Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

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

www.theqca.com

Financial Conduct Authority,
25 The North Colonnade,
Canary Wharf,
London, E14 5HS

fca-dp16-13@fca.org.uk

13 July 2016

Dear Sirs,

Availability of information in the UK Equity IPO Process

Introduction

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

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Corporate Finance, Legal and Secondary Market Expert Groups has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Response

We welcome the opportunity to respond to this Discussion Paper.

We believe that it is in principle a cause for concern that in most cases a draft prospectus is not available until at least two weeks after the ITF and a final prospectus is only available after pricing. The current approach in the typical UK IPO timetable leads to the prospectus (or admission document for AIM companies) being published at the end of the marketing and fundraising process, rather than at the beginning, when it is required.

We do not have concerns about connected research. We believe that, with the current approach, connected research serves an essential role in price formation for an IPO, by including prospective financial information and valuation opinion and analysis.

Although we generally support the outlined high level aims for reform of the UK IPO process, we consider that they may be more appropriate for larger IPOs than for smaller ones. Therefore we do not believe that any of the three models proposed would achieve the desired outcomes or be relevant to small and mid-size quoted companies, such as AIM companies.

Subsequently, we outline an alternative model for consideration. We believe that the UK IPO process can only be enhanced if the need for chronological barriers between the prospectus and the connected research are reduced or even eliminated altogether.

Regarding blackout periods, we acknowledge that its exact length is a judgement call, however we believe that if, as a matter of regulation, the blackout period is reduced from the current 14 days to seven days, it would be helpful despite not being legally conclusive.

We have responded below in more detail to the specific questions, reflecting the point of view of the majority of our members, small and mid-size quoted companies.

Responses to specific 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.

Yes, we generally agree that it is in principle a cause for concern that in most cases a draft prospectus is not available until at least two weeks after the ITF and a final prospectus is only available after pricing. The current approach in the typical UK IPO timetable leads to the prospectus (or admission document for AIM companies) being published at the end of the marketing and fundraising process, rather than at the beginning, when it is required. For the reasons discussed in our answers below, we believe that the pre-IPO research note can act as a proxy for a pathfinder offer document, when it should be the prospectus that fulfils this function.

However, the impact of this in an AIM IPO, where there is typically no offer to the public and funds are raised from institutions in a private placing with access to connected research, a verified management presentation and a pathfinder admission document (prepared to prospectus standard), these concerns are much more limited. We believe that, in these circumstances, the delayed publication of the final admission document until after pricing does not give rise to significant concern.

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

No, we do not have concerns about connected research. We believe that, with the current approach, connected research serves an essential role in price formation for an IPO, by including prospective financial information and valuation opinion and analysis. Although we acknowledge that prospective financial information is important to the price formation process, we note that there are two key obstacles to its inclusion in prospectuses:

i. The strict rules on profit forecasts mean that very few companies wish to include this information in their prospectuses because the additional costs of reporting involved would impact disproportionately on smaller companies and increase their cost of equity capital even further; and

ii. The issuer and its directors would face heightened risk of legal liability claims for misrepresentation if such forecasts did not correspond with the eventual outcome.

In addition, we believe that it must be recognised that almost all AIM IPOs involve fundraisings from qualifying investors only, with almost no element of an offer being made to the public. In such circumstances, there is no commercial rationale for any unconnected research to be produced as there is no opportunity for an unconnected bank or broker producing such unconnected research to generate commission income from intermediating public interest in the offering.

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.

We believe that the main legal issue is the extent to which liability may arise for any inaccurate or misleading information contained in a pre-IPO research report. Connected research reports may erroneously be regarded by potential investors as being informed and authorised by the IPO company. There is a risk that the prospectus and the pre-IPO research note will be inextricably linked and that potential investors could make claims against the issuer, its directors and others responsible for the prospectus for any inaccurate or misleading information contained in the pre-IPO research note.

Moreover, information on the IPO company included in the research note may contain different information from that subsequently included in the prospectus, will not be subject to the full rigours of formal due diligence and a verification process that the prospectus has been subjected to and will not have been approved by the IPO company. The research note will also contain prospective financial information that underpins any valuation analysis that will almost certainly not be included in the prospectus. In addition, the research note may well contain an investment recommendation, which could be construed as an inducement to invest in an offering.

