

## Proposals to Shake Up the UK IPO Timetable

### *The FCA seeks to improve transparency in the UK equity IPO process.*

The FCA is proposing significant reforms to the UK equity IPO process, in order to address its concerns that investors should be receiving better information, earlier in the process. The key focus is on improving transparency by ensuring that an approved prospectus or registration document is published earlier on in the process, prior to an issuer's announcement of its intention to float (thereby making the prospectus more central to the process), and that unconnected analysts are given better opportunity to produce research on the issuer.

While the proposal to bring greater focus on the prospectus is to be welcomed, in our view it is questionable whether there is genuinely a market for unconnected IPO research.

The FCA asks for responses to the consultation by 1 June 2017 and states that it expects to publish its final rules later in the year, meaning the changes would be likely to come into effect in 2018.

### Background to the proposed reforms

In April 2016, as part of the FCA's investment and corporate banking market study, it published a Discussion Paper<sup>1</sup> on the availability of information in the UK equity IPO process. In this paper, the FCA voiced its concerns about the current way in which the IPO process functions, in particular regarding the timing, sequencing, quality and availability of information provided to market participants. The FCA proposed three alternative models for a reformed IPO process within the UK:

1.	A blackout on connected research until seven days after an approved prospectus or registration document is published.
2.	Opening any analyst presentation to unconnected analysts and requiring a blackout on connected research until seven days after the publication of an approved prospectus or registration document.
3.	Opening any analyst presentation to unconnected analysts and prohibiting such a meeting from taking place before the publication of an approved prospectus or registration document.

Following on from this Discussion Paper, on 1 March 2017 the FCA published a Consultation Paper<sup>2</sup> that sets out two new proposed measures in relation to the UK equity IPO process:

Measure 1 – availability of prospectus / unconnected research	Measure 2 – pre-mandate role of analysts
<p>A series of new Handbook rules that seek to ensure that:</p> <ul style="list-style-type: none"> <li>• An approved prospectus or registration document is published before any connected research is released.</li> <li>• Unconnected analysts (as well as connected ones) have access to the issuer’s management, before any connected research is published.</li> </ul> <p>The FCA sets out two alternative new IPO timetables, which are described further below.</p>	<p>Handbook guidance clarifying the FCA’s expectations on analysts’ interactions with the issuer’s management and their corporate finance advisers around the time that an underwriting/placing mandate, and subsequent syndicate positioning, is being considered.</p> <p>The FCA proposes new guidance to the effect that participating in pitches for new business (which is prohibited by the FCA rules) includes analysts interacting with issuers/their representatives <b>before</b> the firm has accepted a mandate to carry out underwriting or placing services for the issuer, <b>and</b> the firm’s position in the syndicate has been contractually agreed.</p> <p>The FCA may extend this to include any interaction between analysts and corporate finance advisers during the production of research.</p>

The FCA states that the key reason behind the proposed reforms is to ensure that investors receive better information about the issuer, earlier in the process. Having voiced its desire for change almost a year ago, the FCA is now setting the wheels in motion to reform the UK equity IPO process.

This consultation comes shortly after the publication of another Discussion Paper and Consultation Paper focusing on the FCA’s review of the effectiveness of UK primary markets, and so sits against a backdrop of wider consideration of the regulation of the UK’s equity markets.

## What does the timeline for an equity IPO currently look like in the UK and how is the FCA proposing to change this?

At present, a company seeking to list will give an early presentation to the analysts at the investment banks which are working on the IPO. Following publication of the company’s announcement of its intention to float, these connected analysts will publish their research on that company. After a blackout period typically of 14 days, the pathfinder prospectus will be made available to select investors to gauge demand and price. A key point to note about the current process, therefore, is that a draft prospectus will normally only be published at a fairly late stage in the process.

