FCA opens debate on reform of the UK equity IPO process

On 13 April 2016, the Financial Conduct Authority (the "FCA") published a discussion paper on the availability of information in the UK IPO process (DP16/3) (the "Discussion Paper") identifying a series of concerns relating to both the timing of publication of the approved prospectus and the role and availability of connected and unconnected research. In order to stimulate debate, the FCA has proposed three models for possible reform of the process.

Background
Since 2011 several reports have been published which have identified concerns with the way in which key information is provided to investors as part of the IPO process. Of particular concern is the fact that the prospectus is only published at the back-end of the process which is too late for investors to fully consider and absorb the information contained in it.

Recognising that the recommendations of these reports have failed to bring about a change in market practice, the FCA is of the view that regulatory intervention may be required to bring about change.

Existing market practice and limitations of the IPO process
The FCA carried out a market study of UK IPO practice which identified two key concerns in relation to the typical UK IPO process, namely (i) the timing of prospectus availability (i.e. that it becomes available to investors too late in the IPO process) and (ii) whether too much reliance is placed on connected research (and that, as a consequence of (i) above, the process does not facilitate the preparation of unconnected analyst research before the closing of the transaction).

The FCA identified that typically the only information available to investors in the investor education phase of the IPO process is the research prepared by the research analysts at the investment banks mandated to advise on the IPO (i.e. connected research) and that arguably such research has the potential to be at heightened risk of bias due to potential pressure on such connected analysts to produce favourable research. One of the cited aims of the FCA is for an IPO process where firms adhere to high standards of conduct, in particular in their management or conflicts of interest inherent during the preparation and distribution of connected research.

Set out below is an illustrative timeline showing the key sources of information made available during a typical UK IPO process.

Timeline of key sources of information during Main Market and AIM IPO processes

Source: Investment and corporate banking market study information request; Dealogic; London Stock Exchange.

1 All diagrams are extracted directly from the FCA’s Discussion Paper.
The models for reform

In order to address the issues identified and ensure that the prospectus, approved by the FCA, should play a central role within the IPO process, the FCA have proposed three models for possible reform of the IPO process, comprising combinations of two key measures:

- re-sequeencing the publication of the approved prospectus and connected research in order to make the approved prospectus the primary source of information available to investors; and
- allowing unconnected research analysts access to the issuer’s management so as to enable them to prepare unconnected research.

**Model 1 – Requiring a blackout period on connected research until 7 days after an approved prospectus is published**

This model envisages the FCA introducing a rule preventing the publication of connected research until 7 days following publication of the approved prospectus.

The intention is that this would result in the publication of the approved prospectus earlier than is currently the case which would set the clock ticking on the blackout period to permit publication of connected research and the subsequent marketing, roadshow and bookbuilding activities at the back-end of the timetable. The FCA believes that this model would reduce investor reliance on connected research and reinstate the prospectus as the central information source on an IPO.

This re-sequeencing could also facilitate the preparation of unconnected research as a result of unconnected analysts having access to the published prospectus earlier in the process, enabling their research to be published at the same time as that of the connected analysts (although this assumes that the unconnected analyst can prepare and publish research within 7 days).

**Model 2 – Opening any analyst presentation to unconnected research analysts and requiring a blackout on connected research until 7 days after publication of an approved prospectus**

This model has the key features of Model 1 but also includes a mandatory requirement that unconnected analysts are provided with an opportunity to have access to the issuer’s management through attendance at the analyst presentation given by the issuer (which is currently only typically provided to connected research analysts). The FCA notes that in practice it may be necessary for the issuer to release its ITF announcement in advance of such an analyst presentation (which would be a deviation from current market practice) and that such a presentation could occur either before (as is currently the case) or after the approved prospectus is published.

**Model 3 – Opening any analyst presentation to unconnected research analysts and prohibiting such a meeting from taking place before publication of an approved prospectus**
Like Model 2, Model 3 requires that unconnected research analysts have the opportunity to attend the analyst presentation given by the issuer (which is currently only typically provided to connected research analysts), however, it goes further by also requiring that such analyst presentation only take place following the publication of an approved prospectus. In contrast to Model 1 and Model 2, no mandatory blackout period would be imposed and both connected and unconnected research analysts would be free to issue their research reports as soon as they are ready following the analyst presentation. This Model would represent the most significant shift from current practice.

Clifford Chance views

The FCA’s proposals give rise to a number of considerations for stakeholders, including the following:

- The proposals could significantly lengthen the public marketing phase of the timetable which would expose the issuer to a longer period of market risk between launch and closing of the transaction.
- By re-sequencing the IPO process and publishing a prospectus up-front, an issuer would be exposed to greater risk of having to update or amend its prospectus.
- Could the proposals impact access to US institutional investors as a consequence of a lengthened timetable meaning that closing would not occur within the 135-day period required for "SAS-72" comfort letters to be issued by the auditors?
- Issuers would no longer have the benefit of being able to consider the valuation ranges that are included in connected research reports as part of their “go / no-go” decision that takes place immediately before public launch of the IPO.
- Will it be possible to include a price range in the approved “prospectus” if research has got to be published?
- Will investment banks seek enhanced contractual protection from issuers to mitigate any concerns around exposure to greater legal and regulatory risk as a result of any change to the research process?
- Will the proposals apply to all types of IPOs involving admission to the Official List?
- How will any FCA rules implementing the proposals work in circumstances where an IPO comprises a dual listing / offering structure?

**Next steps**

The FCA has requested feedback and responses to the questions posed in the Discussion Paper by 13 July 2016. In addition, the FCA noted that it is keen to meet with stakeholders during this feedback period to provide opportunities for comment on the contents of the Discussion Paper. Once this discussion period has closed, the FCA will consider the responses and provide feedback, and should the FCA wish to take forward any specific policy proposals, it expects to issue a further consultation paper.

If you would like to discuss any of the FCA’s proposals and their potential impact for your organisation or the IPO process generally, then please contact any of the authors of this note.

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This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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