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FINANCIAL CONDUCT AUTHORITY

Primary Market Bulletin

Newsletter from the FCA for primary market participants

About this edition

Welcome to the 23rd edition of the Primary Market Bulletin (PMB).

In this short edition, we finalise our guidance on periodic financial information and inside information, after consulting on updating Technical Note UKLA/TN/506.1 in Primary Market Bulletin 19.

We also outline our findings and set out our expectations on some of the issues raised in our recent supervisory review of the new regulatory requirements for firms managing securities offerings. Introduced in 2018, these were: (i) the MiFID II rules governing the provision of underwriting and placing services; and (ii) the domestic reforms on the availability of information in the UK initial public offering (IPO) process.

Finally, we provide an update on the implementation of the EU Prospectus Regulation.

Consultation feedback and changes to the Knowledge Base

Technical Notes

Category – Periodic financial information

FCA/TN/506.2 – Periodic financial information and inside information (Amendment)

We received considerable feedback expressing approval of the draft update. We will not discuss this positive feedback here.

Upon further consideration, we decided to make it clear that to delay disclosing inside information in line with Article 17 of the Market Abuse Regulation, an issuer must be able to ensure the confidentiality of the information in question. We will therefore add a sentence to the Technical Note to confirm this.

We also received suggestions for amendments which we judge would inappropriately soften – or directly contradict – the key messages we want to communicate to the market. Here, we explain our reasons for not incorporating these suggestions in this final published version of the Technical Note.

Use of 'ongoing'

Two respondents questioned our use of the word 'ongoing' (...'issuers should assess on an ongoing and case-by-case basis the extent to which the information they hold fulfils the criteria defining inside information...' – and in a similar manner on three other occasions).

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They were concerned that this statement may drive behavioural change, including more frequent holding of board or disclosure committee meetings.

We believe that the assessment of the nature of information held by an issuer – and, when the delay provision is used, the extent to which the conditions permitting delay continue to be fulfilled – should be undertaken on an ongoing basis.

It is not acceptable for a firm to take a view at a given point in time and to remain of that view – and to act accordingly – without undertaking further assessment. As a situation evolves, the facts of that situation change. It is only by reassessing those facts that a firm can arrive at an appropriate judgment. It is important that firms assess and re-assess, as the situation requires.

So we are clear that the assessment of the facts should be **'ongoing'**. But we do not mandate who in a firm should conduct this assessment. A board or disclosure committee is not necessarily the best or only body which can take these decisions. We would expect individuals at other levels in the firm, including in the first line, to be well-trained enough to recognise when information may become inside information, and to be able to act accordingly.

So, we will maintain our use of the word 'ongoing' in the final version of the note.

'...information relating to financial results could constitute inside information'

Two respondents noted our statement that '...information relating to financial results **could** constitute inside information'.

These respondents stated that this wording would be interpreted by issuers as a presumption that financial results information **should** be viewed as inside information.

We have considered this point at length. We have deliberately not chosen the word '**should**'. We have instead selected '**could**'. We are clear that financial results '**could**' constitute inside information – but equally, they could not. It is for issuers to assess whether this is the case, on an ongoing and case-by-case basis.

Issuers not to take a blanket approach / neither always nor never

Respondents noted our statements that issuers must not take a '**blanket**' approach and should not consider information to be included in financial reports to be '**always or never**' inside information.

One suggested amending the second phrase to read '...should not assume... will **always** constitute inside information' (ie to delete the 'never').

We will not make this amendment. We will keep our use of 'never' in the final note because:

- It is in line with our thoughts that information to be included in a periodic financial report 'could' constitute inside information;
- And it avoids any suggestion that we might accept an issuer concluding that such information could 'never' constitute inside information.

'Would' or 'could' result in the incorrect assessment of the information by the public

The example legitimate interest we set out has 2 limbs. Immediate disclosure 'would impact on the orderly production and release of the report' and 'could result in the incorrect assessment of the information by the public'.

In an earlier draft of our proposal, both limbs used 'would'. We later softened the second to 'could'. We considered that this acknowledgment of uncertainty moved us closer to the standard of the relevant example provided by ESMA ('...would jeopardise the correct assessment...')

Two respondents also suggested softening the remaining 'would' to 'could', or 'would be likely to'. They said it would be difficult for issuers to determine with sufficient certainty that disclosure of inside information 'would' have an impact on the orderly production and release of a report.

We believe that such a change would set the bar for use of the legitimate interest we set out at too low a level. Delaying disclosure of inside information should be the exception rather than the rule. We believe the current balance between 'would' and 'could' is appropriate. We will retain the wording as previously published.