The risk, which may be more theoretical than real, particularly when the marketing is conducted with seasoned investment professionals, has never been tested in the UK courts. In order to reduce this risk, a practice has developed of separating the publication of the research note and the publication of the pathfinder prospectus/admission document by the use of the blackout period. In essence, the purpose of imposing the blackout period is to create a chronological gap between the publication of research and the publication of offering documentation, so as to make it less likely that the research note will be argued as being connected to the investment decision, which in theory, should be based on the prospectus alone.

This practice was imported into the UK from the US during the late 1980s, but we note that the period has reduced over time. Originally, blackout periods of 28-30 days were common. Now, market practice has settled on around 14 days. The use of the blackout period is also reinforced by appropriate "health warnings" on the research note and also through confirmations by investors at the time they subscribe for shares under the terms and conditions of the offering. Nevertheless, the practice of having blackout periods is very likely to remain because of the untested nature of this contrivance and our judicially created common law legal system. Unless, and until, a Court determines the circumstances in which a research note may or may not be considered by investors to be part of the prospectus/admission document, a cautious and well advised issuer will continue to maintain the separation.

The period is not an exact science; we believe that the exact length of the blackout period is a judgement call. We believe that it could be as little as a few days, but given the legal uncertainty, it is unlikely that a shorter period will develop through market practice alone. However, if as a matter of regulation, the

blackout period is reduced to, say, seven days, we believe that would be helpful, although we note it would not be legally conclusive.

In the absence of a determination by a Court, the only way to resolve the issue conclusively would be for appropriate legislation to create clarity. However, we appreciate that this is an unlikely solution in the short term.

We note that a connected research report will fall within the financial promotions regime under section 21 of FSMA unless it is distributed to certain exempt investors. If research reports are distributed to the wider public and not in accordance with the financial promotions regime, then commitments to invest in an IPO may be unenforceable. Furthermore, a breach of section 21 is a criminal offence.

The Prospectus rules prohibit the publication of an advertisement relating to an offering of securities unless it refers, amongst other things, to the full prospectus. Therefore, if connected research is deemed to be such an advertisement then it would not be possible to issue it until after the prospectus is approved and published.

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

We believe that another possible driver of the existing blackout period is FCA regulation. The FCA Handbook classifies connected research as a marketing communication (COBS 12.3.2R) and encourages firms to restrict research "around the time of an investment offering" (COBS 12.2.12G), as a means of promoting a perception that the research is an impartial analysis and is consistent with any conflicts policy.

We believe that the Discussion Paper attaches little significance to this guidance as a reason for maintaining the practice of blackout periods. We note that the FCA acknowledges that it has been previously requested by the Association of British Insurers to remove this guidance, although it has not yet done so which may mean that the FCA considers it to be a necessary restriction.

In addition, we note that due to the global nature of London's capital market and the significant presence of major US investment banks in London, US practices have been influential in the development of accepted approaches in London, as US laws and regulations impose specified blackout periods for connected research during the IPO process.

Please refer also to our answer to Q3.

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?

Page 10 of the Discussion Paper includes a table analysing the UK IPO market over the past five years. This table suggests that, between the Main Market and AIM, there have been a total of 460 IPOs that have raised, in aggregate, £53,062 million. However, we believe that these figures are potentially misleading because 408 of these transactions were placings and so only 52, raising in aggregate £19,182 million, involved any element of a genuine offer to the public.

Furthermore, none of these involved AIM companies, which all came to market exclusively through placings. Accordingly, there was only an opportunity for unconnected banks or brokers to participate in and

earn intermediation revenues from the 52 offerings on the Main Market. In addition, 26 of these offerings were for investment funds, which do not generate pre-IPO research in the same way as trading companies. Therefore, against this commercial background, it is hardly surprising that there is very little unconnected research being produced in the IPO market.

The main barrier to increasing unconnected research is the fact that a substantial proportion of so-called IPOs do not involve any public offering, but are carried out by means of placings with the lead adviser's or syndicate's (for larger issues on the regulated market) investment clients. We believe that it is difficult to envisage that any bank or broker would be prepared to invest in pre-IPO research if there was no possibility of generating revenues from inducing and intermediating allocations in the IPO to their own investment clients.

