CHARTA LEARNING · INTERVIEW PREPARATION

Regulation, Documentation and Legal Process (Investment Banking)

Interview preparation summary · IB track

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INT.BL.1.a · Rules of the game

Explain what makes information inside information, the main forms of market abuse, and the practical rules a banker follows to avoid them.

Under UK and EU-style rules, inside information is precise information that has not been made public, relates to an issuer or its securities, and would be likely to have a significant effect on the price if it were public. US law speaks of material non-public information and ties liability to breach of a duty, so the tests differ in detail. The main forms of market abuse are insider dealing (trading on the information), unlawful disclosure or tipping (passing it on outside the proper course of duties) and market manipulation (false or misleading signals). A banker cannot tell whether information is price sensitive by feel: compare the likely price move with normal daily volatility and ask whether a reasonable investor would use it. Practical rules include need-to-know sharing, insider lists, watch lists and restricted lists, pre-clearance of personal dealing, and no discussion in public places. The usual mistake is to think that only trading is an offence. Passing the information on is an offence of its own, whether or not the banker profits.

WORKED EXAMPLE: MERROW PACKAGING: IS IT INSIDE INFORMATION, AND WHAT ARE THE OFFENCES?

Your client is preparing a possible cash offer for Merrow Packaging plc, an invented listed company whose shares trade at 480p. The offer would be 624p a share. Merrow's shares typically move about 1.6% on a normal day. A junior colleague tells a friend, who buys 100,000 shares at 480p before the announcement, and also buys 20,000 shares for his own account. Assume the share price moves to the offer price on announcement. Test the information, then calculate the friend's and the colleague's gains.

Answer: The information is price sensitive (a 30% premium, about 19 times a normal daily move), the friend gained GBP 144,000 and the colleague GBP 28,800, and both the tip and the dealing are separate offences under UK and EU-style rules.

> **Interview tip:** Say it is education not legal advice if asked about a specific case, name the test, and stress that tipping is an offence even if you make no trade yourself.

INT.BL.1.b · Rules of the game

Describe how information barriers, wall-crossing and conflict management work in a bank and apply them to a conflict between fee streams.

A bank holds confidential information on one side of its business, such as M&A or capital markets deal teams (the private side), and trades and publishes on another (the public side). Information barriers, often called Chinese walls, combine separate teams and systems, need-to-know rules and monitoring by compliance, which keeps a watch list of confidential deals and a restricted list of names where activity is barred. Wall-crossing is the controlled step of telling an outside person, for example an investor sounded before a placing, inside information after they agree to confidentiality and not to trade until the information is announced or no longer inside. Practice is logged and compliance usually approves it in advance. Conflicts arise where the bank has competing interests, such as advising a seller while financing a bidder. They are managed by disclosure, informed consent, separate teams, review by a conflicts committee, or declining the work. A barrier does not cure every conflict. A common mistake is to assume that it does.

WORKED EXAMPLE: CALLOWAY FOODS: ADVICE AGAINST FINANCING

A bank is asked to advise Calloway Foods plc, an invented seller, for an advisory fee of 5.0m. A bidder separately asks its leveraged finance team to underwrite 600m of acquisition debt for a fee of 2.25%. Calculate the financing fee and compare it with the advisory fee. Say why this is a conflict, how it may be managed and when the bank should decline.

Answer: Financing fee 13.5m against advisory fee 5.0m, a ratio of 2.7 times, so the conflict is serious: manage it with consent and barriers if possible, and decline if the seller does not consent or the risk to the seller's interests remains.

> **Interview tip:** Do not say a wall solves a conflict. It controls the flow of information. Conflicting duties still need disclosure and consent, or a decision to decline.

INT.BL.1.c · Rules of the game

Summarise customer due diligence (KYC and AML) and the main features of takeover and listing rules at overview level, noting where jurisdictions differ.

Know-your-customer and anti-money-laundering rules require a bank to identify its client and the people behind it (beneficial owners), screen against sanctions and politically exposed persons, understand the purpose of the relationship and the source of funds, and monitor over time. Staff who suspect money laundering report internally, and usually must not tip off the client. Takeover rules vary. In UK-style regimes, a bidder who reaches 30% must generally make an offer for the rest at no less than the highest price it paid in a lookback period. A named bidder usually has 28 days to announce a firm offer or withdraw, and the target board cannot take frustrating action without shareholder approval. In the US there is no general mandatory-bid threshold, but ownership above 5% triggers disclosure and tender offers follow their own rules. Listing rules typically require prompt disclosure of price-sensitive information and approval of prospectuses. A banker should know the shape of the rules and say that the detail depends on jurisdiction and on legal advice.

WORKED EXAMPLE: ASTLEY HOLDINGS: CROSSING THE MANDATORY OFFER THRESHOLD

Astley Holdings, an invented bidder, holds 26.0m of the 100m shares of Wexcombe Retail plc, an invented UK-listed company, bought at an average of 400p. Under UK-style rules a holding of 30% or more triggers a mandatory offer for the rest at no less than the highest price paid in the previous 12 months. Astley buys another 5.0m shares at 430p. Calculate its new holding, the minimum offer price and the cost of the mandatory offer. Compare with stopping at 29.9%. Treat the rules as illustrative.

Answer: A 31.0% holding triggers a mandatory offer for the remaining 69.0m shares at no less than 430p, costing at least 296.7m, whereas stopping at 29.9% costs 16.77m and no obligation.

> **Interview tip:** Name the regime you are describing. Say 'in UK-style rules' and add that US practice differs, then say that in a live case lawyers advise on the details.

