and objectivity • reviewing the effectiveness of the external audit process, taking into consideration relevant UK professional and regulatory requirements • developing and implementing policy on the engagement of the external auditor to supply non-audit services, ensuring there is prior approval of non-audit services, considering the impact this may have on independence, taking into account the relevant regulations and ethical guidance in this regard, and reporting to the board on any improvement or action required, and • reporting to the board on how it has discharged its responsibilities (*Provision 25*).	accordance with Article 5 of the Audit Regulation 5. inform the administrative or supervisory body of the issuer of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the relevant body was in that process, and 6. be responsible for the procedure for the selection of statutory auditor(s) and recommend the statutory auditor(s) to be appointed in accordance with article 16 of the Audit Regulation (*DTR 7.1.3 R).*

Disclosures related to the audit committee	1. The responsibilities of the chair, chief executive, senior independent director, board and committees should be clear, set out in writing, agreed by the board and made publicly available. The annual report should set out the number of meetings of the board and its committees, and the individual attendance by directors (*Provision 14*). 2. The annual report should describe the work of the audit committee (*Provision 26*).	An issuer must make a statement available to the public disclosing which body carries out the functions required by DTR 7.1.3 R and how it is composed (*DTR 7.1.5 R*). In the FCA's view, compliance with Provisions 14, 24, 25 and 26 of the UK Corporate Governance Code and following the statement of good practice set out in paragraph 63 of the 'Guidance on Board Effectiveness' published by the FRC in July 2018 will result in compliance with DTR 7.1.1 R to DTR 7.1.3R and with DTR 7.1.5R except as regards disclosing how the body which carries out the functions required by DTR 7.1.3R is composed (*DTR 7.1.7 G*).
Statement relating to internal controls	The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls. (*Provision 29*)	The corporate governance statement must contain a description of the main features of the issuer's internal control and risk management systems in relation to the financial reporting process (*DTR 7.2.5 R*).
Statement relating to board committees	• The responsibilities of the chair, chief executive, senior independent director, board and committees should be clear, set out in writing, agreed by the board and made publicly available. The annual report should set out the number of meetings of the board and its committees, and the individual attendance by directors *(Provision 14).* • The annual report should describe the work of the nomination committee *(Provision 23).*	The corporate governance statement must contain a description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees. (*DTR 7.2.7 R*) In the FCA's view, the information specified in Provisions 14, 20, 23, 26, 35 and 41 of the UK Corporate Governance Code and paragraph 63 of the *'Guidance on Board Effectiveness'* published by the FRC in July 2018 will satisfy the requirements of DTR 7.2.7 R, except as regards a description of the composition of the issuer's administrative, management and supervisory bodies and their committees. (*DTR 7.2.8 G*)

	• The annual report should describe the work of the audit committee *(Provision 26).* • There should be a description of the work of the remuneration committee in the annual report *(Provision 41).*	

Case Study 1

Please use the following scenario to answer questions 1 and 2:

A legal adviser is providing a briefing to the board of an established private company that is considering listing. The briefing will specifically cover two areas:

1. The regulations around the provision of financial assistance to enable third parties to buy the company's own shares.
2. The structure of the Corporate Governance Code applicable to listed companies.

Question 1

The financial assistance briefing is likely to cover which of the following? Please select all that apply.

A. The principle of capital maintenance
B. The comply or explain approach
C. Legality under Companies Act 2006
D. Consequences of any contravention

Question 2

The Corporate Governance Code briefing is likely to cover which of the following? Please select all that apply.

A. That the Code consists of both 'principles' and 'provisions'
B. The comply or explain approach
C. A section on executive remuneration
D. The overlap with the FCA's Disclosure, Guidance and Transparency Rules

The answer to this exercise can be found at the end of this workbook.

6. Financial Promotions and Misleading Statements

6.1 Financial Promotions

5.3.2 Be able to interpret the key provisions of Section 21 (financial promotions) of the Financial Services and Markets Act (FSMA) as they relate to corporate finance transactions

A financial promotion is an invitation or inducement to engage in investment activity. The term, therefore, describes most forms and methods of marketing financial services. It covers traditional advertising, most website content, telephone sales campaigns and face-to-face meetings.

The purpose of regulation in this area is to create a regime where the quality of financial promotions is scrutinised by an authorised firm who must then comply with lengthy rules to ensure that their promotions are clear, fair and not misleading (FCA Principle for Businesses 7) and that customers are treated fairly (FCA Principle for Businesses 6).

6.1.1 Application of the Financial Promotions Rules

The financial promotions rules apply to a firm:

- communicating with a client in relation to designated investment business other than a third-party prospectus
- communicating or approving a financial promotion (with some exceptions) in respect of:
    - non-investment insurance contracts, and
    - unregulated collective investment schemes (CISs).

The financial promotion rules do apply to corporate finance contacts and **venture capital** contacts.

6.1.2 Fair, Clear and Not Misleading

A firm must ensure that a communication or financial promotion is fair, clear and not misleading, and is appropriate and proportionate considering the means of communication and the information to be conveyed.

Some specific interpretations of this are as follows:

- If a product or service places a client's capital at risk, this should be made clear.
- Any yield figure quoted should give a balanced impression of both short- and long-term prospects for the investment.
- Sufficient information must be provided to explain any complex charging arrangements, taking into account recipients' needs.
- The regulator (FCA) should be named, and any non-regulated aspects made clear.
- A fair, clear and not misleading impression should be given of the producer for any packaged or stakeholder products not produced by the firm.

A firm must ensure that a financial promotion addressed to a client is clearly identifiable as such.

6.1.3 Excluded Communications

A firm may rely on one or more instances which make a communication an excluded communication for the purposes of the rules. The exclusions include:

- A financial promotion that is subject to, or exempted from, the Takeover Code.
- A one-off financial promotion that is not a cold call. The following conditions indicate that the promotion is a 'one-off', but they need not necessarily be present for a promotion to be considered as one-off.
    - The financial promotion is communicated only to one recipient or only to one group of recipients in the expectation that they would engage in any investment activity jointly.
    - The identity of the product or service to which the financial promotion relates has been determined having regard to the particular circumstances of the recipient.
    - The financial promotion is not part of an organised marketing campaign.

6.1.4 Financial Promotions Order

Section 21 of the Financial Services and Markets Act 2000 makes it criminal for someone to undertake a financial promotion, ie, invite or induce another to engage in investment activity, unless they are either:

- an authorised firm (ie, issuing the financial promotion), or
- the content of the communication is approved by an authorised firm.

Contravention of s21 is punishable by up to two years in jail and an unlimited fine.

There are a number of exemptions from s21 set out in the Financial Promotions Order. The effect of being an exemption is that the promotion would not need to be issued or approved by an authorised firm. It would therefore not have to comply with the detailed financial promotion rules.

The main examples are as follows.

Exemption	Comments
Investment professional	A communication to an authorised or exempt person.
Deposits and insurance	Very limited application of COBS.
Certified high net worth individuals	Anyone may promote unlisted securities to persons who hold certificates of high net worth (normally signed by their accountant or employer, however, these can be self-certified by an individual) and who have agreed to be classified as such. Requirements for a certificate are that a person must have a net income of £100,000 or more, or net assets (excluding principal property) of £250,000 or more.
Associations of high-net- worth individuals	Anyone can promote non-derivative products to associations of high-net-worth investors.
Sophisticated investors	Anyone can promote products to a person who holds a certificate indicating that they are knowledgeable in a particular stock (signed by a firm or self-certified) and who have signed a statement agreeing to be such.
Takeover Code	Promotions subject to the Takeover Code.

Of particular relevance in relation to corporate finance transactions are a number of provisions under the Financial Promotion Order (FPO) which provide specific exemptions from the requirements of the financial promotion rules.

There are a number of exemptions, some of which are available to unauthorised persons (including those regulated by designated professional bodies (DPBs)) exempting them from complying with the financial promotion rules:

- the sale of a body corporate (eg, an information memorandum in relation to a company sale)
- offering qualifying credit to corporate entities
- communications by a company to its shareholders and creditors, and
- prospectuses and supplementary prospectuses approved by the FCA.

Consequently, the relevance of financial promotion provisions under Section 21 FSMA 2000 in the context of an acquisition is, on account of exemptions available, very limited.

Notwithstanding the above, it is worth noting a recent development in relation to the financial promotions regime.

While the regime to date has permitted any authorised firm to approve any financial promotion of an unauthorised firm, the introduction by the Financial Services and Markets Act 2023 of a new ‘Financial Promotions Gateway’ which authorised firms must pass through before being able to approve, as they could to date, financial promotions for an unauthorised firm, has introduced some changes to the regime.

Under the 2023 Act, an authorised firm must obtain permission from the FCA before they may approve financial promotions of an unauthorised person. The intent is that the introduction of the gateway will encourage greater scrutiny of financial promotions before they are authorised which, in turn, will mean consumers of such financial promotions will be more suitably protected. Nevertheless, it remains the case that in relation to corporate finance transactions such as acquisitions or disposals, the financial promotion regime, including after the introduction of a revised regime, will continue to benefit from the exemptions as explained above.

6.2 Misleading Statements and Impressions

6.2.1 Misleading Statements

Section 89 of the 2012 Financial Services Act covers misleading statements. Under s89, it is an offence to:

a. make a statement which the person, P, making the statement knows to be false or misleading in a material respect
b. make a statement which is false or misleading in a material respect, being reckless as to whether it is, or
c. dishonestly conceal any material facts whether in connection with a statement made by P or otherwise.

P commits an offence if P makes the statement or conceals the facts with the intention of inducing, or is reckless as to whether making it or concealing them may induce, another person to:

a. enter into or offer to enter into, or to refrain from entering or offering to enter into, a relevant agreement, or
b. exercise, or refrain from exercising, any rights conferred by a relevant investment.

The provisions under Section 89 also apply to a person who creates a false or misleading impression of the market for, or the price of, an investment. An offence is committed if this is done in order to induce another person to acquire, dispose of, underwrite, subscribe for, or exercise rights in relation to, those investments, or to refrain from doing any of these things.

6.2.2 Misleading Impressions

Section 90 of the 2012 Financial Services Act covers misleading impressions.
A person (‘P’) who does any act or engages in any course of conduct which creates a false or misleading impression as to the market or the price or value of any relevant investments, commits an offence if P intends to create the impression.

6.2.3 Manipulation of Benchmark Rates

Finally, in response to the LIBOR scandal, s91 created a new offence which deals with the manipulation of benchmark rates. In summary, offences are committed if misrepresentations are made in the course of setting the benchmark, or if false impressions are given as to the value of an investment that may in due course have an impact upon the benchmark rate.

6.2.4 Penalties

This is a criminal offence, and the maximum penalty is seven years' imprisonment and/or an unlimited fine. The fine is often referred to as the 'statutory fine'.

7. Other Investment Business Regulations

5.3.3 Be able to interpret key aspects of the UK Markets in Financial Regulation and the FCA's Conduct of Business Sourcebook for firms conducting designated investment business: client categorisation; conflicts of interest; investment research; personal account dealing rules

In the context of corporate finance transactions such as acquisitions, a number of additional regulatory provisions will routinely be relevant.

Under the FCA's Conduct of Business Sourcebook, and the UK Markets in Financial Instruments Regulation, firms that conduct designated investment business must comply with a significant number of regulations governing their investment advisory, transactional and investment activities.

While each regulatory provision is equally important, most relevant in relation to an acquisition transaction are likely to be provisions relating to the following:

7.1 Client Categorisation

Chapter 3 of the FCA's Conduct of Business sourcebook (COBS 3) identifies three different categories of client: retail clients, professional clients and eligible counterparties. Broadly, retail clients are defined as those clients that are not a professional client or an eligible counterparty, while professional clients are defined as those clients that possess the experience, knowledge and expertise to make their own investment, and eligible counterparties include banks, insurers, investment funds, pension funds and other institutional and financial markets' participants.

The full range of FCA rule protections apply to retail clients whereas more limited rules apply to clients classified as professional clients, and even less protection is provided to eligible counterparties on grounds that they have the most expertise in securities, products and activities which the FCA oversees.

Prior to embarking on any transactional activities, an FCA authorised firm must categorise their client in order to ensure that the appropriate level of protection, and information, is provided to the client. In the context of corporate finance transactions, it is likely that in many circumstances, clients would be categorised as eligible counterparties and to a lesser extent, as professional clients.

8. Conflicts of Interest

A conflict of interest in respect of a corporate finance firm may arise when:

- the firm has more than one interest in a transaction, or
- the multiple interests may impact or appear to impact the firm's ability to deliver independent financial advice.

The FCA requires that all UK-based firms properly identify and correctly manage actual and potential conflicts of interest that arise within their business areas. Compliance with the FCA rules on conflicts of interest is one way firms ensure that customers are treated fairly, and that conflicts of interest are identified and managed effectively.

Under the conflicts of interest rules, firms are required to act honestly, fairly and professionally in accordance with the best interests of their clients. These rules also reflect the FCA's Principles for Businesses (Principle 8), with the detailed rules contained in SYSC.

The rules require that firms take all reasonable steps to identify conflicts of interest between:

- the firm, including its managers, employees, appointed representatives/tied agents and parties connected by way of control and a client of the firm, and
- one client of the firm and another.

Firms under these obligations should, inter alia:

- maintain (and apply) effective organisational and administrative arrangements designed to prevent conflicts of interest from adversely affecting the interests of their clients
- for those producing externally facing investment research, have appropriate information controls and barriers to stop information from these research activities from flowing to the rest of the firm's business (for example, this may include Chinese walls/information barriers)
- where a specific conflict cannot be managed away, ensure that the general or specific nature of it is disclosed (as appropriate to the circumstances). Note that disclosure should be used only as a last resort
- prepare, maintain and implement an effective conflicts policy
- provide retail clients and potential retail clients with a description of that policy, and
- keep records of those of its activities when a conflict has arisen.

Principle 8 of the Principles for Businesses states that *'a firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client'*. Therefore, Principle 8 requires that authorised firms ensure that when conflicts of interest materialise, they manage the conflicts to ensure that customers are treated fairly. The requirements of the SYSC conflicts of interest provisions will apply only when a service is provided by a firm. The status of the client to whom the service is provided (as a retail client, professional client or eligible counterparty) is irrelevant for this purpose.

8.1 Identifying Conflicts

To identify the types of conflict of interest that arise, or may arise, in the course of the firm providing a service and whose existence may entail a material risk of damage to the interest of a client, the firm must take into account whether the firm, or a person directly or indirectly linked by control to the firm:

- is likely to make a financial gain, or avoid a financial loss, at the expense of the client
- has an interest in the outcome of a service provided to the client, or of a transaction carried out on behalf of the client, which is different from the client's interest in that outcome
- has a financial, or other, incentive to favour the interest of another client, or group of clients, over the interest of the client
- carries on the same business as the client, and/or
- receives, or will receive, from a person other than the client an inducement in relation to a service provided to the client, in the form of monies, goods or services other than the standard commission or fees for that service.

Conflicts of interest may arise if the firm, or person, carries on a regulated activity or ancillary activity, provides ancillary services, or engages in other activities. For non-common-platform firms, the above requirements must be taken as being guidance rather than a rule, except when the firm produces or arranges the production of investment research in accordance with COBS 12.2 (investment research and non-independent research).

When a firm is managing a securities offering, its duty is to its corporate finance client (often the corporate issuer or seller of the relevant securities). However, its responsibilities to provide services to its investment clients remain unchanged. This situation must be carefully controlled to ensure that inside information about the corporate finance client is not provided to investment clients (as covered by the UK Market Abuse Regulation (UK MAR)), and that the pricing of the securities offer and the allocation of securities are not influenced by the interests of the firm's investment clients.

Measures a firm might consider in developing its conflicts of interest policy for managing a securities offering include:

- agreeing with its corporate finance client on relevant aspects of the offering process at an early stage, such as the process the firm proposes to follow to determine recommendations about allocations for the offering:
    - how the target investor group will be identified

    - how recommendations on allocation and pricing will be prepared
    - whether the firm may place securities with its investment clients or with its own proprietary book, or with an associate, and how conflicts arising might be managed

- agreeing allocation and pricing objectives with the corporate finance client
- inviting the corporate finance client to participate actively in the allocation process
- making the initial recommendation for allocation to retail clients of the firm as a single block and not on a named basis
- having internal arrangements under which senior personnel responsible for providing services to retail clients make the initial allocation recommendations for allocation to retail clients of the firm, and
- disclosing to the issuer details of the allocations actually made.

An example of a conflict would be a firm advising a client on the acquisition of a company in which the same firm held a material interest.

8.2 Managing, Disclosing and Recording Conflicts

8.2.1 Managing Conflicts

A firm must maintain and operate effective organisational administrative arrangements to ensure that it is taking all reasonable steps to prevent conflicts of interest arising (as defined in SYSC 10.1.3) and from constituting or giving rise to a material risk of damage to the interests of its clients.

Firms will require the following processes and procedures to manage conflicts of interest and ensure the fair treatment of clients:

- information barriers, such as reporting lines
- remuneration structures
- segregation of duties, and
- policy of independence.

Information barriers (sometimes also referred to as ‘Chinese walls’) are arrangements made by a firm to manage conflicts of interest where the information held by an employee in one part of the business must be withheld from (or, if this is not possible, at least not used by) people working in another part of the business.

There is no requirement for a firm to have information barriers in place; they are just one example of how to manage conflicts of interest. However, SYSC requires that if a firm establishes and maintains such practices, then it must:

- withhold or not use the information held
- for that purpose, permit its employees in one part of the business to withhold the information from those employed in another part of the business, but only to the extent that at least one of those parts of the business is carrying on regulated activities, or another activity carried on in connection with a regulated activity, and

- take reasonable steps to ensure that these arrangements remain effective and are adequately monitored.

It need only do so to the extent that at least one of those parts of the business is carrying on regulated activities, or another activity carried on in connection with a regulated activity.

The requirement to maintain information barriers includes taking reasonable steps to ensure these arrangements remain effective and adequately monitored.

When a firm establishes and maintains information barriers, it allows the persons on one side of the wall (eg, corporate finance) to withhold information from persons on the other side of the wall (eg, equity research/market-making arm), but only to the extent that one of the parts carries on regulated activities, ancillary activities or MiFID ancillary services.

For example, an information barrier between the corporate finance department and the equity research department would isolate the equity research department from plans for a client company that would change the valuation of that company's shares. The inability to pass this knowledge on to clients is not seen as a failure of duty to their clients.

A firm will not be guilty of the offences of misleading statements and misleading impressions (Sections 89, 90 FSA 2012), market abuse (UK MAR), or be liable to a lawsuit under S.138D FSMA when the failure arises from the operation of an information barrier.

Firms may use the following additional processes and procedures in order to manage conflicts of interest and ensure the fair treatment of clients (SYSC 10.2): information barriers such as reporting lines; remuneration structures; segregation of duties; and policy of independence.

8.2.2 Disclosing Conflicts

When the arrangements that a firm puts in place to manage potential conflicts of interest are not sufficient to ensure, with reasonable confidence, that the risk of damage to the interest of a client will be prevented, the firm must clearly disclose the general nature and/or source of conflicts of interest to the client before undertaking business for/on behalf of the client.

Disclosure must be made in a durable medium and include sufficient detail, taking into account the nature of the client, to enable that client to make an informed decision with respect to the service in the context of which the conflict of interest arises. The FCA has defined 'durable medium' as paper or any instrument which enables the recipient to store information addressed personally to them in a way which is accessible for future reference for a period of time adequate for the purposes of the information.

While disclosure of specific conflicts of interest is required under SYSC 10.1.8, over reliance on disclosure without adequate consideration of how conflicts may be appropriately managed is not permitted. Therefore, the disclosure of a conflict of interest should be undertaken as a last resort, if internal controls (managing conflicts) do not sufficiently mitigate the risk of material damage to the client's best interests.

8.2.3 Recording Conflicts

Firms must keep and regularly update a record of the kinds of services or activities carried out by, or on behalf of, the firm in which a conflict of interest entailing a material risk of damage to the interest of one or more clients has arisen or, in the case of an ongoing service or activity, may arise.

8.3 Conflicts of Interest Policies

Firms are required to have in place (and apply) an effective conflicts of interest policy, which is set out in writing and is appropriate to the size and organisation of the firm and the nature, scale and complexity of its business. The rules do not prescribe how the policy should be structured so large and complex firms may have more detailed policies than smaller and simpler ones.

SYSC requires that the policy should be designed to ensure that all of a firm's relevant persons who are engaged in activities that involve a conflict of interest with material risk of damage to client interests carry on those activities with a level of independence. The policy should record the circumstances which constitute, or may give rise to, a conflict of interest if they have been identified as having the potential to impact the firm's business, and should detail how these are to be managed, specify the procedures that are to be followed, and outline the measures adopted in order to manage such conflicts.

If a firm is a member of a group, the policy should take into account any potential conflicts arising from the structure or business activities of other members of that group.

The procedures and measures provided for must:

- be designed to ensure that relevant persons engaged in different business activities involving a conflict of interest of the kind specified above carry on those activities at a level of independence appropriate to the size and activities of the common-platform firm and of the group to which it belongs, and to the materiality of the risk of damage to the interests of clients
- include the following as necessary and appropriate for the common-platform firm to ensure the requisite degree of independence:
    - have effective procedures to prevent or control the exchange of information between relevant persons if the exchange of that information may harm the interests of one or more clients
    - ensure the separate supervision of relevant persons whose principal functions involve carrying out activities and represent different interests that may conflict, including those of the firm
    - remove any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, another activity
    - include measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out services or activities, and

- have measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate services or activities if such involvement may impair the proper management of conflicts of interest.

If the adoption or the practice of one or more of those measures and procedures does not ensure the requisite level of independence, a firm should adopt such alternative or additional measures and procedures as are necessary and appropriate.

8.4 Conflicts of Interest in Relation to Investment Research and Research Recommendations

In general, the conflict management rules on the production and dissemination of investment research apply to all firms. The requirements for certain disclosures in connection with research recommendations are derived from MAR.

