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UK Main Market IPO regime – developing market practice under the "new" rules

INTRODUCTION

It has been two and a half years since the Financial Conduct Authority (FCA) introduced several changes to the UK Main Market IPO regime. The intended purpose of these changes was threefold - to:

- provide investors with disclosure about the issuer earlier in the IPO process through the publication of a registration document before any research had been published;
- broaden the research published on new issuers beyond that published by analysts from the banks underwriting the IPO (connected analysts) to include unconnected analysts; and
- improve the perception of connected analyst research by ensuring independent research analysts were not involved in a bank's pitch process for a role on the IPO.

It has taken some time for the new rules to bed in, primarily because market conditions have generally been unfavourable for IPOs. But, as we look forward to 2021 and a potential spate of UK IPOs, it is a good time to reflect on the impact of those changes on the IPO process and whether we can start to talk about market practice being established.

IPO ACTIVITY SINCE JULY 2018

Putting to one side IPOs by funds and SPACs, technical listings, step-ups from AIM and the GDR listings on the Shanghai-London Stock Connect, there have been 14 UK IPOs to which the "new" regime has applied.

Of these, 10 were premium listings and four were standard listings. These IPOs involved a large proportion of +£1 billion issuers (10 of the 14), with six issuers having a market capitalisation of over £2 billion on admission.

Only two of these IPOs involved an issuer with a market capitalisation of less than £500 million, with DWF (c.£366 million) being the smallest.

Amongst these transactions, we have seen the following common themes to the IPO processes conducted under the new regime.

ANALYST PROCESS

Under **COBS 11A**, there are two options for IPO candidates when interacting with research analysts that are not connected with the banks underwriting the IPO (unconnected analysts):

- they can be invited to meetings alongside connected analysts, allowing connected research to be published on the day following publication of the registration document; or
- they are provided with the same information as connected analysts but only once the registration document has been published – connected research must then not be published until seven days after publication of the registration document.

The upshot of the two approaches is that an issuer must either let unconnected analysts "inside the tent" before the public launch of the IPO, or extend the public phase of the IPO by seven days (i.e., the period between the first public disclosure (registration document) and the admission of the shares).

So far as we are aware, all IPOs under the new regime have opted for the additional seven-day process. The key reason given is that it maintains confidentiality around the IPO process for a longer period. Whilst the split approach is clearly the favoured option, there are scenarios where a joint process may in the future be adopted; for example, a very high profile and pre-flagged IPO where confidentiality is less of an issue and the issuer and its shareholders want to be seen to be completely transparent with unconnected analysts (perhaps a UK privatisation?).

Dealing with connected and unconnected analysts separately means ensuring that all analysts receive the same information. The guidance from the Association of Financial Markets in Europe (AFME) and European Association of Independent Research Providers (Euro IRP) has helped establish procedures for this process that has guided market practice in this area.

Reaching out to unconnected analysts

The rules require the underwriting syndicate to ensure that a range of unconnected analysts can communicate with the issuer team.

It was proposed that representative bodies would compile lists of unconnected analysts interested in writing pre-IPO research to facilitate this communication. As it stands, this approach does not appear to have been successful as Euro IRP's **list** contains only 9 names. However, in reality, including details of the unconnected analysts process in the proposed intention to float (ITF) announcement in reality provides analysts with the information that they need. It is difficult to see how an issuer and the underwriting syndicate could be criticised for not trying to reach out to a range of analysts given this public disclosure and the ability for analysts to sign up to a list to express their interest.

There is also an AFME **guidance note** that provides a template form memorandum that can be adapted to record the steps taken to ensure that a range of analysts was approached.

Who is a bona fide unconnected analyst?

One issue that has arisen under the new regime is that underwriting banks need to verify that those seeking to attend unconnected analyst briefings and receive the information that was provided to connected analysts are bona fide unconnected analysts.

An AFME **guidance note** gives useful advice as to whom should be considered an unconnected analyst: the key point being that the analyst must produce research, which is disseminated to at least one third party that is also an external client of the research analyst's employer's group. Following this guidance provides comfort to investment banks who seek to exclude investors from the process.

Presentation to unconnected analysts

To ensure equality of information between connected and unconnected analysts, most (but not all) IPO candidates have offered a presentation to unconnected analysts that typically takes place one or two days after the publication by the company of the registration document.

Anecdotally, we understand that interest in these meetings amongst the analyst community has been very low – often less than five analysts request invites – and attendance has been even lower.

Ensuring equality of information

When the rules were first being tested on live IPOs, there was much debate as to what information had to be shared with unconnected analysts to ensure equality. For example: was it necessary to provide verbatim accounts of all meetings with connected analysts? Were unconnected analysts entitled to a site visit if connected analysts received a tour? How did you ensure that the information given to the two groups of analysts was the same?

The approach taken by underwriting syndicates, in line with the relevant AFME **guidance note**, is to provide unconnected analysts with the slide-deck used at the connected analyst presentation as well as any other written materials provided at the time or after the meeting. Oral answers to any questions raised by connected analysts or any voice over to the slides that included further information to what is in the slide-deck is also provided. This can be done by providing voice recordings of those meetings or a written minute of any such information that was provided orally.

As for site visits, anecdotally, in most cases, issuers and their advisers have been comfortable that a separate site visit for unconnected analysts is not normally required even where connected analysts attended one, so long as the information provided to the connected analysts at those visits is also made available to unconnected analysts. Also, perhaps as a result of the changes to working practices arising from the travel restrictions during the coronavirus (COVID-19) pandemic, virtual tours of facilities have been proposed as a workable alternative, as these can be recorded and shown to the unconnected analysts.

