Financial Conduct Authority

Discussion Paper

DP16/3

Availability of information in the UK Equity IPO process

April 2016

Contents

We are asking for comments on this Discussion Paper by 13 July 2016.

You can send them to us using the form on our website at:
www.the-fca.org.uk/dp16-3-response-form.

Or in writing to:

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Abbreviations used in this paper

ABI	Association of British Insurers
AIM	Alternative Investment Market
COBS	Conduct of Business sourcebook
FCA	Financial Conduct Authority
ECM	Equity Capital Markets
FINRA	Financial Industry Regulatory Authority
IPO	Initial Public Offering
ITF	Intention to Float
LSE	London Stock Exchange
MiFID	Markets in Financial Instruments Directive
MTF	Multilateral Trading Facility
PD	Prospectus Directive
PR	Prospectus Rules sourcebook
RIE	Recognised Investment Exchange
SEC	Securities and Exchange Commission
UKLA	United Kingdom Listing Authority

1. Overview

1.1 The UK Initial Public Offering (IPO) process plays a vital role in helping companies raise finance, and providing fresh investment opportunities for pension funds, insurance companies, other institutional investors and individuals. It facilitates the recycling of investment capital to the next generation of early-stage businesses and the renewal of the portfolios of the investors in the UK's public equity markets. Between 2011 and 2015, a total of 460 companies floated on the London Stock Exchange (LSE), for example, raising an estimated £53 billion[1].

1.2 The UK IPO process underpinning this success has considerable strengths. It is successful in attracting international issuers, like the US market, but has the more variable and cheaper fee structures typical of European IPO markets.[2] However, in recent years a number of external reports have identified some concerns with the way in which key information is provided to investors. These reports include the study by the Association of British Insurers (ABI) into encouraging equity investment[3], the HM Government-commissioned Myners Review of the Royal Mail IPO[4] and TheCityUK's review of the European listings regime.[5] A common concern raised is that the prospectus, the key source of information on the issuer for investors, is published too late in the process for investors to be able to rely on it in their decision-making.

1.3 Current market practice for UK IPOs includes a 'blackout' period of around 14 days between the publication of research by syndicate banks ('connected' research) and the circulation of the pathfinder prospectus. Responses gathered from investment banks as part of our market study have stated that they impose this blackout period to manage potential legal liability and perceived regulatory risks.

1.4 Despite market participants' desire for an appropriately targeted improvement to the process and calls for change including within the reports above, there has so far been no change in market practice. This suggests that individual firms are unlikely to make changes without regulatory intervention. This discussion paper explores possible avenues for reform, including potential amendments to the regulatory framework, to address our concerns and improve the process in the interest of issuers and investors.

1 This figure includes capital raised on AIM.

2 See ABI's study on Encouraging Equity Investment (July 2013), John Kay: Other People's Money (2015), Abrahamson, Jenkinson and Jones in Why don't US issuers demand European fees for IPOs in Journal of Finance (2011).

3 op. cit.

4 An Independent Review for the Secretary of State for Business, Innovation & Skills: IPOs and Bookbuilding in Future HM Government Primary Share Disposals (December 2014).

5 Capital Markets for Growing Companies: A Review of the European Listings Regime (July 2015).

Our market study and the basis of concerns

1.5 On 22 May 2015, the FCA launched a market study into investment and corporate banking by publishing its Terms of Reference[6]. We said that we wanted to understand further whether:

- our rules and/or existing market practices dictate when the pathfinder and full prospectuses are published
- the timing of the publication of the pathfinder and full prospectuses allows unconnected analysts to publish research during the IPO process and, if not
- the only source of information for the majority of the IPO process is 'connected' research and
- the combination of these factors has implications for the robustness of investors' decision-making

1.6 To answer these questions, we have examined the availability of information during the UK IPO process by gathering evidence through data requests and feedback from a range of stakeholders, including investment banks, corporate finance advisers, and buy-side investors.

1.7 The evidence from our market study shows that, in the typical UK IPO process, the blackout period means the pathfinder and final approved prospectuses are often made available to investors late in the IPO process.[7] We have found that the pathfinder is typically available 14 days before admission to trading on the stock market, while the final approved prospectus is published on the first day of trading.

1.8 The late availability of the approved prospectus, combined with a lack of access to the issuer's management, also means that independent research providers and analysts in non-syndicate banks ('unconnected' analysts) have little or no information from which to produce research. Of the 169 IPO transactions we examined, only one transaction featured unconnected research published during the IPO process. Therefore, the only source of information on the company provided to investors during the investor education period[8], beyond possible coverage in the media, is connected research. Arguably, this research has the potential to be at heightened risk of bias due to potential pressure on connected analysts to produce favourable research. Inadequate or biased analysis could lead to inefficiency in the price formation process or inappropriate investment decisions.

Our objective in considering reform to market practice

1.9 Given the importance of the efficiency and integrity of the UK IPO process for both issuers and investors, we want our regulatory framework to encourage an optimal IPO process for issuers, sell-side service providers, and buy-side investors. This aligns with our operational objectives to promote market integrity and effective competition, and to protect the interests of the various consumers in the market. The prospectus, approved by the FCA, should play a central role within the IPO process. Investors value this as the officially recognised source of comprehensive, neutral and reliable information about the issuer.

6 https://www.fca.org.uk/your-fca/documents/market-studies/ms15-1-1-investment-and-corporate-banking-market-study-tor.

7 The current standard UK IPO method, as described in Chapter 2, is effected by way of a 'private placement' and does not technically constitute a public offer.

8 The investor education period is the initial marketing period prior to the management roadshow.

1.10 IPO practices differ across the EU, despite the harmonised prospectus regulatory framework, and across international markets. Earlier prospectus publication is a feature in many jurisdictions. In some, notably the US, connected research publication is prohibited throughout the IPO process and immediately afterwards. In his review of the Royal Mail IPO, Lord Myners particularly highlighted the market practice in France for the approved 'registration document' to be published early in the process. This document is the component of the overall prospectus that is then relied upon for investor education and book-building and which provides the relevant material for analysis.

1.11 In considering reform we are aiming for an efficient and well-informed IPO process where:

- an approved prospectus is the central document in the IPO process and is made available to investors when they need it
- firms foster high standards of conduct, in particular in their management of conflicts of interest inherent during the preparation and distribution of connected research, and
- conditions exist for unconnected research to be published during the IPO process, where there is demand for it.

1.12 We are also mindful of the need to avoid unwarranted lengthening of the IPO timetable, an increase in execution risk or any other unnecessary disruption of the established market practice.

1.13 In this paper we consider three potential models for reform that incorporate various combinations of the following two measures:

i. Re-sequencing the publication of an approved prospectus and connected research in order to make the approved prospectus the primary source of information available to investors.

ii. Providing unconnected analysts with access to the issuer's management.

1.14 These models are intended to stimulate debate with market participants and other interested parties over possible improvements to the way in which information is provided to investors.

Structure of this discussion paper

1.15 This paper is organised as follows:

- Chapter 2 sets out the background and context of the current UK IPO process, including the different markets on which prospective issuers may wish to float in the UK, the value and volume of UK IPOs, the key participants involved, a typical timeline of the process and the regulatory framework.
- Chapter 3 focuses on concerns around the timing and sequencing of key sources of information in the UK IPO process.
- Chapter 4 sets out our initial policy considerations including the aims of any potential policy intervention.
- Chapter 5 presents three models for reform.

- Chapter 6 addresses some further policy issues.

Next steps

1.16 Stakeholders should consider our findings on the availability of information during the IPO process reported in Chapters 2 and 3, and the discussion of policy considerations and potential models for reform in Chapters 4-6.

1.17 We welcome submissions on the questions posed in the Annex of this discussion paper by 13 July 2016. Please send your views to fca-dp16-3@fca.org.uk.

1.18 During this period, we will be keen to meet with stakeholders to provide opportunities for comment on this discussion and our analysis.