8.4.1 Measures and Arrangements

If a firm produces investment research, it must implement all the measures for managing conflicts of interest set out in SYSC 10.1.11 in relation to the financial analysts involved in producing research, and other relevant persons, if their interests may conflict with those to whom it is disseminated. The SYSC rules prescribe the contents of a firm's conflicts of interest policy.

Firms must also ensure that they have in place arrangements designed to ensure that the following conditions are satisfied:

- Financial analysts and other relevant persons who know the likely timing/content of investment research which is not yet publicly available or available to clients and which cannot be inferred from information that is so available. They cannot undertake personal transactions, or trade for others, until the recipient of the investment research has had a reasonable opportunity to act on it. However, there are certain exceptions, such as the receipt of an instruction from an execution-only client or a market-maker acting in good faith.
- In cases not covered by the above, they cannot undertake personal account transactions without prior approval from the firm's compliance or legal department, and then only in exceptional circumstances.
- A physical separation exists between the financial analysts involved in the production of investment research and other relevant persons whose responsibilities, or business interests, may conflict with the interests of the persons to whom the investment research is disseminated or, when considered not appropriate to the size and organisation of the firm as well as the nature, scale and complexity of its business, the establishment and implementation of appropriate alternative information barriers.
- The firm and any person involved in the production of research must not accept inducements from those with a material interest in the subject matter of the research.
- The firm may not promise issuers favourable research coverage.
- Issuers, relevant persons other than financial analysts, or anyone else must not be allowed to review draft investment research which includes a recommendation or target price other than to verify compliance with the firm's legal obligations.

Some conflict management rules are disapplied to the extent that a firm produces non-independent research labelled as a marketing communication.

It is generally accepted that investment research plays a crucial role in providing analysis and forecasts to potential and existing investors. Historically, brokerage firms typically 'bundled' research costs with execution commissions (ie, the cost was charged to clients to trade in shares). In January 2018, MiFID II introduced requirements to separate charges for execution and charges for research, thereby 'unbundling' these two services. Firms were required to either pay for research themselves from their own resources (referred to as the profit and loss or P&L model) or agree a separate research charge with their clients (referred to as the Research Payment Account or RPA model).

In August 2024, the FCA added an option for UK MiFID investment firms to pay for research using combined payments for trade execution and research. The approach to the allocation across clients of the costs of research purchased through joint payments must be appropriate and fair, such that the relative costs incurred by clients are commensurate with relative benefits received. This same joint payment option was extended to UK fund managers (AIFMs and UCITS management companies) from 9 May 2025.

The EU has also relaxed its rules. On 4 December 2024, the EU Listing Act rolled back the strict MiFID II unbundling requirements and reallowed joint payments. The deadline by which EU Member States must transpose the changes introduced by the Listing Act into their national laws is 5 June 2026.

Under Research Payment Account (RPA), the total amount of research charges received may not exceed the research budget set by the investment firm for the purpose of establishing the need for third-party research. Similarly to the general inducement regime, the research specific inducements rules include reporting and record-keeping obligations. Where a firm makes use of the RPA, it is required to provide the following information to clients:

- before the provision of an investment service to clients, information about the budgeted amount for research and the amount of the estimated research charge for each of them, and
- annual information on the total costs that each of them has incurred for third-party research.

8.4.2 Required Disclosures

Information must be objectively presented and conflicts of interest disclosed – including those concerning the relevant financial instruments. Article 20 of UK MAR provides the relevant rules in relation to the fair presentation and disclosure associated with the investment recommendations.

- Article 3 of UK MAR has obligations relating to the objective presentation, including:

    a. facts are clearly distinguished from interpretations, estimates, opinions and other types of non-factual information
    b. all substantially material sources of information are clearly and prominently indicated

c. all sources of information are reliable or, where there is any doubt as to whether a source is reliable, this is clearly indicated
d. all projections, forecasts and price targets are clearly and prominently labelled as such, and the material assumptions made in producing or using them are indicated, and
e. the date and time when the production of the recommendation was completed are clearly and prominently indicated.

- Where the disclosure of the information required in points (b) or (e) is disproportionate in relation to the length or form of the recommendation, including in the case of a non-written recommendation that is made using modalities, (such as meetings, roadshows, audio or video conferences, as well as radio, television or website interviews), the person who produces the recommendations shall state in the recommendation where the required information can be directly and easily accessed by the persons receiving the recommendation free of charge.
- Persons who produce recommendations shall substantiate any recommendation they have produced to the FCA upon its request.

9. Personal Account Dealing (COBS 11.7)

9.1 Personal Account Dealing Rules

These rules apply to employees who are relevant persons and involved in activities that could lead to conflicts of interest or have access to inside or other confidential client information. Relevant persons include:

- directors
- managers
- partners
- appointed representatives, or
- those carrying out regulated activities.

Note that COBS 11.7 does not apply to MiFID business; COBS 11.7A contains the equivalent requirements for firms carrying on MiFID, equivalent third-country, or optional exemption business.

Firms must establish, implement, and maintain adequate arrangements to prevent certain activities when:

- these activities may give rise to conflicts of interest
- the individual involved in these activities has access to inside information, as defined in UK MAR, or
- the individual involved in these activities has access to other confidential information relating to clients or transactions with or for clients.

Firms must have arrangements to prevent employees from:

1. entering into a personal transaction that is contrary to MAR involves misuse or improper disclosure of confidential information, or conflicts with the firm's duties to a customer
2. improperly advising or procuring that anyone else enters into a transaction that (if it had been done by the employee themselves) would have fallen foul of 1. above or of a relevant provision, or
3. improperly disclosing information or opinion, if they know or should know that the person to whom they have disclosed it is likely to enter into a transaction that (if it had been done by the employee themselves) would have fallen foul of 1. above or of a relevant provision, or encouraging someone else to do so.

The relevant provisions are:

- The rules on personal account transactions undertaken by financial analysts contained elsewhere in COBS (ie, investment research – COBS 12.2).
- The rules on the misuse of information relating to pending client orders.

Firms must keep records of all personal transactions notified to them, and of any authorisation or prohibition made in connection with them.

9.2 Compliance with, and Exceptions to, the Personal Account Dealing Rules

Firms must ensure that employees are aware of restrictions on personal transactions and the firm's procedures. Arrangements must ensure the firm is promptly informed of any personal transaction, either by notification of the transaction or through other means that enable the firm to identify it.

When outsourcing, firms must ensure the outsourcing firm maintains records of personal transactions undertaken by any relevant person and provides them promptly upon request.

The rules on personal account dealing are not applied to:

- deals under a discretionary management service if there is no prior communication between the portfolio manager and the relevant person (or any other person for whose account the transaction is being executed) about the deal
- deals in units/shares in certain classes of the fund if the relevant person (and any other person for whom the deals are effected) is not involved in the management of the fund, or
- personal transactions in life policies.

10. Market Abuse and Insider Dealing

10.1 Market Abuse

5.4.1 Be able to interpret the following key aspects of the UK Market Abuse Regulation to a given corporate finance scenario: the five offences of market abuse; qualifying investment and markets; defences and penalties; reporting suspicious transactions; the FCA's Code of Market Conduct; price stabilisation and buybacks

Market abuse is a statutory offence that covers financial market manipulation and insider dealing. It is a serious offence that can damage investor confidence and the integrity of financial markets.

Certain types of behaviour, such as insider dealing and market manipulation, can amount to market abuse. Types of conduct constituting market abuse are set out in the UK Market Abuse Regulation (UK MAR), and came into effect in the UK and across the EU on 3 July 2016, replacing existing requirements under the Market Abuse Directive and FSMA.

Market abuse is a civil offence which provides an alternative civil regime for enforcing the criminal prohibitions on insider dealing and market manipulation.

The territorial scope of market abuse is very wide. It covers everyone, not just authorised firms and approved persons. Furthermore, firms or persons outside the UK are also covered by the offence.

As market abuse is a civil offence, the FCA must prove, on the balance of probabilities, that a person is:

- engaged in market abuse, or
- by taking or refraining from action required or encouraged another person to engage in market abuse.

10.1.1 The Definition of Market Abuse

UK MAR describes market abuse as '*a concept that encompasses unlawful behaviour on the financial markets*'. For the purposes of UK MAR, this should be understood as comprising:

- insider dealing
- unlawful disclosure of inside information, and
- market manipulation.

Unlawful behaviour of this kind 'prevents full and proper market transparency' and adversely impacts trading in integrated financial markets.

In all three cases, the behaviour is judged on the basis of what a reasonable investor of the market would view as a failure to observe the standards of behaviour normally expected in the market, or what a reasonable person would consider appropriate.

10.1.2 The Five Offences of Market Abuse

The five types of behaviour which can constitute market abuse are:

1. **Insider dealing** – where an insider deals in, or attempts to deal in, a qualifying investment or a related investment on the basis of inside information. For market abuse purposes, an insider has inside information:

    a. as a result of their membership of the administrative, management or supervisory bodies of the issuer of the investment
    b. as a result of their holding in the capital of the issuer of the investment
    c. as a result of having access to information through their employment, profession or duties
    d. as a result of criminal activities, or
    e. which they have obtained by other means and which they know, or could reasonably be expected to know, is inside information.

2. **Unlawful disclosure** – where an insider discloses inside information to another person otherwise than in the proper course of the exercise of their employment, profession or duties.
3. **Manipulating transactions** – where the behaviour consists of effecting, or attempting to effect, transactions or orders to trade that are not for legitimate reasons and in conformity with accepted practices on the relevant market, and which:

    a. give, or are likely to give a false or misleading impression as to the supply, demand or price of one or more qualifying investment, or
    b. secure the price of one or more such investment at an abnormal or artificial level.

4. **Manipulating devices** – this consists of effecting transactions or orders to trade which employ fictitious devices or any other form of deception.
5. **Dissemination** – this consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to a qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading.

There were seven types of market abuse prior to MAR. Misuse of information and misleading behaviour and distortion were removed, but the items covered have been effectively included in the other categories. MAR 1.9 continues to include a reference to misleading behaviour and distortion, referencing Article 12(1)(c):

> *'disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances or secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level, including the dissemination of rumours, where the person who made the*

dissemination knew, or ought to have known, that the information was false or misleading'.

10.1.3 Qualifying Investments and Markets

UK MAR affects any market participant trading:

1. Any financial instruments admitted to trading on a UK or EU regulated market or where a request for admission to trading on a regulated market has been made.
2. Any financial instruments traded on a UK or EU multilateral trading facility (MTF), admitted to trading on an MTF, or where a request for admission to trading on an MTF has been made.
3. Any financial instruments traded on a UK or EU organised trading facility (OTF).
4. Any financial instruments not covered in the above points, but for which the price is dependent on or influences.

10.1.4 Defences and Penalties

Market abuse is a civil offence and, therefore, is not prosecuted through the criminal courts, and imprisonment is not a possible sanction. The burden of proof required for conviction is balance of probabilities.

Market abuse cases are investigated by the FCA and heard by the Regulatory Decisions Committee (RDC).

Before deciding to take action, the FCA will consider the full circumstances. Decision Procedure and Penalties Manual (DEPP) provides details on the approach taken by the FCA in relation to the decision process and penalty regime.

DEPP 6.2.1 provides guidance on the factors that the FCA will take into account, which include the:

- nature and seriousness and impact of the 'suspected' breach
- conduct of the person after the breach
- previous disciplinary record and compliance history of the person
- degree of sophistication of the users of the market in question, the size of the market and the susceptibility of the market to abuse, and
- impact, having regard to the nature of the behaviour, that any financial penalty or public censure may have on the financial markets or the interest of consumers

DEPP 6.5 identifies the appropriate level of penalty that the FCA can apply when making its determination.

The FCA's penalty-setting regime is based on the following principles:

1. **Disgorgement** – a firm or individual should not benefit from any breach.
2. **Discipline** – a firm or individual should be penalised for wrongdoing.
3. **Deterrence** – any penalty imposed should deter the firm or individual who committed the breach, and others, from committing further or similar breaches.

The total amount payable by a person subject to enforcement action may be made up of two elements:

- disgorgement of the benefit received as a result of the breach, and
- a financial penalty reflecting the seriousness of the breach.

FSMA gives the FCA the power to impose sanctions. These powers can be exercised if the FCA is satisfied that a person has engaged in market abuse, or if the person has taken (or refrained from taking) any action which required or encouraged another party to engage in behaviour that would amount to market abuse. The sanctions available are:

- withdrawal of approval or authorisation
- imposing an unlimited civil penalty
- making a public statement that a person has engaged in market abuse
- applying to the court for an injunction to restrain threatened or continued market abuse, an injunction requiring a person to take steps to remedy market abuse, or a freezing order
- applying to the court for a restitution order, and
- requiring the payment of compensation to victims of the abuse.

However, if there are reasonable grounds for the FCA to be satisfied that the person believed, on reasonable grounds, that the behaviour in question did not amount to market abuse, or that the person had taken all reasonable precautions and exercised all due diligence to avoid engaging in market abuse, the FCA cannot impose a penalty. This is referred to as the due diligence defence. In particular, the FCA will have regard to how far the person has complied with the provisions of the Code of Market Conduct.

Under the previous market abuse rules, how a hypothetical reasonable regular user, familiar with the market in question, would view the behaviour was used as the benchmark for judging market abuse. MAR has removed the ‘regular market user’ definition but added ‘accepted market practices’ and ‘reasonable investor’ definitions. It is anticipated that these will be very similar unless a behaviour has been explicitly prohibited.

10.1.5 Reporting Suspicious Transactions (Market Abuse)

UK MAR requires that any person professionally arranging or executing transactions (in qualifying investments) shall establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions. Where such a person has a reasonable suspicion that an order or transaction in any financial instrument, whether placed or executed on or outside a trading venue, could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation, the person shall notify the FCA without delay. This is referred to as a Suspicious Transaction and Order Report (STOR).

The provisions require that firms decide on a case-by-case basis whether there are reasonable grounds for suspecting that a transaction or order involves market abuse, taking into account the circumstances. Further, Principle 11 of the Principles for Businesses requires that a firm discloses to the FCA everything of which the FCA would reasonably expect notice; many firms (or rather their employees) interpret this as giving them grounds to also report suspicious unexecuted transactions.

10.1.6 The Code of Market Conduct and Ongoing Requirements

Code of Market Conduct and Ongoing Requirements

The FCA Handbook includes a sourcebook entitled MAR (Market Conduct), which sits within the Business Standards block of the Handbook. MAR contains the FCA's Code of Market Conduct, together with certain supplementary rules and guidance relating to market abuse.

Prior to 2016, the FCA maintained a statutory Code of Market Conduct under FSMA. This was largely superseded by the introduction of the EU Market Abuse Regulation (MAR), which came into force in July 2016. As MAR was a directly applicable EU regulation, it was not implemented through UK primary legislation. Following Brexit, it was onshored and amended as UK MAR, which now provides the binding legal framework for market abuse in the UK.

Role of the Code of Market Conduct

UK MAR requires the FCA to prepare and issue a code containing such provisions as it considers appropriate to provide guidance on whether behaviour amounts to market abuse. This guidance is contained in the Code of Market Conduct, which forms part of the MAR sourcebook.

The Code provides non-exhaustive guidance on:

- what does, and does not, constitute market abuse, and
- the factors taken into account when determining whether market abuse has occurred.

Although FCA guidance is not legally binding in the same way as rules, the FCA will have regard to whether behaviour is consistent with the guidance when investigating conduct and reaching enforcement decisions.

MAR, UK MAR and Regulatory Guidance

The introduction of MAR changed the UK's approach to guidance on market abuse. Because MAR was a directly applicable EU regulation, the FCA had no discretion over its implementation (unlike an EU directive). Before Brexit, guidance on MAR was therefore primarily led by ESMA, which issued guidelines, Q&As and opinions, including on Accepted Market Practices (AMPs).
Following Brexit, responsibility for guidance under UK MAR has transferred to the FCA. While ESMA guidance may remain persuasive, divergence between UK and EU practice is now possible. The UK has not adopted separate AMPs under UK MAR.
The MAR sourcebook:

- includes FCA guidance and certain rules in areas not fully addressed by UK MAR, and
- directs readers to the text of UK MAR, which provides the definitive rules for most aspects of market abuse.

10.1.7 Interaction with Other Regulatory Requirements

FCA rules and information barriers

Behaviour resulting from the proper operation of a Chinese wall (or information barrier), or behaviour relating to the timing, dissemination or content of disclosures made in accordance with the UK Listing Rules, will not of itself amount to market abuse.

Takeover Code

Behaviour that conforms with the rules of the Takeover Code concerning the timing, dissemination or content of disclosures will not, in itself, amount to market abuse, provided that:

- the behaviour is expressly required or permitted by a Takeover Code rule, and
- it conforms to the General Principles of the Takeover Code.

Buy-backs and Price Stabilisation

Behaviour that complies with the Buy-back and Stabilisation Regulation, as set out in UK MAR, benefits from a statutory safe harbour and will not amount to market abuse. Buy-back programmes that do not meet the requirements of the regulation are not automatically abusive, but do not benefit from the safe harbour.

The Market Conduct section of the FCA Handbook sets out how and when a lead manager in an initial public offering may carry out price stabilisation without committing market abuse. The stabilisation safe harbour is available only where, among other things:

- the offer is for cash
- the offer is public and made on a qualifying exchange
- stabilisation is carried out for a limited period
- adequate prior disclosure is made in the prospectus, and
- appropriate information on stabilising activity is provided to the issuer.

Price stabilisation is commonly achieved through overallotment, supported by a greenshoe option. By allotting more than 100% of the shares initially issued, the stabilising manager creates a short position, which it may cover by purchasing shares in the market to support the price. The greenshoe option allows the manager to acquire additional shares from the issuer at the issue price, protecting it from losses if the market price rises.

Key Requirements Introduced or Clarified by UK MAR

UK MAR introduced or expanded a number of important obligations, including:

- **Inside information and disclosure** – the definition of inside information was widened, including to cover certain spot commodity contracts. Issuers whose securities are admitted to trading on MTFs or OTFs are subject to disclosure obligations, as are certain Emission Allowances Market Participants (EAMPs). Issuers and EAMPs must notify the regulator when disclosure is delayed, and financial

institutions must seek regulatory consent where disclosure is delayed for financial stability reasons.

- **Insider dealing and unlawful disclosure** – the use of inside information to amend or cancel an order constitutes insider dealing. UK MAR also clarifies that recommending or inducing another person to transact on the basis of inside information amounts to unlawful disclosure.
- **Market manipulation** – the offence was extended to cover attempted manipulation. Benchmarks and, in some cases, spot commodities are now within scope. Examples of manipulation include collaboration to secure a dominant market position and certain disruptive algorithmic trading strategies.
- **Market soundings** – a formal framework was introduced to permit legitimate disclosures of inside information during market soundings, subject to procedural safeguards and detailed record-keeping requirements.
- **Accepted market practices (AMPs)** – UK MAR permits regulators to establish AMPs, subject to specified criteria and conditions.
- **Insider lists** – issuers and EAMPs must maintain insider lists. Issuers on SME growth markets (including AIM and the AQSE Growth Market) need only be able to produce a list on request by the regulator.
- **Suspicious transaction and order reports (STORs)** – reporting obligations were extended to cover suspicious orders, including requests for quotes, even where no transaction is executed. Trading venues are also subject to STOR obligations.
- **Directors'/managers' transactions** – persons discharging managerial responsibilities (PDMRs) within issuers, and persons closely associated with them, must notify the issuer and the regulator of relevant personal transactions they undertake in the issuer's financial instruments. The issuer must publish the information within three business days. UK MAR defines a PDMR as a person within an issuer (or another entity covered by UK MAR) who is either of the following: a member of the administrative, management or supervisory body of that entity (that is, a director), or a senior executive who is not a member of the bodies referred to above but who has regular access to inside information relating directly or indirectly to that entity and has the power to make managerial decisions affecting the future developments and business prospects of that entity.
- **Investment recommendations** – UK MAR continues to require persons producing or disseminating investment recommendations to ensure information is objectively presented, and to disclose any conflicts of interest. There are some limited exemptions that apply – such as when the recommendation is provided to a single individual (client).
- **Whistleblowing** – UK MAR places requirements on firms and regulators to receive and appropriately handle whistleblowing reports.

The EU Market Abuse Regulation

At the time of writing (February 2026), the EU Market Abuse Regulation (MAR) is being amended under the EU Listing Act, with several key changes coming into force on 5 June 2026 that dual-listed issuers or UK-EU cross-border companies will need to manage and that create UK/EU divergence because the UK has not (at least not so far) mirrored all anticipated changes in UK MAR.

10.2 Insider Dealing

5.4.3 Be able to interpret the requirements of the following as they relate to the corporate finance profession: the Criminal Justice Act (specific provisions on insider dealing); the Insider Dealing (Securities and Regulated Markets) Order 2023)

Insider dealing is a criminal offence under Part V of the Criminal Justice Act 1993 (CJA 1993). Broadly, it involves an individual who possesses inside information dealing in price-affected securities, encouraging others to do so, or improperly disclosing that information.

Insider dealing is fundamentally the offence of acting on information that is not freely and openly available to all participants in the market.

The current criminal regime was introduced by Part V of the CJA 1993, which came into force in May 1994, and was significantly updated by the Insider Dealing (Securities and Regulated Markets) Order 2023, effective from 15 June 2023.

The maximum penalty for insider dealing is up to ten years' imprisonment and/or an unlimited fine.

The Insider Dealing (Securities and Regulated Markets) Order 2023 modernised Part V of the CJA 1993 to align it more closely with the MiFID/MAR framework. In particular, it:

- replaced the list of securities in Schedule 2 to the CJA 1993 with a cross-reference to Schedule 2 to the Regulated Activities Order (RAO)
- replaced references to named markets with references to Regulated Markets, MTFs and OTFs, using MAR/MiFIR definitions, and
- expanded the scope of instruments covered (including derivatives, UCITS and emission allowances).

