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FCA Confirms Reform to the UK IPO Process

The new rules are designed to improve the availability of information during the UK IPO process.

Key Points:

- New rules will be introduced from 1 July 2018 to change the timing and sequencing of the availability of information in the UK IPO process, and to help enable the production of unconnected research.
- The FCA is also introducing new guidance to help address the issues around conflicts of interest arising during the production of connected research.

Background

On 26 October 2017, the FCA published a Policy Statement (PS17/23) setting out its final rules, which intend to reform the sequencing of the UK IPO process and address potential conflicts of interests arising for analysts involved in the process.

The FCA consulted on changes to its Conduct of Business (COBS) rules in March this year (see Latham's related *Client Alert*), following an earlier Discussion Paper on the topic that coincided with the FCA's interim findings from its Investment and Corporate Banking market study. The study had found that, in the typical UK IPO process, the pathfinder and final approved prospectuses were often made available to investors late in the IPO process. The FCA felt that the prospectus should play a central role in the process, and that FCA intervention was needed to create a process whereby:

- An approved prospectus is the central document in the IPO process, and is made available to investors when they need it.

- Firms foster high standards of conduct, in particular in their management of conflicts of interest in the preparation and distribution of "connected" research.

- Conditions exist for "unconnected" research to be published during the IPO process, if there is demand for it.

The final rules reflect these overarching aims, and broadly remain as proposed in the consultation. The FCA is introducing new provisions in COBS 11A around the timing and sequencing of information in the equity IPO process. The FCA is also introducing new guidance in COBS 12 to help address the issues around conflicts of interest arising during the production of connected research. These new provisions will come into effect on 1 July 2018, which the FCA hopes will prevent undue disruption, and provide some time for industry guidelines to be produced to complement the new rules in COBS 11A. The FCA notes that the new COBS 11A rules will only apply if all of the key events governed by those rules (*i.e.* analyst presentations, the publication of a prospectus or registration document, or the release of connected research) take place on or after 1 July 2018.

These changes have come as part of a wider review of UK primary markets stemming from the market study, and were published alongside the FCA's Policy Statement (PS17/22) on enhancements to the UK listing regime, and a feedback statement on the UK primary markets landscape.

Timing and sequencing of the IPO process

The new rules in COBS 11A seek to ensure that an approved prospectus or registration document is published before any connected research, and that unconnected analysts have access to an issuer's management. These rules aim to address the FCA's concerns that investors do not have access to the prospectus sufficiently early for the document to play its proper role in informing investor decisions. The FCA is particularly concerned that at present investor education is driven by connected research, while unconnected analysts lack access to appropriate information to produce unconnected research on an IPO.

In summary, the new rules require that:

- If a relevant firm (such as an underwriter or syndicate bank) is allowing its analysts access to an issuer, then prior to the firm's analysts communicating with the issuer the firm must ensure a range of unconnected analysts will have the opportunity either:
  - To join the firm's analysts in any communication with the issuer, before any connected research is published; or
  - To have access to the issuer, such that those unconnected analysts are given access to all of the information given to the firm's analysts that is relevant for producing investment research on the issuer's offering.
- The firm must select a range of unconnected analysts that, in the firm's reasonable opinion, has a reasonable prospect of enabling investors to undertake a better-informed assessment of the value of the issuer's shares, as compared with a situation in which only connected research is available.
- A firm must not impose any restrictions on access to the issuer by unconnected analysts that would unreasonably prevent, limit, or discourage those analysts from producing unconnected research.
- The firm must not disseminate its connected research until either:
  - If unconnected analysts have been briefed at the same time as the firm's analysts, one day after the publication of the approved prospectus or registration document; or
  - If connected and unconnected analysts have not been briefed simultaneously, seven days after the publication of the approved prospectus or registration document.

- The firm must keep written records of the information given to its analysts, and to unconnected analysts, to show the information is identical. The firm must also keep a written record of its assessment process and decision relating to the range of unconnected analysts selected to have access to the issuer.

