Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

T +44 (0)20 7600 3745
F +44 (0)20 7600 8288
mail@theqca.com

www.theqca.com

Lucas Penfold
Markets Policy Department
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

cp17-05@fca.org.uk

31 May 2017

Dear Mr Penfold,

**CP17/5 Reforming the availability of information in the UK equity IPO process**

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

We welcome the opportunity to respond to the FCA's proposals on reforming the availability of information in the UK equity IPO process.

The Quoted Companies Alliance Legal, Primary Markets and Secondary Markets Expert Groups have examined your proposals and advised on this response. A list of members of the Expert Groups is at Appendix A.

***Responses to specific questions***

**Q1 Are you aware of any other conduct risks associated with the production of connected research? If so, please describe them.**

We are not aware of any other conduct risks associated with the production of connected research.

**Q2 Do you agree that connected research should continue to play a role in the UK IPO process?**

We agree that connected research should continue to play a role in the UK IPO process. It has an essential part to play in the price formation process for an IPO by including prospective financial information and valuation opinion, as well as providing an insightful analysis of a company for investors.

It should also be recognised that almost all AIM IPOs involve fundraisings from qualified investors, with almost no element of an offer being made to the public. In such circumstances, we have seen that there has been no commercial rationale for any unconnected research to be produced as there is no opportunity for an unconnected bank or broker producing such unconnected research to generate commission income from public interest in the offering. We are also not aware of any demand for such unconnected research from qualifying investors in respect of potential MTF IPOs.

Nonetheless, we question whether the proposals will trigger an increase in the demand for unconnected research from institutional investors. Independent analysts will need to consider whether they have the capacity or the desire to produce research in a short period of time. Furthermore, analysts will want to consider whether they will be appropriately compensated for providing research reports in a limited time period.

Connected research is typically provided as an additional and complementary service by the financial adviser, rather than being specifically accounted for in the transaction fees. Therefore we question whether there will be appetite amongst the potential investors and other recipients to pay for this research. Similarly, we question whether the quality of the research produced in a limited time period will trigger sufficient demand from investors over time.

The process of the banks and issuers engaging with the relevant independent analysts on 'reasonable terms' will add a further layer of complexity to the timetable. We question whether these factors outlined above will have an impact on whether we will see a trend for more unconnected research being produced in offerings. As mentioned above, we think that it is very unlikely that the proposals will trigger more demand in respect of MTF IPOs and consequently, we advocate not extending these proposals to such transactions.

**Q3 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 believe that the simultaneous publication of a prospectus or admission document and connected research should be a desired objective. However, the reason that there is not a level playing field for connected and unconnected analysts is that there is simply no commercial rationale for unconnected banks or brokers to produce such research, particularly for IPOs on MTFs. A substantial proportion of IPOs do not involve any public offering. Rather, they are carried out by means of placing with the lead adviser's or syndicate's (for larger issues on the regulated market) investment clients.

In many cases, it is generally unlikely that any bank or broker would invest in pre-IPO research if there was no possibility of generating revenues in some form from their investment clients. We acknowledge that in time fund managers may start to pay unconnected analysts to provide research on a specific sector or company.

**Q4 Do you agree that, if unconnected analysts were to be provided with access to 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?**

The rationale for the seven day period is to provide independent analysts with sufficient time to prepare and publish their research reports following the publication of the prospectus. This is an acceptable period of time that will not cause significant disruption to the overall IPO timetable (although we question whether seven days is sufficient time for unconnected analysts to prepare high quality research on the issuer of a quality which is comparable to the connected research).

Connected analysts are likely to have access to information prior to the analyst presentation, particularly if they have long established relationships with the issuer. As a result, they are likely to produce a higher

standard of research than an unconnected analyst, who must analyse information and produce research within a limited period.