1.19 After the consultation period has closed, we will analyse responses and provide feedback. Should we take forward any specific policy proposals we will issue a further consultation paper, and we will keep under consideration any requirements under EU law and relevant regulation, including MiFID II.

2.
Background on UK IPOs

2.1 In this chapter we provide background on the UK IPO process which draws on the evidence provided by our investment and corporate banking market study. In particular, we focus on the aspects of the process that will be examined later on in the paper when we look at concerns and possible interventions.

2.2 This chapter begins by setting out how and where companies can come to market or 'float' in the UK, and details the value and volume of UK IPOs. It then sets out the role of the different participants in the IPO process and includes a description of the process, incorporating findings from our market study on the sequencing of key sources of information and events. It ends with a brief consideration of the UK regulatory framework governing the process.

UK markets

2.3 Despite the proliferation of trading venues, the London Stock Exchange (LSE) continues to be the principal market which new entrants use for admission of their shares to trading and where existing quoted companies maintain their market quotation and presence.

2.4 Depending on their size, growth objectives and funding needs, companies seeking to float and achieve an LSE quotation are able to choose between two broad markets. The Main Market is an EU regulated market[9] as defined by MIFID[10]. This means that a number of EU directives are relevant, including the Prospectus Directive (PD)[11], Transparency Directive and Market Abuse Directive. With the exception of certain segments, like the Special Fund Segment, the Main Market is also a market for listed securities. This means that applicants will also need to apply to the FCA's UKLA Department for admission to the Official List and will have to meet the relevant provisions of the Listing Rules while they remain listed.

2.5 Alternatively, applicants seeking a quotation can apply to the LSE's Alternative Investment Market (AIM). This market is regulated by the LSE, and so is an exchange-regulated market. It falls within the definition of a Prescribed Market[12] under FSMA and is subject to the UK market abuse regime. It is not, however, a 'regulated market' under MiFID, but instead falls within the definition of a Multilateral Trading Facility (MTF).

9 A regulated market is defined under MiFID as a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments - in the system and in accordance with its non-discretionary rules - in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions of Title III of MiFID [article 4(1)(14].

10 The European Parliament and Council Directive on markets in financial instruments (No. 2004/39/EC).

11 The Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

12 A market prescribed by HM Treasury in the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001 (SI 2001/996) as amended by regulation 10 of the (SI 2005/381).

2.6 Main Market listing will generally be chosen by companies that are large in size and relatively mature in their business model. There is the further option of seeking admission to the LSE's High Growth Segment (HGS). This has been specifically designed with high growth companies in mind that are likely to become Premium listed[13] companies over time. HGS companies are also subject to EU minimum standards and the HGS rulebook issued by the LSE.

2.7 AIM is targeted at companies that are generally smaller, and usually at an earlier or growing phase of their life cycle.

Value and volume of UK IPOs

2.8 London is one of the leading financial services centres in the world. Based on the value of IPO transactions in 2015, the UK ranked third globally[14]. In terms of market capitalisation, on 31 December 2015, there were 1,257 companies listed on, the LSE Main Market, with a combined value of £3,876bn. The aggregate value of the 1,044 companies quoted on AIM on 31 December 2015 was £73bn[15].

2.9 Table 1 sets out the number and value of IPO transactions over the 5-year period 2011-2015 on the LSE. This shows that a total of 460 companies floated there, 199 of which were on the Main Market, raising a total of nearly £48 billion, and 261 on AIM, raising a total of just over £5 billion.

Table 1: Number and value of UK IPO transactions (1 Jan 2011 to 31 December 2015)

	Main Market			AIM		
	Number of IPOs	Money raised (£m)	Money raised per transaction (£m)	Number of IPOs	Money raised (£m)	Money raised per transaction (£m)
2011	30	15,347	512	45	525	12
2012	23	4,107	179	43	643	15
2013	36	10,448	290	61	974	16
2014	56	11,799	211	79	2,472	31
2015	54	6,278	116	33	470	14
Total	199	47,978	241	261	5,084	19

Source: London Stock Exchange

Role of key participants in the IPO process

2.10 In its journey to flotation, an issuer will typically commission a number of firms to perform various roles. In this section we describe some of the key features of these different roles.

13 Premium listing is the class of listing to which the full provisions of the Listing Rules apply and which provides a benchmark for high standards of governance."

14 On the basis of data from Dealogic.

15 The information was sourced from the London Stock Exchange (http://www.londonstockexchange.com/statistics/markets/markets.htm).

In some cases, one firm might act in more than one capacity in a particular transaction, for example as both underwriter and sponsor[16].

Syndicate Members

2.11 In most IPOs, a syndicate of firms collectively manages the offering, and these intermediaries (i.e. investment banks) have traditionally played the central role in bringing a company to market. A syndicate bank's main tasks typically involve providing advice to the issuer on the key elements of a transaction, placing the securities with investors, underwriting the deal and producing analyst research on the issuer. Given the potential conflicts of interest between the different clients and services offered, there are regulatory requirements (discussed in more detail below) for firms to identify and manage these conflicts. These can include, for example, putting information barriers in place to separate corporate finance staff who are structuring the IPO terms from both analysts producing research and sales and trading staff servicing investor clients.

2.12 When managing an offering of securities, the intermediary owes a duty of care to its issuer client. In discharging this duty the intermediary takes responsibility for many aspects of the offering process, including marketing the offer (i.e. with investor roadshows) and providing advice on pricing and allocations. In a 'firm commitment' underwriting, the intermediary will also take on inventory risk by purchasing all shares from the company and then re-selling them to investors at the price specified. However, this way of operating has largely been replaced by a book-building process, under which the shares are allocated to investors before admission to trading and the bank's underwriting risk is limited to the period between allocation and settlement.

2.13 In placing securities with investors and producing research, the intermediary is also providing services and owes corresponding duties to its investor clients. In the secondary market, analysts regularly produce recommendations about a quoted company based on their analysis of its financial position and performance. However, when an analyst produces research relating to a new issuance on the primary market in circumstances where their bank is acting for the issuer, no such explicit recommendations are made. This is mainly to manage the banks' and issuer's legal liability and misrepresentation risk. However, even without an explicit recommendation, there is a risk that such research is perceived as not entirely impartial in this situation, even though the analyst should be objective and should not have access to any non-public information on the issuer.

Corporate finance advisers

2.14 The practice of appointing additional corporate finance advisers - often referred to as 'independent advisers' given their independence from the syndicate - is relatively new, and dates from around 2010. For the purposes of this discussion paper we refer to such firms as corporate finance advisers. These firms may become involved in a number of aspects of IPOs, including:

- General advice on the transaction such as the timing, structure and terms of the transaction.
- Advising on the choice of bookrunner/syndicate banks and running the Request for Proposal process. This includes holding a beauty parade, vetting meetings with research analysts, syndicate composition, and negotiation of fees. This can also include assistance with other third-party appointments such as lawyers and accountants.

16 The roles of the underwriter and sponsor firm in the IPO process are discussed below in *'Syndicate members'* and *'Sponsors'*, respectively.

- Assisting with the organisation of investor roadshows. This includes providing advice on the valuation of the company, composition of a company's core investment case, marketing materials, and drafting the prospectus.

- Assistance with due diligence processes.

- Scrutinising banks' proposals for allocations. This can also include analysis of potential institutional investors and their 'quality' in terms of possible anchor or cornerstone investments[17].

2.15 The role that corporate finance advisers play in IPO transactions is in principle distinct from that of banks but in practice there is often overlap in their activities. Corporate finance advisers do not provide underwriting services and do not bring trading, sales or distribution capabilities to bear in an IPO. Instead, their role is purely advisory and they effectively act as an intermediary between issuers and book-runners. Their role is to scrutinise the actions of the banks. Some of the advisory work they do has traditionally been done by the syndicate banks, e.g. advice on stock valuation. In this case, they are providing a second opinion to the issuer. However, they also provide advice in other areas, such as selection of book-runners.