As a result, the CJA 1993 now applies to all financial instruments listed in Schedule 2 to the RAO.

For statutory purposes, the CJA uses the term 'securities' rather than 'financial instruments'. These include:

1. Transferable securities.
2. Money-market instruments.
3. Units in collective investment undertakings.
4. Options, futures, swaps, forward rate agreements and other derivatives relating to securities, currencies, interest rates or yields, emission allowances, financial indices or financial measures.
5. Cash-settled commodity derivatives.
6. Physically settled commodity derivatives traded on a UK regulated market, MTF or OTF (subject to certain exclusions).
7. Other physically settled commodity derivatives with the characteristics of derivative financial instruments.
8. Credit-risk transfer derivatives.
9. Financial contracts for differences.

10. Derivatives relating to climatic variables, freight rates, inflation rates or official economic statistics.
11. Emission allowances recognised under the UK emissions trading regime.

Who Is an 'Insider' ?

Under section 57 CJA 1993, an insider is an individual (not a company) who:

- has inside information
- knows that the information is inside information, and
- knows that the information came from an inside source.

The Act also makes it a criminal offence for connected persons who receive inside information to act on that information.

Inside Sources

An inside source is an individual who has access to inside information by virtue of their position, including:

- a director, employee or shareholder of the issuer, and
- a person who has access to the information through their employment, office or profession.

A person may also be an inside source if they receive information directly or indirectly from such a person and satisfy the general definition of an insider.

Inside Information

Under section 56 CJA 1993, inside information is information which:

a. relates to securities traded on, admitted to trading on, or the subject of a request for admission to trading on, a UK, EEA or Gibraltar Regulated Market, MTF or OTF
b. relates to securities traded on or admitted to trading on a regulated market outside the UK (for example, NASDAQ, SIX Swiss Exchange or the New York Stock Exchange)
c. relates to other securities whose price depends on, or affects, the price or value of securities falling within (a) or (b)
d. is specific or precise
e. has not been made public, and
f. is price-sensitive, meaning that, if made public, it would be likely to have a significant effect on the price of the securities.

When Is Information 'Made Public'?

The CJA provides helpful guidance by setting out a non-exhaustive list of circumstances in which information is deemed to be public. Information is treated as having been made public if it is:

- published through a regulated information service or in accordance with the rules of a regulated market (for example, a UK-listed company announcement)

- contained in records open to public inspection
- readily available to market users (for example, through the financial press)
- derived from public information
- obtainable only by expertise or by payment of a fee
- published to a section of the public (rather than the public generally), or published outside the UK, or
- capable of being acquired by observation (for example, a factory fire).

Accordingly, information does not need to be formally announced to be 'public'. It is sufficient that it is accessible to diligent or expert market participants, even if effort or cost is involved.

The Offences

Under section 52 CJA 1993, once a person satisfies the definition of an insider, it is an offence to:

- deal in price-affected securities, either on a regulated market or through a professional intermediary;
- encourage another person to deal, where there is reasonable cause to believe that the dealing would take place on a regulated market or through a professional intermediary, or
- disclose inside information otherwise than in the proper performance of the individual’s employment, office or profession.

Defences

Dealing or encouraging dealing
An individual is not guilty of insider dealing if they can show that:

- they did not expect the dealing to result in a profit attributable to the price-sensitive information;
- they reasonably believed that the information had been disclosed widely enough to ensure that no participant would be prejudiced by lacking it, or
- they would have acted in the same way even if they had not possessed the information.

Equivalent defences apply to the offence of encouraging another person to deal.

Disclosure Offences

An individual is not guilty of insider dealing by virtue of disclosure if they can show that:

- they did not expect the recipient to deal in securities, or
- although they expected dealing to occur, they did not expect it to result in a profit attributable to the price-sensitive nature of the information.

Specific Statutory Safe Harbours

An individual is also not guilty of insider dealing if they can show that:

- they acted in good faith as a market maker
- the information was market information, and it was reasonable to act despite possessing it
- the information arose directly from involvement in an acquisition or disposal, or
- they acted in conformity with price stabilisation rules.

10.2.1 Insider Lists

In the context of corporate finance transactions, including an acquisition, issuers and persons acting on their behalf are required to draw up a list – an insider list – of all persons who have access to inside information, including where they are working for them under a contract of employment, or otherwise performing tasks through which they have access to inside information, such as advisers, accountants or credit rating agencies. The list must be promptly updated where there is a change (ie, in the reason for including a person already on the list, where there is a new person who has access to inside information and needs to be added to the list or where a person ceases to have access to inside information).

11. Money Laundering and Terrorist Financing

5.4.2 Know activities considered to constitute: money laundering; terrorist financing

5.4.3 Be able to interpret the requirements of the following as they relate to the corporate finance profession: The Proceeds of Crime Act (specific provisions for money laundering); The Counter Terrorism Act (specific provisions on money laundering of terrorist funds and terrorist financing); Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

11.1 Money Laundering

Money laundering (ML) is the process of turning money derived from criminal activities into money that appears to be from legitimate sources and origins. Dirty money is difficult to invest or spend in its current format, and carries the risk of being used by the legal authorities in order to evidence the initial crime. Laundered money can more easily be invested and spent without risk of incrimination.

Increasingly, anti-money laundering provisions are being seen as the frontline against drug dealing, organised crime and the financing of terrorism. Much police activity is directed towards making the disposal of criminal assets more difficult, and more effectively monitoring the movement of money.

The current rules and regulations in relation to money laundering are derived from a variety of sources but include:

- **The Proceeds of Crime Act (POCA) 2002** – which is widely drafted and specifies that money laundering relates to any benefit (money or otherwise) which has arisen from criminal conduct.
- **The Serious Organised Crime and Police Act (SOCPA) 2005** – which has amended certain sections of POCA.
- **The Criminal Finances Act 2017** – which creates two criminal offences for firms that fail to prevent the criminal facilitation of tax evasion. One offence relates to UK tax evasion, with the second offence being the evasion of foreign tax. Firms and other bodies that fail to prevent associated persons from criminally facilitating tax evasion can be held to account for their failure where tax evasion is facilitated.
- **The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR 2017)** – which deal predominantly with the administrative provisions that firms, including banks and advisers involved in corporate finance transactions must implement to combat money laundering.
- **The Money Laundering and Terrorist Financing (Amendment) (No 2) Regulations 2022** – which make a variety of amendments to the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.
- **The Counter Terrorism Act 2008** – which gives new powers to the Treasury to issue directions to firms in the financial services sector to tackle terrorist financing and related money laundering.

Each of these is considered in greater detail further in the following sections.
It is widely regarded that there are three stages to ML that participants in financial markets, including advisers on corporate finance transactions, must be alert to:

1. **Placement** – introduction of the money into the financial system; typically, this involves placing the criminally derived cash into a bank or building society account, a bureau de change or any other type of enterprise which can accept cash, for example, a casino.
2. **Layering** – which involves moving the money around the financial system in order to make it difficult for the authorities to link the placed funds with the ultimate beneficiary of the money. This may involve buying and selling foreign currencies, shares or bonds in rapid succession, investing in funds, insurance-based investment products or moving the money from one country to another.
3. **Integration** – the final stage in the process, when the layering process has been successful and the ultimate beneficiary appears to be holding what was previously dirty money as legitimate funds (clean money). The money is now regarded as integrated into the legitimate financial system.

Broadly, the anti-money laundering provisions in regulations are aimed at identifying customers and reporting suspicions at the placement and layering stages and keeping adequate records which will try to prevent the integration stage being reached.

11.1.1 The Proceeds of Crime Act 2002 (POCA)

The POCA establishes five offences:

1. **Concealing** – it is an offence for a person to conceal or disguise criminal property.
2. **Arrangements** – that is, being concerned in an arrangement which the person knows, or suspects, facilitates the acquisition, retention, use or control of criminal property for another person. Being concerned in an arrangement can be widely interpreted – it could include advising on a transaction.
3. **Acquisition, use and possession** – acquiring, using or having possession of criminal property.

These offences are punishable by a fine and a jail term of up to 14 years.

4. **Failure to disclose** – three conditions need to be satisfied for this offence:

- The person knows or suspects (or has reasonable grounds to know or suspect) that another person is laundering money.
- The information giving rise to the knowledge or suspicion came to him during the course of business in a regulated sector (such as the financial services sector).
- The person does not make the required disclosure as soon as is practicable.

This offence is punishable by a fine and a jail term of up to five years.

5. **Tipping off** – giving another person information, knowing or suspecting that an ML report has been made to the authorities, when that information is likely to prejudice the investigation.

This offence is punishable by a fine and a jail term of up to five years, or two years in relation to the regulated sector. This offence also includes prejudicing an investigation. This applies differently within and outside the regulated sector. The Crown Prosecution Service updated its guidance on prosecuting stand-alone ‘failure to disclose’ cases under Section 330 of POCA 2022. From June 2021, it has been possible to prosecute a Section 330 offence regardless of whether an offence of money laundering has been substantiated.

11.1.2 The Serious Organised Crime and Police Act (SOCPA) 2005

The Serious Organised Crime and Police Act (SOCPA) 2005 amended certain sections of POCA. In particular, one feature of POCA was that criminal conduct was deemed to include anything which would have been an offence had it been done in the UK, regardless of where it actually happened. This resulted in the often-cited Spanish bullfighter problem – bullfighting is illegal in the UK, but not in Spain, meaning that, arguably, a financial institution should have regarded deposits made by a Spanish bullfighter as the proceeds of crime, even if they represented their legitimate earnings in Spain.

SOCPA addresses this difficulty – in part at least – in that there is a defence for alleged offenders if they can show that they know, or believe on reasonable grounds, that the conduct was not criminal in the country where it happened. However, the Secretary of State has reserved the right to prescribe certain offences as relevant criminal conduct that are legal where they occurred, but are illegal in the UK and still need to be reported.

For example, the government may specify serious tax evasion or drug cultivation as types of criminal conduct which do need to be reported, despite occurring overseas.

11.1.3 The Criminal Finances Act 2017

The Criminal Finances Act 2017 introduced two corporate offences making it easier for companies and partnerships to be held criminally liable for the actions of their employees and associated persons acting on their behalf. The offence is committed where a company and/or a partnership, but not a natural person (individual), fails to prevent the facilitation of tax evasion by a person associated with it no matter where that occurs – either in the UK or globally.

The objective of the new offences is to ensure that it is easier for law enforcement agencies to recover the proceeds of crime, tackle money laundering, tax evasion and corruption, and combat the financing of terrorism.

11.1.4 The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR 2017)

The Money Laundering Regulations 2017 (The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017) give effect to the Fourth Money Laundering Directive (4MLD), and the Money Laundering and Terrorist Financing (amendment) Regulations 2019 gave effect to the Fifth Money Laundering Directive (5MLD).

4MLD was introduced to strengthen anti-money laundering legislation. It brought about a number of changes, including relating to the rules around customer due diligence (with tighter rules for simplified due diligence, and those requiring enhanced due diligence). 5MLD introduced further changes, including new requirements for cryptoassets (including token) exchanges and custodian wallet providers, various changes to customer due diligence (including the more stringent requirement to ‘determine and verify’ information relating to the law to which the company is subject, its constitution and the full names of the board of directors and the senior persons responsible for the company’s operations), and additional rules around enhanced due diligence.

The Regulations deal predominantly with the processes which firms must adopt in order to combat money laundering.

For example, they deal with firms’ requirements for systems and training to prevent money laundering and their obligations to check the identity of new customers which, in the context of corporate finance transactions, can possibly include undertaking appropriate checks on individuals selling family businesses, individuals or their businesses involved in joint ventures, and on other business vehicles such as partnerships and companies either disposing of, acquiring or raising financing.

11.1.5 The Money Laundering and Terrorist Financing (Amendment) (No 2) Regulations 2022

The Money Laundering and Terrorist Financing (Amendment) (No 2) Regulations 2022 amend a number of provisions in the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. While a number of the amendments relate to cryptoassets, of the other amendments, the most relevant in the context of corporate finance transactions are:

- New obligations to mitigate proliferation financing in addition to combatting money laundering and terrorist financing. Proliferation financing entails, among other things, providing funds or financial services for use in the manufacture, acquisition, development, transport, or other related activity or use of weapons (whether chemical, biological, nuclear or radiological).

The 2022 Regulations impose an obligation to conduct a risk assessment to identify and assess the risks of proliferation financing in relation to a business/client, taking into account the entity's:

a. customers
b. countries or geographic areas in which it operates
c. products or services
d. transactions, and
e. delivery channels.

- In practice, as such an assessment is almost identical to money laundering and terrorist financing risk assessments currently required to be undertaken, the additional requirements introduced by the 2022 Regulations are not, in this regard, unduly burdensome.
- The implementation and maintenance of proliferation financing policies, procedures and controls to mitigate and manage the risks of proliferation financing, together with related staff training.

11.1.6 The Counter Terrorism Act 2008

This Act gives new powers to the Treasury to issue directions to firms in the financial sector. In summary, directions can be given to individual firms, to firms that fit a particular description, or to the sector as a whole, concerning individuals or institutions who are doing business or are resident in the UK. Directions can relate to customer due diligence (CDD) and ongoing monitoring, systematic reporting on transactions and business relationships, and limiting or ceasing business.

Under the legislation, the Treasury may issue directions when one or more of the following are met:

- The FATF (Financial Action Task Force) has advised that countermeasures should be applied to a country (as per the Money Laundering Regulations).
- The Treasury reasonably believes that money laundering/terrorist financing activities are being carried on in the country, by its government or by persons

resident/incorporated there, which pose a significant threat to the UK's national interests.
- The Treasury reasonably believes that the country is developing or producing nuclear or chemical weapons, or doing anything to facilitate that, and poses a significant threat to the UK's national interests.

Directions given in such circumstances could entail:

- **Customer due diligence and monitoring** – the provisions are broadly similar to the requirements already imposed under the Money Laundering Regulations. However, the Treasury is now able, for example, to direct that CDD be undertaken again or completed before entering into a business relationship (where it might otherwise be conducted in parallel); or to direct that enhanced measures be carried out. It may also direct that specific activity monitoring be carried out.
- **Systematic reporting** – until now, reporting orders have only been available to law enforcement and must be obtained through the courts. Under the CTA, the Treasury itself can now require information to be provided concerning business relationships and transactions involving the specified person(s), on a one-off or periodic basis.
- **Limiting or ceasing business** – the Treasury's powers under the Money Laundering Regulations (Regulation 18) are limited to where the Financial Action Task Force (FATF) has applied countermeasures.

11.2 Terrorist Financing

In light of the war against terrorism, legislation in the form of the Terrorism Act 2000 was introduced by the government. Many of the requirements of anti-terrorism legislation are similar to that of the anti-money laundering provisions highlighted above.

A person commits an offence if they enter into, or become concerned with, an arrangement which facilitates the retention or control of terrorist property by concealment, removal from the jurisdiction, transfer to nominees, or in any other way. Any person may have a defence if they can prove that they did not know, and had no reasonable cause to suspect, that the arrangement related to terrorist property.

There is a duty to report suspicions and it is an offence to fail to report if there are reasonable grounds to do so. The Terrorism Act 2000 and the Anti-Terrorism Crime Security Act 2001 specify that a failure to report is liable to a term of up to five years in jail and a fine. The Counter Terrorism Act 2008, described above in greater detail in the context of anti-money laundering regulations, provides additional scope for the UK to tackle terrorism.

Because terrorist groups can have links with other criminal activities, there is inevitably some overlap between anti-money laundering provisions and financing terrorist acts.

However, there are two major difficulties when comparing terrorist funding with that of money laundering activities:

1. Often, only quite small sums of money are required to commit terrorist acts.
2. If legitimate funds are used to fund terrorist activities, it is difficult to identify when the funds become terrorist property.

Financial services firms, including those involved in corporate finance transactions, need to ensure that their preventative measures take into account the different nature of terrorist financing in order to comply with the regulator's requirements for combating financial crime. Adopting and following guidance issued by the Joint Money Laundering Steering Group (known as the JMLSG) provides a sound basis for firms to meet their obligations under POCA, the Terrorism Act, the MLR 2017 and the regulator's own regulatory rules. As such, the JMLSG Guidance serves to ensure both money laundering and terrorist financing are suitably addressed.

12. Miscellaneous Regulations

12.1 Bribery Act

5.4.3 Be able to interpret the requirements of the following as they relate to the corporate finance profession: The Bribery Act

The Bribery Act was enacted in 2010 to modernise the regulations on bribery and became effective in July 2011.

Bribery is defined as giving someone a financial or other advantage to encourage that person to perform their functions or activities improperly or to reward that person for having already done so. A bribe, therefore, does not have to be monetary in nature but could include an offer of employment, other contractual entitlement or gift. Function or activity includes any function of a public nature and any activity connected with a business.

Improper performance of functions occurs where the expectation of good faith or impartiality has been breached, or when the function has been performed in a way not expected of a person in a position of trust.

The act creates four offences, namely:

- offering, promising or giving a bribe to another person
- requesting, agreeing to receive, or accepting a bribe from another person
- bribing a foreign public official, and
- a corporate offence of failing to prevent bribery.

The Act is very wide in jurisdiction and will apply if any part of an organisation's business takes place in the UK, regardless of where the organisation is incorporated and regardless of where the bribe took place. The offence applies to both making and receiving bribes.

The penalties for committing bribery are a maximum of ten years' imprisonment, along with an unlimited fine, and the potential for the confiscation of property under the Proceeds of Crime Act 2002, as well as the disqualification of directors under the Company Directors Disqualification Act 1986.

The Act also introduces a corporate offence of failure to prevent bribery. A company may be guilty even if no one within the company knew of the bribery. There is a defence if the company can show that it has in place:

> *'adequate procedures designed to prevent persons associated with (the organisation) from undertaking such conduct.'*

The government has provided guidance as to what constitutes 'adequate procedures' and each organisation needs to have a code of conduct in place that appropriately reflects this guidance and to ensure its personnel are fully conversant with the risks and adequately trained. Failure by an organisation to prevent bribery is punishable by an unlimited fine.

In the context of corporate finance transactions, one area where the Bribery Act may appear to be particularly relevant and is most likely to be encountered is in relation to hospitality. As a 'financial advantage' could include corporate hospitality, consideration should be given to ensure the act is not breached. The statutory guidance details that it will not amount to a bribe provided that the hospitality has a legitimate business aim, is reasonable, proportionate and appropriate in the circumstances. In practice, financial services firms routinely require disclosing and recording of any hospitality offered or received so as to ensure compliance with the Bribery Act.

12.2 Other Regulations

5.5.1 Be able to evaluate in a given corporate finance scenario the likelihood of intervention from the following regulators: The Competition and Markets Authority; The Pensions Regulator; The Department for Business, Energy and Industrial Strategy (the National Security and Investment Act)

As the preceding sections have indicated, corporate finance transactions require compliance with myriad regulatory and legal provisions. Transactions can sometimes be subject to intervention from regulators. While perhaps the most prominently known intervention is from competition authorities such as the Competition and Markets Authority (as described in section 2.8.2), interventions by other regulators can also arise.

In recent years, the Pensions Regulator (TPR) has been one such regulator. The Pension Scheme Act 2021, which came into force on 1 October 2021, gave the UK's TPR a number of new powers including the ability to impose criminal sanctions, or prosecute offences relating to defined benefit pension schemes, with one of its many aims being to ensure the pension rights of current and future employees will be protected during and after an acquisition. As part of its role, TPR considers whether companies entering into transactions (including acquisitions or disposals) may weaken their financial position to the detriment of a defined benefit pension scheme.

Many of the legislative changes introduced are a result of recent high-profile corporate insolvencies, including Carillion and BHS, which left pension schemes underfunded and caused pensioners to lose out on some (or all) of their pensions due to significant deficits in the pension schemes.

To prevent a recurrence of such events, transactions including acquisitions must take account of pension plans. Considerations such as the provision of guarantees to make whole any pension deficit and early engagement in the transaction process with pension trustees around the impact of the transaction on the scheme are now expected. In part due to the TPR's increasing powers, it is expected that there will be greater focus on a target's pension schemes, any deficits in the scheme and how an acquirer will ensure pension benefits are protected and not eroded.

In addition to the Pension Regulator's involvement, scrutiny and intervention from the government, in relation to national security, is likely to increasingly feature in transactions.

In relation to the National Security and Investment Act, as explained in section 2.8.2, responsibility for the regime and the unit which undertakes assessment of notified transactions, the Investment Security Unit, moved from the Department for Business, Energy and Industrial Strategy (BEIS) (now dissolved) to the Cabinet Office.

Illustrative of the type of transactions that the regime focuses on are the two transactions that were blocked in 2024/2025:

1. **FTDI Holding ltd / Future Technology Devices International (FTDI)**

    - FTDI Holding ltd (ultimately owned by five Chinese state-backed funds) acquired 80.2% of Future Technology Devices International (FTDI), a UK semiconductor company, in December 2021.
    - The UK government issued a Final Order in November 2024 requiring the buyer to divest its entire 80.2% stake.
    - In July 2025, the High Court rejected the acquirer's judicial review, confirming the government's power to unwind the transaction.

2. **LetterOne / Upp (L1T FM Holdings UK ltd)**

- LetterOne, an investment fund linked to Russian nationals, acquired FibreMe (later Upp) in January 2021.
- Due to concerns linked to the Russia/Ukraine situation and sanctions on affiliated individuals, the UK government issued a Final Order requiring divestment under the NSIA.
- The High Court upheld the order in late 2024, confirming the government's discretion to require unwinding for national security reasons.

It is important to note that the regime allows not just the blocking of transactions but also the imposition of remedies to mitigate any national security risks.