In order to create a level playing field, the FCA amended the proposed rules to add the requirement that, if connected and unconnected analysts are given separate access to an issuer's management, the information received by each analyst must be identical. There is also a requirement for firms to maintain written records of the information shared with both connected and unconnected analysts.

However, this requirement may be a challenge for affected firms to achieve in practice, particularly so if analysts are attending different events where they have opportunities to ask questions. It will also be very difficult for firms to police situations in which connected analysts have informal access to the issuer.

Another aspect of the rules that is likely to cause difficulties is trying to select an appropriate range of unconnected analysts to have access to the issuer. There could well be competition issues in selecting unconnected analysts and firms potentially will be open to criticism whichever range they pick — whether that be a selection of their competitors or a selection of much smaller firms.

The FCA does recognise that there may be difficulties for firms here, and is hoping to collaborate with trade associations to develop industry guidelines to help firms decide which range of unconnected analysts to give management access. The FCA envisages these being prepared with unconnected analysts, who could then sign up to the guidelines and thus make themselves eligible to be offered management access.

Preventing underlying conflicts of interest

The FCA is also introducing new guidance in COBS 12 to clarify that it considers certain analyst interactions with issuers as activities that might compromise the analyst's objectivity. The FCA highlighted in its consultation how it is common for analysts within prospective syndicate banks to meet with the issuer's management and advisers around the time that underwriting or placing mandates are being considered. The FCA emphasised that, during these meetings, analysts can come under pressure to produce favourable research on an IPO to help their bank secure a mandate to manage the offering and its desired position in the syndicate.

Therefore, the new guidance indicates that the FCA would regard analyst interactions with an issuer before both: (i) the bank has accepted a mandate to carry out underwriting or placing services for the issuer; and (ii) the bank's position in the syndicate has been confirmed in writing, as "participating in pitches for new business". This is prohibited as an activity inconsistent with the maintenance of an analyst's objectivity.

The FCA reports that some respondents highlighted that analysts play an important role in vetting the issuer. However, the FCA believes this role can also create conflicts of interest, potentially encouraging an analyst to exaggerate the positive messaging in their research in order to support their bank's involvement in the IPO. Therefore, the FCA highlights the need for firms to consider their obligations under SYSC 10 (Conflicts of interest), and the new requirement under MiFID II that explicitly obliges firms to introduce a physical separation between analysts and others in the business whose interests may conflict with those of the recipients of the analyst's research (for example, traders).

The FCA also explains that it received comments that an analyst may be unclear about when exactly pitching is taking place, particularly when analysts are interacting with issuers who already have securities admitted to trading and so may be unaware of further planned issuances. In light of this, the FCA has amended the guidance to provide that it may be possible, in limited circumstances, for an analyst's interactions with an issuer to be entirely separate from the firm's pitching activity. However, this will not be the case if the analyst is aware of any pitches by the firm, or has reason to believe pitches are taking place. The FCA also reminds firms that they need to make a case-by-case assessment, and that any situation in which there is a connection between a firm's pitches and an issuer with which an analyst within the firm is interacting can give rise to conflicts of interest.

Also in response to feedback, the FCA clarifies that the new provisions do not apply to producers of marketing communications (non-independent research). However, the FCA warns that such producers must be conscious of their SYSC 10 obligations, and cannot assume that it is always appropriate for analysts to participate in pitches.

Market abuse considerations

A related issue that the FCA raised in its consultation, was the possibility that investor presentations could contain inside information, and that obligations under the Market Abuse Regulation (MAR) may not be being met properly by the parties involved. The FCA asked for feedback from firms as to how they believe they are meeting these requirements.

The FCA reminds firms that a debut issuer's financial instruments generally will not come within the scope of MAR until the issuer has requested admission to trading. However, those instruments may be within scope if their value depends on, or has an effect on, the price or value of a financial instrument that is in scope of MAR. This may be the case if, for example, the issuer already has listed debt, or if the issuer's parent company has financial instruments within scope of MAR.