We believe that the making of genuine public offerings is hampered by the following factors:

i. A large base of smaller and retail investors is more time-consuming and expensive for companies to relate to and consult with and is not as readily accessible for further funding rounds as a smaller group of institutional investors;

ii. Marketing processes to assess investment appetite cannot be made with retail investors prior to the publication of the prospectus or admission document due to legal restrictions; and

iii. For smaller companies coming to AIM, the making of a genuine public offering would involve the production of a prospectus that would create a significant and disproportionate extra cost of capital relating to the extra time taken to complete the FCA's pre-vetting and approval process.

Unless these issues are addressed, we believe that it is difficult to envisage that more IPOs would be conducted by genuine public offerings and it is unlikely, in our view, that more unconnected research would be published.

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

We believe that, in cases where there is a public offering, the concern that price formation is made on the basis of connected research, rather than the prospectus, is valid. Please refer to our answer to Q2 for the key reasons.

With regard to the consumer protection concern, we believe that investors would like to receive the informational elements of the prospectus in fully approved form contemporaneously with the marketing process. It is already possible to issue an approved prospectus without final pricing and information in the issue and subsequently to issue an approved pricing supplement, but this is rare in practice. Please see our comments in Q11.

We believe that the principal regulatory obstacles to this are:

i. The additional costs that would be incurred with the inclusion of prospective financial information in prospectuses;

ii. The increased legal liability exposure for issuers and their directors with the inclusion of prospective financial information in prospectuses;

iii. That if a smaller company seeking admission to listing on the regulated market were to obtain an approved prospectus before the marketing process took place and then failed to complete the IPO but remained a private company, the fact of having produced a prospectus would, or may, then expose them to the Takeover Code regime for the next ten years; and

iv. The potential reputational risk of a more visible unsuccessful fund raising.

With regard to the competition concern, it is possible that the barriers to unconnected research are essentially self-imposed because there is little opportunity for unconnected banks and brokers to generate revenues from such research because of the substantial use of placings as a method for executing IPOs. Accordingly, such an obstacle is a commercial reality and not a regulatory barrier.

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?

We generally believe that two key regulatory interventions could encourage the earlier publication of prospectuses:

i. Granting national competent authorities the ability to provide an interim approval for a pathfinder prospectus, which would become a document that could be used legally for public marketing purposes without constituting a legal prospectus (perhaps similar to a financial promotion); and

ii. Providing some form of regulatory assurance that connected research and prospectuses did not need to be chronologically separated, so to allow them to co-exist in the marketing process. This could be done by a clarification of the law, or by an express reduction, from a regulatory perspective, of the length of blackout periods.

However, for smaller quoted companies in particular, the adverse reputational impact of a failed IPO could have a significant impact on the company's business. Therefore, as nearly all AIM IPOs are conducted through private placements, most of them are actually marketed confidentially and intention to float announcements are only made shortly before admission when the certainty of success is substantially assured. Issuers are reluctant to publish prospective financial information due to the additional costs of the reporting requirements in relation to such forecasts but also due to liability concerns. Therefore we note that, even if an appropriate regulatory intervention was made, it might not necessarily be utilised by smaller quoted companies. We would not support regulatory intervention which required publication of a final form admission document ahead of marketing and pricing.

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

We generally support the outlined high level aims for reform of the UK IPO process, although we consider that they may be more appropriate for larger IPOs than for smaller ones.

We believe that the prospectus should be the principal document that investors use to base their investment decision upon. However, we also recognise that the valuation material contained in connected research is a valuable element in the price formation process. Accordingly, we believe that the UK IPO

process can only be enhanced if the need for chronological barriers between these two components are reduced or even eliminated altogether.

The difference between research and the prospectus should be distinct. The key driver of pre-IPO research is about obtaining prospective financial information to guide and lead the price-determination process, whereas the prospectus is the definitive, factual document for investors. It is important to note that research can be disregarded by the board.

If there was to be no blackout period, and only connected research produced by a broker or a bank, the research could focus on valuation and prospective financial information, or, alternatively, could be a trigger for a financial forecast published at the same time as the prospectus.

We note that the combination of research and the prospectus is an important basis upon which institutional investors make their investment decision.

We would welcome a reduction in the current blackout period of 14 days mandated for unconnected research – current market practice – to seven days at most, or even eliminated altogether. Subsequently, this could allow the prospectus to be published with all the necessary notes and risk warnings to investors, although there would need to be suitable regulation so that issuers do not bear an inappropriate liability risk.

