The City of London Law Society

The Law Society

FCA Consultation DP16/3: Availability of information in the UK Equity IPO process

Law Society and City of London Law Society joint response

July 2016

The views set out in this paper have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society (**CLLS**) and the Law Society of England and Wales (the **Law Society**).

The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

The Law Society is the professional body for solicitors in England and Wales, representing over 160,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to capital markets.

Introduction

We believe that the UK IPO process can be improved significantly if the issuer's principal disclosure document (a draft "pathfinder" prospectus or registration document) is made available to potential investors earlier in the process, with research available as a commentary on that disclosure. This will require some rule changes to support the conclusion, set out in the Appendix, that the typical blackout period currently applied in the IPO process does not alter legal or regulatory risks for the participants in a meaningful way (although that is not to say that some separation between the publication of the issuer's document and research may not be useful for other reasons). The advantages from this approach include:

- the research can be much shorter and more focussed, taking less time to produce
- the risk of inconsistencies between the research and the prospectus is reduced, without requiring issuer involvement in the research production process (checking factual accuracy), which is otherwise necessary but which could be seen as prejudicing the independence of the research
- investors will be able to rely principally on the issuer's document for the background information on the company and the risks associated with an investment in its shares.

We are not in favour of an unnecessarily prescriptive approach but suggest that if the rule changes we have suggested are made the way will be open for banks and brokers organizing the process to respond appropriately to the pressure from investors for earlier access to the issuer's document. We think a market-led solution is likely to produce a better result than one dictated by rules.

Q1: Having regard to the typical UK IPO timetable, do you agree that it is in principle a cause for concern that in most cases a draft prospectus is available two weeks after the ITF and a final prospectus is only available after pricing? Please state reasons.

We do not think undue significance should be attached to the nature of the principal disclosure document published by the issuer at an early stage in the process. That document may be a pathfinder prospectus or a registration document (or, although less likely, a stamped prospectus). As noted in DP16/3, typically a pathfinder will only be published once the FCA has confirmed that it has no further comments on the prospectus and any material differences between the pathfinder and the final prospectus will be brought to the attention of investors. Accordingly, in our view, investors are not disadvantaged by a transaction structure which involves them receiving a pathfinder prospectus and we do not consider that the FCA should take any steps which would mean that the ability to use pathfinder prospectuses is curtailed.

Questions 2, 3, 4 and 6 are addressed in the Appendix below

Q5: What do you think are the main barriers to more unconnected research on IPOs? Do you think fostering the conditions for more unconnected research is a suitable objective to improve further the UK process?

The principal legal risk from unconnected research is that unconnected analysts could release their research in a jurisdiction where to do so may raise securities law concerns for the issuer or other offering participants (for example the US). At the extreme this might result in an offering having to be pulled. This risk in relation to connected analysts is managed by obtaining their agreement not to do so by their acceptance of research guidelines, which govern the distribution of research amongst other things. Whilst we believe that it should be for the issuer and its advisers to determine whether to meet with unconnected analysts, in the event the FCA decides to make it a requirement to open analyst presentations to connected and unconnected analysts, it would be important to ensure the rules allowed issuers to require unconnected analysts to agree, as a condition of their attendance, to adhere to research guidelines no more onerous than those to which the connected analysts are subject.

Q7: Do you agree with our conclusion that a regulatory intervention is required to achieve reform? If not when and how do you believe a market-led solution could be secured?

In our view, with a clear statement as to the FCA's position and amendments to COBS 12.2.12G and UKLA/TN/604.1 the way is open for the practice of adopting research blackouts to cease.

Q8: Do you support these high level aims for reform of the UK IPO process? If not, please set out concerns and/or alternatives.

We support the aims of the reform but are not in favour of extensive regulatory intervention. The rule changes required are those required to remove any suggestion that a blackout period is required for regulatory reasons. Please see our response to Question 7.

Q9: Do you agree that a ban on (i) all research and (ii) only connected research in the IPO process would not be a suitable option for reform? If not, why not?

Agreed.

Q10: Do you agree that simultaneous publication does not represent a suitable or practical basis for reformed market practice?

While we see practical difficulties with simultaneous publication, and would expect market practice to adopt a short pause before research is published, we are not in favour of rules that would dictate the result.

Q11: Do you agree that requiring publication of the registration document component of the prospectus prior to the publication of research would improve the IPO process? If not, why not?

We do not agree that rules requiring this would be helpful. We are of the view that the rules should permit market participants flexibility to adopt the most effective approach.

Q12: Do you agree that requiring issuers to open the presentation to analysts to unconnected research analysts would improve the IPO process? If not, why not?

No. We consider that it should be up to the issuer and its advisers to determine who should be able to attend a company presentation.

In the event that the FCA was nonetheless to implement this change, the FCA should permit an issuer to restrict attendance to analysts who are prepared to agree to comply with research guidelines which are no more onerous than those agreed to by connected analysts. As noted in our response to Question 5, this is required, for example, to ensure that unconnected analysts do not distribute research in a manner that may be in breach of applicable securities laws (whether by the analyst or other offering participants).