The FCA suggests that firms should make (and record) both upfront and ongoing assessments of any price or value relationships between instruments subject to a potential IPO, and financial instruments within scope of MAR. The FCA also advises (following the view expressed in recent ESMA Q&A on MAR) that, if there is doubt as to whether there is a relevant relationship between instruments subject to a potential IPO and financial instruments within scope of MAR, the market soundings regime should be followed to ensure that the protection of that regime will be afforded, if necessary.

In relation to the potential for inside information to be included in analyst presentations, the FCA explains that the fact of the proposed IPO is not necessarily always inside information, nor is it the only potential inside information that needs to be considered. The FCA stresses that all information in the presentation needs to be assessed, including in particular any strategic and forward-looking information on the issuer.

The FCA also warns firms that it is wrong to assume that the disclosure of inside information during an analyst presentation should always be considered to be taking place in the normal exercise of the issuer's employment, profession, or duties (and so considered a legitimate disclosure of inside information under MAR). The FCA states that its work looking at MAR implementation will consider these issues further. It does not clarify whether it may decide to consult on formal guidance on these issues, although this was suggested as a potential outcome in the consultation.

Application to IPOs on MTFs, including AIM

Although the FCA considered that it might be necessary to apply the new COBS 11A rules in respect of IPOs taking place on MTFs, such as AIM, ultimately it has decided not to do so. On balance, the FCA concludes that the potential increase in transparency does not outweigh the risk that a longer public phase in the process could deter early-stage companies from pursuing an IPO on an MTF. The FCA also highlights the fact that it is unclear how much unconnected research would actually be likely to emerge in the context of IPOs taking place on MTFs.

However, the FCA advises that it will be considered best practice for larger IPOs on MTFs to follow the new rules in COBS 11A. The FCA plans to revisit the question of whether the new rules should be extended to IPOs on MTFs in future, but states that it will not do so until at least a year after the new rules have come into effect.

Concluding thoughts

It has been clear for a while that the FCA has wanted to reorder the IPO process, and a number of trade associations have supported that approach, and assisted with its development. Therefore, this cannot be seen as a paper where the regulators have dragged the industry kicking and screaming along the way. However, there are a number of areas of the FCA's proposals that are likely to cause concern:

- If, as the authors expect, many affected firms are reluctant to bring unconnected analysts into the IPO process until the registration document is published, IPO timetables will potentially be increased by seven days. A number of the options proposed by the FCA to mitigate this increased execution risk, including a shorter period of pre-deal investor education, not distributing connected research, or not providing connected analysts with access to the issuer's management, appear unattractive and/or may reduce the quality of information available to investors. Instead, shareholders seeking more deal certainty in the face of increased execution risk are likely to undertake even more early look and pilot fishing meetings. This approach is in keeping with the general trend the authors have seen before the proposed changes were published.

- The timing of the publication of connected research has traditionally been seen as sensitive, and disconnected from the prospectus, in order to manage the potential risk that an investor could say that they invested in the IPO because of the research. The FCA's proposals will make this a harder line to maintain.

- There is a question as to whether there really is an appetite amongst providers to write unconnected research — but if there is, a considerable documentation burden will fall on firms producing connected research. How will they come up with a list of proposed unconnected research providers that is not, in some way, potentially anti-competitive? How will they comply with the burden to show perfect equality of information between connected and unconnected analysts? How will they ensure that appropriate records are kept of all information shared, including when it is shared via less formal interactions?

- Analysts have grown accustomed to having considerable periods of time "inside" in order to produce their research. Will this reordering shorten that period of time? Will the FCA's comments about MAR bring this under further pressure?

- Finally, will these proposals help the competitive position of the UK IPO market, or put it out of line with its international peers?

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult

James Inness
james.inness@lw.com
+44.20.7710.3019
London

Claire A. Keast-Butler
claire.keast-butler@lw.com
+44.20.7710.3014
London

Rob Moulton
rob.moulton@lw.com
+44.20.7710.4523
London

David Boles
david.boles@lw.com
+44.20.7710.1872
London

Charlotte Collins
charlotte.collins@lw.com
+44.20.7710.1804
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