**Q5 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 understand that the earlier publication of the final prospectus may be valuable to certain potential investors (particularly retail investors) who may wish to receive more detailed and comprehensive information on the company before making their investment decision. However, we do not believe the proposals should apply to MTF IPOs as there is very rarely a retail offering in respect of such transactions. This should also be the case where there is no retail element to an IPO money raising on the regulated market.

Institutional investors in companies to be listed on an MTF are likely to make their investment decisions based on the analyst presentation or the pathfinder document (which is, in any case, a near final document). Furthermore, as explained above, we question whether the changes will trigger more demand for unconnected research from institutional investors.

**Q6 Do you agree with the proposed rules set out in Appendix 1? If not, how should they be amended?**

As explained above, we do not believe that the proposed rules should apply to MTF IPOs. If any changes are proposed to be made to the MTF IPO process, we suggest that a separate, in-depth review is conducted.

This notwithstanding, some of our members are concerned at the proposed rules set out in Appendix 1, supported by the indicative timetables of the IPO process in Figures 1 and 2. They regard an ITF announcement being required by an issuer prior to the investor education and initial price discovery phase as potentially detrimental to issuers seeking to list. Different issuers approach IPOs in different ways. For example, one issuer may be more sensitive to failure (perceived or otherwise) than another and may seek only to announce its intention to float once the book build is complete and the issue has been priced. This approach addresses issues regarding execution risk and failure to raise funds. Requiring issuers to publicise the approval of a prospectus or registration document before any meaningful marketing or book building has taken place could make an IPO less attractive. This could be mitigated if distribution to potential investors was done in private.

Please note an issue in accessing unconnected analysts prior to the ITF announcement in that there may be a risk of unlawful disclosure under MAR to such unconnected analysts. This is discussed in the answer to Q10 below.

**Q7 If you think that there are advantages to an alternative approach to the one we had envisaged, please provide details.**

See our answer to Q6 above.

**Q8 Does this proposal have any practical implications for the transaction review process?**

If a final prospectus or registration document is published earlier in the process, we would expect that much of the due diligence and drafting would need to be conducted earlier to ensure that a final document

can be approved and published earlier in the timetable. This should not have any significant implications for the transaction review – as issuers and banks would need to factor this into the timetable prior to when the transaction review process commences.

However, the proposal would likely lengthen the overall timetable by "front loading" the prospectus preparation and vetting processes as currently the analyst marketing phase may still be used for the final stages of document review. The associated costs would be a significant burden for smaller companies wishing to come to market.

Please also see our response to Q13 which explains why MTF issuers are more reluctant to publish a prospectus or admission document earlier in the IPO process given the impact that a failed IPO may have on their business, due to their relative size.

**Q9 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?**

The suggested industry guidelines could help operationalise the proposed rule requiring syndicate banks to provide unconnected analysts with an opportunity to be in communication with the issuer's management. However, if the issue noted in the proposed approach in our answer to Q6 is addressed then the need for such guidance would be significantly reduced.

**Q10 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 understand that Article 2 of MAR applies to actions and omissions anywhere in the world, and to any transaction, order or behaviour whether or not on a trading venue, concerning financial instruments being admitted to trading on a regulated market; traded or admitted to trading on an MTF or for which a request for admission to trading on a regulated market has been made; or for which a request for admission to trading on an MTF has been made.

In the context of an IPO, where the shares being issued are not already within the scope of Article 2 of MAR, interactions between a first time issuer with potential investors will only come within the regime at the earliest from the point at which a request for admission to trading on a regulated market or MTF for those shares is made. Information disclosed during an analyst presentation which is delivered prior to when the request for admission is submitted, will fall outside of the scope of MAR.

Yet, it is the FCA's view – as set out in the Market Conduct section of its Handbook paragraph 1.2.5 – that potentially widens the scope of MAR to create this problem by interpreting the term "in respect of which a request for admission to trading … is subsequently made" to mean, in effect, "for which it is intended a request for admission to trading is subsequently made".