Sponsors

2.16 A particular feature of the UK's premium listing segment is the requirement for an issuer to appoint a 'sponsor'[18] in circumstances. These include where the issuer is undertaking transactions or submitting documentation including prospectuses to the FCA's UK Listing Authority (UKLA). The sponsor is typically an investment bank, and is often the lead book-runner. Its role is to 'sponsor' the application to the FCA for the applicant's shares to be admitted to the Official List and make a number of declarations or attestations to the FCA's UKLA Department about the applicant and its documentation. To sponsor a transaction, a firm has to be admitted to the FCA's Sponsor Register which will mean it will be subject to additional FCA regulation established under the Listing Rules. The principal benefit of the sponsor system is that the sponsor is required to have a reasonable basis for making any of the declarations it makes to the FCA, and can potentially be held to account for the declarations. This has the effect of ensuring that appropriate levels of due diligence are performed in relation to the transaction.

FCA

2.17 For the purposes of the Prospectus Directive, the FCA is the UK's competent authority responsible for reviewing and approving prospectuses – including for IPOs – prior to publication. As the UK's listing authority, it also maintains the Official List and can grant or refuse applications to be admitted to listing. The Listing Rules, among other things, set out a series of admission conditions (known also as eligibility criteria) that applications for listing must meet.

The standard UK IPO process

2.18 The standard method of bringing new issuers to market in the UK is through a 'private placement', following a book-building exercise which is only open to institutional investors. Such methods do not include a retail element, although companies will, from time to time,

17 A cornerstone investor is a prominent institutional, or sometimes private, investor given a preferential allocation of shares at the book-build price in exchange for their commitment, given and disclosed at an early stage, to hold the shares at least for a stipulated period and for thereby signalling their support for the credentials of the IPO. Pricing, disclosure and terms of any lock-up arrangements can vary.

18 The position of sponsor is provided for by S.88 of the Financial Services and Markets Act (2000). The requirements for sponsors are provided for in Listing Rules Chapter 8.

depart from this model and also include a retail offering. This is an important determining factor in when a prospectus becomes available. The requirement to publish a prospectus is triggered by the issuer doing one of two things: requesting admission to trading on a regulated market, or making a public offer of securities (within the meaning of the Prospectus Directive). In a standard UK IPO, there is no public offer within the meaning of the Directive. Therefore the requirement for a prospectus is only triggered by the request for admission to trading on a regulated market, which will be relatively late in the process. If the transaction includes an offer of securities to the public then the requirement for a prospectus to be published will be triggered earlier in the process. The timetable of an issue with a retail offering will also be likely to be of longer duration.

2.19 AIM IPOs, which typically use the same book-building techniques as for the Main Market, involve neither an offer to the public nor an admission to trading on a regulated market. Therefore, in an AIM IPO the company will not typically prepare a prospectus at all. Instead, the AIM company will file the prospectus-like document required by the AIM rules, which is called an 'admission document'. In this document we follow common UK market terminology and use the term 'IPO' to refer to any debut on a stock market, irrespective of whether the transaction would be defined as a 'public offer' under the Prospectus Directive.

2.20 We consider the standard UK IPO process in two stages; the 'private' and 'public' phases. Timeframes referred to in this section are based on: (i) feedback from market participants through our market study; and (ii) our analysis of the data for 169 Main Market and AIM transactions from January 2010 to May 2015, obtained through our market study data request, Dealogic and the London Stock Exchange.

Private phase

2.21 Investment banks and corporate finance advisers told us that it is common for representatives of the issuer (including corporate finance advisers if appointed) to meet analysts within prospective syndicate banks prior to an issuer awarding any mandates for an IPO. In some cases, investment banking or Equity Capital Markets (ECM) staff attend these meetings, including when these meetings relate to a pitch for a place on the underwriting syndicate.

2.22 The issuer's management or its corporate finance advisers can use these meetings to gain an understanding of the analyst's views on the relevant sector and its prospects. We were told that, in some cases, the issuer or corporate finance adviser asks the analyst to explain their methodological approach to valuing the IPO.

2.23 From our engagement with corporate finance advisers, we were told that they consider that a positive research message conveyed by analysts is one of the main factors when advising the issuer on which banks to appoint to the syndicate. We consider the role of corporate finance advisers further below (see Chapter 6), and in the market study interim report.

2.24 Once the issuer appoints investment banks to the syndicate, the drafting of the prospectus begins. Around six weeks before the Intention to Float (ITF) announcement (which marks the beginning of the public phase), the sponsor firm submits a draft prospectus[19] to the FCA for review.

2.25 Around four weeks before the ITF, there is an 'analyst presentation', where the issuer's management presents information from the draft prospectus to analysts employed by syndicate banks (i.e. connected analysts). Connected analysts use this presentation to

19 Draft prospectus (sometimes colloquially described as 'unstamped') refers to the prospectus document, or a component of it, in its form before having been approved by the FCA. The pathfinder is a particular form of the draft prospectus issued to investors at its stage of development immediately prior to its being approved.

prepare their research. We were told that this meeting is typically attended by the issuer's management, connected analysts, the issuer's corporate finance advisers and legal counsel and perhaps representatives of the syndicate banks' investment banking team as observers. Most investment banks told us that connected analysts may have follow-up questions for the issuer's management, which are usually dealt with by conference calls, though sometimes a physical meeting is required.

Public phase

2.26 The public phase formally starts when the company announces its ITF, which sets out its plans for the IPO. From this point, the impending transaction is in the public domain. We were told by investment banks that, at the ITF announcement, the standard practice in the UK is for the underwriting syndicate to publish connected research and then impose a 'blackout' period of 10-14 calendar days during which they release no new information. They then circulate a draft unapproved prospectus with the price range, known as the 'pathfinder' prospectus. We explore the reasons for this blackout period further in Chapter 3.

2.27 It is important to note that, in terms of content, the pathfinder is unlikely to change significantly from the final approved prospectus. Most investment banks will aim to get the draft prospectus to a position where the UKLA, which will have reviewed and commented on the draft document during the private phase, has no further comments at the point the pathfinder is issued. The prospectus is 'locked down' at this point. The difference between the two is that the issuer will not have requested FCA approval of the document and therefore the pathfinder does not carry the status of 'approved prospectus'. It can nonetheless be distributed to select persons and will be subject to the Prospectus Directive (PD) advertisement rules. The pathfinder will include an additional statement warning users of this fact and explaining its status.

2.28 During the blackout period, connected research has the central role in the investor education process by which the syndicate familiarises potential investors with the company. At this stage, investors' focus is on understanding the company, its background, its markets and its prospects. Once the pathfinder prospectus is released to potential investors, the formal book-building process begins, which includes the issuer management's roadshow with institutional investors. This typically lasts around two weeks. Presentations given by the issuer's management at the roadshows must, according to the PD advertising regime, be consistent with the information that will be contained in the prospectus. We were told that connected analysts are usually available on request during this time but they do not publish any new connected research.

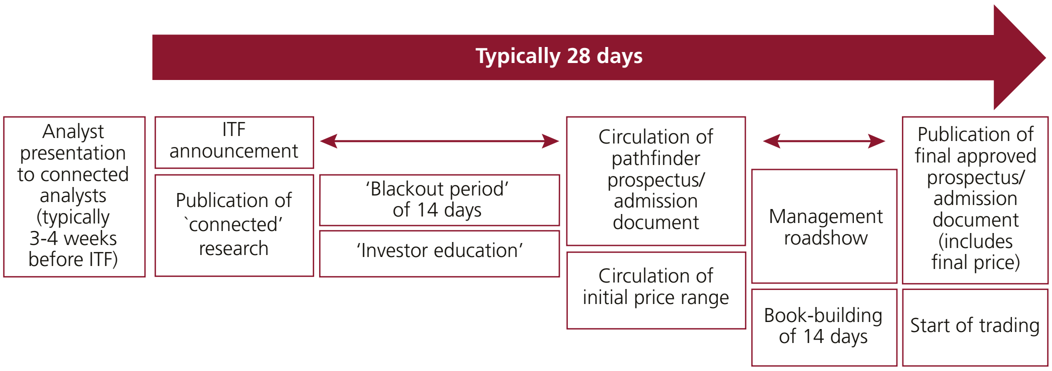
2.29 Investors at roadshows are not able to keep material such as the pathfinder prospectus and roadshow materials. These materials are usually available in hard copy form for a short period of time or through commercially provided web portals.