Illustrative of the types of mitigation remedies that the regime has required, notable measures that have been required or made a condition of proposed transactions include:

i. restrictions regarding the transfer of sensitive information, technology or intellectual property
ii. enhancement of security requirements, requirements to maintain strategic capability in the UK or of the provision of certain services to the UK government
iii. requirements to notify (or obtain UK government approval for) certain contracts or activities
iv. requirements to notify the UK government regarding compliance with remedies
v. requirements to provide the UK government access rights to enable inspections
vi. restrictions on the appointment of board members or staff, and
vii. requirements to place on the boards of relevant companies government observers.

Consequently, it can be seen that the measures and the regime can be far reaching and to some extent, intrusive.

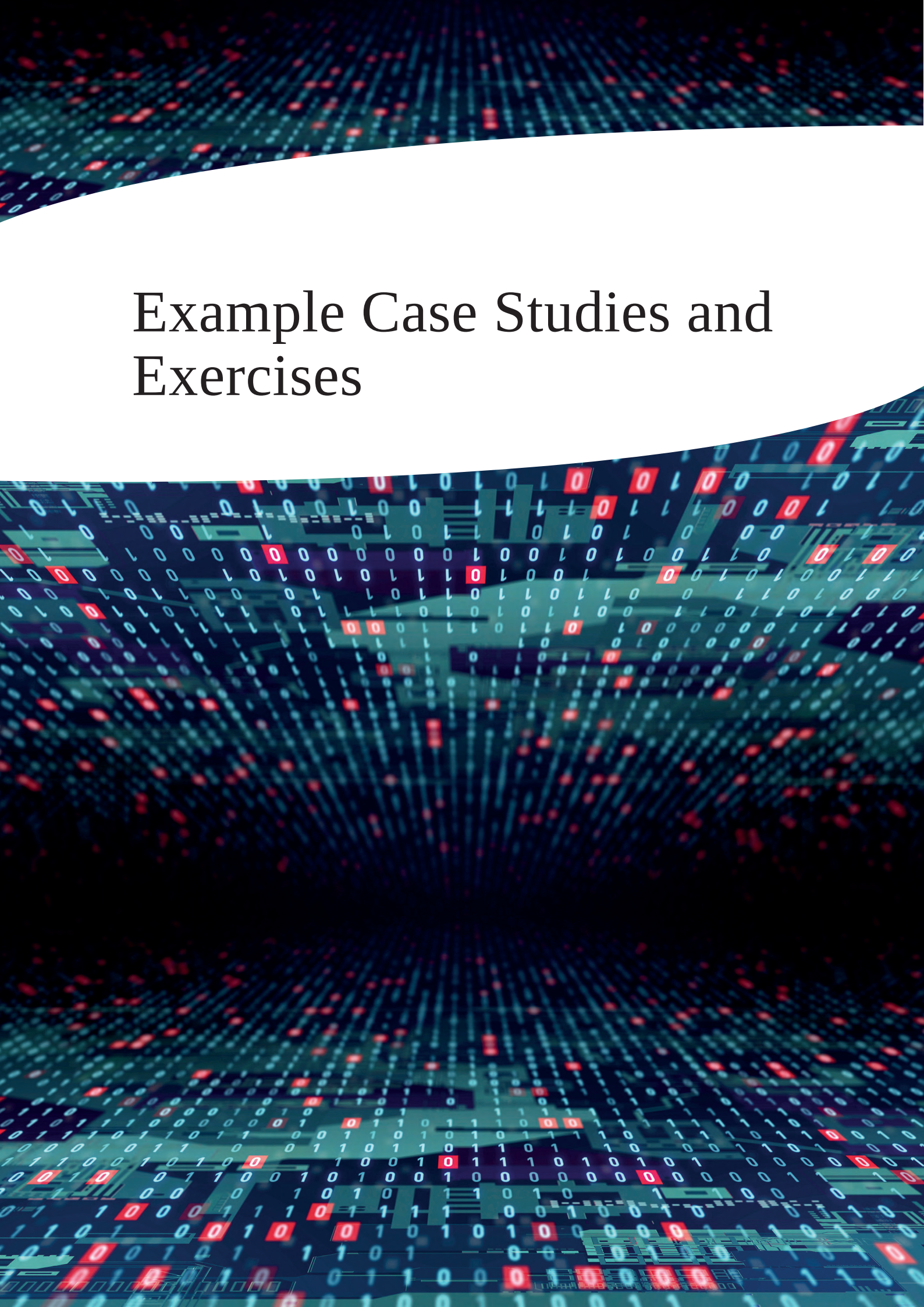
Chapter Roundup

Chapter 5: Other Regulatory and Ethical Considerations

This chapter describes the financial services regulatory regime which is in operation in the UK, in particular the establishment of the Financial Conduct Authority (FCA) and enhanced regulatory powers for the Bank of England. It also considered other corporate finance related regulations, including competition law and national security law.

Ethical codes of conduct relevant to the work of corporate financiers were also considered, as were corporate governance rules, including the Corporate Governance Code and the Quoted Companies Alliance Corporate Governance Code. The regulatory frameworks in relation to market abuse, insider trading and misleading statements are also explored, together with related financial crime related laws that seek to address and tackle financial crime.

Example Case Studies and Exercises



Chapter 1

Exercise 1

Shriver plc is looking at a potential acquisition and a member of staff has identified a number of potential synergies that are likely to arise as a result. They now need to allocate the synergies to the most appropriate of three headings: ‘costs’, ‘revenues’ and ‘one-offs’.

Please allocate each of the following to the most appropriate heading.

1. Redundancy entitlements.
2. Sale of non-core operations.
3. Cross-selling opportunities.
4. Elimination of duplicate departments.
5. Improved financial structure post-acquisition.
6. Sale of surplus assets.

Answer

	Cost synergies	Revenue synergies	One-off synergies
Redundancy entitlements			 Note 1
Sale of non-core operations			 Note 2
Cross-selling opportunities		 Note 3	
Elimination of duplicate departments	 Note 1		
Improved financial structure post-acquisition	 Note 4		
Sale of surplus assets			 Note 4

Exercise 1 (cont'd)

Note 1 – The payment of redundancy entitlements to the staff at the target who are no longer required will be non-recurring, whereas the elimination of the costs of duplicate departments will be an ongoing saving each year.

Note 2 – The sale of the target company's non-core operations and its surplus assets will provide a one-off cash receipt for Shriver plc.

Note 3 – Cross-selling Shriver's products to the targets customers and vice versa should provide an ongoing boost to revenues for the business combination.

Note 4 – An improved financial structure post-acquisition should reduce the costs to the group on an ongoing basis.

Exercise 2

Chandler plc designs and manufactures Scandinavian-style furniture that is sold to retail stores. Five potential acquisitions have been identified for Chandler – is the motivation for each acquisition primarily horizontal integration, vertical integration or diversification?

1. Clarke ltd designs and manufactures mock antique furniture.
2. Clarney ltd sells furniture in its own discount warehouses.
3. Crocker ltd runs a successful blog on interior design.
4. Claffin ltd provides a warehousing and delivery service, particularly for household items.
5. Chaffinch ltd is an online sales channel that specialises in furniture.

Answer

	Horizontal integration	Vertical integration	Diversification
Clarke ltd designs and manufactures mock antique furniture	✓ Note 1		
Clarney ltd sells furniture in its own discount warehouses		✓ Note 2	
Crocker ltd runs a successful blog on interior design			✓ Note 3
Claffin ltd provides a warehousing and delivery service, particularly for household items		✓ Note 2	
Chaffinch ltd is an online sales channel that specialises in furniture		✓ Note 2	

Note 1 – Broadening the existing business beyond Scandinavian-style furniture to add the design and manufacture of mock antique furniture is considered to be horizontal integration.

Note 2 – Moving further into the selling of furniture to the end consumer by purchasing either Clarney or Claffin is considered vertical integration. Similarly, acquiring an online sales channel (Chaffinch) is primarily a step towards vertical integration, albeit arguably alongside some diversification.

Note 3 – Crocker's blog on interior design is primarily a step into diversification for Chandler given that its link to the lines of furniture manufactured is not clear cut.

Question 1

Grimes plc is about to make a significant acquisition of an early-stage company for cash that it hopes will broaden, deepen and grow its product offering over time. Grimes will need to raise capital to finance the transaction. Which of the following are likely to be more appropriate sources of capital? Choose all of those that are appropriate.

A. 100% debt finance
B. 100% equity finance
C. A mix with a high proportion of debt
D. A mix with a high proportion of equity

Answer

The correct answers are B and D.

Since the acquisition is an early-stage company, post-acquisition financing should take into account the strong possibility of volatile operational cash flows and concentrate on equity financing where servicing can be minimal and the funding is permanent.

Case Study 1

Greene plc has taken over Gray ltd in a horizontal integration acquisition for cash. The two companies standalone income statement figures (assuming no acquisition) and combined figures after the acquisition are shown below:

£000s	Greene (assuming no acquisition)	Gray (assuming no acquisition)	Combined (post acquisition)
Revenue	144.0	91.2	288.0
Cost of goods sold	(96.0)	(72.0)	(192.0)
Gross profit	**48.0**	**19.2**	**96.0**
Other variable costs	(12.0)	(4.3)	(14.4)
Other fixed costs	(7.2)	(4.8)	(10.8)
Profit before tax	**28.8**	**10.1**	**70.8**
Tax expense	(7.2)	(2.4)	(9.6)
Profit after tax	**21.6**	**7.7**	**61.2**

Based on the above, please answer the following questions:

i. Were any revenue synergies achieved and how might they have arisen?
ii. Whether any before tax cost synergies were achieved, and how they might have arisen?
iii. Whether any tax savings were realised?

Case Study 1: Suggested Answer

The three sets of figures are reproduced below with some key percentages added:

£000s	Greene (assuming no acquisition)		Gray (assuming no acquisition)		Combined (post acquisition)	
Revenue	144.0		91.2		288.0	
Cost of goods sold	(96.0)		(72.0)		(192.0)	
Gross profit	**48.0**	GP% **33%**	**19.2**	GP% **21%**	**96.0**	GP% **33%**
Other variable costs	(12.0)	Rev% 8.3%	(4.3)	Rev% 4.7%	(14.4)	Rev% 5.0%
Other fixed costs	(7.2)	Rev% 5.0%	(4.8)	Rev% 5.3%	(10.8)	Rev% 3.75%
Profit before tax	**28.8**	PBT% **20%**	**10.1**	PBT% **11%**	**70.8**	PBT% **25%**
Tax expense	(7.2)	Eff rate 25%	(2.4)	Eff rate 24%	(9.6)	Eff rate 14%
Profit after tax	**21.6**	PAT% **15%**	**7.7**	PAT% **8.4%**	**61.2**	PAT% **21.25%**

Based on the above, the answers to the following questions are as follows:

i. **Were any revenue synergies achieved and how might they have arisen?**
Yes. Significant revenue synergies were achieved with the combined sales of £288,000 comfortably ahead of the sum of the two standalone revenues of £235,200. Presumably this reflects the ability to cross sell over the two companies' customer base, as well as the impact of an increased market presence.

ii. **Whether any before tax cost synergies were achieved, and how they might have arisen?**
Yes. Despite Gray's standalone gross profit percentage being 21% compared to Greene's 33%, the combination saw the overall gross profit percentage at Greene's superior 33%. This could have arisen through the combination being able to reduce costs of sales through more effective purchasing from suppliers.

Significant savings were also achieved in other variable costs, presumably from savings on duplicate costs like HR and other administrative functions. Other fixed costs fell in absolute terms to £10,800 from a standalone combination of £12,000 which probably arose from the sale of surplus fixed assets at Gray ltd post-acquisition.

Case Study 1: Suggested Answer (cont'd)

iii. Whether any tax savings were realised?

Yes. In absolute terms the tax paid by the combination was the same as the sum of the two standalone entities at £9,600, but this represented a substantial reduction in the effective rate to approximately 14% compared to standalone effective rates in the mid-twenty percentages.

Question 2

Conrad plc has identified an attractive target acquisition that is itself a listed company. When will the bulk of the due diligence be carried out?

A. Before the initial approach
B. After the initial approach
C. Once approval is given by the target's board
D. Once a confidentiality agreement is signed

Answer

The correct answer is A.

As a listed entity, the target company should have sufficient public information available for Conrad to do the bulk of the due diligence before any approach.

Question 3

Under the Code which of the following would trigger a mandatory offer? Please select all that apply.

A. A plc holds 0% of E plc and purchases just over 5% in the market
B. B plc holds 0% of F plc and purchases 30% in the market
C. C plc holds 40% of G plc and increases its stake by 2%
D. D plc holds 20% of H plc and increases its stake by 9.99%

Answer

The correct answers are B and C.

Chapter 2

Question 1

Which ONE of the following is normally considered an advantage of structuring an acquisition with significant contingent consideration?

A. The vendor will be tempted to adjust profit to meet targets
B. The full price will only be paid if financial targets are achieved
C. The acquired company will need to be kept separate for profit calculations
D. Managers may be tempted to focus on short term profitability and not longer term sustainability

Answer

The correct answer is B.

All of the other options would be considered to be disadvantages that might arise if a deal is structured with significant deferred and contingent consideration.

Exercise 1

It is estimated that a company will receive income net of direct costs of £100,000 pa over the three-year life of a project/investment, Project/Investment A. An alternative three-year project/investment, Project/Investment B, will generate £324,000 at the end of the third year.

The initial capital required for either project is £240,000, which will be used to acquire a machine that will be fully depreciated and scrapped at the end of this time.

Using ROCE, which project if either, should be undertaken on the basis that the alternative use for this cash is to place it on deposit for three years earning compound interest at 10% pa?

Solution

Project/Investment **A**

Over Three Years	£
Total net income	300,000
Total depreciation	(240,000)
Total profit before interest payable	60,000
Average annual profit	£20,000

ROCE = £20,000 / £240,000 = 8.33%

Solution (cont'd)

Project/Investment B

Over Three Years	£
Total net income	324,000
Total depreciation	(240,000)
Total profit before interest payable	84,000
Average annual profit	£28,000

ROCE = £28,000 / £240,000 = 11.67%

On the basis of ROCE, Project/Investment B appears better than Project/Investment A under this criterion, but should it be undertaken?

Having calculated the ROCE for our projects, we need a required rate for comparison purposes in order to make our decision. This could be the bank account return of 10% compound interest, which gives the following:

Year £	Balance B/F £	Interest for Year £	Balance C/F £
1	240,000	24,000	264,000
2	264,000	26,400	290,400
3	290,400	29,040	319,440
		79,440	
Average annual profit		26,480	

ROCE = £26,480 / £240,000 = 11.03% pa

As we can see, Project/Investment B generates a higher return than this; hence, in the absence of any other information, Project/Investment B is acceptable.

Exercise 2

Company Z acquired Company X on 1 January 2026, financed by issuing new shares of £7.00 each and £50,000 cash. The information in the following table relates to the year ending 31 December 2025.

	Company Z	Company X
Non-current assets	£440,000	£192,000
Current assets	£360,000	£288,000
Interest-bearing borrowings	£240,000	£120,000
Current liabilities	£288,000	£96,000
Number of shares outstanding	200,000	30,000

Immediately before the acquisition, the following information about Company X comes to light:

- The fair value of non-current assets is £72,000 above the book value.
- Inventory amounting to £4,000 is obsolete and must be written down.

In calculating the purchase price, due to expected post-acquisition synergies, an amount of £40,000 in excess of the net asset value of Company X will be paid.

What is the pro-forma net assets per share (to two decimal places) immediately after the acquisition?

Answer

The first step towards answering this question is to arrive at the net assets of both companies:

	Company Z	Company X
Non-current assets	£440,000	£192,000
Current assets	£360,000	£288,000
Total assets	**£800,000**	**£480,000**
Interest-bearing borrowings	(£240,000)	(£120,000)
Current liabilities	(£288,000)	(£96,000)
Total liabilities	**(£528,000)**	**(£216,000)**
Net assets	**£272,000**	**£264,000**

Answer (cont'd)

Next, the net assets of the acquired company need to be adjusted as detailed in the question:

Starting net assets of Company X	£264,000
Fair value adjustment	£72,000
Inventory write down	(£4,000)
Amended net assets	**£332,000**
Addition to purchase price to reflect synergies	£40,000
Total price paid for Company X	**£372,000**

Now the purchase price can be used to work out the number of new shares issued to settle the transaction:

Total price paid for Company X	£372,000
Less cash paid	(£50,000)
Amount settled in shares	£322,000
Divided by £7 per share	**46,000 shares issued**

The proforma net assets of the combination will be the following:

Starting net assets of Company Z	**£272,000**
Less cash paid out as part of purchase price	(£50,000)
Amended net assets of Company Z	**£222,000**
Add the updated net assets of Company X (Note 1)	£372,000
Total net assets of the combination	**£594,000**
Total shares in issue post-acquisition (200,000 + 46,000)	246,000
Net assets per share	**£594,000 / 246,000 = £2.41**

Note 1: It is debatable whether the net assets of Company X would include the value of the synergies of £40,000. However, even if these were not included, they would be reflected as goodwill paid by Company Z on the transaction and therefore appear in the net assets of the combined entity.

Exercise 3

Company ABC took over Company XYZ on 1 January 2025 at a value of £650,000. The deal was financed by issuing 50,000 new shares and 5% five-year bonds. The relevant financial information prior to the transaction is shown below:

	Company ABC	Company XYZ
Market value of shares	£9	N/A
Interest-bearing borrowings	£400,000	£420,000
Non-interest-bearing borrowings	£240,000	£150,000
Shareholders' funds	£880,000	£560,000

What is the percentage proforma debt-to-equity ratio (to two decimal places) immediately after the acquisition?

Answer

First, the amount of debt issued to part-finance the transaction needs to be calculated:

Purchase price	£650,000
Equity finance: 50,000 x £9	(450,000)
Balance is financed by the issue of bonds	£200,000

Next the interest-bearing debt of the combined entity can be calculated:

Interest-bearing borrowings of Company ABC pre-acquisition	£400,000
Additional borrowing to satisfy the purchase price	£200,000
Interest-bearing borrowings of Company XYZ	£420,000
Total interest-bearing debt in the combination	**£1,020,000**

Answer (cont'd)

Next the net assets/equity of the combination needs to be calculated:

Shareholders' funds of ABC pre-transaction	£880,000
Addition to shareholders funds as a result of the transaction – based on the equity issued at market value (50,000 shares at £9 each) (note 1)	£450,000
Total equity in the combination	**£1,330,000**

Note 1: the change in equity will be the addition of the net impact of the purchase of XYZ for £650,000, less the new debt raised of £200,000.

Now, the debt can be compared to the equity:

Debt / equity = £1,020,000 / £1,330,000 = 76.69%

Question 2

Magpie plc took over Blackbird ltd on 1 January 2026, settled by issuing 40,000 new shares and £75,000 cash. The issue price of the new shares was a 7.5% premium to the last trading price. The information on 31 December 2025 is shown below:

	Magpie plc	Blackbird ltd
Number of shares	200,000	40,000
Market value of shares	£6	£7
Net income	£20,000	£8,000

What is the percentage bid premium paid by Magpie plc (to the nearest whole number)?

Answer

Total consideration paid by Magpie plc:

40,000 x £6 x 1.075 = 258,000 + 75,000 = 333,000

Compared to Blackbird ltd at pre-bid market value:

40,000 x £7 = 280,000

Percentage premium calculation:

333,000 – 280,000 = 53,000 divided by 280,000 = 18.93% rounded to 19%

Question 3

Which of the following valuation techniques require a control premium to be added? Select all that apply.

A. Comparable company multiples
B. Comparable transaction multiples
C. Discounted cash flow with synergies
D. Discounted cash flow without synergies

Answer

The correct answers are A and D.

Comparable transactions and DCF with synergies already incorporate the control premium.

Chapter 3

Question 1

ABC Group wants to raise funds by selling a substantial subsidiary company that it does not consider as 'core'. All of the following would potentially be appropriate EXCEPT:

A. Spin-off
B. Trade sale
C. Equity carve-out
D. Divestiture

Answer

The correct answer is A.

A spin-off would see shares gifted to the existing shareholders and raise no funds. A trade sale or divestiture would result in the entity being sold to another business organisation. An equity carve-out would sell most or all of the equity of the entity to other, new shareholders for cash.

Question 2

Which one of the following is normally considered the 'traditional' approach to selling a company?

A. Using an auction inviting selected purchasers to bid
B. Using on online marketplace to bring sellers and buyers together
C. Using a corporate finance adviser to introduce a potential buyer

Answer

The correct answer is C.

Both auctions and using online marketplaces/websites are considered alternatives to the traditional approach of using an adviser to introduce a purchaser.

Exercise 1

Please put the following eight documents/activities in the correct order for the auction process, from start to finish:

- Ranking the potential purchasers.
- Heads of terms document.
- No names teaser distributed.
- Letter of intent.
- Final bid submission.
- Sale and purchase agreement.
- Signing a confidentiality agreement.
- Information memorandum shared.

Answer

1. No names teaser distributed.
2. Signing a confidentiality agreement.
3. Information memorandum shared.
4. Letter of intent.
5. Ranking the potential purchasers.
6. Final bid submission.
7. Heads of terms document.
8. Sale and purchase agreement.

Question 3

Forster Group is holding a board meeting that is discussing the sale of a substantial subsidiary that is facing some challenges. Not disclosing which of the following would be unacceptable? Select as many as you think are correct.

A. The recent loss of a key customer.
B. The fact that the most recent quarter's sales are substantially below target and prior years.
C. The loss of a key member of staff in the sales department holding important customer relationships.
D. A flood that has put a major distribution facility out of action for a considerable time.

Answer

A, B, C and D (all of the suggested non-disclosures). It is a criminal offence to withhold information dishonestly to induce an investment.

Question 4

Which of the following would be considered as potential problems when undertaking a demerger? Select as many as you think are correct.

A. A focus on the central strategy of the group
B. The possibility of a credit rating downgrade
C. A failure to protect the interests of the employees
D. The likelihood of some loan covenants being breached

Answer

The correct answers are B, C and D.

