Insight: Emerging Markets

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Should we judge a bookbuilder by its cover?

As we continue to witness the aftershocks of the tsunami that ripped its way through the financial markets in 2008, many of the key global regulators have a heightened focus on bribery and corruption issues, especially in transactions involving the emerging markets.

In the UK, it is generally thought that the Serious Fraud Office (SFO) and Director of Public Prosecutions (DPP) seem keen to claim an early high profile scalp after all the publicity surrounding the arrival of the UK Bribery Act. The record fines the FSA imposed on AON in 2009 and Willis in 2011 in proceedings that focussed on regulated firms' systems and controls in this area are a strong indication of the willingness of the FSA to pursue such matters, and it is only a matter of time before it brings another case against a market participant. On the other side of the Atlantic, the US SEC has restocked its armoury with a battery of new tools designed to combat fraud and corruption (including the Dodd-Frank Act's "whistleblower" rules which offer a potential financial reward for those who report to the SEC that someone is violating federal securities laws).

With the spotlight firmly on investment banks' response to the financial crisis, and banks investing heavily in ensuring their systems and controls are adequate and appropriate globally, White & Case held a seminar as part of our "Emerging Markets Breakfast Series" to discuss the potential impact of bribery and corruption issues on banks' reputations. Given the fact that the UK Bribery Act could open banks up to a charge of aiding, abetting, counselling or procuring bribery (and senior management to charges of consenting to or conniving in bribery), one of the questions raised at that seminar concerned the challenge posed when other banks are brought into transactions (often at short notice before pricing at the instigation of the issuer) in the capacity of joint lead or co-managers. We thought it might be useful if we gave a wider circulation to our considered answer to this potentially thorny problem.

What is the issue in working with unfamiliar co-managers?

The primary question lead managers in non-US offerings may not have had cause to consider in the past is whether their due diligence procedures should extend beyond the issuer to other participants in the transaction. Rather than necessarily addressing a black letter "legal" risk, the issue can be more one of protecting the bank's reputation in the markets by attempting to avoid association with an entity which may be conducting itself in a way which your regulator or the UK courts would deem inappropriate.

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When should I be concerned?

In many cases, banks co-lead transactions and will have little or no connection with the issuer or its clients. If the banks are all seasoned market participants and part of global organisations, the risk of a new co-manager being an entity that rings any alarm bells from a diligence perspective is remote. But what if the new bank is a financial institution that is mainly a local market participant, not regulated outside its home jurisdiction, and is brought into the transaction by the issuer at a late stage of the deal? Is this something that should raise an alarm bell and merit consideration of the participant and its role in the transaction?

Not surprisingly, the answer to this is not clear cut. However, it seems to us that if a manager has never before co-led a deal with the new bank, this is one situation where the manager might reasonably ask itself whether conducting some due diligence is advisable. We consider the level of diligence further below but it would obviously depend on the new bank in question and what is uncovered on an initial background check. Another potential trigger point is where the new bank could be deemed to be an "associated person" of the bank under the UK Bribery Act. This could be the case where, for example, the new bank is to act as a local selling agent and is therefore providing services to the joint lead manager.

Practical steps

If a JLM has determined to look into the background of a new bank it does not know well, what can and should the JLM do to mitigate risks of damage to its reputation by association? For example, it may be that there are business sensitivities with the client wanting to bring in a new bank and there could be concerns that refusing could damage the relationship with the client.

- **Due Diligence** – Given that the JLM will be entering into a contractual relationship with the new bank in the Agreement Among Managers and Subscription Agreement (not to mention having names side by side on the cover of the prospectus), it might be prudent to do due diligence on:
  - the new bank's regulator and their relationship
  - the new bank's previous capital markets deal arranging/underwriting experience (including whether the bank has its own account in the relevant clearing system(s))
  - the new bank's key personnel and shareholders (and whether any of them have been investigated for bribery or corruption offences)
  - the new bank's relationship with the issuer or its shareholders (the JLM's due diligence on the issuer should have picked up whether the local bank may be an "associated person" of the issuer for the purposes of the Bribery Act)
  - whether the new bank's local laws or regulator mandate the importance of good anti-bribery and corruption systems and procedures and whether it does in fact have them in place
  - where the new bank does business or has joint venture arrangements (including checking the relevant lists for deals it has done in sanctioned jurisdictions or which involved Politically Exposed Persons)
  - the new bank's relationship with "foreign public officials" (i.e., their local government).