2.30 Shortly after book-building is complete, the bank takes decisions, in consultation with the issuer and its corporate finance adviser, on pricing and allocations and the final approved prospectus is published. Publication typically marks the first day of trading. If an IPO involves a retail offering the approved prospectus is published at the start of the roadshow (i.e. at the time that a pathfinder prospectus is usually circulated) and it includes a price range for the offer.

2.31 We explored whether there were any circumstances in which information is made available to investors earlier in the IPO process. We were told that a draft prospectus may sometimes be made available solely to a cornerstone or anchor investor under a non-disclosure agreement up to six months prior to the IPO. Investors may also have access to the issuer's management in the weeks prior to the ITF so that the banks can gauge the investors' appetite for the issue.

2.32 Figure 1 combines the data we collected from banks with the descriptions above to illustrate the sequencing of key sources of information during the public phase of a typical UK IPO, on both the Main Market and AIM.

Figure 1: Timeline of key sources of information during Main Market and AIM IPO processes



Source: Investment and corporate banking market study information request; Dealogic; London Stock Exchange.

2.33 Our analysis from Main Market and AIM IPO transactions, showed timing of key sources of information consistent with what we were told by investment banks.

- On a typical transaction, connected research is published on the day of the ITF announcement.
- The most common length of time between the release of connected research and the release of a pathfinder prospectus (i.e. the blackout period) is 14 days.
- It is common practice for connected research to be the first document available to potential investors, and for the pathfinder prospectus to follow once the blackout period has been observed.
- There is typically a period of 14 days between the release of a pathfinder prospectus and publication of a final approved prospectus, which is commonly published on the first day of trading on the stock market.

2.34 We found no material differences in timing when we examined the Main Market and AIM IPOs separately.

Regulatory framework governing the IPO process

2.35 Regulatory requirements apply to various aspects of the IPO process across a number of areas of the FCA Handbook ('the Handbook'). Below, we discuss some of the more specific requirements for preparing and publishing the prospectus for a public offer/admission to trading on a regulated market (including published advertising materials and information), firms undertaking underwriting and placing activities, and the role of analysts in producing and distributing investment research. In addition, all authorised firms performing regulated or ancillary activities are subject to the Principles for Businesses.

Prospectus Rules

2.36 A prospectus is a document which an issuer (e.g. a company or a government) is required to publish if it: (1) makes an offer of transferable securities; or (2) seeks admission of transferable securities to a regulated market. In other words, a prospectus must be prepared when an issuer offers securities to the public or when they seek to have their securities traded on the most regulated type of market which includes in particular for equity IPOs, securities that will be on the FCA's Official List and traded on the LSE Main Market.

2.37 A prospectus provides a single source of information to allow investors to make an informed assessment about the issuer's finances and prospects and about its securities. The information has to be presented in an easily analysable and comprehensible form. There are prescriptive requirements regarding items that need to be disclosed, combined with an overarching test of whether all necessary information has been included to allow an informed assessment. This in turn is underpinned by a liability regime regarding the contents of the prospectus and the statements made within it.

2.38 The PD requires an issuer to publish an approved prospectus if it is making an offer of securities to the public or if it is seeking to admit securities to a regulated market. The PD has been implemented in the UK in Part 6 of the Financial Services and Markets Act 2000 and in the PR. Prospectuses are approved by Member State competent authorities. In the UK this is the FCA.

2.39 Many UK IPOs do not include an offer of securities to the public within the meaning of the PD, as they are made as private placements (i.e. they do not incorporate what is sometimes referred to as a 'retail offering'). In these cases, an approved prospectus is only published because the securities are being admitted to a regulated market.

2.40 The current regime allows a prospectus to be produced as either a single document or as separate documents dividing the information into a registration document, a securities note and a summary (this is often referred to as a tripartite prospectus). The registration document contains information on the issuer, including historical financial information. The securities note provides information about the offer to the public and/or the admission to the regulated market. The summary provides information drawn from these other two components.

2.41 The tripartite prospectus approach allows issuers to publish an approved registration document and then publish the securities note and the summary at a later date, at which point all three documents together make up an approved prospectus. In the UK it is unusual to use tripartite prospectuses but they are used in some other EU jurisdictions and Lord Myners recommended their use in his report.

2.42 The PD requires that if there is an initial public offer of a class of shares which will be admitted to trading on a regulated market for the first time, then the prospectus must be available to the public: (1) as soon as practicable and, in any event, at a reasonable time in advance of, and at the latest at the beginning of, the offer to the public/admission to trading; and (2) at least six days before the end of the offer. For other public offers and admissions to trading on a regulated market, only the first requirement applies, and therefore the prospectus can be published later in the process.

2.43 In November 2015, the European Commission published its proposal for a Level 1 Prospectus Regulation to replace the PD. This proposal will be subject to change before it enters into legislation but its current provisions do not change the PD's current arrangements for using tripartite prospectuses for equity securities or the required timeframe for publishing a prospectus.

Existing relevant SYSC and COBS provisions

2.44 We set out our provisions governing the role of intermediaries in IPOs in our Senior Management Arrangements, Systems and Controls (SYSC) and Conduct of Business Sourcebook (COBS).

2.45 Firms managing securities offerings and producing research during an offering usually act in different capacities on behalf of different clients. The interests of the issuer client may conflict with the interests of the firm itself, or with those of the firm's investor clients. Under the conflicts of interest rules in SYSC 10, these firms have to identify and record any conflicts of interest and put arrangements in place to manage the conflicts to avoid detriment to clients.

2.46 SYSC 10 provides specific guidance on securities offerings. It reminds firms that, during a securities offering, their duty is to their corporate issuer client but that their responsibilities to provide services to investment clients are unchanged. It also contains guidance on measures a firm should include in its conflicts of interest policy for managing a securities offering.

2.47 As well as the over-arching conflicts of interest rules, there are specific rules and guidance governing firms, analysts, and other relevant persons involved in the production of research set out in COBS 12. Analysts must not promise issuers favourable research coverage, nor should they become involved in corporate finance activity, including pitches for new business and road shows[20]. In addition, firms should consider whether it is appropriate to restrict the timing of research around the period of an investment offering[21].

2.48 Although not yet finalised, MiFID II Level 2 provisions[22] will introduce new requirements for investment firms about disclosing information to issuer clients. It will also include more prescriptive provisions concerning the need for firms offering underwriting and placing services to manage conflicts of interest, particularly where they are also providing other services such as lending or research. MiFID II will also introduce a new conflicts management measure in the area of investment research, explicitly requiring firms to create a physical separation of analysts from other parts of the business. Our domestic implementation of these requirements into the Handbook will be consulted on separately later in 2016.

20 See COBS 12.2.5R (4) and COBS 12.2.9G, respectively.

21 See COBS 12.2.12G.

22 Refers to measures implementing the framework or 'Level 1' legislation.

3.
Concerns with the UK IPO process

3.1 In Chapter 2, we noted that the pathfinder prospectus is typically made available to investors two weeks after the ITF and the final approved prospectus is published a further two weeks later, at the end of the book-building process. The main reason given for this was the blackout period between the publication of connected research and the circulation of the pathfinder prospectus. In this chapter we consider the concerns this creates. We look at:

- the timing of prospectus availability and what impact this has on the robustness of investors' decision-making
- concerns over how much the UK IPO process relies on connected research
- why the blackout period exists
- whether the timing of the circulation of the pathfinder and publication of the final approved prospectus limits the ability of unconnected analysts to publish research during the IPO process
- risks that current market practice present to the FCA's objectives

The timing of the publication of the prospectus

3.2 The feedback we have received from investors consistently emphasises how important it is for them to be able to review a prospectus during the IPO process, as a part of their investment decision. This is the point that has been made most consistently to us by buy-side participants during our market study.

