

FCA publishes consultation on reforming the availability of information in the UK IPO process

On 1 March 2017, the Financial Conduct Authority (the "FCA") published a consultation paper, CP17/5 (the "Consultation Paper") setting out its proposed reforms to increase the availability and quality of information in the UK IPO process. The Consultation Paper follows the publication of an earlier discussion paper, DP16/3 (the "Discussion Paper") in April 2016, which highlighted a series of concerns relating to both the timing of publication of an approved prospectus and the role and availability of connected and unconnected research.

Background to and concerns with the current IPO process

In its 2016 Discussion Paper, the FCA identified two key concerns in relation to the typical UK IPO process, namely:

- the late stage at which the approved prospectus is published. The key concern is that the prospectus becomes available to investors too late in the IPO process to allow for meaningful and considered analysis and, in addition, such late publication does not facilitate the preparation of unconnected analyst research before closing of the transaction; and
- whether too much reliance is placed on connected research. In particular, the FCA raised concerns 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 undue pressures on such connected analysts to produce favourable research.

As such, in its Discussion Paper, the FCA proposed three new models for reform (refer to our April 2016 briefing [FCA opens debate on reform of the UK equity IPO process](#) for further details on these), which comprised

Key reforms proposed by the FCA

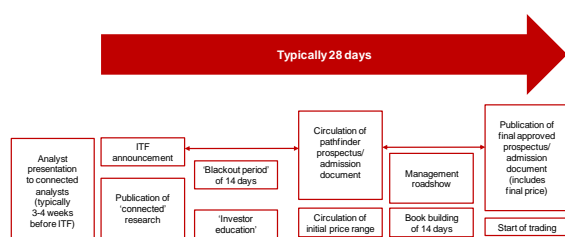
- New Conduct of Business Handbook rules which seek to ensure that an issuer must publish an approved prospectus and provide unconnected analysts with access to its management before any connected research is published.
- New Handbook guidance clarifying the FCA's expectations in relation to analysts' interactions with an issuer's management and their corporate finance advisers around the time an underwriting or placing mandate and subsequent syndicate positioning is being considered.
- The development of industry guidelines for unconnected analysts setting out "reasonable" terms of access to an issuer's management (these would be likely to include matters such as geographical restrictions on distribution of research and the "range" of unconnected analysts that should be invited to meet with management).
- The FCA is also seeking views on whether its proposals on the timing and sequencing of information for IPOs on regulated markets be extended to IPOs on MTFs, such as AIM and NEX Exchange growth markets.

combinations of two key measures:

- re-sequencing 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.

An illustrative timeline showing the key sources of information currently made available during a typical institutional-only IPO process is set out below¹.

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



Policy analysis following feedback on the Discussion Paper

Whilst there was widespread support for the earlier publication of the prospectus, in formulating its proposals for reform, the FCA has undertaken a policy analysis of three key issues highlighted below. Having set out its own initial views on the status of these issues, the FCA is consulting on these three key issues:

Whether connected research should continue to be permitted in the IPO process?

Despite feedback highlighting additional risk areas for bias in connected research at a number of key stages during the IPO process following the award of the initial underwriting mandate, on balance, the FCA has concluded that it does not favour a prohibition on connected research given the importance it plays in investor education. The FCA is instead focussing its proposals on mitigating the conduct risks underpinning the preparation of connected research by strengthening the rules around conflicts of interest, which it believes are not currently sufficiently robust.

If connected research is allowed, should the FCA mandate a temporal separation (i.e. a blackout period)

between publication of an approved prospectus or registration document and connected research?

The FCA favours a blackout period separating the publication of the prospectus and connected research and wants to ensure the primacy of the prospectus as the document upon which investors base their investment decision. Some buy side firms have indicated in their feedback that if both prospectus and research were published at the same time they would look at the research first to form an initial view rather than reading the prospectus. The FCA is also of the view that the simultaneous publication of the prospectus and connected research would not foster the right environment to encourage more unconnected analysts' research, given that, by the time they had received the prospectus, the connected analysts would have already published their research, thereby maintaining the primacy of connected research in the IPO process.