Q13: Which of models 1 to 3 do you think would provide the best basis for reformed market practice?

We are not in favour of any approach which involves a timetable for the IPO process dictated by rules. Our view is that it is preferable to minimise mandatory time periods in connection with the equity offering process so that as much flexibility as possible can be retained for issuers to execute transactions quickly should they wish or need to do so. Please see our response to Question 10.

In relation to model 3, we also note that the proposal that the analysts' presentation not be permitted to take place before the prospectus is published would mean that the transaction timetable would be extended, as a period (possibly of 2-4 weeks) would likely be required to enable research to be prepared. As noted above, we consider that it is unhelpful to introduce new rules that restrict the ability of the issuer and its advisers to determine what they consider to be the optimum timetable in the particular circumstances. This model could lead to delays in the execution of an IPO (and hence heightened execution risk) or potentially to a decision being taken not to publish research.

Q14: For each model (1 to 3), please consider • Are there any practical issues that we need to consider? • Would it lead to an increase in the length of the IPO process? • Would it create conditions for unconnected research to be produced? • Would it lead to any increase in costs or risks for the issuer, investors or intermediary firms?

Please see our response to Question 13.

Q15: Are there any other options you think we should consider?

No.

Q16: Do stakeholders have concerns with how conflicts of interest are managed when investment banks' analysts meet an issuer and/or their advisers as part of premandate IPO pitching process? If so, do stakeholders have suggestions on how this could be improved, for example by firms establishing best practices or clarification of our regulatory expectations in this area?

We consider that it would be helpful for the FCA to clarify its regulatory expectations in this area if it does not consider current market practice to be compliant with the rules.

Q17: Would the models of reforms considered above also be appropriate as the basis for reformed practice in IPOs on non-regulated markets?

We consider that the rule changes we have suggested should also apply to non-regulated markets.

APPENDIX

Liability and regulatory issues: Questions 2- 4 and 6

Purpose of this paper

In its discussion paper, ***"Availability of information in the UK equity IPO process"*** (DP16/3), the FCA sought views on the liability issues that may arise in relation to the publication of research in the context of an IPO and on the regulatory drivers for adopting a blackout period. The purpose of this paper is to set out the view of the members of the Company Law Committees on these questions.
The questions asked were:

Q3: ***What is the basis on which you consider legal liability may attach to the publication of research in close proximity to the publication of an approved prospectus? Please explain by reference to the current legal framework. It would be helpful if you consider the question from a perspective of both issuers and research publishers.***

Q4: ***Do you have any comments on regulatory or other possible drivers of the existing blackout period?***

This paper addresses these questions.

The purpose of the blackout period – historical perspective

We believe that the practice of publication of research prior to IPOs began in the UK in the early 1980's in the context of the early privatisations. Those were carried out under the regime regulating public offers under the Companies Act 1948, which required any "*prospectus" published for the purposes of an offer of securities to the public*" to be filed with the Registrar of Companies, attached civil and criminal liability to such a prospectus and imposed certain requirements as to its content. "Prospectus" was not defined beyond a reference to it including "any document by which the offer for sale to the public is made". Accordingly, great care was taken to avoid distribution of marketing documents. The initial blackout periods were at least three months and were intended to support an analysis that with a substantial gap in time it was clear that the research was not part of the offer and therefore not a prospectus. After implementation of the Admissions and Listing Directives under the Financial Services Act 1986 the Companies Act regime ceased to apply.

The purpose of the blackout period – current thinking

On an IPO it is customary to issue guidelines for the publication of research by connected analysts. These guidelines would typically set out, among other things, the blackout period that is to be adopted, typically two weeks but sometimes less. The purpose of the guidelines is likely to be explained as being to reduce the possibility of:

(a) the success of the Offer being prejudiced by research;
(b) research being regarded as part of the Offer; and
(c) the incurrence of liability by any of the Company, any of the Company's shareholders or any syndicate member as a result of the contents or distribution of research.

It is not usual for the guidelines to give a detailed explanation of why these objectives are important or how the stipulated procedures assist in achieving them.

Possible explanations include:

- to minimise the risk of investor claims against the issuer, any selling shareholder and/or the banks handling the offering, based on alleged errors in or omissions from the research

- to minimise the risk of the banks involved breaching applicable FCA rules.

These are addressed in turn below.

The risk of investor claims

Under English law, claims by investors, based on the research, would be for misrepresentation, either pre-contractual misrepresentation, under the Misrepresentation Act 1967 or negligent misrepresentation. We are not concerned in this paper with the question whether such claims would be likely to be upheld by a court but only with whether the risk of those claims being pursued or being successful is increased if there is no blackout period. This question can be resolved into two issues:

- does the blackout period reduce the risk of investors successfully arguing that they relied on the research in making their decision to invest in the offering?