3.3 The prospectus is an important document and can fulfil a range of functions. These include:

- Giving prospective investors all the information they require to be able to assess the issuer's investment merits and to decide on how many shares and at what price they wish to apply.
- Creating confidence for potential investors in the offer through the liability that attaches to the statements made in the prospectus. Because of this liability, issuers and their investors undertake due diligence to ensure the statements in the document have a reasonable basis
- creating a document of record that can be valuable to prospective new investors and other stakeholders in the early stages of the company's post-flotation existence

3.4 However, as the market study evidence we have presented in Chapter 2 shows, under current UK market practice, the approved prospectus does not generally fulfil the first of these functions. At the ITF announcement, investment banks typically impose a blackout period of

14 days between the publication of connected research and the circulation of the pathfinder prospectus. A final approved version is made available only when the book-building has been completed. Investors have told us that this results in:

- insufficient time to carry out detailed analysis and due diligence, leading to potentially less informed investment decisions
- investors being unable to input into the price discovery process in a meaningful way
- an inefficient use of resources on roadshows and unnecessarily reviewing other, less reliable sources of information

3.5 We are sympathetic to these concerns. As the UK's competent authority under the Prospectus Directive, we review and approve prospectuses, working with issuers and their advisers to ensure the documents are complete, comprehensible, and otherwise fit for purpose. We are currently working with other authorities and stakeholders on the European Commission's review of the Prospectus Directive, which seeks to improve how the European prospectus regime functions. This work demonstrates the importance we and other policy makers give to the prospectus as part of the overall system of securities regulation. Our starting point when we consider information availability in IPOs is that any finding that investors are not able to access the prospectus during an IPO process is self-evidently a cause for concern.

3.6 We also recognise that restricted circulation of the pathfinder prospectus to a select group of potential investors does not fulfil the same role as the publication of the approved prospectus. We discuss this further in Chapter 4 in the context of facilitating unconnected research access to prospectus information. If, however, a retail component is included in an IPO this triggers the requirement to publish the approved prospectus at an earlier stage. Whether IPOs should or should not include a retail element is outside the scope of this discussion paper. However, we would be concerned if decisions on whether to include a retail element were to be prejudiced by a desire to avoid publishing the approved prospectus earlier in the process.

> **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.**

The IPO process's reliance on connected research

3.7 As set out in Chapter 2, all the IPOs we examined as part of our market study featured connected research, and we were told by banks and corporate finance advisers that it is common for analysts to attend meetings with representatives of the issuer's management before an underwriting mandate has been awarded. Some banks stated that, despite COBS guidance on analyst involvement in pitches, they believed there is ambiguity about what constitutes a 'pitch'. The nature of this engagement creates a heightened risk of pressure on analysts that may bias their research. In the US this risk manifested itself in the 2010 IPO of Toys'R'Us, where ten US broker dealers were found to have used their equity research analysts to win investment banking business by offering favourable research coverage[23].

23 https://www.finra.org/newsroom/2014/finra-fines-10-firms-total-435-million.

3.8 Given that most buy-side participants in UK IPOs are sophisticated institutional investors, they have expressed some scepticism over connected research. Evidence we gathered through our market study suggests that investors agree that the connected research produced during IPOs is at heightened risk of bias. Most are also aware that connected research is banned in some markets.

3.9 However, they told us that, as sophisticated investors, they should be able to make their own allowances for these potential biases and to exercise their own judgements. Investors have told us that they see some value in both connected research and unconnected research as a complement to the prospectus, and few felt an outright ban on connected research was merited.

3.10 The main concern over connected research that emerges from our market study is not that it exists as a feature of the UK IPO process, but that, during a crucial part of the typical IPO timetable, connected research is the only written source of information on the company.

Q2: Do you have concerns about connected research? If so, please describe those concerns.

The observation of the blackout period

3.11 Investment banks gave two principal reasons for the blackout period. These were:

- the management of legal liability and
- the management of regulatory risk

3.12 Below we consider each of these in turn. However, it is worth noting that we were also informed by some investment banks that they simply view the blackout period as a market practice that they follow, and they do not give much consideration as to why.

Management of legal liability

3.13 Liability attaches to statements made in prospectuses. Some investment banks told us that, if connected research were to be published at the same time as the prospectus, there would be a heightened risk that the connected research would be judged as forming part of the prospectus, and attract the same liability as would attach to the prospectus. The same investment banks stated that the current blackout period is a response to this legal liability risk.

3.14 These views appear to be long-standing and, as such, would have been formed in an environment that pre-dates the current legal framework but may not necessarily have been revisited in light of the current legal framework. Our market study has not revealed why market participants think this risk still applies and what legal analysis underpins it.

3.15 In order to understand the rationale behind the blackout period, we invite views as to what the liability concerns in relation to publishing research are for issuers and investment banks, with reference to the current legal environment.

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 could consider the question from the perspective of both issuers and research publishers.

Management of regulatory risk

3.16 Investment banks have frequently told us that Handbook provisions (specifically guidance on investment research and conflicts of interest in COBS 12.2.12G) are the cause of observing a blackout period. COBS 12.2.12G states that a firm should consider whether its conflicts of interest policy should contain restrictions on the timing of the publication of investment research, given other business activities of the firm, e.g. restricting the publication of investment research around the time of an offering.

3.17 We do not believe this guidance drives the current blackout period. There are three reasons for this. First, the existing market practice of imposing a blackout period pre-dates the FCA's guidance, which was the outcome of an FSA consultation in 2003[24]. Second, the FSA's original proposal in 2003 was to introduce a Handbook rule requiring syndicate banks to impose a 'quiet period' of 30 days after the publication of the prospectus, whereby no connected research could be distributed. This is clearly different to the pre-prospectus blackout period observed today. Although the FSA did not end up prescribing a precise post-prospectus quiet period, the eventual outcome of the consultation was for the FSA to introduce the guidance currently in COBS 12.2.12G. Third, when we asked investment banks how they ensure research is objective, none actually gave COBS 12.2.12G compliance as their means of achieving this.

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

Barriers to unconnected research

3.18 Given the concerns about the level of trust and confidence attributed to connected research, one possible target of reform could be a focus on the provision of research by firms who are independent of the syndicate members of an IPO. Our market study therefore explored the issue of unconnected research. We found that, between January 2010 and May 2015, unconnected research was published during the IPO process on only one out of 169 UK IPO transactions and that unconnected research would typically only become available 6-12 months following flotation.

3.19 We found that there are two main barriers to the production of unconnected research. The first is that the prospectus is made available to unconnected analysts too late in the IPO process for them to use as a source for their research. We were told that unconnected analysts are only able to access the final approved prospectus, which is typically published on the first day of trading. The pathfinder is made available only to investors, at the beginning of the book-building process. Further, because this is not an approved prospectus, even if unconnected analysts had access to it they might not be able to rely on it.

3.20 The second barrier for unconnected analysts is that they have no access to the issuer's management, which they see as important to supplement the information they could get from the prospectus. These two factors together mean that unconnected researchers are effectively excluded from the IPO process and unable to compete with research produced by connected analysts.

24 CP171 and CP205, see: http://www.fsa.gov.uk/pubs/cp/cp205.pdf.

3.21 Removing these barriers could provide conditions under which unconnected research would be capable of being produced in response to investor demand. We were told by independent research providers that there have been instances where they have been unable to meet this demand for IPO research from their clients. We were told by these firms that it is common for them to operate a 'retainer model', where clients are charged a fixed annual fee in exchange for access to research material. Some buy-side investors have said that, under current conditions, unconnected research can be viewed as a potentially helpful source of independent information. However, it is generally acknowledged that unconnected analysts' lack of access to the issuer's management, and lack of timely access to the prospectus, could jeopardise the potential quality of their research.