An improved focus on the central/core strategy of the group is likely to be considered a benefit of a demerger, rather than a potential problem.

Question 5

Charles Group is planning to demerge into two entities. Which demerger method is most likely to result in the creation of two new companies ('Newco's')?

A. The dividend approach
B. A scheme of arrangement
C. Using a 'dividend in specie'
D. The liquidation method

Answer

The correct answer is D.

Putting the existing parent into voluntary liquidation will necessitate the creation of two new companies ('Newco 1' and 'Newco 2') to hold the assets.

Chapter 4

Exercise 1

Match the percentages

Here is a list of percentage levels:

- 5% or more
- 10% or more
- 20% or more
- 25% or more

And here is a list of requirements under the equity shares (commercial companies) requirements in the Listing Rules.

- Level of voting rights held to classify as a ‘related party’.
- Level which means a related party transaction must be approved by the board and disclosed.
- Level at which transactions are considered ‘significant’ to require one or more prescribed announcements under the Listing Rules.
- Minimum free float – the percentage of shares in public hands to be eligible for listing.

Please match the requirement to the appropriate percentage.

Answer

- Level of voting rights held to classify as a ‘related party’ = **20% or more.**
- Level which means a related party transaction must be approved by the board and disclosed = **5% or more.**
- Level at which transactions are considered ‘significant’ to require one or more prescribed announcements under the Listing Rules = **25% or more.**
- Minimum free float – the percentage of shares in public hands to be eligible for listing = **10% or more.**

Question 1

KVC Group is considering listing a substantial subsidiary on the main market of the London Stock Exchange. As a result, a prospectus is being prepared. Which of the following will be required? Please select all that apply.

A. A summary longer than ten A4 pages
B. Inclusion of all necessary information to enable investors to make an informed assessment
C. Declaration from those accepting responsibility
D. Forecast information covering the next two years

Answer

The correct answers are A, B and C.

There is no requirement for forecast information to be included in a prospectus.

Question 2

Which ONE of the following is required to report to the FCA that a listed issuer has met its responsibilities under the UK Listing Rules?

A. The reporting accountant
B. The lawyer
C. The broker
D. The sponsor

Answer

The correct answer is D.

Although it is possible that a broker or accountant could act as a sponsor, the Listing Rules specifically requires a sponsor to report to the FCA.

Question 3

Norfolk Group is listed on the main market of the London Stock Exchange and is trying to establish whether disclosure is required of some inside information. To require disclosure which one of the following tests applies?

A. The reasonable investor test
B. The gross assets test
C. The consideration test
D. The gross capital test

Answer

The correct answer is A.

Disclosure is generally required when the information would be likely to have a significant impact on the price in the judgement of a reasonable investor. This is known as the ‘reasonable investor test’.

Case Study 1

Parlour Group is listed on the main market of the LSE and is planning to acquire Bloom ltd, a substantial private company.

i. The group has discovered that news of the planned acquisition has been disclosed inadvertently. What should Parlour Group do?
ii. The transaction represents 21% under the gross assets test, 30% under the consideration test and 17% under the gross capital test. Is it likely to be considered to be a significant transaction?
iii. If Bloom ltd was controlled by a director of Parlour Group what, of anything, would additionally be required?

Answer

i. Where confidentiality of inside information can no longer be maintained, Parlour should immediately disclose the information via an RIS.
ii. Yes. As long as any of the three tests amounts to 25% or more it is considered a significant transaction.
iii. The transaction would be a ‘related party transaction’ and require board approval, sponsor confirmation that it was on fair and reasonable terms and notification via an RIS.

Chapter 5

Exercise 1 – Unravelling the Acronyms

Here is a list of acronyms relevant to the UK regulatory structure. Identify what each acronym stands for, and its place in the financial regulatory system in the UK.

UK Financial Services Regulatory Regimes
BoE, FCA, FOS, FPC, FSA 2012, FSA, FSMA 2000, FSMA 2023, HMT, POATR, PRA, PRM, PSR

Answer – Unravelling the Acronyms

Acronym	Stands for	Explanation
BoE	Bank of England	Responsible for ensuring the stability of the financial system and for regulating settlement systems and recognised clearing houses. Houses the PRA and FPC.
FCA	Financial Conduct Authority	Regulates conduct issues across the entire spectrum of financial services, market supervision, as well as the prudential supervision of firms not supervised by the PRA.
FOS	Financial Ombudsman Service	Deals with disputes between consumers and financial services firms. Designed to provide quick resolution of disputes, between eligible complainants and their product/service providers with a minimum of formality, by an independent person.
FPC	Financial Policy Committee	Established within the Bank of England, the committee with responsibility for macro-prudential oversight of the regulatory system. It publishes two Financial Stability Reports a year, including a summary of its activities and an assessment of the effectiveness of its actions in the period since the last report.
FSA 2012	Financial Services Act 2012	Abolished the Financial Services Authority and replaced it with two statutory regulators (FCA and PRA).
FSA	Financial Services Authority	The previous single statutory regulator that has now been replaced.
FSMA 2000	Financial Services and Markets Act of 2000	Replaced the previous self-regulatory organisations with a single statutory regulator (the Financial Services Authority).
FSMA 2023	Financial Services and Markets Act of 2023	Recent act that enabled the retained EU law on financial services to be replaced after Brexit.

Answer (cont'd) – Unravelling the Acronyms

Acronym	Stands for	Explanation
HMT	His Majesty's Treasury	The government department with overall responsibility for the UK's financial system and the legislation that governs it.
POATR	Public Offers and Admissions to Trading Regulations 2024	Replacement for the Prospectus Regulation that creates a new framework for the offering of securities to the public in the UK.
PRA	Prudential Regulation Authority	Regulates banks and building societies, credit unions, insurers and systemically important investment firms.
PRM	Prospectus Rules: Admission to Trading on a Regulated Market	The FCA's sourcebook that sets out when a prospectus is required for admission to trading on a UK regulated market and what information it must contain.
PSR	Payment Systems Regulator	The regulator that ensures payment systems are operated and developed in a way that considers and promotes the interests of all the businesses and consumers that use them. Also promotes effective competition in payment systems and services - between operators, PSPs and infrastructure providers.

Exercise 2 – International Regimes: Unravelling the Acronyms

Here is a list of acronyms relevant to selected overseas financial services regulatory regimes. Please attempt to identify what each acronym stands for, and the country it relates to.

Overseas Financial Services Regulatory Regimes

Overseas Financial Services Regulatory Regimes
ASIC, CSRC, EBA, EIOPA, ESFS, ESMA, ESRB, FINRA, FSA, HKFE, HKMA, JSDA, MAS, NFRA, SEHK, SEC, SEBI, SFC

The answer to this exercise can be found at the end of this workbook.

Answer – International regimes: Unravelling the Acronyms

Acronym	Stands for	Country/Countries of Operation
ASIC	Australian Securities and Investments Commission	Australia
CSRC	China Securities Regulatory Commission	Mainland China
EBA	European Banking Authority	European Union
EIOPA	European Insurance and Occupational Pensions Authority	European Union
ESFS	European System of Financial Supervision	European Union
ESMA	European Securities and Markets Authority	European Union
ESRB	European Systemic Risk Board	European Union
FINRA	Financial Industry Regulatory Authority	USA
FSA	Financial Services Agency	Japan
HKFE	Hong Kong Futures Exchange	Hong Kong
HKMA	Hong Kong Monetary Authority	Hong Kong
JSDA	Japan Securities Dealers' Association	Japan
MAS	Monetary Authority of Singapore	Singapore
NFRA	National Financial Regulatory Administration	Mainland China
PBOC	People's Bank of China	Mainland China
SEHK	Stock Exchange of Hong Kong	Hong Kong
SEBI	Securities and Exchange Board of India	India

Answer 2 (cont'd) – International Regimes: Unravelling the Acronyms

Acronym	Stands for	Country/Countries of Operation
SEC	Securities and Exchange Commission	USA
SFC	Securities and Futures Commission	Hong Kong

Exercise 3 – Market structures: Unravelling the Acronyms

Here is a list of acronyms relevant to selected overseas financial services regulatory regimes. Please attempt to identify what each acronym stands for and explain its meaning.

Overseas Financial Services Regulatory Regimes
DIE, LSE, MTF, NYSE, OTF, RIE, ROIE, SI

Acronym	Stands for	Explanation
DIE	Designated Investment Exchange	Overseas-based exchanges that (unlike ROIEs) do not offer membership and access to participants based in the UK. The designated status indicates that the exchange is regulated and supervised to standards that the FCA believes meet certain criteria, in terms of protection for investors dealing on it.
LSE	London Stock Exchange	The largest formal market for securities in the UK. An example of a UK RIE.
MTF	Multilateral Trading Facility	Essentially an 'exchange lite' – a system that brings together buyers and sellers but without a listing process or the ability to change the regulatory status of a security.
NYSE	New York Stock Exchange	Along with the NASDAQ, the US is one of the big two US exchanges. It is an example of a DIE.
OTF	Organised Trading Facility	Similar to an MTF in that multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives can interact in a way that results in a contract. Equities are not permitted to be traded through an OTF.

Exercise 3 (cont'd) – Market structures: Unravelling the Acronyms

Here is a list of acronyms relevant to selected overseas financial services regulatory regimes. Please attempt to identify what each acronym stands for and explain its meaning.

Acronym	Stands for	Explanation
RIE	Recognised Investment Exchange	A UK recognised investment exchange (RIE) is an investment exchange which is recognised by the FCA. Once recognised, these exchanges are subject to supervision and oversight by the FCA.
ROIE	Recognised Overseas Investment Exchange	UK RIEs can be UK- or overseas-based. In the latter case, they are often referred to as recognised overseas investment exchanges (ROIEs). An example of an ROIE is the NASDAQ, established in the US.
SI	Systematic Internaliser	An investment firm which on an organised, frequent, systemic and substantial basis, deals on own account when executing client orders outside a regulated market, MTF or OTF.

Question 1

Which of the following are included in the role of the Takeover Panel for takoevers and mergers? Please select all that apply.

A. Issuing the Code
B. Administering the Code
C. Assessing the commercial merits of a takeover
D. Enforcing the Code

Answer

The correct answers are A, B and D.

The Panel issues, administers and enforces the Code. It is the role of the Competition and Market Authority to assess the commercial aspects of a deal that might be harmful.

Question 2

Which of the following are generally considered to be key in relation to ethical behaviour in a merger and acquisition context? Please select all that apply.

A. Managing conflicts of interests
B. Structuring fee arrangements
C. Continuing professional development
D. Maintaining confidentiality

Answer

A, B, C and D are correct.

All of these are key in a mergers and acquisitions context.

Case Study 1

Please use the following scenario to answer questions 1 and 2:

A legal adviser is providing a briefing to the board of an established private company that is considering listing. The briefing will specifically cover two areas:

1. The regulations around the provision of financial assistance to enable third parties to buy the company's own shares.
2. The structure of the Corporate Governance Code applicable to listed companies.

Question 1

The financial assistance briefing is likely to cover which of the following? Please select all that apply.

A. The principle of capital maintenance
B. The comply or explain approach
C. Legality under Companies Act 2006
D. Consequences of any contravention

Question 1 – Answer

The correct answers are A, C and D.

Section 678 of the Companies Act 2006 details illegality in relation to directly or indirectly providing financial assistance. This is aiming to maintain capital. Contravention will mean the actions taken were void. Comply or explain does not apply in relation to financial assistance for the purchase of shares.

Case Study 1 (cont'd)

Question 2

The Corporate Governance Code briefing is likely to cover which of the following? Please select all that apply.

A. That the Code consists of both 'principles' and 'provisions'
B. The comply or explain approach
C. A section on executive remuneration
D. The overlap with the FCA's Disclosure, Guidance and Transparency Rules

Question 2 – Answer

A, B, C and D are correct.

All of the four options are likely to be covered: The code consists of 5 principles and supporting provisions, and one of the principles is about remuneration. The Code does adopt a comply or explain why any aspect has not be complied with. There is a degree of overlap with the FCA's Disclosure, Guidance and Transparency Rules that is covered in detail in section 5.3.

Glossary



Asset

A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Associate

An entity over which the investor has significant influence.

Balance Sheet

Also called the Statement of Financial Position, this is the statement of a company's assets and liabilities at a particular date.

Beta

A measure of market risk. Beta measures the degree to which the historical returns on an asset (security) change with changes in the market portfolio return. Beta is referred to as an index of the systematic risk due to general market conditions that cannot be diversified away.

Bond

A debt security which may be traded in the secondary market where the borrower (issuer) promises to repay the lender (investor) the principal amount plus any periodic interest charges over a specified period of time.

Book Value

In equity: the total shareholders' equity, as shown on the statement of financial position (balance sheet), as distinct from the market value. In assets: the value as shown in the statement of financial position, as distinct from the market value.

Capital

Represents the financial resources that a company uses to fund its operations and investments. It consists of two primary components: debt and equity.

Capital Market

Segment of the financial market where investors, companies, and governments raise long-term funds through the issuance and trading of various financial instruments. These instruments include stocks, bonds, mutual funds and other securities.

Cash

Cash comprises cash on hand and demand deposits.

Cash Flows

Cash flows are inflows and outflows of cash and cash equivalents.

Client

Individuals or firms that conduct business through an authorised person. Every client is either a customer (retail or professional) or an eligible counterparty (ECP).

Comply or Explain

A term used to summarise a mechanism often adopted in regulations where a company is required to comply with relevant regulations or law or, alternatively, explain in detail the reasons for not doing so. An example of this mechanism exists in the UK Corporate Governance Code. Companies must comply with the Code or explain why they deviate from it.

Control

Control is the exposure, or rights, to variable returns from an entity's involvement with its investee. The investor has the ability to affect those returns through its power over the investee.

Coupon

The rate of interest payable to investors periodically over the life of a bond. Can be expressed in either percentage or currency amounts. Can be fixed or variable, ie, adjusted periodically by reference to a spread over a set benchmark.

Current Assets

Assets that are expected to be sold or consumed during the company's trading cycle. Includes inventory, trade receivables and cash.

Debt Securities

Securities whereby the issuer acknowledges a loan made to it. The term includes instruments such as bonds, certificates of deposit (CDs) and commercial paper.

Depreciation

Reduction in the value of a tangible asset over time, due to wear and tear, obsolescence or depletion. Allocated over the life of the asset and recognised as an expense in a company's accounts.

Discounted Cash Flow (DCF)

Valuation and investment appraisal methodology; calculates the present value of a series of cash flows receivable in the future, taking into account risk and time value of money. Obtained by discounting the sums by a known discount rate.

Diversification

The reduction of investment risk by investing in a wide variety of assets or asset classes. The underlying principle of diversification is based on the concept that different assets have varying degrees of risk and return characteristics. When assets are combined in a diversified portfolio, they may not all move in the same direction at the same time. Some assets may perform well when others underperform, leading to a potential offsetting effect and smoothing out overall portfolio returns.

Due Diligence

A detailed investigation into the history, current status and future prospects of a company in connection with a fundraising or acquisition.

Earnings per Share (EPS)

Net profit after tax and before ordinary dividends, divided by the weighted average number of shares outstanding during the period.

Enterprise Value (EV)

Value of all the operational assets of a company; equivalent to the total of its equity value plus its net debt, plus any other capital sources, such as preference share capital or minority interests.

Equity

The residual interest in the assets of the entity after deducting all of its liabilities.

Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Financial Conduct Authority (FCA)

The regulatory body that from 2013 is responsible for regulating the conduct of business and markets and for authorising those firms not authorised by the PRA. It is responsible for the UK Listing Rules in the UK through its primary market functions.

Free Cash Flow

Cash flow generated by the underlying business operations of a company. Generally shown before interest but after tax, capital expenditure and working capital investment.

Future

A futures contract is a legally binding arrangement by which parties commit to buy/sell a standard quantity and (if applicable) quality of an asset from/to another party on a specified date in the future, but at a price agreed today. Because the price is agreed at the outset, the seller is protected from a fall in the price of the underlying asset in the intervening time period (and vice versa).

Gearing

The ratio of debt to equity of a company. A useful indicator of financial stress, relative over time or to companies. Also referred to as 'leverage'.

Goodwill

In acquisition consideration, the premium paid in excess of the net asset value of the target company. Goodwill may assume a negative value when the purchase price of an asset is lower than the fair value of the acquired assets (a bargain acquisition).

Income

Income represents increases in economic benefits during the accounting period, in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

Income Statement

The statement of income and expenditure over a period. Part of the Statement of Comprehensive Income. Also called profit and loss account.

Initial Public Offering (IPO)

The process by which a private company offers its shares to the public for the first time, thereby becoming a traded company. Through an IPO, the company issues new shares to raise capital from public investors, and existing shareholders, such as founders, employees, and early investors, may also sell some of their shares to the public.

Intangibles

Intangibles are identifiable non-monetary assets without physical substance.

Lease

A contract that conveys the right to use an asset for a period of time in exchange for payment.

Leverage

Proportion of debt to equity in a company's balance sheet. Also referred to as gearing in the UK.

Liability

A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Liquidity

a. A company's ability to meet its debts, as they fall due, out of existing assets; two key measures are the quick ratio and the current ratio.
b. The extent to which it is possible to buy or sell shares (or any other type of securities) in a market. If it is possible to do so with ease, then the market for those shares (or other securities) is liquid; if it is difficult to do so, then the market is considered illiquid.

London Stock Exchange (LSE)

The dominant UK market for trading in securities, especially shares and bonds. The LSE is a recognised investment exchange (RIE).

Market Capitalisation/Market Value

The total market value of a quoted company's equity. Calculated by multiplying the ordinary share price by the number of ordinary shares outstanding.

Minority Interest

The proportion of the profit/loss and assets/liabilities of a company's subsidiary not attributable to the company's own shareholders. Instead, this 'minority interest' is attributable to minority shareholders of that subsidiary. Also called non-controlling interest (NCI).

New Issue

A new issue of ordinary shares whether made by an offer for sale, an offer for subscription or a placing.

Option

An option gives the holder the right (but not the obligation) to buy or sell a fixed quantity of an underlying asset on, or before, a specified date in the future. There are two basic types of option – puts and calls. The holder of a call option has the right to buy the underlying asset at a given price. The holder of a put option has the right to sell the underlying asset at a given price.

Parent

A parent is an entity that controls one or more entities.

Pension Fund

A fund that is established for investment of pensions savings and the payment of retirement benefits. Pension funds are major investors in the worldwide capital markets.

Preference Shares

A class of equity that typically has limited voting rights, priority over ordinary shares, a fixed dividend rate and the right of conversion and/or redemption. Also known as preferred shares or preferred stock. Dividends on preference shares are typically cumulative.

Present Value

The value of a sum of money receivable at a known future date expressed in terms of its value today. A present value is obtained by discounting the future sum by a known discount rate.

Primary Market

The market for newly issued securities (bonds or shares).

Principal

Amount of debt that must be repaid.

Private Equity

Provision of equity capital to private companies by professional investment firms, generally operating collective investment vehicles, with the view of achieving an exit of their investment in a period of three to five years and a return exceeding that available in public listed companies .

Prospectus

Document to be published when a company seeks to issue shares to the public, or seeks admission to listing for securities on a stock exchange.

Redemption

Borrower’s payment of a debt instrument’s face value to the investors at the debt instrument’s maturity date.

Return on Capital Employed (ROCE)

Calculates the operating profit generated by the company as a percentage of the capital invested in it. Calculated as operating profit (EBIT) divided by total capital employed.

Return on Invested Capital (ROIC)

A measure of the profitability of a company’s investments, calculated as the net operating profit after taxes divided by the invested capital.

Rights Issue

Offer of new ordinary shares to existing shareholders, for cash, in proportion to their existing shareholding. Entitlement is renounceable.

Secondary Market

The market where securities are traded after having been issued in the primary market. Trading of shares on a stock exchange is trading in the secondary market.

Share Buyback

The redemption and cancellation by a company of a proportion of its irredeemable ordinary shares. May be carried out through on-market or off-exchange purchases.

Share Capital

In the statement of financial position, this is the nominal value of a company's equity or ordinary shares. A company's authorised share capital is the nominal value of equity the company may issue, while issued share capital is that which the company has issued. The term 'share capital' is often extended to include a company's preference shares.

Stabilisation

The activity of supporting the price of a new issue of securities or bonds in order to minimise the volatility that can sometimes arise with new issues.

Subsidiary

A subsidiary is an entity that is controlled by another entity.

Transaction Value

Valuation achieved on a negotiated sale or purchase of a company.

UK Corporate Governance Code (2024)

A set of principles of good corporate governance providing a code of best practice aimed at companies with a premium listing on the London Stock Exchange (LSE). It is overseen by the Financial Reporting Council (FRC), and its importance derives from the FCA's LRs, which require that premium-listed companies disclose how they have complied with the code, and explain where they have not applied the code – in what the code refers to as comply or explain. The code adopts a principles-based approach in the sense that it provides general guidelines of best practice.

UK Listing Rules

Contained in the FCA Handbook, the UK Listing Rules provide rules for the London Stock Exchange (LSE) main market and other listed companies, including criteria for listing, processes, documentation and continuing obligations. The UK Listing Rules are based on principles which take into account the interests of listed entities, maintenance of investor protection and the need to protect the reputation of the market.

UK Recognised Investment Exchange (UKRIE)

A term used to denote those UK exchanges which operate markets in investments, meeting certain standards set by the Financial Conduct Authority (FCA). There are currently six exchanges granted this status.

Underwriting

In a share offering – an agreement by the issuer's bank to buy any shares that remain unsold in the offering at a pre-agreed price.

Variability

The extent to which data points differ from each other. In finance, it is taken to indicate the degree to which returns could differ from expectations.

Variance

A measure of dispersion of a set of data from their mean. Abbreviated to σ^2 and calculated as the average of the squared deviations from the mean.

Venture Capital

Investment funds available for investment in smaller, younger companies that are perceived to have high growth prospects.