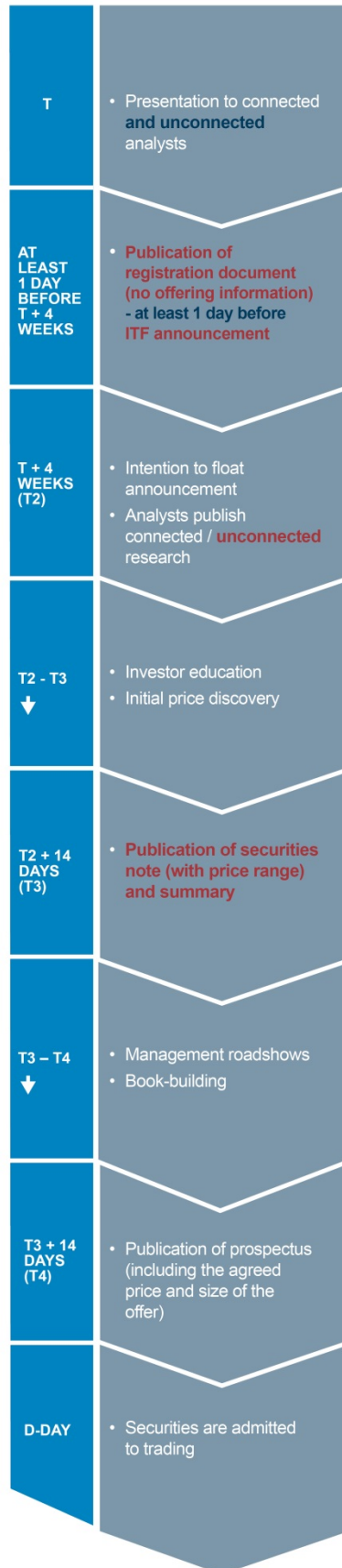
The FCA has put forward two alternative IPO timetables. Both of these include publishing a registration document at an early stage and bringing unconnected analysts into the picture at the start of the process. The proposed timetables differ in terms of the temporal separation between publication of the registration document and connected research — one timetable includes a one-day minimum separation, the other includes a seven-day minimum separation. The driver for this is the timing of the unconnected analyst briefing and giving them time to write their reports. The diagram below illustrates how these proposed timetables differ from the current timetable, and from each other.

# The IPO Process

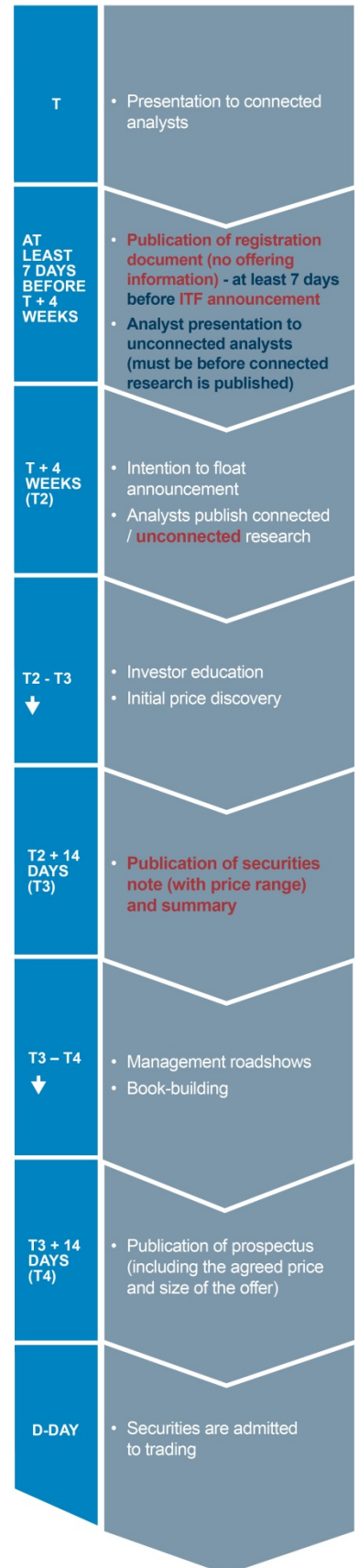
What does the timeline look like now?



Model 1 - briefing connected/ unconnected analysts at same time



Model 2 - briefing unconnected analysts after connected analysts



Aspects which are new under the FCA's proposals are outlined in **red**, and aspects which differ between the two FCA models proposed outlined in **blue**.

## Purpose of the proposed reforms

The FCA's view is that information enabling investors to make an informed decision on whether or not to invest must be made available earlier in the IPO process, and must be made available to a wider audience, not simply those connected to the company. At the heart of the reforms, therefore, is a drive towards increased transparency.

Through the introduction of the proposed measures, the FCA is seeking to improve the range and quality of information available to investors and facilitate the availability of this information early enough in the process to support more balanced investor education and price discovery. The FCA aims to do this by restoring "the primacy of an approved prospectus document" and reducing the reliance on what it sees as potentially biased connected research.

Further, by adding Handbook guidance that clarifies the FCA's expectations on analysts' interactions with the issuer's management and their corporate finance advisers around the time of a placing mandate, the FCA is looking to enhance the standards of conduct through the IPO process, in particular, to mitigate the risk of bias being imparted to connected research in the first place.

In the FCA's view, the more informed investors are about the decisions they are making, the less their uncertainty will be, which in turn means improved price efficiency in IPOs and a more cost effective route to raising capital. The desired outcome of this? To attract companies to conduct their IPOs within the UK and boost the UK market, something that is, of course, seen as desirable in the current political climate.