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?

Risks to FCA objectives

3.22 The concerns around market practice in relation to IPOs discussed above create risks to our operational objectives:

- Market integrity is jeopardised if investors and issuers lose confidence in the UK IPO market because price formation is made on the basis of connected research, which can be perceived as biased, rather than information in the prospectus.
- Consumer protection is weakened when potential investors cannot obtain timely access to the information they require and are instead forced to rely on connected research that they perceive as biased or potentially biased.
- Effective competition is inhibited because unconnected research analysts face barriers to entry into the market for IPO research.

Q6: Do you agree with the concerns that we have set out in Chapter 3?

4.
Initial policy considerations

4.1 In Chapter 3 we identified a series of concerns with the typical UK IPO process. The UK practice of observing a blackout period means that the prospectus is available too late in the process, leaving investors reliant on connected research. There is also a concern that current market practice creates barriers to the production of unconnected research which could act as a useful source of additional information for investors.

4.2 In this chapter we begin by considering whether an intervention by the FCA is warranted, or whether a solution could be market-led. We then set out what improved market practice might look like and the changes a policy intervention would aim to achieve. We then consider the extent to which both connected and unconnected research are a valuable feature of the IPO process, where the prospectus is available in good time, and compare regulatory and market practice in the US.

Regulatory remedy or market-led solution

4.3 In Chapter 3 we considered the practice by the syndicate of observing a blackout period after the publication of connected research and the concerns of investors and others that this is the direct cause of late prospectus publication. We examined the possible reasons for this practice. The two reasons frequently given by investment banks are management of legal liability risk and regulatory compliance. Regardless of whether either of these explains the existing blackout period, it is evident that market practice is entrenched. Despite a number of reports highlighting the same concerns, no market-led reform has emerged, though the TheCityUK's report indicated that a consensus appears to exist over what types of outcome market participants seek. We therefore consider that a regulatory intervention would be necessary in this area to change market practice.

> **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?**

Aims of any policy intervention

4.4 In approaching any policy intervention, we have considered what type of outcomes would address the concerns identified in Chapter 3 most effectively. We envisage an efficient and well-informed IPO process where:

- an approved prospectus is the central document in the IPO process and is available to investors when they need it

- firms foster high standards of conduct, in particular enhanced management of the inherent conflicts of interest when preparing and distributing connected research and

- the market creates conditions for publishing unconnected research during the IPO process, where there is demand for it

4.5 We have also engaged with regulators in a number of other jurisdictions to understand whether the UK can learn from alternative market practices and regulatory frameworks, to support a more effective IPO process.

4.6 The following outcomes could support our overarching aims:

- **A more iterative approach to publishing the approved prospectus, so that it, or an important component of it, is available much earlier in the process.** This may involve use of the tripartite prospectus model allowed under the Prospectus Directive, which is the market practice in France. In the tripartite model, the 'registration document' is the first source of information available for investors. It is published at the ITF announcement and contains no information on the IPO's price range. There is then a 'securities note', which comes later in the process and contains more information, including on price range. In the US IPO process the initial registration statement is filed early with the Securities and Exchange Commission (SEC). The 'Red Herring' prospectus is circulated when the price range is set, the issue is marketed and the book-building process begins. There is then a final prospectus containing the pricing. There is an explicit requirement on underwriting syndicate members to observe a quiet period within which no research is published and the prospectus is the only document that can be used for marketing the offering.

- **A book-building and investor education process which relies less on connected research.** Again, market practice in France relies on the registration document as the central source of information during investor education and book-building, making connected research less prominent in the process. In the US, research does not feature in the IPO process at all, and the 'Red Herring' is used to conduct investor education.

- **A higher degree of access for unconnected analysts to the prospectus and, perhaps, the issuer's management.** This would enable unconnected analysts to publish their own research, which introduces a new source of information to investors. In France, there is a requirement for the issuer to hold a 'town hall' meeting, which provides unconnected analysts with an opportunity to access the issuer's management.

4.7 An additional outcome that could help to address our policy aims may be changes to existing practices which increase the risk of bias in research, including analysts within prospective syndicate banks interacting with the issuer's management before the bank is awarded an underwriting mandate.

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

Policy considerations around the role of research in IPOs

4.8 Given concerns about potential bias in connected research and the fact that it is currently the main source of information for investors to base decisions on, an important question is whether or not it should be a feature of the IPO process. Assuming that there is a valuable role for research during IPOs, we would also wish to ensure that it contributes to an overall market in investment research that works well with high standards of conduct.

Quiet periods or bans on research and implications in the UK context

4.9 Under the US regulatory framework, the prospectus is the only document that can be used for marketing the offering, brought about through an explicit requirement on underwriting syndicate members to observe a quiet period on their research. Until recently, this quiet period lasted until several weeks after the offering was first made available to the public, though this has now been reduced to 10 days.

4.10 In the UK, the absence of any connected research during the IPO process would strongly encourage an earlier prospectus to ensure an informed investor education and book-building process. There would no longer be any reason to delay publication of the prospectus.

4.11 It is important, however, to consider the extent to which removing connected research from the process may create risks that are not present under the current status quo. Market participants might regard a ban as overly disruptive. As mentioned in Chapter 3, the buy-side sees some value in both connected and unconnected research as a complement to the prospectus.

4.12 There is also a significant risk that removing published connected research from the process would also remove the practical assurance that at least some research is produced. The further risk here is that, in the absence of any written research, an analyst may embark on verbal dissemination informally, which could result in lower standards of market conduct. This is also likely to increase risks of information asymmetries among potential investors.

4.13 The absence of any connected research during the crucial phase of the IPO process would potentially create a significant gap in the market for information on the transaction, beyond that provided in the prospectus. This may generate an opportunity for unconnected analysts to publish research, though not an assurance that such additional research offerings would be produced.

4.14 In any event we would want to ensure that research acts as a complement to the prospectus and not as a substitute for it.

> **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?**

Simultaneous publication of connected research and the prospectus

4.15 In its 2013 report, the ABI considered an elimination of the existing blackout period. It envisaged the simultaneous publication of the prospectus and connected research, so that investors have both sources of information at the same time. This would allow connected research to be a continued feature of the IPO process, but would mean that the prospectus is published earlier in the process and that connected research is no longer the only source of information available during investor education.

4.16 However, set against our concerns with current practices set out in Chapter 3, we do not believe simultaneous publication would deliver an optimal outcome. It would leave a competitive advantage to connected research which would already have been published at the time unconnected analysts will be able to access the prospectus information they require to produce research. This implies that unconnected research would come too late in the process to make a meaningful contribution to investors' decision-making.

4.17 Additionally, even if simultaneous publication of prospectus and research were to be the desired objective then unless the perceived legal liability and regulatory compliance problems associated with simultaneous publication were resolved that objective would be unworkable.

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

5.
Policy options: routes to reform

Three models to frame discussion

5.1 In this chapter we present three models for possible reform of the IPO process. They comprise combinations of two key measures, which might be considered building blocks, in order to address the concerns outlined in Chapter 3. The combinations are likely to produce different impacts on timetable and behaviours, which we set out in the final section below. These models need to be considered against both principled and practical criteria, for example whether they:

- will encourage appropriate sequencing of the necessary components of the process and iteration of research material, including appropriate accuracy checking against published prospectus information, and
- would enable the prospectus to include considered feedback.

5.2 The two key measures are:

- A re-sequencing of the publication of an approved prospectus and connected research. This could eliminate the existing blackout periods so connected research would not be distributed by syndicate banks for a specified period after the publication of the prospectus.
- Allowing unconnected analyst access to the issuer's management, creating an opportunity for unconnected analysts to produce research.