Volatility

A measure of the extent to which investment returns, asset prices and economic variables fluctuate. Volatility is measured by the standard deviation of these returns, prices and values.

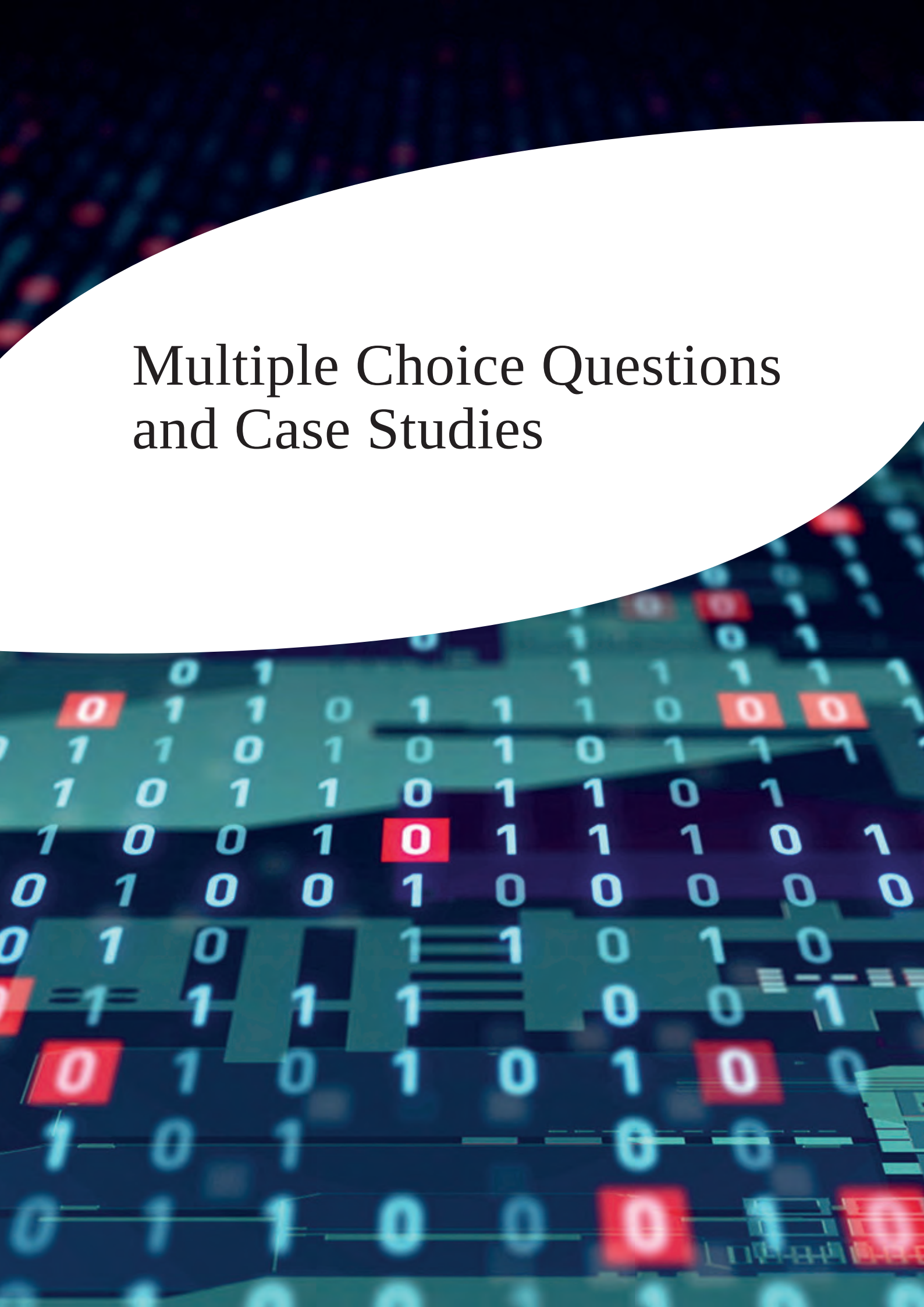
Warrant

A transferable security giving the holder the right to buy a set number of the underlying equities at a predetermined price on specified dates, or at any time up to the end of a predetermined time period. Warrants are usually issued by companies or by securities houses.

Weighted Average Cost of Capital (WACC)

Weighted average of a company's cost of debt and cost of equity. Calculated as $((K_d \times MV_d) + (K_e \times MV_e)) / (MV_d + MV_e)$. Used as a discount rate in evaluating the company's value or its investments.

Multiple Choice Questions and Case Studies



The following additional questions are for learning and revision purposes. Whilst they are based on the syllabus, they do not necessarily replicate actual examination standard questions and are included to test your knowledge and understanding of the relevant sections of the workbook.

1. **Company X is the leading high-end smartphone manufacturer in the UK due to its evolving product innovation and streamlined organisational structure. However, the company cannot meet the demand in the market due to shortages of various high-tech electronic parts. Also, the company would like to capture the potential growth in the Southeast Asia region.**

   Company X is reviewing the potential benefits of acquiring Company Z, which is a high-tech microchip manufacturer, with a production base in Vietnam. The company recruits talents in artificial intelligence from all over the world and maintains a lean organisational structure to minimise administrative costs.

   Which of the following are key criteria for Company X to justify the acquisition of Company Z? Select ALL that apply.

   A. Product production
   B. Location of production base
   C. Its approach to recruitment
   D. Organisational structure

2. **Company A is a chain of supermarkets with over 100 stores all around the UK. The company adopts competitive pricing on its products due to well-established relationships with suppliers. Company A is looking for an acquisition target to enhance its market share in the grocery industry and to improve the distribution network of online sales. It is reviewing the potential benefits of acquiring Company X, a market leader in convenience stores, with over 10,000 branches in the UK. Company X secures a stable supply of goods as its parent company is a conglomerate which produces various fresh food and consumer staples. Company X is currently listed in the London Stock Exchange, currently with a 20% discount on valuation when compared to its peers due to a recent scandal on the departure of the CEO.**

   Which of the following are appropriate criteria for Company A to justify the acquisition of Company X? Select ALL that apply.

   A. Low company valuation
   B. Extensive sales network in the UK
   C. Leading position in convenience stores
   D. Stable supply of fresh food and consumer staples

3. Company P, which is engaged in manufacturing printers for office use, is a market leader in the UK. The strength of the company is in producing a high-quality and evergreen series of printers which require minimal effort in connection with research and development. However, the volatility of the operating cash flows is high as 70% of sales proceeds will be received in the last quarter of the year. Therefore, the company is seeking to improve its operating cash flow through acquisition.

Last year, Company P acquired Company Q, a well-known smartphone accessories manufacturer, at a 5% discount to the market capitalisation, with the acquisition being fully financed by debt. Company Q is an emerging market player in the sector targeting young professionals by designing innovative and evolving products. The manufacturing workers of Company P were surprised by the acquisition, as the management team did not disclose it before it was publicly announced.

Upon the acquisition, Company Q's performance severely deteriorated. In addition, the recent economic slowdown resulted in Company P being unable to pay salaries to staff and it is looking for a white knight to support its operation.

Which of the following reasons contributed to the failure of the acquisition? Select ALL that apply.

A. Ineffective integration
B. Inappropriate acquisition price
C. Inappropriate financing structure
D. Diversification outside company expertise

4. Company H is a confectionery manufacturer with a steady operating cash flow. The CEO periodically seeks acquisition targets to expand the product mix. Two years ago, the major shareholder of Company K, a candy manufacturer with consistent revenue growth and a strong brand image, stepped down from the company. Company H successfully acquired Company K by paying a 30% premium to its market capitalisation. The purchase consideration was financed by issuing new shares at the market value of Company H at that time.

Following the acquisition, Company K's organisational structure and distribution network were adjusted to align with those of Company H within one month. Many experienced managers departed due to confusion regarding the reporting lines post-acquisition, resulting in a 40% decline in net profit during the first year after the acquisition.

Which of the following reasons can explain the failure of the acquisition? Select ALL that apply.

A. Ineffective rationalisation
B. Inappropriate acquisition price
C. Inappropriate financing structure
D. Diversification outside company expertise

5. **Company A, a chain toy retailer in the UK, is seeking opportunities to expand its product mix through acquisition. It aims to obtain full control of the acquired business while minimising adviser fees, charges and stamp duty to maximise the benefits of the acquisition. Consequently, Company A does not employ any financial advisers for support during acquisitions.**

   The principal shareholder of Company B, which operates in the same sector and is also listed on the London Stock Exchange, is an investment trust which is looking to realise all its investments, including their entire shareholding to Company B. The principal shareholder of Company B has expressed their support of an acquisition of Company B by Company A at the current share price.

   The shareholding structure of Company B is outlined below:

Shareholders	Stake
Major shareholder	40%
Senior management	30%
Public investors	30%

   Although public investors have varied opinions on the potential acquisition, the board and the senior management of Company B do not support it due to there being no proposed bid premia. The board of Company B has consequently declined to provide any assistance in the acquisition process to Company A.

   Which of the following factors prevents Company A from using a scheme of arrangement for the acquisition? Select ALL that apply.

   A. Company A cannot get the required voting stake for the scheme of arrangement
   B. Company A cannot secure entire control of the acquired business by using the scheme of arrangement
   C. The potential acquisition lacks the support of the board of Company B
   D. The scheme of arrangement incurs high stamp duty

6. **Company X is a cosmetics retail chain in the UK and is seeking opportunities to expand its product mix through acquisition. It aims to obtain full control of the acquired business while reducing the legal procedures and time required to acquire the controlling stake of the potential target.**

The major shareholder of Company Y, which operates in the same industry, plans to sell their entire shareholding to develop new ventures related to artificial intelligence. They have proposed to senior management of Company Y that Company Y is sold to Company X in order to realise their shareholding.

The shareholding structure of Company Y is detailed below:

Shareholders	Stake
Major shareholder	60%
Senior management	20%
Public investors	20%

Public investors have various perspectives on the potential acquisition, and the senior management of Company B is in favour of it as they believe that Company X's industry leadership could enhance financial performance.

Which of the following factors would justify Company X's use of the scheme of arrangement for the acquisition? Select ALL that apply.

A. Company X can get the required voting stake for the scheme of arrangement
B. Company X can secure entire control of the acquired business by using the scheme of arrangement
C. The scheme of arrangement incurs low adviser fees and charges
D. Court approval is not required for the acquisition when using the scheme of arrangement

7. **Global Bank, a multinational financial institution, is planning to expand its digital banking services. They have identified FinTech Company, a fintech startup listed on the London Stock Exchange. FinTech Company has a solid customer base with secure long-term sales contracts and strong research capacity. FinTech Company also has significant tax losses. However, Global Bank does not want to take on the large amount of outstanding debt with a high interest rate borrowed by FinTech. Additionally, Global Bank intends to review recent market acquisitions to determine the purchase consideration and complete the acquisition process promptly.**

Which of the following factors support the use of share purchase rather than asset purchase to acquire FinTech Company? Select ALL that apply.

A. Global Bank can secure the current customer base of FinTech Company
B. Global Bank can choose not to take over the outstanding debt of FinTech Company
C. The purchase consideration can be determined by using market multiples
D. The tax losses of FinTech Company can be utilised to reduce Global Bank's tax expense

8. **Rowing Company, a prominent residential property developer in England, seeks to extend its presence into Scotland. They have identified Aberdeen Company, a mid-sized residential property developer listed on the Stock Exchange. 30% of Aberdeen's development projects are based in Scotland, while the remaining sites are distributed throughout England. However, Rowing Company is hesitant to assume Aberdeen Company's significant outstanding debt, which carries a high interest rate. Additionally, Rowing Company aims to avoid the creation of goodwill, as it can complicate investors' understanding of the company's financial performance.**

   Which of the following factors support the use of asset purchase rather than share purchase to acquire Aberdeen Company? Select ALL that apply.

   A. Rowing Company can choose the particular property developments it is interested in
   B. Rowing Company can choose not to take over the outstanding debt of Aberdeen Company
   C. The purchase consideration can be determined by using market multiples
   D. The creation of goodwill can be prevented

9. **Case Study – Company X acquired Company Y on 1 January 2026 for £200,000. The information in the following table relates to the year ending 31 December 2025.**

	Company X	Company Y
Number of shares	50,000	40,000
Market value of shares	£10	£5
Interest-bearing borrowings	£200,000	£180,000
Shareholders' funds	£300,000	£150,000

   The consideration is financed by issuing 15,000 new shares and 8% three-year bonds.

   Assuming there is no intention to refinance Company Y's debt, calculate the pro-forma gearing (Debt/Equity) ratio (in percentage, rounded to two decimal places) of the enlarged group immediately after the acquisition.

10. **Case Study – Company P acquired Company S on 1 February 2026 for £300,000. The information in the following table relates to the year ending 31 December 2025.**

	Company P	Company S
Number of shares	80,000	50,000
Market value of shares	£18	£8
Interest-bearing borrowings	£100,000	£140,000
Shareholders' funds	£400,000	£100,000

The accrued profits in January 2026, amount to £20,000 for Company P and £10,000 for Company S.

The consideration is financed by issuing 10,000 new shares and a 6% five-year bond.

Assuming there is no intention to refinance Company S's debt, and the market value of P's shares has not changed, calculate the pro-forma gearing (Debt/Equity) ratio (in percentage, rounded to two decimal places) of the enlarged group immediately after the acquisition.

11. **Case Study – Company P acquired 100% of Company Z on 1 January 2026 for £200,000, settled by 70% new shares and 30% bank loan. The financial data of individual companies before acquisition and forecasted financial data of the combined group are shown below:**

	Company P (pre- acquisition)	Company Z (pre- acquisition)	Combined (post- acquisition)
Sales revenues	£100,000	£38,000	£168,000
Costs of goods sold	(£68,000)	(£12,000)	(£78,000)
Gross profit	**£32,000**	**£26,000**	**£90,000**
Operating expenses	(£7,000)	(£7,500)	(£13,000)
Amortisation expenses	(£1,000)	(£500)	(£1,500)
Interest expenses	(£2,000)	(£1,000)	(£3,500)
Net profit before tax	**£22,000**	**£17,000**	**£72,000**
Tax expenses	(£5,000)	(£3,000)	(£7,000)
Net profit after tax	**£17,000**	**£14,000**	**£65,000**
Total capital	£300,000	£150,000	£440,000
Total current liabilities	£150,000	£60,000	£210,000
Total long-term liabilities	£70,000	£40,000	£170,000

Calculate the return on invested capital (ROIC) of the combined company after the acquisition. (rounded to 2 decimal places).

12. **Case Study – Company A acquired 100% of stake in Company D on 1 January 2026 for £300,000, settled by 60% new shares and a 40% bank loan. The financial data of the individual companies before acquisition and forecasted financial data of the combined group are shown below:**

	Company A (pre- acquisition)	Company D (pre- acquisition)	Combined (post- acquisition)
Gross profit	£52,000	£46,000	£100,000
Net profit before tax	£22,000	£27,000	£72,000
Amortisation expenses	£2,000	£1,000	£3,000
Interest expenses	£3,000	£3,000	£6,500
Tax expenses	£4,000	£2,000	£5,000
Total capital	£400,000	£170,000	£580,000
Total current liabilities	£180,000	£70,000	£250,000
Total long-term liabilities	£100,000	£30,000	£250,000

Calculate the return on invested capital (ROIC) of the combined company after the acquisition. (rounded to 2 decimal places).

13. **Auto Parts Company (APC) is a UK-based automotive engines manufacturer in Europe. Three years ago, the company acquired the entire stake in Precious Parts Company (PPC), which specialises in producing high-performance car engines in the UK, to enhance its profit margin. PPC is highly geared with a large amount of floating rate bonds (denominated in British pounds) outstanding to finance ongoing research and development costs.**

The landscape of the automotive industry has changed significantly with the emergence of electric vehicles. The company faces increased competition from Asian engine manufacturers that use low-cost strategies to capture market share. As a result, the revenue of PPC dropped significantly last year. In order to improve the operation of PPC, APC will have to limit the resources allocated to broaden its product mix in engines for agricultural trucks through internal research and development.

Meanwhile, the market expects the Bank of England to raise the market benchmark interest rate by 2% in the coming two years to combat high inflation.

Last week, the CEO proposed to dispose of PPC through an equity carve-out to improve the overall operation. Which of the following are reasonable justifications for the CEO's proposal? Select ALL that apply. The disposal would:

A. diversify product mix
B. reduce financing costs
C. raise funds to support other operations
D. ensure compliance with regulatory requirements

14. Legacy Group, an established multi-generational family business listed on the Stock Exchange, was founded in the 1960s by Jame White. The White family holds a 70% ownership stake in the group, while the remaining shares are held by public investors.

Initially, the group operated as Legacy Apparel, a wholly owned subsidiary specialising in premium suit retailing. Over the years, the company diversified into e-commerce and private-label manufacturing. Currently, the suit retailing operation accounts for 3% of the group's revenue and 1% of its assets. The primary growth driver for the group is now digital sales of fast fashion targeted at young professionals. Consequently, the company enjoys a debt-free status with robust operating cash flow.

Emma White, the CEO and a third-generation member of the White family, acknowledges that the suit retailing business is undervalued compared to other competitors due to its potential market penetration in casual and lifestyle segments. Therefore, she plans to spin-off Legacy Apparel, which will subsequently be listed on the Stock Exchange.

Which of the following are reasonable justifications for the CEO's proposal? Select ALL that apply. The disposal would:

A. reduce financing costs
B. raise funds to support other operations
C. enhance the market value of Legacy Apparel
D. maintain control of Legacy Apparel by the White family

15. Global Group, a multinational conglomerate listed in the UK, operates in three business segments:

(1) the manufacture of consumer electronics in the UK

(2) oil exploration and extraction in the US, and

(3) financial services in Brazil.

The first two operations were initiated by the current major shareholders, while the financial services segment was acquired from the previous controlling shareholder. Each segment operates through a separate subsidiary with its own central services.

Due to rising oil prices, the oil extraction operation has experienced substantial earnings growth in recent years, currently accounting for 80% of the group's profit. Recently, the company issued 10-year bonds to the public to finance the expansion of its oil operations. Conversely, the financial services segment has been negatively impacted by the depreciation of the Brazilian real. Furthermore, the shares of the group are trading at a discount to net asset value due to investors' limited knowledge of the Brazilian financial market. Consequently, the company is considering the potential sale of its financial services operation through a demerger which will then be listed as a separate business.

The demerger will: Select ALL that apply.

A. reduce the exchange rate risk of the group
B. enhance the market valuation of the separate entities
C. reduce the credit rating of the 10-year bonds
D. require significant resources and time for internal reorganisation

16. Good Consumer Group, listed on the London Stock Exchange, owns two wholly owned subsidiaries:

(1) Good Food & Beverages Company, and

(2) Good Personal Care Company.

The former specialises in the production and sales of packaged snacks with a strong brand presence in various countries, while the latter manufactures skincare, cosmetics and hygiene products under the single 'Revive' brand in the UK. Each subsidiary operates with its own central services.

Both companies invoice their clients in British pounds. Over the past five years, the group's revenues and profits have primarily stemmed from the food and beverages segment. 'Revive' holds just a 2% market share and faces significant competition within its sector. Internal estimates suggest that the food and beverages segment contributes approximately 90% of the company's market capitalisation, amounting to roughly £100 million.

The food and beverages division benefits from regional customisation in distribution networks, whereas the personal care division relies on e-commerce. Consequently, inefficiencies in sales and distribution development have been identified. As a result, the CEO is considering splitting the two subsidiaries into separate publicly listed companies.

The demerger will: Select ALL that apply.

A. improve the operational efficiency of both companies
B. reduce its exposure to the exchange rate risk of Good Food & Beverages Company
C. increase the takeover pressure for Good Personal Care Company
D. create problems for the rearrangement of central services such as treasury and tax

17. ABC Manufacturing Group, listed on the London Stock Exchange, is a large industrial company with two wholly owned subsidiaries: Heavy Machinery Company and Automotive Parts Company. Both subsidiaries have been profitable in the past ten years, with £200 million retained earnings shown in the latest financial statement of the group.

The group's shares are trading at 30% discount to net asset value as investors find it difficult to determine the valuation of the two operations. Therefore, the CEO of the group is considering demerging Automotive Parts Company and listing it separately on the London Stock Exchange, while retaining Heavy Machinery Company. The market valuation of Automotive Parts Company is estimated at £150 million.

The CEO aims to maintain the existing shareholding structure of the group in the new listed company and is concerned about the time and procedures of the proposed demerger. Additionally, he seeks to avoid restructuring plans for the outstanding debts.

Which of the following approaches is the most appropriate in this case?

A. Dividend approach
B. Scheme of arrangement
C. Liquidation method
D. Divestiture

18. XYZ Energy Group operates in two primary segments: renewable energy and fossil fuels. Over the past three years, profitability in both areas has significantly declined, resulting in retained earnings of £50 million as indicated in the group's latest financial statement. Investors are urging XYZ Energy Group to separate its green energy segment from its traditional fossil fuels operations into two publicly traded companies, as some institutional investors prefer to invest in only one segment. They estimate that the market value of each segment could exceed £100 million, representing a 20% increase after the demerger.

The controlling shareholder of the group, James White, who owns 78% of the company, supports the proposed demerger. Creditors, who have established relationships with the controlling shareholder, intend to finance both companies under the new structure.

Which of the following approaches is the most appropriate in this case?