Often time can be short for making these enquiries and it can be a sensitive area to bring up with the team at the local bank direct. You may consider hiring a third party background checking service to assist with these enquiries just like you may do at the pre-mandate stage when you consider whether to pitch for business to a potential issuer client.

- **Listing concerns?** If the bank has concerns about the new bank as a result of due diligence procedures conducted before an initial filing of a draft prospectus for UKLA review (or if in fact the timetable has not allowed such diligence enquiries or internal approval processes to be satisfactorily completed before the first UKLA filing), you may consider removing your name from the prospectus before it is circulated outside the working group to avoid your reputation being tainted by association with the new bank.
- **Mandate letter stage** – It is always better to stop a problem arising at all than have to fire fight in the heat of the run up to pricing a deal. A simple practical change would be to include language in your mandate letter so the issuer agrees that another bank may not be brought into the syndicate without the consent of the JLMs and in any event has to be, for example, regulated by a respected authority. This may give you some comfort about the level of investigation you may need to carry out on an unfamiliar new bank if the universe of potential syndicate members is circumscribed from the outset or, at the very least, enable you to push back with more conviction if the issuer raises the idea of an unfamiliar bank joining the syndicate at the eleventh hour.

What if *you* are the bank brought in late in a deal?

While we are on the topic, we might consider how this issue can work in reverse if you are the bank being brought into an emerging markets deal late in the day because the original syndication plans have changed. It is a challenge for such a bank to get itself comfortable with the issuer and the disclosure at short notice. Regulators and courts work with 20:20 hindsight and it may be hard to argue that you were reasonable in simply standing back and relying on the due diligence which has been done by other syndicate members without taking steps to do your own due diligence. In order to demonstrate that your procedures are robust (and satisfy your internal compliance committees), the following issues are likely to come into play:

- **Why are you being brought into the deal?** It is important to establish the role you are expected to play at the outset (especially whether you will be making sales into the United States) and why you have been brought in at a late stage. Has another bank resigned, if so, why?

- **What is the timing?** Have you missed the whole due diligence exercise or is there still time to get involved in face to face meetings with management, etc? At the very least you will want to see the due diligence questions asked and find out which of the issuer's management team attended the meetings. You are likely to want to schedule a call (or a face to face meeting if appropriate) to raise with the other JLMs, their counsel and the issuer any additional due diligence questions you think were missing from the original exercise and any concerns flagged by your credit committee.
- **Who is the issuer?** If you already have a close relationship with the issuer, you may have pretty fresh existing intelligence on the current state of their business and need to do less to refresh your knowledge.
- **Who are the other participants?** Have you worked with the other managers before and are they respected securities houses experienced in due diligence investigations? Which law firms and auditors are involved and what do their draft 10b-5s, opinions and comfort letters say?
- **What do the documents say?** A thorough review of the current draft of the disclosure (including risk factors) will obviously be vital (and your comments should be fed into the drafting process to cover off your concerns). You will also follow your usual internal checklists to ensure that all the usual representations and warranties, indemnities and other protections which you require to see in the Subscription Agreement are present.

Of course when asked to act as a co-lead manager or other non-JLM role or in a non-US investment grade offering, the procedures mandated by your internal compliance committees are likely to be different although the fundamental question of satisfying yourself that your reputation will not be tarnished by your involvement in the deal remains as pressing.

The key question is whether there is time for you to do the checks you and your credit committee want to do or should you walk away from the deal? If you take the decision to walk, it would obviously be ideal to do so before your name is publicly associated with the transaction in order to limit damage to your reputation. However, as we mentioned above, even the confidential filing of the draft prospectus could cause reputational damage.

Ultimately, the issues discussed in this note are delicate and need to be handled carefully with the issuer, the new bank/ other managers and your regulator. Our team of experts can help you navigate these discussions, drawing on our experience of handling dialogue with regulators in the UK, the US and throughout the world, providing anti-bribery systems audits and of course advising on capital markets deals. Please get in touch with your usual White & Case contact if you would like to discuss how we can assist.

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