What level of management access should be offered to unconnected analysts, and when and how should any access be offered?

Feedback varied on the appropriate level of management access that should be offered to unconnected analysts and when and how such access should be offered. The FCA is consulting on whether, if unconnected analysts are only provided with access to management at a later stage than the connected analysts, there should be a mandatory seven-day period of separation between publication of the prospectus and connected analysts' research to provide unconnected analysts with sufficient time to prepare their research.

The FCA's Key Proposals

New Handbook rules to ensure earlier publication of an approved prospectus and to provide unconnected analysts with access to the issuer's management prior to publication of connected research

The proposed changes to the Conduct of Business Sourcebook ("COBS") are intended to satisfy the FCA's primary aim of putting the prospectus at the front and centre of investor decision making, whilst also improving the range and quality of information available to investors. The proposed rules will allow issuers and syndicate banks to retain some flexibility over how the IPO process is conducted, depending whether they decide to allow unconnected analysts access to management on the same terms as connected analysts.

¹ All diagrams are extracted from either the Discussion Paper or the Consultation Paper.

Under the new proposals, an issuer will publish its approved prospectus or registration document² during the private phase of the IPO process, up to seven days prior to the ITF announcement. Where connected and unconnected analysts are both briefed by management at the same time, then the indicative timetable shown in figure 1 below may emerge as the norm. However, if unconnected analysts are only provided access to management at a later stage than the connected analysts, then connected analysts would be prohibited from publishing their research until at least seven days after publication of an approved prospectus or registration document, which is likely to produce an indicative timetable like that shown in figure 2 below. The overall IPO timetable is unlikely to differ materially depending on whether the approach taken follows that in figure 1 or figure 2. The FCA is seeking views on these proposals and whether there are any practical problems that will arise from this process.

Figure 1: Management access for unconnected analysts alongside connected analysts in private phase and a minimum one day separation between publication of the registration document and connected research

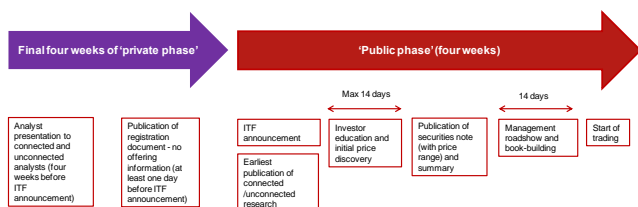
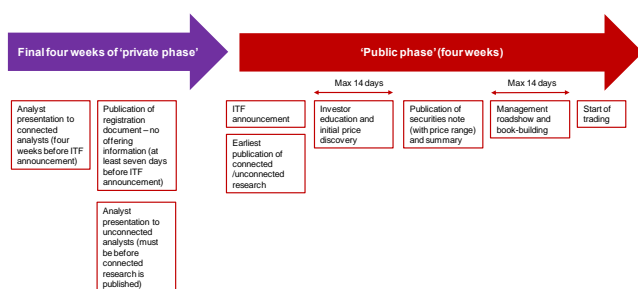


Figure 2: Management access for unconnected analysts post-publication of the registration document and seven-day separation between registration document and connected research



One such practical consideration is how unconnected analysts would be made aware of opportunities to access an issuer's management and how decisions would be made

as to which analysts would be provided with access. As a potential solution the FCA has proposed the development of industry guidelines for unconnected analysts setting out "reasonable" terms of access to an issuer's management (this would be likely to include matters such as geographical restrictions on distribution of research and the "range" of unconnected analysts that should be invited to meet with management).

CLIFFORD CHANCE VIEW:

- It is helpful that the FCA has recognised the need for a black-out period which will help mitigate the risks associated with the research being considered to form part of the issuer's offering materials alongside the prospectus, but unhelpful that there is limited flexibility about its duration. In particular, the only way to shorten the proposed seven-day period is to allow both connected and unconnected analysts to attend the analyst presentation. There may be circumstances where greater flexibility in the duration of the black-out period might be desirable.
- The FCA appears to be persuaded by the feedback received that it is important that the IPO timetable is not made significantly longer. Any extension of the public marketing phase would expose issuers to greater execution risk, and offerings made to QIBs in the US need to close within 135 days of the last audited or reviewed balance sheet date. The proposals contemplate the publication of an approved prospectus or a registration document immediately prior to, or in circumstances where unconnected analysts are not briefed alongside connected analysts, seven days before publication of research. This would add a maximum of seven days to transaction timetables depending on which route was followed. Whilst this may lead to more congested execution windows, this ought to be manageable.

