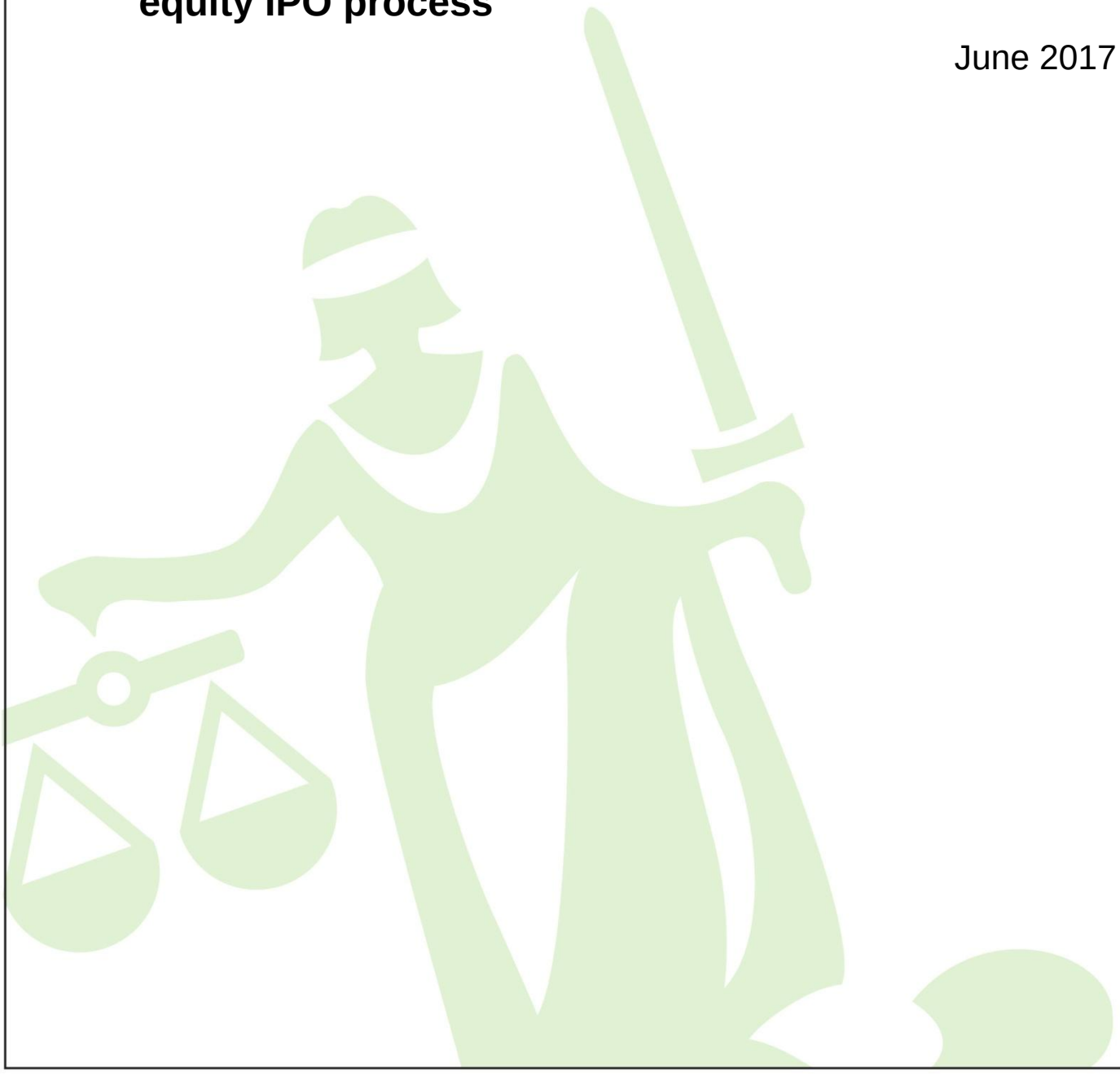
The Law Society

Response to FCA Consultation Paper 17/5: Reforming the availability of information in the UK equity IPO process

June 2017



We set out our responses to the specific questions raised in CP 17/5 below:

1 ***Are you aware of any other conduct risks associated with the production of connected research? If so, please describe them.***

No.