5.3 These models have been developed to frame discussion. We would like to understand whether a viable market practice can coalesce around any of these models, or an iterated version of them. They are neither definitive proposals for reform nor are they listed in any order of preference. We are interested in whether they are appropriately specified and which model(s) would serve investors and issuers best, or, alternatively, whether there are other options we should consider that would provide a better basis to address our concerns.

Model 1: Requiring a blackout on connected research until 7 days after an approved prospectus is published

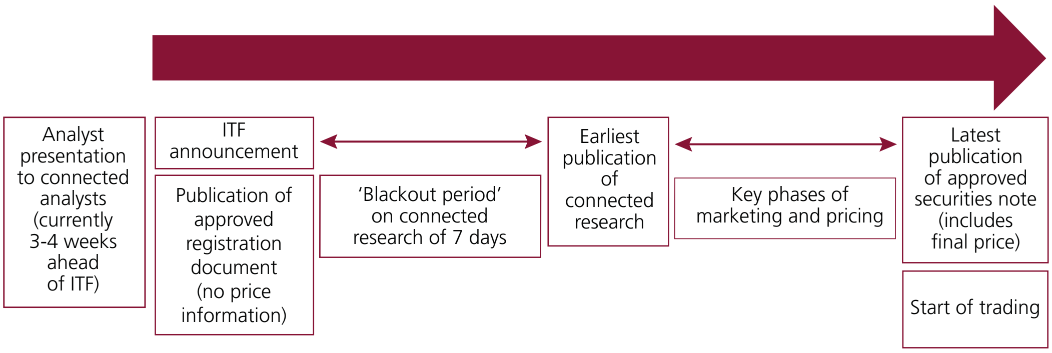
5.4 The most direct way to re-sequence the prospectus and connected research, and so to 'invert' the existing pre-prospectus blackout period, would be for us to introduce a provision preventing underwriting and placing firms from publishing connected research until, say, 7 days after the publication of the approved prospectus (or the 'registration document' part of it, which sets out the essential corporate information on the issuer). A similar proposal was floated by TheCityUK in its recommendations to improve the European listings regime.

5.5 This provision would be likely to incentivise underwriting and placing firms wishing to publish connected research to advise their IPO clients to publish the approved prospectus earlier in the process. This would then start the blackout period and enable the syndicate to publish its research once this has expired. Re-sequencing the process in this way would also foster conditions for producing unconnected research, because unconnected analysts would have access to the prospectus much earlier than currently and could use it to inform their research.

5.6 This measure would reduce investor reliance on connected research, reinstate the prospectus as the central information source and so increase the likelihood of better investment decisions and more efficient price formation.

5.7 As the approved prospectus would be available to unconnected research analysts much earlier, it would address directly one of the two barriers unconnected analysts face. The model might create conditions in which the issuer would be more interested in meeting unconnected analysts who could be producing research that could further inform investors about the IPO. Issuers could give access to unconnected analysts who agree to publish their research to the same timetable restrictions as connected research. However that would be a matter for agreement between issuer and parties attending their meeting.

Figure 2: Illustrative timeline of key sources of information during IPO process under Model 1



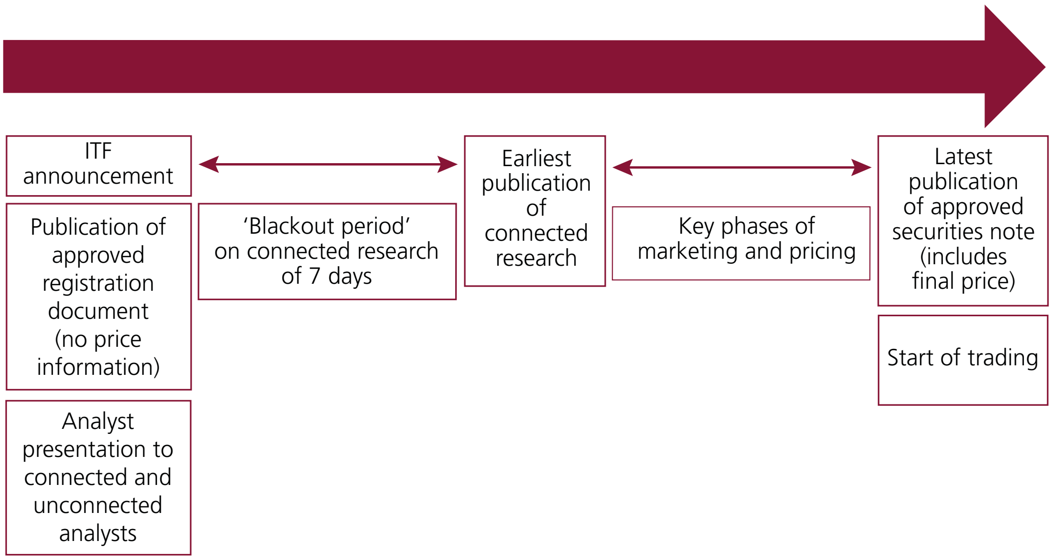
Model 2: Opening any analyst presentation to unconnected research analysts and requiring a blackout on connected research until 7 days after publication of an approved prospectus

5.8 This model retains the key features of Model 1 but includes a mandatory additional measure that would give unconnected analysts access to the issuer's management. To minimise disruption to the current process (and additional costs to the issuer and/or underwriting firm) and to ensure that unconnected analysts are given access to management at the right stage in the process, it could be sensible to frame this measure in a way that provides unconnected analysts with access to the issuer's management as part of the same meeting as connected analysts. This would also ensure that both receive the same information, delivered with the same levels of engagement and quality.

5.9 The 'analyst presentation' is the meeting which takes place after the mandate has been awarded, and currently around 3-4 weeks before ITF, where the issuer's management presents information on the company and its business to connected analysts to help them prepare connected research. Under this model, analysts from the underwriting firm(s) would not be allowed to attend such a presentation unless it has been opened up to unconnected analysts whose main business is to disseminate research (i.e. analysts employed by non-syndicate banks or independent research providers). It would be possible for the issuer and the syndicate to choose the appropriate time for this meeting bearing in mind the likely practical need to make an ITF announcement in advance of this meeting. The meeting might also occur either before (as now) or after the prospectus is published.

5.10 This model builds on current practice by adapting the existing analyst presentation to place unconnected analysts on the same footing as their counterparts within the syndicate.

Figure 3: Illustrative timeline of key sources of information during IPO process under Model 2



Model 3: Opening any analyst presentation to unconnected analysts and prohibiting such a meeting from taking place before publication of an approved prospectus

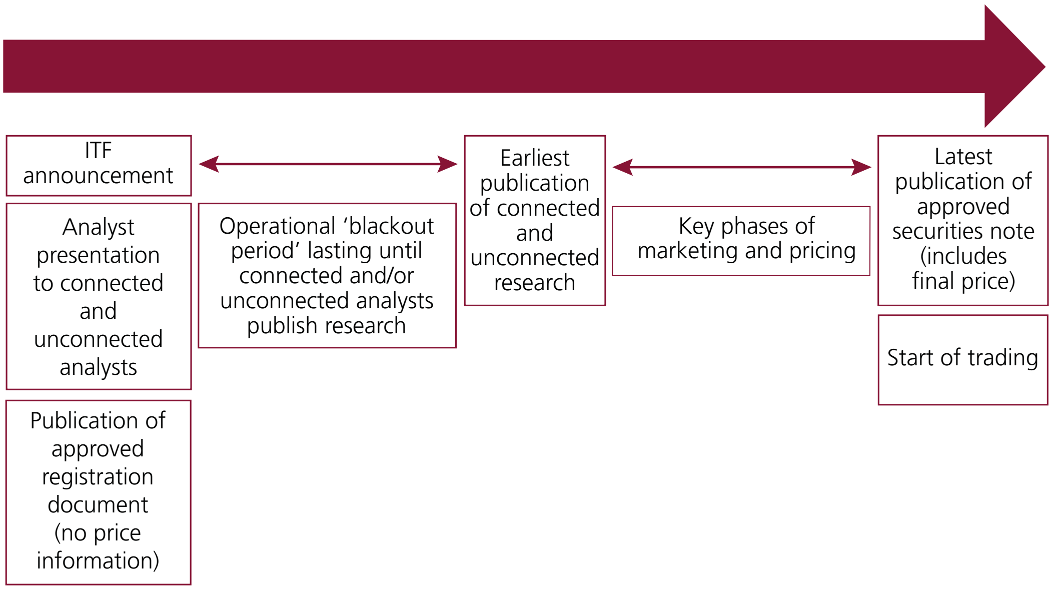
5.11 This model would require the underwriting firm to open up the 'analyst presentation' to unconnected analysts and prohibit that meeting from taking place before an approved registration document is published. There would be no requirement for any inverted blackout period for research as required by the two models outlined directly above.