² The Prospectus Directive allows for the publication of a tri-partite prospectus which consists of a registration document (containing information about the issuer), a securities note (containing information about the securities being offered) and a summary. Publication of a tri-partite prospectus is not currently market norm for UK equity IPOs.

- Whilst the Prospectus Directive contemplates the ability to publish an approved prospectus without specifying the price and number of securities by indicating the method for determining the offer price (including stating who has set the criteria or is formally responsible for the determination), this flexibility has rarely been used across Europe or, more particularly, in the UK. We believe that the FCA proposals are likely to lead to UK issuers using tri-partite prospectuses, with a registration document being published prior to the research being published, following the approach taken in some other European markets, notably France. The FCA has indicated that it does not expect that a registration document could be followed by a single approved price range prospectus (although the securities note and summary can be included in a single combined document so long as each is clearly identifiable as such).
- By requiring the publication of a prospectus or registration document at a much earlier stage in the IPO process, the likelihood of an issuer having to update or amend its prospectus is increased. Any updates or amendments can be reflected in the securities note (although once all the provisions of the draft Prospectus Regulation (known as "PD3") take effect (currently expected to be in H2 2019), any significant new factor, material mistake or material inaccuracy must be reflected in a supplement to the registration document which can be submitted for approval at the same time as the securities note and the summary).
- Whilst there is flexibility as to when to publish the securities note and summary, the FCA contemplates that these would be published immediately prior to commencement of the management roadshow. An alternative would be only to publish the securities note and the summary at the end of the management roadshow and bookbuilding, once the final offer price and size of the offering have been determined, with potential investors receiving a single draft document, similar to an unapproved pathfinder prospectus at the beginning of the management roadshow. Whilst permitted under the Prospectus Rules and the underlying EU legislation (assuming an institutional only offering), this approach would seem contrary to the FCA's stated desire of having the approved prospectus made available earlier in the process.
- There is general acknowledgement that connected analysts typically have four weeks from attending the analysts' presentation to prepare and publish their research. It is unclear therefore whether the proposed seven-day period will be sufficient for unconnected analysts to prepare properly considered and reasoned research. If this is not the case then the FCA's goal of providing investors with a more diverse set of substantiated opinions on the present or future value of an issuer's securities is unlikely to be achieved.
- Helpfully, the proposed changes to COBS recognise the logistical difficulties that may arise in providing unconnected analysts with access to an issuer's management and contemplate that such communications could take place via web-based communications or conference calls.
- It remains unclear whether the unbundling requirements under MIFID2 will have an adverse effect on research providers in the market, and whether buy-side investors will be willing to pay for research or fund managers will be willing to absorb the cost themselves. Whilst the proposed changes to COBS make it clear that the assumption will be that an unconnected analyst given the opportunity to participate in management meetings will do so and will subsequently publish research, there is no certainty that they will do so or that a thriving unconnected research industry will develop.
- The earlier publication of an approved prospectus or registration document containing detailed information on the issuer may increase the possibility of a trade sale, even where a formal dual-track M&A process has not been conducted alongside the private stage of the IPO. With detailed information about the issuer, including its three year financial track record, being publicly available up to four weeks earlier in the process, this may provide the opportunity for shareholders to benefit from unsolicited M&A approaches.