2 ***Do you agree that connected research should continue to play a role in the UK IPO process?***

Yes. Research coverage and the role that connected analysts play is positive for the market in that connected research, which is typically produced by an analyst with experience in the relevant sector, provides commentary on the issuer from a broader, market perspective. The result is better quality information being available overall. We do not believe that it would be helpful to prohibit connected research.

3 ***Do you agree that simultaneous publication of an approved prospectus or registration document and connected research does not adequately address level playing field issues for unconnected analysts and still leaves connected research excessively prominent in initial price discovery?***

We express no view on this.

4 ***Do you agree that, if unconnected analysts were to be provided with access the issuer's management only at a later stage than connected analysts, there should be a mandatory seven-day period of separation before any connected research could be released?***

We express no view on this.

5 ***Do you agree that this proposed policy measure would effectively advance our objectives of enhancing market integrity, protecting investors and promoting effective competition? If not, how should it be amended? Please explain how your alternative suggestion would advance our objectives.***

We express no view on this.

6 ***Do you agree with the proposed rules set out in Appendix 1? If not, how should they be amended?***

6.1 *Definition of unconnected analysts*: The definition of "unconnected analyst" does not take account of the fact that the research function of a syndicate

bank may be established in a different legal entity from the underwriting function. The definition should be redrafted as follows:

> "an "unconnected analyst" means a person other than the *firm* or any *affiliated companies* of the *firm*, or their respective staff:
>
> (a) who does not provide or work for a person who, directly or through *affiliated companies* provide, the service of underwriting or placing of the same relevant securities to the same *issuer* client; and
>
> (b) whose business or occupation may reasonably be expected to involve the production of research."

6.2 *Scope:* It would be helpful for the FCA to clarify the scope of the relevant provisions to ensure that they do not inadvertently catch research written outside of the deal context (for example, credit research).

6.3 *Assessment of the potential range of unconnected analysts:* Proposed COBS Rule 11A.1.4BR(4) includes a requirement on banks to undertake: *"an assessment of the potential range of unconnected analysts" for each transaction which would lead to "a reasonable prospect of enabling potential investors to undertake a better informed assessment of the present or future value of the relevant securities based on a more diverse set of substantiated opinions"*. We note that the requirement is placed on the investment banks who form part of the syndicate. We would expect issuers and their advisers to have an interest in the selection of unconnected analysts. See further our comments under Question 9 below. The burden that the current language imposes on investment banks is very high. We do not believe that underwriters should be responsible for determining the type of communication that would allow unconnected analysts to form a "substantiated opinion" on the IPO. In addition, we do not believe that the underwriters should be responsible for determining the number and character of unconnected analysts such that there is a "reasonable prospect" that "potential investors can undertake a better informed assessment of the present or future value…" of the IPO. We believe that the underwriters should be required to act in good faith in making these determinations but should not be subject to the highest standard set out in the draft rules.

6.4 *Unconnected analysts – terms of access*: Proposed COBS Rule 11A.1.4CR provides that any opportunity given to unconnected analysts to participate in the process must be given on "reasonable terms." It is not sufficiently clear what "reasonable terms" means, as the provisions of proposed 11A.1.4D only apply to geographical restrictions. To ensure clarity while

maintaining a level playing field, we suggest requiring that terms applied to unconnected analysts should not be materially more onerous than those imposed on any connected analysts in relation to the offering.

6.5 *Form of unconnected analysts' presentation*: Proposed COBS Rule 11A.1.4BR(2)(b)(i) requires that "*the mode of communication must be reasonably appropriate for the purposes of enabling those unconnected analysts to receive information from and make enquiries to the issuer team*". We believe that issuers should be able to choose the form of communication (face to face or electronic or a combination) that is most appropriate to the circumstances of the issuer and the relevant offering. Issuers should be able to impose additional restrictions on electronic access, where relevant (for example, regarding the length of time that any presentation may be viewed electronically).

6.6 *Drafting points:* We also have the following drafting points*:*

Proposed COBS Rule 11A.1.4ER(1) to be revised to read: "*A firm must not disseminate investment research or non-independent research on the relevant issuer client or relevant securities as described in COBS 11A.1.4AR(1) until on or after the relevant time in paragraph (2)".* This would clarify that the earliest time that the research could be published is on (or after) the first day after the publication of the prospectus (consistent with paragraphs 1.19 and 4.4 of FCA CP 17/5) – rather than only 'after' the first day.