We should not disregard the fact that for the smaller end of the market, mandating any number of days may be counterproductive, as, on the one hand, smaller companies struggle to get research produced on them, and on the other hand, this could have harmful timing implications. For example, this could crunch the time the company has to produce the pathfinder document, or it could end up adding unnecessary time to the process and close a window of opportunity.

It is important to note that investors will always be in favour of a prospectus being published and research as early as possible. However, the potential cost to small and mid-size quoted companies publishing an early prospectus, possibly followed by a supplementary prospectus, should also be considered if this happened.

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?

We believe that any ban on research would not be a suitable option for reform. As we have argued, research (whether connected or not) is an integral element of the marketing and pricing process.

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

No, we do not agree with this proposition. We believe that contemporaneous (or near contemporaneous) publication of a prospectus/admission document and research should be a desired objective. As argued in this response, we believe that this will only ultimately be achieved if there is legislative intervention. In the meantime, a reduction in blackout periods by regulation would assist, but not cure, the current position. We are not convinced that this would squeeze out or eliminate unconnected research. We believe a more convincing reason for the lack of unconnected research in the IPO process is not the existence of anti-

competitive barriers in the market place but rather that there is simply no commercial rationale for unconnected banks or brokers to produce such research.

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?

In principle, we would agree that, where a prospectus is required and is to be issued in tripartite form, the early publication of the registration document could improve the IPO process. However, each one of the proposed approaches would involve an "inversion" of the current marketing process and would involve the early publication of an approved prospectus (with no pricing information) and then the subsequent publication (after the marketing period) of an approved securities note with pricing information; this sequencing is very rare in UK offerings.

Equity issuance is not an ongoing frequent event like debt issuance by larger quoted companies on the Regulated Market. Therefore, the efficiency of having a base registration document to support such issuance programmes may not exist for equity fund raises. We would be concerned that a mandatory requirement for early publication of the registration document would not be helpful in every case. In addition, for equity fund raises on AIM where there is not a public offering there would be no equivalent of a registration document, so this approach would not work for AIM companies.

We would also therefore reiterate our comments with respect to our answer to Q7.

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?

We do not agree that requiring issuers to open the presentation to analysts to unconnected research analysts would improve the IPO process.

Nevertheless, we believe that, in principle, giving unconnected analysts access to an analyst presentation could be healthy transparency, although in the majority of cases for small companies, due to commercial reasons, there is unlikely to be interest from unconnected analysts in attending a presentation. Mandating that an official analyst presentation be held may hence result in an unnecessary level of cost and bureaucracy. We believe that issuers should only hold a presentation for unconnected research analysts if requested by the unconnected research analysts themselves.

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

We do not believe that any of the three models proposed would achieve the desired outcomes or be relevant to small and mid-size quoted companies, such as AIM companies, for the reasons given in our answers to other questions. The most significant and beneficial factor for AIM companies carrying our private placements would be the elimination of the need for chronological separation of the research (with its valuation material) from any pathfinder admission document.

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?**

Please refer to our answers above.

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

Please refer to our answer to Q7.

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 premandate 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?

We note that there are concerns that investment banks' analysts have access to too little information in terms of a company's performance and condition. It is opined that the more access and contact an analyst has to a company, this will correspondingly lead to an increased level of influence over the analyst such that the analyst may convey a false perception of the company's state of affairs, leading to research that investors cannot rely on.

However, although analysts must always be independent, we do not believe that increasing contact between analyst and company leads to distorted and/or unreliable research. It is essential that analysts are able to carry out their work with low a barrier as possible so that they can gather all the relevant information available.

Although there is a case that there could be a conflict of interest for the analyst in the event of increased contact between them and the company, we believe this is an inevitable risk. However, we ultimately believe that the analyst will want to protect and/or enhance their reputation by producing accurate research of the company.

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

We believe that any such proposed models of reforms would be more difficult and have a greater negative impact on companies on non-regulated markets, such as AIM or ISDX. In the case of these companies, connected research is the only research available because there is, simply, very little interest to produce unconnected research with small and mid-size companies. Opening up the possibility for this research to be produced would also not solve the problem of the dearth of investment research on smaller companies. Moreover, this research would not end up being useful, if at all produced, as investors are not there.

We are also concerned that more 'mandated' research could lead to poor quality reports on the company being produced (for the fact that these would not be paid) and at the same time prejudice the companies, which may be unable to frontload the costs or be so exposed up front.