New Handbook guidance clarifying the FCA's expectations regarding analysts interactions with the issuer's management and their corporate finance advisers when the underwriting mandate and subsequent syndicate positioning are under consideration

Whilst existing guidance in COBS 12.2.9G states that an analyst should not become involved in activities which are inconsistent with the maintenance of their objectivity (such as participation in "pitches" for new business), the feedback received from the Discussion Paper indicates that there are pinch points throughout key stages of the IPO process where analysts come under some pressure to produce favourable research. As such, the FCA is proposing to supplement the existing guidance in COBS 12.2.9G to clarify that participating in pitches for new business would include where an analyst interacts with the issuer prior to the firm accepting an underwriting or placing mandate for the issuer and before the firm's position in the syndicate has been contractually agreed.

The FCA is consulting on the above proposals as well as seeking views as to whether there should be tighter control of the interaction between analysts and corporate finance advisers to prevent the control of messaging as part of the review process which is leading to a lack of variety of views contained in the published connected research.

CLIFFORD CHANCE VIEW:

- Whether tighter control of analysts and corporate finance advisers is needed in part depends on how the FCA would propose to regulate this. Issuers do need to receive financial advice when reviewing drafts of research reports and the role of independent financial advisers and the corporate finance teams at the syndicate banks play in analysing the research analysts' projections is helpful. It is not in anyone's interest for the analysts to publish research where their projections or valuations are based on incorrect modelling or a misunderstanding of the business and only through receiving guidance from the independent financial advisers and corporate finance teams at the syndicate banks are issuers able to analyse the projections in an efficient and timely manner.

Application of FCA's proposals to IPOs on MTFs

Given that the timing and sequencing of information for IPOs on MTFs is similar to that on regulated markets, the FCA is seeking views (but not formally consulting) on whether the proposed new Handbook rules should also apply to firms providing underwriting or placing services in an MTF context.

FCA's views on scope of market sounding regime and whether the handling of information on an IPO is consistent with MAR

There has been an ongoing debate as to the scope of the market sounding regime under the Market Abuse Regulation ("MAR"). The FCA has taken a different view to many in the market, including various industry bodies. Until now the FCA's view has been known informally. However, in the Consultation Paper, the FCA has made its view public.

Industry papers on market soundings have taken the view that only securities which fall within the scope of MAR will be caught. In brief, this would mean that the market sounding would fall within the regime if it is conducted in relation to a transaction involving (a) securities already admitted to a regulated market or an MTF, or for which a request for admission has been made OR (b) if the new securities in respect of which the sounding is being conducted would have an effect on the price of securities referred to in (a).

The market was aware informally that the FCA disagreed with the industry view and instead was focused on whether the issuer rather than the securities was within the scope of MAR. In the Consultation Paper, the FCA has confirmed publicly its opinion (subject to anything further from ESMA on this issue) that all issuers which have securities to which MAR applies would be caught by the market sounding regime, notwithstanding that the securities themselves that were the subject of the transaction in relation to the market sounding fell outside the scope of MAR.

Separately in the Consultation Paper, the FCA is seeking views on whether the handling and disclosure of inside information in the IPO process is consistent with MAR, with a particular focus on the disclosure of information to analysts and whether this may breach provisions on unlawful disclosure of inside information under MAR.

CLIFFORD CHANCE VIEW:

- The FCA's views on the scope of the market sounding regime would be relevant in an IPO context where the applicant already has existing in-scope debt securities. Following the FCA's line of reasoning, regardless of whether the new equity securities the subject of the IPO will have an effect on the price of the existing debt securities, all disclosures to potential investors regarding the issuer in relation to gauging their interest in the IPO would need to be conducted in accordance with the market sounding regime set out in MAR in order to benefit from the safe harbour from unlawful disclosure of inside information.

Next Steps

The consultation is open until 1 June 2017, following which the FCA expects to publish a policy statement outlining any proposed Handbook changes in the fourth quarter of 2017. The FCA is seeking views on how long market participants think they would need to adapt their business practices before the changes come into effect.

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

A copy of the Consultation Paper is available at: <https://www.fca.org.uk/publication/consultation/cp17-05.pdf>

A copy of the Discussion Paper is available at: <https://www.fca.org.uk/publication/discussion/dp16-3.pdf>

For further background on the Discussion Paper, refer to our April 2016 briefing at: https://www.cliffordchance.com/briefings/2016/04/fca_open_s_debateonreformoftheukequityip.html

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