In many cases... in some cases...

One respondent disagreed with our suggestion that 'in many cases, an issuer will be able to carefully and appropriately draft an announcement that will enable the correct assessment of information by the public'.

We have considered the message of this paragraph. The key point is to reiterate that delay in disclosure should be the exception rather than the rule.

As the Upper Tribunal noted in 'Hannam', there **will** be circumstances where, practically, it would be very difficult for an issuer to formulate an announcement that does not risk misleading the market. In these circumstances, an issuer would be justified in delaying disclosure of the information.

But such a situation should not be regarded as the default, or even a common situation. In most cases, if an announcement is skilfully drafted with appropriate care and attention, it is unlikely to result in the incorrect assessment of the information by the public. We will retain the paragraph as previously published.

Multi-firm review of the MiFID II requirements on underwriting and placing in Equity Capital Markets and Debt Capital Markets

We introduced new regulatory requirements in 2018 for firms managing securities offerings designed to ensure that the UK's primary capital markets effectively serve issuers and investors. These were: (i) the MiFID II rules governing the provision of underwriting and placing services; and (ii) the domestic reforms on the availability of information in the UK initial public offering (IPO) process.[1]

We have recently reviewed how the industry has applied the new requirements. Here we outline our findings and set out our expectations on some of the issues raised. This should make it clearer for firms applying the new rules.

1 COBS 11A: www.handbook.fca.org.uk/handbook/COBS/11A/?view=chapter

The new provisions in the MiFID II rules introduce specific requirements for firms to manage conflicts of interest and to disclose information relevant to underwriting and placing activities. Many of the new underwriting and placing requirements introduced under MiFID II now add further rigour to what was already required under the conflicts of interest rules in SYSC 10.[2]

The domestic reforms to the UK IPO process seek to improve the range, quality and timeliness of information available to investors during the equity IPO process. They are aimed at restoring the centrality of the prospectus, creating the necessary conditions for unconnected IPO research to be produced, and addressing the underlying conflicts of interest that can arise when producing and distributing connected research.

What we did

In undertaking our review, we engaged with 19 stakeholders, including sell-side and buy-side institutions, trade bodies and issuer representatives. In particular, we examined how sell-side firms have embedded the new requirements into their internal policies and procedures, and into their day to day activities, and we considered the impact of the changes on the functioning of primary capital markets in the UK.

What we found

MiFID II requirements on underwriting and placing

We found that firms generally have a good understanding of their obligations in this area, and have embedded the requirements in their systems and controls. The new requirements on underwriting and placing have resulted in firms formalising their engagement with their issuer client and to ensure that the issuer is put at the heart of the underwriting and placing process.

But in several firms, we identified shortcomings in firms' adoption of the MiFID II requirements on (i) informing and engaging with the issuer regarding risk management transactions; and (ii) justifying allocation decisions.

Risk management transactions

We found it is common for firms managing a securities offering to carry out risk-management transactions in respect of the offering by their rates trading desk, for the issuer, and or for investors participating in the issue.[3]

Firms typically inform the issuer about risk-management transactions that they carry out for themselves. However, they do not typically engage the issuer about risk-management transactions they carry out on behalf of investors participating in the issue. Where disclosures are provided, they generally consisted of a generic

2 SYSC 10: www.handbook.fca.org.uk/handbook/SYSC/10/1.html

3 These transactions can include, for example, a rate lock that mitigates the market participant's exposure to movements in the reference rate used to price a debt issue, or a rate swap that allows the participant to the transaction to move between different interest bases (e.g. swap from a fixed to floating rate, or vice versa).

notification stating that the bank may, or may not, carry out risk-management transactions regarding the offering.

We consider the approach taken by firms informing issuers about risk management transactions to fall short of what is expected. MiFID II requires that firms 'inform and engage'[4] the issuer on any intended hedging or stabilisation strategies it undertakes and how they may impact the issuer's interests. Consistent with this requirement, we expect firms to consider on a case-by-case basis the impact of risk-management transactions they undertake on the issuer's interest. This should include meaningfully engaging the issuer on these transactions as appropriate; enabling the issuer to assess the potential impact of these transactions on their interests. We recognise that it will not usually be appropriate to inform one client about a transaction to be undertaken on behalf of another client. However, when managing a securities offering, firms should, at a minimum, explain to an issuer client whether, and in what circumstances, they will undertake risk management transactions and how those could impact on an issuer client's interests.

Justification of allocations

Overall, firms had appropriate controls to manage conflicts of interest when making allocation decisions. However, when justifying final allocations, we noted that most firms focused on the top 20% of the total allocation by volume and fill.[5] They relied on other recorded documentation to justify the remaining 80% of the book.