- does the blackout period strengthen a defence that relies on the disclaimers (those included in the research rubrics and those included as part of the contractual terms of the offering) that require investment decisions to be made solely on the basis of the prospectus?

When assessing these questions, it is important to note that it is known to all involved in the IPO process that the purpose of the publication of the research is for the research analyst to provide an independent view on the issuer to potential investors in the IPO. Investors know that they will receive both research and a prospectus and although they also know that the content is different and each is produced by a different participant, we see no basis to conclude that any blackout period (possibly other than one of significantly longer duration than is currently the practice) would make any meaningful difference to questions of liability related to the research.

FCA rules

The regulatory risk for banks is in relation to their obligation to manage conflicts of interest. COBS 12.2.3R imposes an obligation on authorised firms to manage conflicts of interest in relation to research. The guidance in COBS 12.2.12G indicates that:

> "*The FCA would expect a firm to consider whether or not other business activities of the firm could create the reasonable perception that its investment research may not be an impartial analysis of the market in, or the value or prospects of, a financial instrument. A firm would therefore be expected to consider whether its conflicts of interest policy should contain any restrictions on the timing of the publication of investment research. For example, a firm might consider whether it should restrict publication of relevant investment research around the time of an investment offering*."

This guidance makes the timing of research a factor in assessing whether there is any compromise or perception of compromise of the independence of the research but does not explain why that should be the case. The guidance does not refer to the duration of any period of restriction of publication. Our analysis is similar to that described above in relation to investor claims. It is explicit that the research is provided to investors for the purposes of the offering and it will be made clear (and should be understood by investors) that there is a potential conflict with the role of the firm in the IPO. In our view a two week gap between publication of the research

and publication of the pathfinder prospectus has no meaningful bearing on whether the research should be regarded as independent, which should be judged by the adequacy of the substantive measures taken by the firm.

COBS 12.2.12G undoubtedly presents challenges for firms considering whether a blackout period is relevant to compliance with its obligation under COBS 12.2.3R and we suggest the FCA should clarify its position on this question.

Other questions

In addition to the principal questions discussed above we have considered whether the existence of a blackout period has any impact on the following:

- Is the research a prospectus?
- Compliance with the rules regarding advertisements
- Compliance with the rules regarding ancillary information

Is the research a prospectus?

As explained above, under the Companies Act regime this was a relevant question. However under the Prospectus Regulation the question does not arise. The Prospectus Regulation requires publication of a prospectus in certain circumstances and it will be clear what document comprises the prospectus as it will have been approved by the FCA.

Compliance with the rules regarding advertisements

Research produced in connection with an IPO may amount to an advertisement subject to the requirements of Prospectus Rule 3.3.2. This will turn on whether it is:

> *"an announcement:*
> *(a) relating to a specific offer to the public of securities or to an admission to trading on a regulated market; and*
> *(b) aiming to specifically promote the potential subscription or acquisition of securities."*[1]

UKLA Technical Note 604.1 refers to the use of blackout periods as one of the things firms should consider when determining whether research satisfies these conditions. We do not think there is any room to argue that pre-IPO research does not meet the first of these conditions, whether or not there is a blackout period. Nor do we think the existence of a blackout period affects the assessment of whether the research is "aiming to specifically promote" the offering.

Compliance with the rules regarding ancillary information

PR 3.3.4R requires "all information concerning an offer or an admission to trading" disclosed in an oral or written form" to be "consistent with that contained in the prospectus". Article 12 of the Delegated Regulation expands what consistency demands for this purpose. It is generally accepted that research is not subject to PR 3.3.4R but this conclusion does not depend on there being a blackout period.

[1] PD Regulation (2004/809/EC) Article 2(9).

Conclusion

We have not attempted in this paper to describe the basis for legal liability to attach to research but have limited our comments to a consideration of whether the existence of the typical blackout period is relevant to the assessment of whether there is liability and on which participant that liability may fall.

The purpose of the blackout period is said to be to create a separation between the research and the offering in order to reduce liability risks and emphasise the independence of the research. However, given that the preparation of the research is inextricably part of a process that leads to the marketing of the shares offered in the IPO we do not believe that a short blackout period provides sufficient separation to make a meaningful difference. Liabilities associated with research should be managed through other means and in our view the blackout period does not have a material effect on legal or regulatory risks for the issuer or the firm publishing the research.

We would emphasise, however, that we are not expressing any view on whether there may be other benefits in having an orderly framework for publication of connected research which may involve a separation in time between publication of a prospectus (or pathfinder prospectus or registration document) and publication of research. We can see, for example, that simultaneous publication of both may make the research appear less independent. If the research follows a short time after the publication of the issuer's document, the perception of the independence of the research may be heightened. There may be other benefits from this approach, such as removing pressure on analysts to be first to publish.

Finally, we note that our analysis has been from the point of view of English law. We are not aware, however, of any other system of law in which the existence of a blackout period has a material effect on the liability risks we have discussed.