"*Relevant time*" in Proposed COBS Rule 11A.1.4ER(2)(a) and (b) should be amended to read:

(a) Where a firm acts in accordance with COBS 11A.1.4BR(2)(a), the first day after the publication of the relevant document in paragraph (3); or

(b) "Otherwise, the seventh day after the publication of the relevant document in paragraph (3)."

6.7 Also see our response to Question 12 below with respect to proposed COBS Rule 12.2.21AG.

7 ***If you think that there are advantages to an alternative approach to the one we had envisaged, please provide details.***

We express no view on this.

8 ***Does this proposal have any practical implications for the transaction review process?***

We have the following observations regarding the transaction review and wider IPO processes where a registration document is published:

8.1 It would be helpful for the FCA to clarify its expectations regarding the role of the sponsor in the revised process, including whether the preparation of a registration document requires the appointment of a sponsor under Listing Rule 8.2 and whether the preparatory work that the sponsor undertakes for the issuer in relation to the registration document constitutes a "sponsor service" under the Listing Rules. It would also be helpful for the FCA to confirm that it does not expect a sponsor declaration to be delivered on approval of the registration statement and for the market to have a clear understanding of how the eligibility process will work going forward.

8.2 It would be helpful if the FCA could clarify how the responsibility and liability regime applies to the registration document. We interpret Prospectus Rule 5.5 and S.90 of FSMA 2000 as meaning that responsibility bites once all constituent parts of the prospectus have been published, albeit that the Prospectus Rule Annexes require a responsibility statement to be included within the registration document. (The position is clearer under the new EU Prospectus Regulation, which provides that responsibility attaches: "*only in cases where the registration document…. is in use as a constituent part of an approved prospectus*" (see Article 11(3)).

8.3 Lack of clarity, or concerns about increased liability, may limit issuers' and banks' appetite for using the registration document approach so that the flexibility this offers is not as widely taken up as it might otherwise be.

8.4 Accountants' opinions regarding the historical financial and other information included within a registration document, which by definition will not include details of the proposed securities offering, may not be able to be given in the same form as in the final full prospectus. In the absence of published information concerning the securities offering, the accountants cannot assume receipt of offer proceeds, with the result that the form of the accountants' report may be affected. This will lead to further review being required by the FCA review team, when updated information is published in the securities note.

8.5 In addition, differences in the information in the registration document and securities note may be confusing to investors. To avoid this, it would be beneficial if the FCA could confirm that a full single-document prospectus may still be approved and published even where a registration document has previously been published.

8.6 We also note that some privately held companies have complex share capital structures, which are typically unwound at the time of IPO. It is often not practicable to unwind such structures until immediately before the IPO closes, which could lead to potentially confusing disclosure for investors, assuming that the registration document includes as the issuer's existing share capital, the pre-IPO capital structure.

8.7 Finally, consideration will need to be given to the requirement in Listing Rule 6.1.3R(b) for the balance sheet included within the prospectus to be dated not more than 6 months before the date of the prospectus, a super-equivalent provision. Under the proposed regime, should the reference to the date of the "prospectus" speak to the date of the registration document or the full prospectus once all constituent parts are published? We believe that it should be the latter.

9 ***Do you think that the suggested industry guidelines would help to operationalise the proposed rule requiring syndicate banks to provide unconnected analysts with an opportunity to be in communication with the issuer's management?***

9.1 We believe that industry guidelines would indeed be helpful. We refer to our comments in paragraph 6.4 above regarding the placement of restrictions on unconnected research analysts.

9.2 It would also be helpful to have guidance on what a "range" of unconnected analysts means. It would be helpful for the guidance to allow for flexibility rather than suggesting concrete numbers and for it to be driven by the FCA's policy of achieving: "*a reasonable prospect of enabling potential investors to undertake a better informed assessment of the present or future value of the relevant securities based on a more diverse set of substantiated opinions*". In practice, the scope of the relevant invitation will be driven by issuer preference and issuer and sector considerations and we believe, in many cases is likely to result in a relatively small number of analysts invited. The FCA's reference to 60-100 unconnected analysts in paragraph 19 of the Cost Benefit Analysis, is, in our view, unlikely to reflect the (much smaller) number of unconnected analysts interested in participating in the process.