## What are the FCA's specific concerns?

The FCA outlines in its Consultation Paper a number of concerns with the current way in which the UK equity IPO process operates:

- **Key independent and objective information is only received relatively late in the process:** currently, investors will receive the pathfinder prospectus only after the key period of investor education and price discovery. Further, the draft prospectus is not made available to unconnected analysts so that they can write unconnected research in relation to the relevant company. Therefore, during the early stages of the IPO process, in particular the price formation stage, investors are relying on information set out in connected research only. **The FCA is of the view that this potentially jeopardises one of its statutory operational objectives: consumer protection.**
- **Effective competition is inhibited:** in allowing connected analysts to attend meetings with the issuer's management earlier on in the process (i.e. before an intention to float announcement has even been made), whilst unconnected analysts are effectively prevented from issuing research during the IPO marketing period, the concern is that unconnected (and therefore "completely" independent) analysts do not have the same ability as connected ones to produce research on the relevant company, which investors could use to inform their investment decisions. **The FCA is of the view that this potentially jeopardises one of its statutory operational objectives: promoting effective competition in the interests of consumers.**
- **Market abuse:** the FCA outlines its concerns that, under the current IPO process, information is often made available without a detailed consideration having been made as to whether the information being disclosed constitutes inside information or not, potentially in contravention of Article 10 of MAR (unlawful disclosure of inside information). Further, the FCA states that companies must be comfortable that they are meeting the conditions set out in Article 17 of MAR, justifying their delayed disclosure of this information to the market. These points may be relevant because the company has issued listed debt. The FCA seeks feedback from firms on how they believe they are meeting these requirements.

- **Conflicts of interest:** the FCA is concerned about its findings from the investment and corporate banking market study, which suggested that members of the relevant corporate finance team advising the company may encourage the company to opt for research from those institutions which offer the most favourable research. Often, this is not independent research brokers. The concern is therefore that the dominant source of investor information during the crucial early stages of an IPO process is analysts at investment banks hoping to win investment banking work in the future as a result. Further, if price formation is based on research that is potentially biased or perceived as biased (rather than on information contained in a prospectus) then investors and issuers may lose confidence in the UK IPO process. **The FCA is of the view that this potentially jeopardises one of its statutory operational objectives: ensuring market integrity.**

## What could this mean for the UK IPO market?

Following the FCA's April 2016 Discussion Paper, the industry appeared to accept that there would be some change in the sequencing of the IPO process. Indeed, there was a considerable amount of engagement by trade associations making proposals as to what a new, improved, process might look like. The FCA refers to recent external reports raising concern over the IPO process, but notes that "there have been no changes in market practice. This suggests that a policy intervention is necessary to facilitate reform".

Over the past few years there has been an increasing desire to provide investors with more information in advance of a listing, and means of doing this such as early look, pilot fishing, management roadshows and research have become more and more developed as a result. The proposal to make the prospectus more central to the IPO process and to ensure that investors receive key information earlier on in the process is, therefore, to be welcomed.

Market participants will be concerned by the FCA's comments attacking the use of connected research. In order to take action, though, the FCA is not primarily proposing steps to improve any perception of a lack of independence. Instead, the proposal that a prospectus must have been published, and unconnected analysts have been given access to the issuer's management, before connected research is released is, in some ways, a strange way to manage this concern. A key concern for participants in the UK market will also be the contradiction of this timing requirement, as it suggests the FCA thinks it is in a better position than firms to know when research should be published. In particular, firms will know the FCA's view that the traditional argument for publishing research and using blackout periods (managing legal risk) has not been supported by firms' own research.

A further change in the UK market will be the prevention of any interaction between analysts and issuers until the firm is actually mandated and its position in the syndicate has been determined. This restriction is to manage the perception that the views of the company's management on the level of support they feel they will receive from analysts may help to determine whether a mandate is awarded, and what position in a syndicate a firm might receive.

Finally, firms active in the UK market are likely to be intrigued by the FCA's suggestion that the market is: (1) awash with; or (2) likely to develop a pool of (depending on your point of view) unconnected analysts. The more commonly held view appears to be that the production of research usually only makes sense by firms that are connected, and that the lack of unconnected research is not caused by structural impediments but by a lack of desire by firms to write research on this basis.

Certainly with the current pressure the buy side faces to pay for research, and given the fact that often sufficient high-quality research is produced by connected analysts, and larger institutions often conduct their own analysis and do not rely on research, it is difficult to see how a market for unconnected research could take off. Although there will continue to be a role for research, with more focus on the prospectus research reports could potentially become shorter and more targeted. Time will prove who was right.

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**Endnotes**

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- <sup>1</sup> DP16/3 Availability of Information in the UK Equity IPO Process *available at* <https://www.fca.org.uk/publication/discussion/dp16-3.pdf>
  - <sup>2</sup> CP17/5 Reforming the availability of information in the UK equity IPO process *available at* <https://www.fca.org.uk/publication/consultation/cp17-05.pdf>