For all other interactions with investors following the time when the request for admission is submitted, MAR would apply to all such actions and behaviour in respect of the relevant securities to be admitted and, consequently, where inside information has been identified, an issuer would need to consider its announcement obligations and whether there are circumstances under which such disclosure can be delayed.

For a proposed IPO of a listed parent's subsidiary, the subsidiary will be within the scope of MAR if the price or value of its shares will have an effect on the price or value of the shares of the listed parent. For such issuers, however, it is unlikely for inside information to be disclosed to an analyst as part of early stage IPO discussions. There is likely to be a careful analysis of what information is likely to be disclosed in the presentation.

If inside information is disclosed, there will be a legitimate reason for delaying public disclosure (that is, to not prejudice the potential IPO which would be announced publicly prior to the analysts publishing their research and speaking to investors). Furthermore, steps will be taken to ensure that any disclosure is in the normal exercise of employment, profession or duties (Article 10 of MAR) such as ensuring that disclosure is limited to what is necessary and that strict confidentiality arrangements are entered into with the analyst.

If it is accepted that there may be an issue under MAR for pre-IPO research, which seems to arise from the FCA's guidance under the Market Conduct section of its Handbook, referred to above, rather than the letter of the regulation itself, then there may be a risk of unlawful disclosure of inside information to unconnected analysts by revealing an intention to float ahead of making an ITF announcement. However, we would expect that such disclosure would be made in the normal exercise of one's employment, profession or duties and the appropriate steps are taken to ensure the confidentiality of the information as noted above.

**Q11 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.**

We are not 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.

**Q12 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?**

The potential conduct risk issues that already exist in relation to connected research will not necessarily be mitigated by allowing access for unconnected analysts, particularly as in most circumstances there is unlikely to be a commercial demand for such access. In addition, as noted above in our answers to Q6 and Q10, the proposed approach could give rise to an extra set of conflict and conduct risks requiring additional red-tape in an attempt to mitigate these newly introduced risks.

**Q13 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.**

As outlined above, we do not believe that it would be appropriate to extend the proposed rules to firms providing underwriting or placing services on IPOs on MTFs, such as AIM and NEX Exchange. Although we generally support the outlined high-level aims for reform of the UK IPO process, we consider that they are more appropriate for larger IPOs, rather than for smaller ones.

Companies listed on MTFs, such as AIM and NEX Exchange, are very different to those admitted to trading on regulated markets. They attract a more specialist type of investor and there are a limited number of specialist analysts who will undertake research on those companies. In the case of such companies, connected research is the only research available because there is simply very little interest or commercial rationale to produce unconnected research with small and mid-size companies.

Opening up the possibility for unconnected research to be produced would also not solve the problem of the dearth of investment research on smaller companies. Moreover, this research would not end up being commercially viable, if at all produced, as we do not believe that potential investors in MTF-traded companies will pay for such unconnected research to the extent that it is viable.

Nearly all AIM IPOs are conducted through private placements, which means that most of them are marketed confidentially and intention to float announcements are only made shortly before admission when the certainty of the success of the IPO is substantially assured. Smaller issuers and other stakeholders in smaller IPOs wish to reduce execution risks because abort fees can be substantial. Issuers are reluctant to publish prospective financial information due to the additional costs of the reporting requirements in relation to such forecasts but also due to liability concerns.

We acknowledge that there is investor demand in receiving financial and other information about a company seeking to be admitted on a public market in good time before they are asked to participate in a money raising.

We suggest that this issue is considered by the London Stock Exchange in conjunction with small cap fund managers and nominated advisers. We stress that this is not taken up by the FCA unless a real market failure on MTFs is identified.

We would propose to market operators of an MTF that for IPOs on MTFs, such as AIM and NEX Exchange, whoever is sent research or receives marketing material ahead of the placement process by the broker should also expect to receive a draft pathfinder document in good time before an investment decision is

taken, as long as this document remains confidential to the recipients and is not made publically available. This will enable investors to analyse a company's business model and financial condition, while at the same time protecting the company in question from incurring damage to their reputation as a result of a potential lack of investor interest.