We note that commission for research is too low on secondary issues and too high for primary issuances; the regulatory pressures around this are incentivising brokers to raise primary capital. We believe that mandated research is unnecessary, as a commercial necessity for sufficient information directing investment decisions already exists.

As a general comment, we believe that regulation should not be overly focused on the primary market, as the secondary market is breaking down. We believe that a low level of liquidity in the secondary market – a situation that currently exists in the UK – could inevitably have negative consequences on the primary market regardless of the model implemented.

If you would like to discuss any of the responses in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Corporate Finance Expert Group

Richard Evans (Chairman)	**Strand Hanson Limited**
David Worlidge Nick Naylor	Allenby Capital Ltd
Chris Hardie	Arden Partners PLC
Chris Searle	BDO LLP
David Foreman Amerjit Kalirai	Cantor Fitzgerald Europe
Stephen Keys	Cenkos Securities PLC
Sean Geraghty	Dechert
Stuart Andrews	finnCap
Simon McLeod	Goodman Derrick LLP
Colin Aaronson	Grant Thornton UK LLP
Nicholas Narraway	Hewitson Moorhead
Robert Darwin Maegen Morrison	Hogan Lovells International LLP
Richard Crawley	Liberum Capital Ltd
Simon Charles	Marriott Harrison
Richard Metcalfe	Mazars LLP
Lesley Gregory	Memery Crystal LLP
Kristy Duane	Nabarro LLP
Richard Thomas	Numis Securities Ltd
Jonathan King	Osborne Clarke
Sandra Bates	Pillsbury Winthrop Shaw Pittman LLP
Leighton Thomas	PricewaterhouseCoopers LLP
Niraj Patel	Saffery Champness
Bidhi Bhoma Mark Percy	Shore Capital Group Ltd
Azhic Basirov	Smith & Williamson LLP
Neil Baldwin Mark Brady	SPARK Advisory Partners Limited
Laurence Sacker	UHY Hacker Young
Paul Shackleton	W H Ireland Group PLC
Rod Venables	Western Selection Plc
Catherine Moss	Winckworth Sherwood LLP
Ross Andrews	Zeus Capital Limited

Quoted Companies Alliance Legal Expert Group

Gary Thorpe (Chairman)	**Clyde & Co LLP**
Maegen Morrison (Deputy Chairman)	Hogan Lovells International LLP
David Davies	Bates Wells & Braithwaite LLP
Martin Kay	Blake Morgan
Paul Arathoon Andrew Collins David Hicks Tom Shaw	Charles Russell Speechlys LLP
David Fuller	CLS Holdings PLC
Mark Taylor	Dorsey & Whitney
June Paddock	Fasken Martineau LLP
Donald Stewart	Kepstorn
Nicola Mallett	Lewis Silkin
Tara Hogg Jane Mayfield	LexisNexis
Stephen Hamilton	Mills & Reeve LLP
Ross Bryson Kate Higgins Nicholas McVeigh	Mishcon De Reya
Philippa Chatterton	Nabarro LLP
Jo Chattle Simon Cox Julie Keefe	Norton Rose Fulbright LLP
Sandra Bates	Pillsbury Winthrop Shaw Pittman LLP
Naomi Bellingham Sarah Hassan Hilary Owens Gray	Practical Law Company Limited
Ben Warth	PricewaterhouseCoopers LLP
John Burnand	Winckworth Sherwood LLP

Quoted Companies Alliance Secondary Markets Expert Group

Simon Rafferty (Chairman)	**Winterflood Securities Ltd**
Jon Gerty (Deputy Chairman)	Shore Capital Group Ltd
Julien Kasparian	BNP Paribas Securities Services
David Cooper	Cenkos Securities PLC
Paul Arathoon Andrew Collins William Garner	Charles Russell Speechlys LLP
Mark Tubby	finnCap
Keith Hiscock	Hardman & Co
Nick Anderson Clare Forster Shreena Travis	Henderson Global Investors
Fraser Elms Katie Potts	Herald Investment Management Ltd
William Lynne Claire Noyce	Hybridan LLP
Peter Swabey	ICSA
Jeremy Phillips	Nabarro LLP
Ian Wright	Numis Securities Ltd
Sarah Bray Sunil Dhall Andrew Palmer	Peel Hunt LLP
James Stapleton	Winterflood Securities Ltd