A. Dividend approach
B. Scheme of arrangement
C. Liquidation method
D. Divestiture

19. Zenith Tech Company, a mid-sized technology solutions provider, is preparing for an initial public offering (IPO) to raise £200 million. The company's CFO has identified the following issues in the drafted prospectus:

- **Financial projections: due to the volatility of the industry and rapid market shifts, the board believes future financial projections are uncertain. As a result, no financial forecast is included in the prospectus.**
- **Audited financial statements: given that external audits were not legally required for a private company of its size, the prospectus includes the latest unaudited three-year financial statements. However, the company assures investors of robust internal controls within the prospectus.**
- **Sales contract disclosure: an ongoing sales contract with a distributor, which represented 0.05% of the annual revenue last year, has not been disclosed in the prospectus.**
- **Loan advance to directors: a loan advance to directors amounting to £100 million has not been disclosed in the prospectus.**

Which of the above issues comply with the Prospectus Rules? Select ALL that apply:

A. Omission on financial forecast
B. Unaudited historical financial statements
C. Omission of sales contract
D. Non-disclosure of loan advance to directors

20. NovaTech Solutions Company is involved in software development and is planning an initial public offering (IPO) to raise capital for expansion. The company's CFO has prepared a prospectus for potential investors but has encountered the following key issues:

- **Forecasted financial statements were prepared by management and presented in the prospectus without an accompanying accountant's report.**
- **Due to a tight schedule, the company plans to submit the prospectus to the Financial Conduct Authority (FCA) 30 working days in advance of the intended publication date.**
- **As the company will have significant capital expenditure in the coming years, no details of the dividend policy are mentioned in the prospectus.**
- **The company will launch AI-driven algorithm software expected to generate substantial sales revenue in the coming years. However, the specific technical details of this software are not disclosed in the prospectus.**

Which of the above issues comply with the Prospectus Rules? Select ALL that apply:

A. Forecasted financial statements without an accountant's reports

B. The timing to submit the prospectus to the FCA

C. Non-disclosure of dividend policy

D. Non-disclosure of technical details about the AI-driven algorithm software

21. Company A, a sportswear retailer listed in the UK, periodically seeks acquisition opportunities, although no official announcements had been previously made. On 1 January, the directors of Company A approached Company B regarding the potential acquisition of Company B, another competitor listed in the UK. Discussions regarding the potential acquisition commenced on 10 January between the two companies. On 20 January, market rumours surfaced about the possible acquisition, resulting in a 20% increase in the share prices of both companies on that day. On 25 January, the controlling shareholder of Company B gave an irrevocable commitment to accept the consideration being offered by Company A.

When should the issue be disclosed according to the Disclosure Guidance and Transparency Rules (DTR)?

A. When the approach is made

B. When the discussion of potential acquisition had started

C. When the market rumours arose

D. When the purchase consideration was accepted

22. ABC Company is listed on the UK Stock Exchange. On 1 February, the company appointed John White as an executive director. The company disclosed the appointment, including Mr White's directorships over the last five years, through the Regulatory Information Service (RIS) on the same date.

On 1 March, William Reynolds, another executive director of the company, notified the board of directors of his intent to retire in three months' time. Subsequently, he decided to sell some of the company stock he had received as part of his performance bonus over the past years to fund the purchase of a yacht, and on 5 March he sold 100,000 shares on the London Stock Exchange at market price. He then disclosed to the company the sale three business days after the sale day and the company disclosed this to the market on the same day.

The company then announced its annual results on 31 March.

Which of the following actions violates the UK Listing Rules and the UK Market Abuse Regulation? Select all that apply.

A. The disclosure of Mr White's appointment as an executive director
B. The sale of company stock by Mr Reynolds without approval
C. The timing of selling company stock by Mr Reynolds
D. The disclosure of selling company stock by Mr Reynolds

23. ABC Bank, based in the UK, recently launched new financial products marketed as principal-protected time deposits with a high fixed interest rate. However, the fixed interest rate is not guaranteed, and investors may lose their principal if the bank's credit rating drops below investment grade in the future.

Which one of the following regulatory bodies will be responsible for addressing this case under the Financial Services Act (FSA) 2012?

A. Bank of England (BoE)
B. Financial Policy Committee (FPC)
C. Prudential Regulation Authority (PRA)
D. Financial Conduct Authority (FCA)

24. XYZ Bank, located in the UK, incurred losses on financial derivative instruments due to a trader in the treasury department making investments beyond their designated limit. As a result, the bank is currently unable to repay its outstanding debts in the near term.

Which one of the following regulatory bodies under the Financial Services Act (FSA) 2012 will be responsible for addressing this case?

A. Bank of England (BoE)
B. Financial Policy Committee (FPC)
C. Prudential Regulation Authority (PRA)
D. Financial Conduct Authority (FCA)

25. Which one of the following scenarios is within the regulatory scope of the Financial Conduct Authority (FCA)?

A. Setting capital requirements for UK banks to enhance financial stability during economic downtowns

B. Investigating the firms engaged in misleading investment schemes targeting retail investors

C. Forcing insurers to hold sufficient capital reserves to protect policyholders

D. Setting maximum loan-to-value ratios for retail mortgages offered by building societies

26. XYZ Bank recently promoted a high-return investment product to retail investors. An investigation by the Financial Conduct Authority (FCA) found that the risks associated with the product were not clearly communicated to investors. Additionally, the bank did not conduct adequate suitability assessments, which led to some vulnerable investors purchasing the product and experiencing significant losses.

Which one of the following actions could the FCA take in this case?

A. Require the bank to increase its capital reserves to prevent insolvency

B. Penalise the mis-sale of the financial product

C. Instruct the bank to limit the number of new investors to mitigate risk

D. Require the bank to submit financial reports regularly to update the risk exposure

27. Which of the following is included in both the principles of the UK Corporate Governance Code and the Disclosure Guidance and Transparency Rules (DTR)?

A. More than half of directors in the audit committee must be independent

B. There should be at least two independent non-executive directors in the audit committee

C. The audit committee should have competence relevant to the sector in which the company operates

D. The board should carry out a review of internal control systems at least annually

28. Jenny is employed as a research analyst at an investment bank in the UK. Recently, she prepared a research report that issued a buy rating for Mega Company, an IT company listed in the UK. Prior to public dissemination, the report underwent a review by the internal compliance department to ensure that all estimates and opinions were clearly labelled. Following the release of the report, Jenny proceeded to purchase shares in Mega Company in the market with approval from her employer.

Three days subsequent to the publication of the report, Jenny participated in a television interview to discuss the future prospects of Mega Company. Due to the constraints of limited airtime, she provided a brief summary of the content and projections outlined in the research report and mentioned that the complete report was accessible on the bank's website.

Which of the following violates the disclosure requirements relating to investment research?

A. Reviewing the research report by the internal compliance department
B. Shares purchased in Mega Company immediately after the report was released
C. Limited coverage on the content and projections of the research report in the television interview
D. There is no violation of the disclosure requirements in this case

29. Jenny, a compliance officer at ABC Investment Bank, is investigating the following staff:

- **Kenny, responsible for allocating new shares in XYZ Company's IPO, applied for 10,000 shares as a retail investor with compliance approval. The retail investor allocation was 0.01% of shares applied for. Kenny received 100 shares.**
- **Judy, an oil sector research analyst, purchased an oil mutual fund managed by DEF Investment Bank without disclosure. The fund includes PRQ Oil Company and Double Energy Company, which she covers.**
- **Katie, a retail sector research analyst, bought 500 shares of Mega Company just before publishing a buy rating report on it.**

Which of the above staff violated Personal Account Dealing Rules?

A. Kenny and Judy
B. Kenny and Katie
C. Judy and Katie
D. Kenny, Judy and Katie

30. AIM rules for companies are more lenient than that of ESCC because:

A. a working capital statement is not required
B. a prospectus is not required in any circumstances
C. there is no restriction on the transferability of shares
D. there is no minimum market capitalisation requirement

31. Paul is an illegal drug dealer. He uses the sales proceeds of drugs to buy and sell foreign currencies in rapid succession. This process is referred to as:

A. placement
B. layering
C. integration
D. divergence

32. The activities to provide funds or financial services for the manufacture, acquisition, development or use of weapons refer to which one of the following:

A. amplification
B. proliferation
C. placement
D. arrangement

33. Samuel works at the Financial Conduct Authority (FCA) and is investigating several suspicious bribery cases:

- Mimi, an investment manager at a financial firm, was offered a personal consulting fee of £50,000 by her client. This payment was in exchange for confidential information regarding upcoming business strategies of the company she was researching. Mimi declined the payment but implied that she might provide some general advice in return for a future favour.
- Jason, a research analyst in the oil sector of an investment bank, received an invitation from an oil company to visit its oil mines in rural Saudi Arabia for an upcoming initial public offering (IPO). The oil company offered him complimentary accommodation in a 3-star hotel for the three-day visit.
- Mark, the CFO of a real estate development company, applied for a substantial business loan. To expedite the approval process, he proposed a payment of £10,000 to the senior loan officer at the bank.

Samuel will thoroughly examine these cases to determine whether any violations of ethical or legal standards have occurred.

Who violated the Bribery Act based on the above information?

A. Mimi and Jason
B. Mimi and Mark
C. Jason and Mark
D. Mimi, Jason and Mark

34. Sammy, employed at the Financial Conduct Authority (FCA), is investigating several suspicious cases of insider dealing:

- **David, a senior executive director of a UK-listed retail company, learned in a confidential board meeting that the company would announce much better-than-expected annual earnings. After the meeting, David disclosed this information to his close friend, Sarah. Sarah promptly purchased a substantial amount of the company's stock and realised significant profit following the public announcement.**
- **Alex attended an informal dinner with Mimi, the CEO of UK-listed Fast AI Company. During the dinner, Mimi mentioned that the company would announce a partnership with a major industry player. Subsequently, Alex discovered the partnership details reported by prominent news websites. The next day, Alex bought shares in Fast AI Company.**
- **Maria, a research analyst at an investment bank, subscribed to a financial news website tailored for financial professionals. Recently, she read an article on the potential share buyback scheme initiated by ABC Company. Consequently, she acquired shares in the company after disclosing her actions to her employer.**

Who committed insider dealing based on the above information?

A. David only
B. David and Alex
C. David and Maria
D. Alex and Maria

35. Sammi works at the Competition and Markets Authority (CMA). Last week, Supermarket A submitted a proposal to acquire Supermarket B. Both entities operate within the UK and intend to merge under the new entity, Supermarket X. The anticipated timeline for finalising the merger is approximately eight weeks.

The key financial information of the two supermarkets is shown below:

	Supermarket A (acquirer)	Supermarket B (acquiree)	Supermarket X (Combined forecast)
Turnover	£100 million	£50 million	£180 million
Net profit	£20 million	£10 million	£35 million
Market share in the UK	20%	10%	35%

Select ALL that apply. The above case would be investigated by the CMA because:

A. the turnover level of Supermarket B before acquisition
B. the market share in the UK of the combined company
C. the new business entity after the merger
D. the status of the proposed merger

36. Lucas works at The Pension Regulator (TPR) and received the following complaints against companies in relation to their pension funds:

- **Company X has been underfunded for five years. Recently, it was discovered that the CEO was paid large amounts in performance bonuses.**
- **Auditors of Company Y found that the presence of the available-for-sales securities shown in the statement of financial statement could not be verified in the pension's securities accounts.**
- **One of the investment mandates of Company Z is to invest at least 40% in principal-protected investments in the pension portfolio. Recently, the pension participants received the following information about the asset allocation of the latest pension portfolio:**

Assets	Proportion
Cash	10%
US Treasury bill	20%
Corporate bonds (credit rating: BB)	30%
Equities	40%
Total	**100%**

Which of the above cases should be investigated by TPR?

A. Company X and Y
B. Company X and Z
C. Company Y and Z
D. Company X, Y and Z

Answers to Multiple Choice Questions and Case Studies

1. Answer: A and B Chapter 1, Section 1.3

A is correct as the company needs to secure electronic parts to meet market demand. B is correct as the company wants to expand in Southeast Asia to enhance growth momentum. C is not correct as expertise acquisition is not the major concern of the company. D is not correct as the organisational structure is not the consideration of the acquisition.

2. Answer: B and C Chapter 1, Section 1.3

A is not correct as company valuation is not the concern of Company A for selecting a target. B is correct as the extensive sales network with 10,000 branches can serve as collection points of online sales. C is correct as it helps enhance market shares in the grocery industry. D is not correct as Company A has a well-established relationship with suppliers and vertical integration is not a key objective for acquisition.

3. Answer: A, C and D Chapter 1, Section 1.4

A is correct as the management failed to communicate the acquisition to the staff. B is not correct as the acquisition price is below market capitalisation. C is correct as debt financing is riskier and requires interest payment. Furthermore, Company P's volatile operating cash flow means it may not have the cash to pay the interest when it is due. D is correct as the business scope of Company Q is totally different to that of Company P.

4. Answer: A and B Chapter 1, Section 1.4

A is correct as the change of organisational structure and distribution network was too quick, leading to the departure of experienced managers. B is correct as the acquisition price was at 30% premium to market capitalisation at that time. This implies the synergies were overstated. C is not correct as equity financing is safe to the acquirer as there is no commitment to pay dividends and repaying the capital amount outstanding. D is not correct as the acquired business is in the same industry as Company H.

5. Answer: A and C Chapter 1, Section 3.1.2

A is correct as the senior management does not support the acquisition and the support of public investors is not enough to gain a 75% stake in support of the proposal. B is not correct as the offeror (Company A) is guaranteed 100% control of the target. C is correct as a scheme of arrangement is typically a proposal from the target board to the target shareholders. As the board of Company B are not assisting, the scheme would not have a recommendation from the board of Company B or from Company B's financial adviser for the scheme. D is not correct as stamp duty is waived by using the scheme.

6. Answer: A and B Chapter 1, Section 3.1.2

A is correct as above 75% of stake will support the acquisition as the major shareholder and senior management supports it. B is correct as the offeror (Company X) is guaranteed 100% control of the target by using the scheme. C is not correct as the scheme incurs high adviser fees and charges due to significant legal procedures and hearing. D is not correct as court approval is required for the acquisition by using the scheme.

7. Answer: A and C Chapter 2, Section 2.1.1

A is correct as the customer base can only be acquired by share purchase rather than asset purchase. B is not correct as the liabilities will be acquired via share purchase. C is correct as FinTech Company is listed on the London Stock Exchange and it is easy to determine the purchase consideration by comparing market multiples of the company and that of recent acquisitions. D is not correct as the acquirer (Global Bank) cannot use the tax losses under share purchase and will be preserved in FinTech Company.

8. Answer: A, B and D Chapter 2, Sections 2.1.1 and 2.1.2

A is correct as asset purchase allows Rowing Company to acquire the sites in Scotland, instead of all property sites owned by Aberdeen Company when using share purchase. B is correct as the liabilities will not be acquired via asset purchase. C is not correct as market multiples are hard to find for asset purchases. In this case, the opinion of a surveyor might be required as each property site is unique and not easy to compare with recent market transactions. D is correct as the acquisition price will become the book value in the accounts of Rowing Company. Goodwill would be created in a share purchase as the purchase consideration is usually higher than the book value of the acquired company.

9. Answer: Case Study Chapter 2, Section 4.3

Issuing amount of three-year bond = £200,000 – 15,000 x £10 = £50,000

Pro-forma Interest-bearing borrowings = £200,000 + £50,000 + £180,000 = £430,000

Pro-forma shareholders' funds = £300,000 + 15,000 x £10 = £450,000

Pro-forma gearing ratio = £430,000 / £450,000 = **95.56%**

10. Answer: Case Study Chapter 2, Section 4.3

Issuing amount of five-year bond = £300,000 – 10,000 x £18 = £120,000

Pro-forma Interest-bearing borrowings = £100,000 + £120,000 + £140,000 = £360,000

Pro-forma shareholders' funds = £400,000 + £20,000 + 10,000 x £18 = £600,000

Pro-forma gearing ratio = £360,000 / £600,000 = **60%**

11. Answer: Case Study Chapter 2, Sec 4.1.2

Net operating profit after taxes = £90,000 – £13,000 – £7,000 = £70,000

Invested Capital = £440,000 + £210,000 + £170,000 = £820,000

ROIC = £70,000 / £820,000 = 8.54%

12. Answer: Case Study Chapter 2, Sec 4.1.2

Net operating profit after taxes = £72,000 + £3,000 + £6,500 - £5,000 = £76,500

Invested Capital = £580,000 + £250,000 + £250,000 = £1,080,000

ROIC = £76,500 / £1,080,000 = 7.08%

13. Answer: A, B and C Chapter 3, Section 2.1

A is correct as the proposal provides room for Auto Parts Company to develop engines for agricultural trucks. B is correct as the financing costs of the floating rate bonds will increase in the coming two years due to an expected interest rate hike. C is correct as shares of Auto Parts Company will be sold to the public through equity carve-out, which can generate cash for Auto Parts Company. D is not correct as there is no information about the non-compliance of the business of Auto Parts Company.

14. Answer: C and D Chapter 3, Section 2.1

A is not correct as the group is debt free and there is less concern on financing costs. B is not correct as a spin-off does not involve raising capital but distributing shares of the new company to existing shareholders in form of a dividend. C is correct as the market value of Legacy Apparel can be realised after listing separately from the group. D is correct as Legacy Apparel will be listed through distributing dividends to existing shareholders of the group. The White family will still hold a 70% stake in Legacy Apparel.

15. Answer: A and B Chapter 3, Sections 5.1 and 5.2

A is correct as the demerger can eliminate the adverse effect of depreciation of the Brazilian real. B is correct as the business line will be more understandable by the investors and enhance the valuation. C is not correct as the issuance of 10-year bonds supports the oil extraction and the majority of the profit comes from the segment instead of finance services. D is not correct as the three segments are operated in separate subsidiaries with their own central services, which minimises the reorganisation effort after demerger.

16. Answer: A and C Chapter 3, Sections 5.1 and 5.2

A is correct as the sales and distribution strategy can be more focused on their own strategies after demerger. B is not correct as sales revenue is denominated in British pounds before and after demerger. C is correct as the small market capitalisation and lacking marketability of the shares after demerger will attract the takeover. D is not correct as they were run in separate subsidiaries with their own central services before demerger.

17. Answer: A Chapter 3, Section 6

A is correct as the new listed company can maintain the same shareholding structure of the group. Besides, the involvement of creditors is not required in a dividend approach. Moreover, the group has sufficient distributable reserve for the dividend in specie. B is not correct as the creditors and court approval are required. C is not correct as all outstanding debt will be paid off under the liquidation method. D is not correct as it is sold to the single acquirer instead of listed in the Stock Exchange.

18. Answer: B Chapter 3, Section 6

A is not correct as the group has insufficient distributable reserves for the dividend in specie. B is correct as the controlling shareholder owns a 78% stake in the company, which is above the 75% threshold of passing a special resolution. Besides, the creditors will agree with the proposal. C is not correct as all outstanding debt will be paid off under the liquidation method, which is not the intention of the creditors. D is not correct as it is sold to the single acquirer instead of listed on the Stock Exchange.

19. Answer: A and C Chapter 4, Section 2

A is correct as it is not required in the prospectus. B is not correct as the latest three-year financial statements must be audited in the prospectus. C is correct as the FCA permits information to be omitted from the prospectus if the information is of minor importance. D is not correct as it is a related-party transaction and it is material to the company compared to the capital amount raised.

20. Answer: B and D Chapter 4, Section 2

A is not correct as it is required to provide an accountant's report if the forecasted financial statement is included in the prospectus. B is correct as the deadline is 20 working days prior to the intended publication of the prospectus. C is not correct as it is required to disclose details of dividend policy. D is correct as the FCA permits information to be omitted in the prospectus if it would be seriously detrimental to the interests of the issuer.

21. Answer: C Chapter 4, Section 5.1

A and B are not correct as the acquisition is still remote and the delay of disclosure is not likely to mislead the public, and the matter remained confidential and disclosure would be detrimental to the negotiations. C is correct as the rumours lead to significant effect on the share prices of both companies. Even though the acquisition had not yet been agreed by the parties, disclosure of the fact that negotiations were taking place is required. D is not correct as it is too late to disclose given that the share prices fluctuated due to the market rumours on 20 January.

22. Answer: B and C Chapter 4, Section 5.4

A is not correct as the disclosure includes the directorship in any companies in the last five years. B is correct as the approval should be sought prior to any trading. C is correct as the directors cannot sell company stocks 30 days before the release of annual result announcement (unless they are in financial distress). D is not correct as the disclosure should be made within four business days.

23. Answer: D Chapter 5, Sections 2.1 to 2.4

A is not correct as the BoE is responsible for ensuring the stability of the financial system and identifying potential crises. B is not correct as the FPC is responsible for macro-prudential oversight of the regulatory system but not for monitoring misconduct of individual financial institutions. C is not correct as the PRA is responsible for promoting the safety and soundness of regulated firms, and minimises any adverse effects of firm failure on the UK financial system. D is correct as the FCA is responsible for consumer protection in financial services, conduct of business and market conduct. ABC Bank missold complex financial products and misled investors in this case.

24. Answer: C Chapter 5, Section 2

A is not correct as the BoE is responsible for ensuring the stability of the financial system and identifying potential crises. B is not correct as the FPC is responsible for macro-prudential oversight of the regulatory system but not for monitoring misconduct of individual financial institutions. C is correct as the PRA is responsible for promoting the safety and soundness of regulated firms and minimises any adverse effects of firm failure on the UK financial system. The potential bank run will affect the banking system. D is not correct as the FCA is responsible for consumer protection in financial services, enhancing the integrity of the UK financial system and promoting effective competition.

25. Answer: B Chapter 5, Sections 2.1 to 2.4

B is correct as one of the FCA's objectives is to secure appropriate degree of consumer protection. A, C and D are not correct as they are roles of the FPC, ie, to conduct prudential regulations of banks, deposit takers and insurers.

26. Answer: B Chapter 5, Sections 2.1 to 2.4

A is not correct as it is the role of the PRA but not the FCA. B is correct as the FCA aims to protect consumers when purchasing financial products. C is not correct as it is a business decision rather than regulatory penalty. D is not correct as the FCA focuses on consumer protection and market integrity rather than supervision of balance sheet risk of banks.