10 ***Do you have any comments on how/if you think that the handling and disclosure of inside information in the IPO process is consistent with MAR? In particular, if an analyst presentation contains inside information please describe:***

- ***Why you believe disclosing inside information in an analyst presentation is in accordance with Article 10 of MAR, taking into account that disclosure is being made both to the analyst and the recipient of the analyst's research,***
- ***Why you think that the grounds for delaying disclosure of that information under Article 17 of MAR will have been met.***
- ***Alternatively, please describe why you believe the information disclosed in an analyst presentation does not amount to inside information as per Article 7 of MAR.***

We are not aware of any general practices, in those cases where the issuer is in scope of MAR, that are inconsistent with MAR.

11 ***Are you aware of any aspects of existing market practice that has developed in relation to the current IPO process that may be inconsistent with the broader regulatory framework (for example the Prospectus Rules)? If so, please describe and comment on whether these would be equally relevant to the market practice adopted following our proposed reforms.***

No.

12 ***Do you agree that the proposed policy measure helps to address the identified conduct risks associated with the production of connected research, and serves as an appropriate basis for reformed market practice? If not, how should it be amended?***

12.1 It would be helpful for the FCA to clarify the scope of proposed COBS Rule 12.2.21AG.

12.2 Firstly, the proposed Rule precludes a financial analyst from interacting with an issuer to whom the firm is "*proposing to provide underwriting services*." It would be helpful for the FCA to clarify what it means by "*proposing to provide underwriting services*." It is not uncommon for issuers to meet with a range of investment banks some months or years before an offering to discuss a wide range of matters including possible IPO plans. The issuer derives benefit from these discussions. Consideration could be given to linking the restriction to the timing of dissemination of formal "requests to

pitch" or the timing of any other formal approach by the issuer or its representatives requesting underwriting services.

12.3 Secondly, proposed COBS Rule 12.2.21AG(2) provides that the restriction on contact continues until: "*the extent of the Firm's obligations to provide underwriting or placing services to the issuer as compared to the underwriting or placing services of any other firm that is appointed by the issuer for the same offering is contractually agreed and documented between the firm and issuer*." It would be helpful for the FCA to clarify what it means by the Firm's obligations being "*contractually agreed and documented*." If a mandate letter is agreed early in the process, in most cases this will not contain a commitment to underwrite. The commitment is contained within the underwriting agreement, which is signed later in the process, after the research has been published.

13 ***Is it appropriate to extend our proposed rules to firms providing underwriting or placing services on IPOs on MTFs, notably the AIM and NEX Exchange growth markets? In supporting your answer, please provide details of the following:***

- ***The sources of information that are currently made available to investors during IPOs on these markets, their role in investor education and price discovery, and a description of the process;***
- ***The extent to which current market practice for IPOs on MTFs poses similar or different risks to the FCA's operational objectives as market practice for IPOs onto regulated markets, as outlined in Chapter 1;***
- ***Any specific concerns with extending the proposed rules to firms providing underwriting or placing services on IPOs on MTFs.***

13.1 The FCA states that one of its objectives in proposing reform is to facilitate the availability of information to investors early enough in the process to support more balanced investor education and price discovery (paragraph 1.18). We understand that, on the AIM market, the existing process typically involves early access to management by investors, subject to compliance with legal and regulatory requirements such as the Market Abuse Regulation. We understand that, given the relative size of AIM candidates and the impact that a failed IPO may have on their business, the decision on whether to list is taken late in the process, after feedback from investors. A requirement to publish a prospectus or registration document earlier in the process would conversely give a clear indication to the market that an

IPO is in contemplation and is inconsistent with moves in other jurisdictions (e.g. the U.S.) towards offering high growth companies the ability to go public at a later stage in the process.

13.2 With respect to the proposals regarding connected research, we understand that research coverage is relatively limited on AIM and would therefore question how much demand exists for unconnected research.

14 ***Do you agree with the CBA for our policy proposals as summarised in Annex 1? Do you expect our policy proposals to give rise to any costs and benefits that are not of minimal significance that have not already been considered in the CBA?***

14.1 The FCA may wish to engage with the accounting profession to ascertain the likely cost of any additional accounting work.

14.2 Also see our response to Question 9 above regarding the number of unconnected analysts likely to be interested in participating in an IPO process.

FOR FURTHER INFORMATION

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