As stated in our answer to Q2, this fundamental difference between AIM and regulated markets means that no unconnected research is conducted as an unconnected bank or broker is unlikely to generate any buy-side interest from their research output. We believe that MTFs should not form part of the outcome of this consultation.

**Q14 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?**

We note that the CBA does not take into account the material increase in costs and reputational risk for companies listed on MTFs like AIM and NEX Exchange due to the front-loading of the expenses of an IPO. These costs will be a significant burden on cash-constrained high-growth companies and is likely to negatively impact the availability and cost of scale-up capital for UK SMEs seeking growth.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

**APPENDIX A**

**Quoted Companies Alliance Legal Expert Group**

| **Gary Thorpe (Chairman)** | **Clyde & Co LLP** |
|---|---|
| Maegen Morrison (Deputy Chairman) | Hogan Lovells International LLP |
| David Davies | Bates Wells & Braithwaite LLP |
| Martin Kay | Blake Morgan |
| Paul Arathoon<br>David Hicks | Charles Russell Speechlys LLP |
| Philippa Chatterton | CMS |
| Mark Taylor | Dorsey & Whitney |
| Jane Wang | Fasken Martineau LLP |
| Richard Pull | Hamlins LLP |
| Danette Antao | Hogan Lovells International LLP |
| Donald Stewart | Kepstorn |
| Nicola Mallett<br>David Wilbe | Lewis Silkin |
| Tara Hogg | LexisNexis |
| Stephen Hamilton | Mills & Reeve LLP |
| Nicholas McVeigh | Mishcon De Reya |
| Simon Cox<br>Julie Keefe | Norton Rose Fulbright LLP |
| Ashmi Bhagani | Pillsbury Winthrop Shaw Pittman LLP |
| Sarah Hassan | Practical Law Company Limited |
| Kieran Rayani | Stifel |
| Catherine Moss | Winckworth Sherwood LLP |

**Quoted Companies Alliance Primary Markets Expert Group**

| **Richard Evans (Chairman)** | **Strand Hanson Limited** |
|---|---|
| David Worlidge<br>Nick Naylor | Allenby Capital Ltd |
| Chris Hardie | Arden Partners Plc |
| David Foreman | Cantor Fitzgerald Europe |
| Stephen Keys | Cenkos Securities Plc |
| Peter Stewart | Deloitte LLP |
| Stuart Andrews | finnCap |
| Samantha Harrison | Grant Thornton UK LLP |
| Niall Pearson | Hybridan LLP |
| Richard Crawley | Liberum Capital Ltd |
| Tom Price | Northland Capital Partners Limited |
| Peter Whelan | PricewaterhouseCoopers LLP |
| Bidhi Bhoma | Shore Capital Group Ltd |
| Azhic Basirov | Smith & Williamson LLP |
| James Spinney | Strand Hanson Limited |
| Paul Shackleton | W.H. Ireland Group Plc |

**Quoted Companies Alliance Secondary Markets Expert Group**

| **Jon Gerty (Chairman)** | **Shore Capital Group Ltd** |
|---|---|
| Mark Tubby (Deputy Chairman) | finnCap |
| David Cooper | Cenkos Securities Plc |
| Andrew Collins<br>William Garner | Charles Russell Speechlys LLP |
| Jeremy Phillips | CMS |
| Stephen Streater | Forbidden Technologies PLC |
| Keith Hiscock | Hardman & Co |
| Shreena Travis | Henderson Global Investors |
| Fraser Elms<br>Katie Potts | Herald Investment Management Ltd |
| Claire Noyce | Hybridan LLP |
| John Howes | Northland Capital Partners Limited |
| Ann Whitfield | Panmure Gordon & Co Plc |
| Sarah Bray | Peel Hunt LLP |
| Simon Rafferty<br>James Stapleton | Winterflood Securities Ltd |