27. Answer: C Chapter 5, Section 5.3

A is not correct as the UK Corporate Governance Code requires a minimum of three members as INEDs, which is not necessarily more than half of the directors in the board. B is not correct as it is not a must to have an INED under the DTR. C is correct. Under UK Corporate Governance Code and DTR, the committee as a whole shall have competence relevant to the sector in which the company operates. D is not correct as there is no requirement to conduct an annual review under the DTR.

28. Answer: B Chapter 5, Section 8.4

A is not correct as the drafted investment research report can be verified due to the firm's legal compliance and obligations. B is correct as a personal transaction is not allowed until the recipient of the investment research has had a reasonable opportunity to act on it. C is not correct as limited coverage on recommendations is acceptable due to limitation on the length or form of the recommendations, and Jenny mentioned that the full report is available in the public domain. D is not correct as Jenny should not purchase shares of Mega Company until the report is distributed to her clients and the public.

29. Answer: B Chapter 5, Section 9

Kenny violated the rules as he takes advantage in the allocation of new shares during the IPO (1% for his application versus 0.1% for other retail investors). Judy did not violate the rules as the oil mutual fund is not managed by the ABC Investment Bank. Katie violated the rules as she misused confidential information for personal dealing.

30. Answer: D Chapter 4, Section 1.4.1

A is not correct as a working capital statement is required for AIM. B is not correct as a prospectus is still required if there is a public offer for the companies listed in AIM. C is not correct as both company shares under ESCC and AIM are transferrable freely. D is correct as there is no minimum market capitalisation requirement for AIM, while there is a £30million minimum for ESCC.

31. Answer: B Chapter 5, Section 11.1

A is not correct as it involves placing criminally derived cash into deposit-taking companies, a bureau de change or a casino. B is correct as it involves moving the money around the financial system (forex in this example) in order to make it difficult for the authorities to link the placed funds with the ultimate beneficiary of the money. C is not correct as it refers to the cash integrated into the legitimate financial system after layering. D is not correct as there is no such process in money laundering.

32. Answer: B Chapter 5, Sections 11.1 and 11.2

A is not correct as there is no such process in terrorist financing. B is correct as it refers to provide funds or financial services for use in the manufacture, acquisition, development, transport, or other related activity or use of weapons. C is not correct as placement refers to moving money around the financial system to make it difficult for the authorities to link the placed funds with the ultimate beneficiary of the money. D is not correct as arrangement refers to facilitating the acquisition, retention, use or control criminal property for another person.

33. Answer: B Chapter 5, Section 12.1

Mimi violated the Act as she agreed to receive a bribe (a consulting fee) for providing a future favour. Jason did not violate the Act as the free accommodation had a legitimate business aim. The quality of hotel and duration of accommodation were reasonable and appropriate. Mark violated the Act as he offered bribe for fast-track approval.

34. Answer: A Chapter 5, Section 10.2

David committed insider dealing as he encouraged Sarah to buy shares by using insider information. Alex did not commit insider dealing as there are reasonable grounds for him to use public information to trade securities. Maria did not commit insider dealing as information acquired by fee is considered as published information instead of insider information.

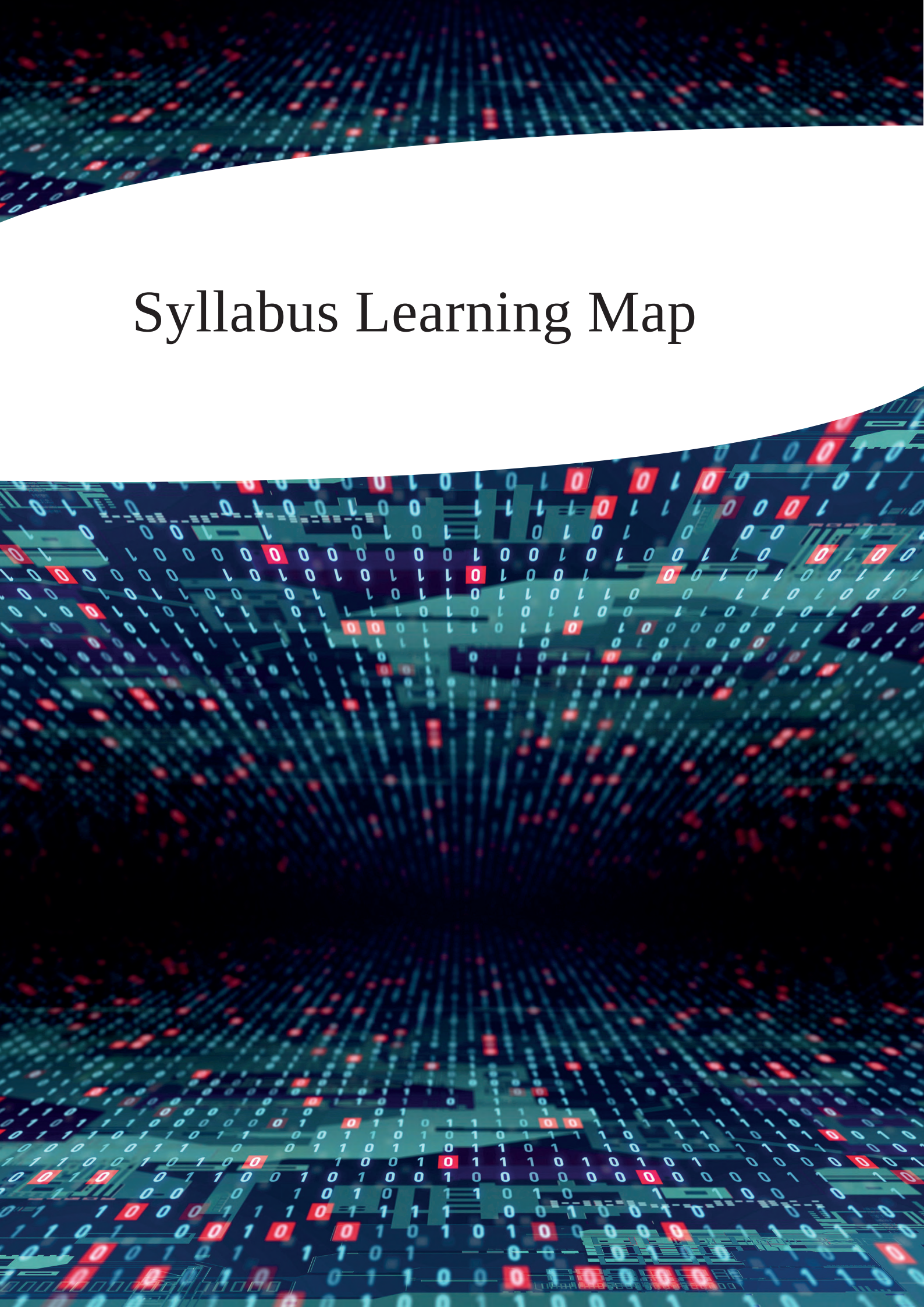
35. Answer: B, C and D Chapter 5, Section 2.8.2

A is not correct because the turnover of the acquiree is less than £70 million. B is correct as the market share of the combined company exceeds 25%. C is correct as the two supermarkets will cease to be distinct. D is correct as the merger has not yet taken place.

36. Answer: D Chapter 5, Section 12.2

All companies work against the interests of pension participants. Company X shows no attempt to improve the underfunding status. The large amounts paid in performance bonuses will make the fund status even worse. Company Y fails to safeguard the fund assets of pension participants. Company Z fails to comply with the investment mandates as corporate bonds without investment grade and equities are not considered principal-protected.

Syllabus Learning Map



Syllabus Unit/ Element		Chapter/ Section

Element 1	Making Acquisitions	Chapter 1
1.1	**Mergers and Acquisitions as a Strategy** On completion, the candidate should:	
1.1.1	Be able to evaluate the arguments for and against the use of mergers and acquisitions as a strategy for growth	1
1.1.2	Be able to apply appropriate criteria for selecting a target for acquisition	1
1.1.3	Be able to evaluate a potential acquisition target for the following synergies: • Revenue synergy • Cost synergy • Financial	1
1.1.4	Be able to analyse the reasons for an acquisition failing to enhance shareholder value and generate anticipated synergies	1
1.1.5	Be able to evaluate alternative strategies to mergers and acquisitions for achieving a strategy of growth	1
1.2	**The Acquisition Process and The Takeover Code** On completion, the candidate should:	
1.2.1	Know the key stages in the acquisition of a private company	2
1.2.2	Know the due diligence process for acquiring private and public companies including: • Scope of due diligence • Vendor due diligence and data rooms • Purchaser due diligence	2
1.2.3	Know the various types of due diligence that may need to be carried out: • Commercial • Financial • People (including management) • Operational • Environmental • Legal (including regulatory) • IT (including cyber and data security)	2

Syllabus Unit/ Element		Chapter/ Section
1.2.4	Know the following aspects of the Takeover Code and their relevance when advising on an acquisition to which the Code relates: • When the Takeover Code applies • The structure of the Takeover Code • The spirit of the Takeover Code • The structure of the Panel on Takeovers and Mergers (PTM) and its powers • Statutory status • Independent advice • Irrevocable undertakings • Financing arrangements • Offers for different classes of shares • Concert parties • Special deals and management incentives • Accuracy and content of documents • The creation of false markets • Restrictions and frustrating actions • Consideration • Mandatory offers • The timetable of an offer • Consulting the Panel	3
1.2.5	Be able to analyse the key stages in the acquisition of a public company via a contractual offer or scheme of arrangement	3
1.2.6	Be able to evaluate appropriate strategies for agreed and hostile offers including hostile bid tactics and defence strategies	3
1.2.7	Be able to evaluate the purpose, scope and contents of different types of legal and other documentation necessary during the acquisition process	3

Element 2	Deal Structuring and Financing	Chapter 2
2.1	**Structuring the Deal** On completion, the candidate should:	
2.1.1	Be able to evaluate the merits of acquisition via a share purchase versus structuring the deal as the purchase of assets	2
2.1.2	Be able to evaluate the use of control premia and marketability discounts in arriving at the acquisition price	6

Syllabus Unit/ Element		Chapter/ Section
2.2	**Financing Options** On completion, the candidate should:	
2.2.1	Be able to evaluate different offer considerations for an acquisition including cash, loan stock, shares and other relevant forms of consideration	3
2.2.2	Know the purpose and scope of loan and security documentation in corporate finance transactions	3
2.2.3	Be able to evaluate the relative merits and demerits of earn outs and deferred consideration as options for financing an acquisition	3
2.2.4	Know the impact that variable interest rates have on financing of transactions	4
2.3	**Analysing Deal Effects** On completion, the candidate should:	
2.3.1	Be able to analyse whether a deal has had an enhancing, accretive or dilutive effect on the acquirer's earnings per share (EPS)	4
2.3.2	Be able to analyse the effects of a deal on the financial risk of the acquirer	4
2.3.3	Be able to analyse the effects of a deal on the relative size of the acquirer with specific reference to net asset per share	4
2.3.4	Be able to analyse the effects of a deal on the return on capital employed (ROCE)	4
2.3.5	Be able to analyse the effects of a deal by considering the return on invested capital (ROIC) of the acquirer	4
2.3.6	Be able to analyse a deal by considering further measures including the size of the bid premium, the post-acquisition P/E ratio and dividend pay-out ratios	4
2.4	**Analysing Merger Gains** On completion, the candidate should:	
2.4.1	Be able to analyse the share of merger gains accruing to the acquirer and the target company shareholders under different financing scenarios	5

Syllabus Unit/ Element		Chapter/ Section

Element 3	Disposals and Demergers	Chapter 3
3.1	**Disposals** On completion, the candidate should:	
3.1.1	Be able to analyse the motivations for disposal of the following: • A subsidiary or division of a public or private company • A private company disposal • A personal disposal of a family business	2
3.1.2	Know the following aspects of the sale process of a disposal in a given scenario: • Traditional and alternative disposal methods • Identifying and shortlisting purchasers • Approaching potential purchasers	3
3.1.3	Know the stages of the auction process in the following situations: • Advising on inviting offers • Evaluating offers	4
3.2	**Demergers** On completion, the candidate should:	
3.2.1	Be able to evaluate the benefits and potential problems associated with a demerger	5
3.2.2	Be able to evaluate the use of the following methods of achieving a demerger: • Dividend approach • Scheme of arrangement • Liquidation method	6

Element 4	Main Regulations for Listed and Quoted Companies	Chapter 4
4.1	**The UK Listing Rules** On completion, the candidate should:	
4.1.1	Know the following aspects of the UK Listing Rules (UKLR) in a given scenario: • The structure, applicability and enforcement of the Listing Rules • The listing principles • The key requirements for listing • The timetable for listing • Obligations of sponsors	1.1, 3, 4

Syllabus Unit/ Element		Chapter/ Section
4.2	**Prospectus Rules** On completion, the candidate should:	
4.2.1	Be able to apply Prospectus Rules: Admission to Trading on a Regulated Market sourcebook (PRM) when advising on: • When a prospectus is required • The format and contents of a prospectus • The approval of a prospectus by the regulator and subsequent publication • The appropriate use of a base prospectus and pricing statements	2
4.3	**Continuing Obligations** On completion, the candidate should:	
4.3.1	Be able to apply the UK Listing Rules, the Disclosure Guidance and Transparency Rules (DTR) and UK Market Abuse Regulation (UK MAR) in relation to: • Announcements to shareholders (including the dissemination of inside information) • Significant transactions and reverse takeovers, including the need for 'class tests' • Related party transactions • Directors' obligations	5
4.4	**AIM Rules** On completion, the candidate should:	
4.4.1	Be able to interpret the AIM rules for Companies	6

Element 5	Other Regulatory and Ethical Considerations	Chapter 5
5.1	**The Regulatory Environment** On completion, the candidate should:	
5.1.1	Understand the regulatory environment: • UK regulatory infrastructure • the Financial Services and Markets Act 2000 • the Financial Services Act 2012 • global considerations	2
5.1.2	Understand the role of the FCA in the regulation of the financial services industry	2
5.1.3	Know how regulated market structures are regulated: • Exchanges • Trading venues (multilateral trading facilities and organised trading facilities) • Systematic internalisers	2.7
5.1.4	Know the roles of the relevant bodies involved in takeovers and mergers	2.8

Syllabus Unit/ Element		Chapter/ Section
5.2	**Ethics and Governance** On completion, the candidate should:	
5.2.1	Be able to apply their professional body's relevant code of conduct (eg, CISI's Code of Conduct and/or the ICAEW's Code of Ethics) in a given scenario	3.1
5.2.2	Be able to apply the main principles of the UK Corporate Governance Code and the QCA Corporate Governance Code in a given scenario	5.1
5.2.3	Know the similarities and differences between the principles of the UK Corporate Governance Code and the Disclosure Guidance and Transparency Rules (DTR)	5.1
5.3	**Legislation and Regulations relevant to Companies and Financial Markets** On completion, the candidate should:	
5.3.1	Be able to interpret the key provisions relevant to the following areas of the Companies Act as they relate to corporate finance transactions: • Section 793 notices • Company meetings • Alterations to capital structure • Financial assistance • Company investigations • Minority shareholder protections • Duties of directors in relation to conflicts of interest	4.1
5.3.2	Be able to interpret the key provisions of section 21 (financial promotions) of the Financial Services and Markets Act (FSMA) as they relate to corporate finance transactions	6.1
5.3.3	Be able to interpret key aspects of the UK Markets in Financial Regulation and the FCA's Conduct of Business Sourcebook for firms conducting designated investment business: • Client categorisation • Conflicts of interest • Investment research • Personal account dealing rules	7

Syllabus Unit/ Element		Chapter/ Section
5.4	**Financial Crime** On completion, the candidate should:	
5.4.1	Be able to interpret the following key aspects of the UK Market Abuse Regulation to a given corporate finance scenario: • The five offences of market abuse • Qualifying investment and markets • Defences and penalties • Reporting suspicious transactions • The FCA's Code of Market Conduct • Price stabilisation and buybacks	10.1
5.4.2	Know activities considered to constitute: • money laundering • terrorist financing	11
5.4.3	Be able to interpret the requirements of the following as they relate to the corporate finance profession: • The Bribery Act • The Criminal Justice Act (specific provisions on insider dealing) • The Insider Dealing (Securities and Regulated Markets) Order 2023) • The Proceeds of Crime Act (specific provisions for money laundering) • The Counter Terrorism Act (specific provisions on money laundering of terrorist funds and terrorist financing) • Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017	12.1 10.2 10.2 11.1.1 11.1.6 11
5.5	**Competition and Other Regulations** On completion, the candidate should:	
5.5.1	Be able to evaluate in a given corporate finance scenario the likelihood of intervention from the following regulators: • The Competition and Markets Authority • The Pensions Regulator • The Department for Business, Energy and Industrial Strategy (the National Security and Investment Act)	12.2

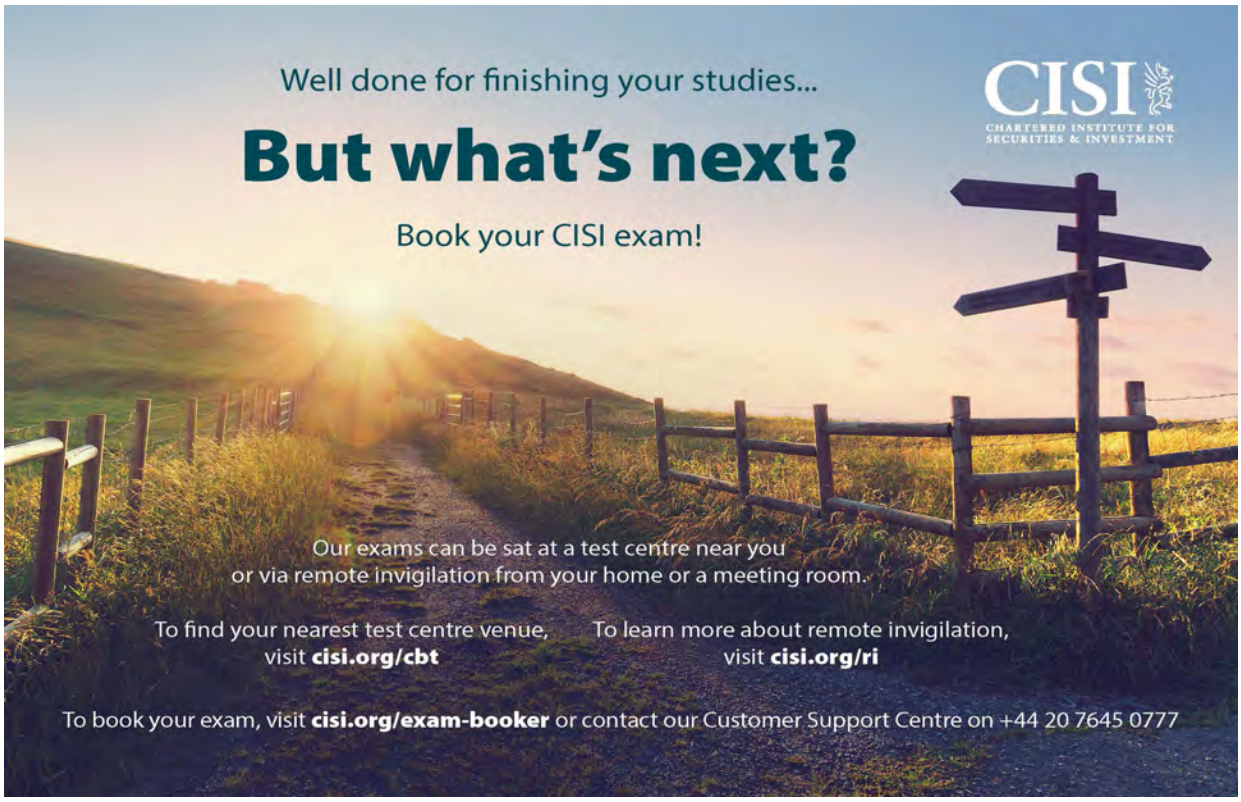
Examination Specification

Each examination paper is constructed from a specification that determines the weightings that will be given to each element. The specification is given below.

It is important to note that the numbers quoted may vary slightly from examination to examination as there is some flexibility to ensure that each examination has a consistent level of difficulty. However, the number of questions tested in each element should not change by more than plus or minus 2.

Element Number	Element	Questions	Case Studies
1	Making Acquisitions	4 Questions*	3 Case Studies (with 5 Questions* each) covering any Element of the syllabus
2	Deal Structuring and Financing	3 Questions*	
3	Disposals and Demergers	3 Questions*	
4	Main Regulations for Listed and Quoted Companies	2 Questions*	
5	Other Regulatory and Ethical Considerations	3 Questions*	
Subtotal		**15 Questions**	**15 Questions**
Total		**30 Questions**	

* May include a mix of multiple choice, drag and drop, numerical answer and multiple response questions.



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Anti-Money Laundering
Understand AML legislation and regulation, the role of the MLRO, and the sanctions and penalties.



Client Assets and Client Money Essentials
Gain an overview of the principles and high-level rules associated with holding and protecting client assets.



Conflicts of Interest
Consider examples of conflicts of interest, tools, policies and procedures, enforcement action, and good practice.



Data Science
Digitisation of business operations has accelerated the speed of data capture. Harness the value of your data.



Diversity and Inclusion
Targeted at those responsible for diversity, equality and anti-discrimination, and those recruiting and managing.



Financial Crime
Gain an overview of insider dealing, market abuse, money laundering, terrorist finance and financial sanctions.



Financial Planning
Gain an overview of the financial planning process, key terms and the regulatory framework that governs it.



Greenwashing
This module explores the key concepts surrounding greenwashing, the wider implications, and the measures being taken to fight it.



Impact Investing
Aim to take ethical and sustainable investment principles a step further through intentional investment.



Integrity and Ethics
Understand ethics in finance, the importance of trust and trustworthiness, and compliance versus ethics.



Market Abuse
Examine offences, penalties, safe harbours, reporting obligations and the relationship with other offences.



Neuroscience at Work
Learn how to work optimally without harming your health when faced with increased workloads and deadlines.



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