While the approach firms adopted may be appropriate and proportionate in some cases, they should not automatically assume that the other recorded documents will be enough to justify all allocations decisions.

We recognise that ESMA's guidance states that firms should focus particularly on justifications for the top 20% of the book by size of allocation and fill. However, firms are required to provide an explicit justification for the allocation decisions made to each investment client. The reasoning for how allocations are determined may be sufficiently evidenced by the records that firms are required to maintain throughout the issuance process (when taken together), but justifications must be explicit and sufficiently detailed. In line with this, we would expect firms to make judgements about whether the records they maintain can genuinely justify the allocation decisions.

UK IPO reforms

During our review, only two IPOs had been subject to the new IPO reform rules.

Overall, stakeholders were largely supportive of the UK IPO reforms.

Publishing an approved prospectus or registration document earlier in the process was considered a key change and to improve the IPO process by both sell-side and buy-side firms. Most of the market participants we engaged with recognised that it improved the information available to investors at an earlier stage and supported a more balanced investor education and price discovery process.

4 COBS 11A.1.5EU; Article 39(2) of MiFID II Delegated Regulation
5 Available at: www.esma.europa.eu/sites/default/files/library/esma35-43-349_mifid_ii_qas_on_investor_protection_topics.pdf

Managing analyst conflicts

Our review found that in some firms, research analysts play a role in providing an internal-facing due diligence advisory service within the firm, prior to underwriting and placing mandates being awarded. We remind firms to carefully consider their obligations to manage conflicts of interest where research analysts perform this role.

As set out in PS17/23[6], when a firm is considering allowing its analysts to provide an internal facing due diligence advisory service, it must carefully consider its obligations under SYSC 10. These include, among other things, the requirement for firms to prevent or control the involvement of its staff in activities that may impair proper management of conflicts of interest.[7] The overarching SYSC framework forms the asis of the more detailed guidance on investment research under COBS 12, which states that analysts should not participate in investment banking activities.[8]

PS17/23 clarified that while analysts producing non-independent research are not subject to COBS 12, firms cannot automatically assume that it is appropriate for their non-independent analysts to participate in pitches. Producers of non-independent research must take all appropriate steps to identify and prevent or manage any conflicts of interest consistently with their SYSC 10 obligations, including during the production and distribution of non-independent research.

Next steps

We will continue to engage with firms on implementing MiFID II underwriting and placing requirements and the domestic IPO rules as part of our ongoing supervisory engagement. We will also maintain an open dialogue with other stakeholders on the impacts of these reforms to the market.

EU Prospectus Regulation implementation - update

The new EU Prospectus Regulation is due to come into full effect on 21 July 2019. As we set out in Consultation Paper 19/6 published on 28 January 2019, on the assumption the new regulation will come into effect in the UK, we plan to make changes to the Prospectus Rules to make them consistent with the new regulation. We are also working to deliver those process and systems changes necessary to ensure we are ready for business when the new regulation comes into effect.

From the end of April 2019 onwards, we will be able to receive prospectuses and other Prospectus Regulation documents intended for approval on or after 21 July 2019 for review. These reviews will be conducted under the new regulation. We will also continue to review documents under the existing regime where approval is scheduled for before 21 July 2019.

As part of the FCA's preparations for the new Prospectus Regulation in the UK, we will be putting transition arrangements into place:

- From the end of April 2019, a submitter using the existing Electronic Submission System (ESS), will be able request their submission is reviewed under either the current regime or the new Prospectus Regulation;

6 *Reforming the availability of the information in the UK equity IPO process, PS 17/23*, October 2017
7 SYSC 10.1.11 R; MiFID II Delegated Regulation Article 34
8 COBS 12.2.21A G; MiFID II Delegated Regulation Recital 56

- Relevant supporting documents, e.g. cross-reference lists and related forms for reviews of transactions under the new Prospectus Regulation will be made available on the FCA website – the corresponding materials supporting the current prospectus regime will also remain available.

To ensure a successful transition, we encourage issuers and their advisors to consider carefully the turnaround times for approval of prospectuses when planning transactions. These remain unchanged and you can check them on our website. As the 21 July changeover date comes closer, all involved should consider whether to prepare the document under the current regime or in accordance with the new rules.

We are also planning to release an upgrade to our ESS portal in July to address changes arising as a result of the new regulation. The upgrade will cover the submission of prospectuses, supporting documentation and listing applications. It will also allow the collection of data we need under the new regulation and support the submission of final terms through ESS. More information will be made available in due course via the FCA website