5.12 Where the issuer wishes to continue holding the analyst presentation at the same stage as current practice (see Chapter 2), this could drive an earlier ITF announcement to enable analysts to be given proper notification of the event and an invitation to attend. It would also deliver the earliest publication of prospectus information under any of the models. This model would involve equivalent provisions as used under Model 2 regarding opening access to analyst meetings. It would also create an additional requirement for the timing of the meeting to be at the same time, or after, the registration document is published.

5.13 Since analysts would rely on the 'analyst presentation' to access detailed information from the issuer's management, their research would not be published until after the meeting and the registration document has been made available. This delivers equal treatment of connected and unconnected analysts because both would have access to key sources of information at the same stage. Connected and unconnected analysts would then be free to produce research whenever they are able to do so. Operationally, this is likely to create a 'quiet period' while they digest the information and prepare their research. Thus there would be an automatic re-sequencing of the process and no need for a specific requirement to invert the blackout period (as in models 1 and 2). This implies that the amount of, and timetable for, research would be determined by market forces and the provider's technical capabilities to publish swiftly.

5.14 This model would represent a significant shift from current practice and achieve the most arm's-length relationship between the underwriting firms and their research analysts. However, a potential disadvantage of this model would be the lack of opportunity for analyst feedback to inform the prospectus document which is released at the start of the investor education and marketing period.

Figure 4: Illustrative timeline of key sources of information during IPO process under Model 3



Assessment of Models

5.15 Each of these models has the potential to deliver benefits but it is possible that a further iteration could achieve the optimum trade-off between transparency improvements and avoidance of unnecessary intrusion on established market practice. Compared to Model 2, Model 1 would reflect a less intrusive intervention and would have very low direct costs as the measure would merely end the practice of deferring publication of a document that has already been written. However, compared to Model 1, Model 2 more directly addresses the issue of how unconnected analysts could access the issuer's management and produce and publish research. Model 3 avoids the prescription involved in requiring a post-prospectus blackout period for connected research as employed by each of the first two models, but loses the dialogue between issuer and the analyst community prior to prospectus publication stage.

5.16 In any event, each of these models provides a prospect of improved transparency and, in particular, prospectus information being made available earlier. They also could help ensure that connected research is no longer the only source of information during the initial investor education period, which then needs to act as a substitute for the prospectus. Such research could be shorter, more focused and avoid replicating elements of the prospectus.

5.17 However, earlier disclosure could impose additional costs or risks to issuers and intermediaries. Yet providing investors with the information from the prospectus they need at the point that they need it and when that information has already been prepared is a worthwhile goal.

5.18 The direct costs for issuers and intermediaries arising from reforms of the type we have suggested should be minimal. The practical effect of bringing forward prospectus publication should not create any material extra costs in the typical UK IPO. This is because, under current practice, the prospectus will need to be complete by the point of the ITF announcement; under at least two of the models, we do not envisage the ITF will be any earlier than under the current timetable.

5.19 In the case of provision to give unconnected analysts access to the issuer's management, the approach we have presented would see unconnected analysts invited to a meeting that would take place anyway. Whilst there will be some cost associated with the expansion of this meeting to cater for more analysts, we expect this to be immaterial in the context of the costs of an IPO generally.

5.20 There is a risk that a change in the IPO process might lead to an extension of the timetable. We cannot be certain about exactly how market practice and corresponding timetabling would coalesce around each of these models. However, our view is that there is no reason why any of these should result in a longer timetable. Indeed they each have the potential to shorten the process.

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?

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?

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

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?**

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

6. Additional Policy considerations

Conduct issues during the IPO process

6.1 The policy options discussed above focus on restoring the prospectus as the central document in the IPO process by requiring or encouraging a re-sequencing of the process to reduce the reliance placed on connected research to inform investor decisions. They also focus on ways to encourage more unconnected research during the IPO process.

6.2 A further area for policy thinking would be whether there is a need to address more directly concerns identified around analysts' involvement in the 'private' phase of an IPO (i.e. prior to the formation of the underwriting syndicate). In particular, we have highlighted possible pressure they face from the issuer, or the issuer's corporate finance advisers, to promise or imply they will produce favourable research coverage in exchange for a place on the syndicate. As discussed in Chapter 3, this type of practice adds to the risk of biased connected research. Although policy measures aimed at re-sequencing the prospectus and connected research would help to mitigate the adverse impact of this potential bias, it would not remove it.

6.3 In relation to corporate finance advisers, we remind such firms that when carrying out regulated corporate finance activity they are subject to conduct of business obligations as set out in COBS 18.3. They are also subject to a broad application of our systems and controls (SYSC) requirements, including managing conflicts of interest and, as authorised firms, they must conduct their business in line with our Principles for Businesses.

6.4 However, regardless of these potential reform options and the existing regulatory framework, concerns may remain over conduct in meetings between analysts and the issuer's management that occur before a mandate has been awarded and which constitute part of a prospective syndicate bank's pitching efforts. We are aware, for example, that the Financial Industry Regulatory Authority (FINRA) in the US has issued guidance in this area.

6.5 We would therefore be interested in stakeholders' views in response to the following question:

> **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 pre-mandate 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?**

AIM IPOs and other companies admitted to UK exchange-regulated markets

6.6 We have framed our discussion primarily in the context of IPOs on regulated markets. In AIM and other non-regulated markets prospectuses are only required to be filed with an EU competent authority if a public offer of securities is made in connection with the IPO. AIM rules, which are made by the London Stock Exchange, provide instead for the distribution of an admission document. So we would need to consider carefully the benefits or risks of applying reforms of the type we explore in this discussion paper to issues of securities on AIM and other non-regulated markets. It may be that these risks and benefits are different for AIM and other non-regulated markets compared to regulated markets.

6.7 We are interested in the views of market participants, and in particular the users of such markets, as to whether and, if so, how best such reforms might also be applied in this context, including if any variation to our models may be appropriate due to the features of non-regulated market IPOs. We are keen to ensure that the benefits of any reforms outweigh any potential risks and costs in this context. We therefore seek views on the following question:

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

7.
Next steps

What do you need to do next?

7.1 Firms should consider our findings on the availability of information during the IPO process reported in Chapters 2 and 3 and on the aims of reform and the options presented through Chapters 4, 5 and 6.

7.2 We welcome submissions on the questions posed in the Annex of this discussion paper by 13 July 2016.

7.3 During this period, we will be keen to meet with stakeholders to provide opportunities for comment on this discussion and our analysis.

What we will do next

7.4 After the discussion period has closed, we will analyse responses and provide feedback. Should we take forward any specific policy proposals, we will issue a further consultation paper, and we will keep under consideration any requirements under EU law and relevant regulation, including MiFID II.

Annex 1
List of questions

Questions on the concerns with the current UK IPO process

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.**

Q2: **Do you have concerns about connected research? If so, please describe those concerns.**

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 could consider the question from the perspective of both issuers and research publishers.**

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

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?**

Q6: **Do you agree with the concerns that we have set out in Chapter 3?**

Questions on the proposed options for reform

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?**

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

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?

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

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?

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?

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

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?**

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

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 pre-mandate 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?

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

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