INT.BL.2.a · Documents

Explain what an engagement letter, a non-disclosure agreement with a standstill and a term sheet each do, and calculate a fee under an engagement letter.

The engagement letter sets the bank's mandate: scope, term, fees, expenses, exclusivity, indemnity and the tail period, during which a fee is still payable if the client does a deal with a party the bank introduced. Fees are usually a retainer, often credited against the success fee, plus a success fee that can be a percentage of transaction value with higher bands above a target. A non-disclosure agreement protects confidential information given to a bidder, and a standstill commits the bidder not to buy target shares or launch an offer without consent, typically for a stated period. A term sheet or heads of terms records the main commercial points, price, structure, conditions, and is usually non-binding except for provisions such as confidentiality, exclusivity and costs. Terms vary by jurisdiction, deal and leverage. Bankers check how fees are defined (enterprise value or equity value), what counts as a transaction, what the tail covers and how long exclusivity runs. The usual mistake is to read the headline percentage and miss the definitions.

WORKED EXAMPLE: CORVANE LOGISTICS: READING THE FEE CLAUSE

An engagement letter for the sale of Corvane Logistics, an invented company, provides a retainer of 0.05m a month for six months, credited against the success fee. The success fee is 1.2% of the first 250m of enterprise value plus 2.0% of enterprise value above 250m. There is a 12-month tail. Calculate the fee on an enterprise value of 340m and the net payable at completion. Then calculate the fee if the mandate is terminated and a buyer introduced by the bank signs eight months later at 310m.

Answer: Success fee 4.8m at 340m and 4.5m payable after crediting the 0.30m retainer, and a tail fee of 4.2m (less retainer paid) if a bank-introduced buyer signs within 12 months at 310m.

> **Interview tip:** Say that percentages hide definitions. Show that you read the base on which a fee is calculated, the credit and the tail.

INT.BL.2.b · Documents

Explain the roles of a prospectus and an underwriting agreement in a share offering and calculate underwriting fee shares and risk.

A prospectus is the offering document that gives investors the information they need to decide. The issuer and its directors are generally liable for untrue or misleading statements, and the banks run due diligence, verification of statements and legal opinions in part to support a due diligence defence, though the position differs by jurisdiction. The underwriting agreement is signed at pricing. The banks agree to subscribe or procure subscribers for the shares at the offer price, and the issuer gives warranties and an indemnity. The banks can usually terminate before settlement only on defined events such as a material adverse change or market disruption. The gross spread is shared by role, often a management fee, an underwriting fee and a selling concession, in proportions that vary by deal. A greenshoe lets banks over-allot shares and buy back in the market to support the price. Bankers check the conditions to terminate, the indemnity, the lock-ups and who bears the market risk between pricing and settlement. The usual mistake is to think a fully underwritten deal has no risk for the bank.

WORKED EXAMPLE: PENNICK HEALTHCARE: FEE SHARES AND UNDERWRITING RISK

Pennick Healthcare plc, an invented company, raises 400m by selling 200m new shares at 200p. The gross spread is 2.5%, split 20% management fee, 20% underwriting fee and 60% selling concession. A 15% greenshoe is available on the same terms. One lead bank takes 40% of the underwriting commitment. Calculate the spread and its parts, the spread if the greenshoe is exercised in full, the lead bank's underwriting fee and commitment, and its loss if 15% of its commitment is left unsold and the price falls 6%.

Answer: Spread 10.0m (2.0m, 2.0m, 6.0m), 11.5m with the greenshoe; the lead bank earns 0.8m on a 160m commitment and loses 1.44m in the stress case.

> **Interview tip:** Say who bears market risk between pricing and settlement. A fully underwritten deal is a commitment to buy, and the fee for that risk is only the underwriting part of the spread.

INT.BL.2.c · Documents

Explain how a sale and purchase agreement allocates price and risk, and what fairness opinions and comfort letters are and are not.

A sale and purchase agreement sets the price and how it is adjusted, the warranties and indemnities that protect the buyer, the conditions to completion and the limits on claims. Price is set either by completion accounts, where cash-free debt-free value is adjusted for actual net debt and working capital against a target, or by a locked box. In a locked box the price is fixed from a balance sheet date and the seller is liable pound for pound for leakage to itself since that date. Limits on warranty claims include a de minimis for small claims, a basket that is either tipping, meaning that the buyer recovers everything once the threshold is passed, or deductible, meaning that only the excess counts, a cap and time limits. A fairness opinion is a financial adviser's view that consideration is fair from a financial point of view, based on valuation work. It is not a recommendation or a guarantee. A comfort letter is the auditor's limited assurance on financial information in an offering document, which supports the underwriters' diligence. Terms vary by jurisdiction and bargaining power. The usual mistake is to treat them as guarantees.

WORKED EXAMPLE: BRINDLE ENGINEERING: COMPLETION ACCOUNTS OR LOCKED BOX

A buyer agrees to pay an enterprise value of 180m for Brindle Engineering, an invented company, on a cash-free debt-free basis. The estimated net debt at completion is 40m and the working capital target is 12m. The completion accounts later show net debt of 45m and working capital of 14m. Calculate the price paid at completion, the final price and the adjustment. Under a locked-box alternative at an equity price of 140m, the target pays a 1.5m management fee to the seller's parent after the locked-box date. What can the buyer claim?

Answer: Completion payment 140m, final price 137m so a 3m repayment, and under the locked box the buyer claims 1.5m of leakage.

Interview tip: Explain that the locked box shifts risk to the buyer for trading performance and gives price certainty, while completion accounts give accuracy and a process for disputes.

Summary of the Charta interview-preparation topic. Companies and figures in the examples are invented. Draft content, not yet expert reviewed.