Clearly, the importance of a site visit to an analyst in trying to understand the issuer's business will depend significantly on the sector and the nature of that business. Whilst site visits remain uncommon for unconnected analysts, there are some sectors (i.e., retail or manufacturing) where issuers and their advisers will decide that equality of information can only be achieved with an in-person tour.

Investment banks remain concerned around the practical difficulties of fulfilling their obligation to ensure equality of information between the two groups of analysts and recording the steps they have taken in this regard. They have been helped in this by AFME's **guidance note** which sets out a procedure to be followed. Whilst these processes appear to be broadly followed by the investment banking community, there does remain some uncertainty as to the level of comfort that an issuer should provide to banks as to what has been shared. This AFME guidance includes a pro forma confirmation from the issuer to the underwriting syndicate containing several representations and warranties in relation to the information provided to the two sets of analysts. Whilst the benefit of such a confirmation is undoubtedly helpful to the underwriting syndicate, we are aware that there has, on occasion, been some reticence to provide the confirmations in the form provided by AFME and that banks have instead sought similar assurances from the issuer in other ways (i.e., as a warranty in the underwriting agreement).

Questions to the issuer by unconnected analysts

If an issuer answers a question asked by unconnected analysts which has not already been asked by the connected analysts, it is necessary for the issuer to circle back with the connected analysts and provide them with the same answers. This can cause some logistical issues as connected analysts may wish to revisit their draft reports in light of the new information.

Issuers and their advisers have found that, to run a smooth process and ensure all information is shared with enough time for analysts to update their reports, any questions from unconnected analysts should only be accepted within the first few days after publication of the registration document.

Are unconnected analysts writing pre-IPO research and, if so, when?

Our discussions with market participants suggest that very few unconnected analysts publish research on IPO candidates before admission and there are examples where no unconnected research report has been published. Whilst this would suggest that the new process adds little or no value to investors, some have highlighted that meeting with management early on at least puts unconnected analysts in a better place post-listing to publish their views.

When the new rules were published there was understandable concern that it would be difficult to regulate when unconnected analysts published pre-IPO research. In particular, there was a risk that a research report could be published very close to pricing, and, if such report contained factual inaccuracies, it would be difficult to correct these in a timely fashion. Any errors in the report could then have an unwarranted effect on an investor's decision to participate. An attempt to control the timing of unconnected analyst reports is included in AFME's **model form research guidelines**, which (i) require an unconnected analyst to use reasonable endeavours to publish research, wherever possible, prior to publication of the prospectus, and (ii) include an expectation that research will not be published in the seven day period prior to pricing. Anecdotally, it appears that unconnected analysts that do publish research have complied with these restrictions and we are not aware of any issues arising from the timing of publication of their research.

DISCLOSURE

Registration document - a document of record

As a registration document is intended to describe an IPO candidate's business and corporate structure and governance as at the time it is published, it quickly became apparent that under the new rules, an issuer was required to disclose information that would be obsolete at the time of IPO. This is because, more often than not, an IPO candidate will undergo a corporate reorganisation, appoint a new board and implement a new corporate governance structure once it has certainty that the IPO will complete (i.e., after the registration document is published).

It was also unclear how much an IPO candidate could include about its intentions for the shape of the company on admission to the Main Market. As a result, some issuers received undue criticism for having in place private-equity capital structures and a board with several shareholder representatives, as readers did not understand that the document did not reflect how the company would be structured and managed on listing.

In its **Q&A in relation to COBS 11A**, AFME has provided some clarification for issuers around registration documents to deal with this uncertainty. To the extent it is known that information in the registration document will be out-of-date or will have changed by the time any prospectus is published, the FCA will accept forward-looking information being included in the registration document. For example, it is possible to include a statement in a registration document that a board of directors will change to become one appropriate for a publicly listed company by the time any prospectus is published. The same applies to the corporate governance framework generally, or the structure of the group if a pre-IPO capital reorganisation has not yet taken place or for material contracts that it is known will fall away if an IPO proceeds.

Sponsor obligations

Listing Rule sponsors were keen to understand whether under the new regime they had any specific obligations to the FCA in connection with the registration document. Whilst there was no obligation to submit a Sponsor's Declaration with a request for approval of a registration document, at the time of publication a sponsor is providing a sponsor service to the issuer in respect of the final prospectus, which is being reviewed by the FCA.

As the registration document includes most of the substantive business disclosure that is then disclosed in the IPO prospectus, it was not surprising that AFME's Q&A in relation to COBS 11A inferred that the FCA expected a Listing Rule sponsor to carry out the required due diligence on that information as well as meet all of its other requirements under Listing Rule 8.

As such, market practice has understandably developed such that, whilst not named in the registration document or required to provide a Sponsor's Declaration on its publication, Listing Rule sponsors will engage with the drafting of a registration document and the diligence that informs the disclosure in the same way as they would for a prospectus. A suite of sponsor "comfort" documents has also been developed to support that diligence process.

Pathfinder vs. price range prospectus

Before these changes, issuers, shareholders and underwriting syndicates had a very strong preference for pathfinder documents for investor marketing, rather than an approved price range prospectus. Price range prospectuses were only used for retail offers where an approved prospectus had to be published before offering the shares to the public.

Pathfinders are drafted to contain all the information that would be in a final prospectus, other than the pricing information. The document is shared with investors during the management roadshow and used to assist with confirming orders and the final size and price of the deal. Once the book is built, the pricing information is added to the pathfinder and the prospectus is published following approval from the FCA.

A price range prospectus is an approved prospectus with a range for the offer price and/or the number of shares to be offered. It is then updated at the close of the bookbuild with the final offer statistics which are published through an RIS. If the bookbuild reveals that the deal size or offer price will fall outside of the range(s) in the price range prospectus, the issuer may have to issue a supplementary prospectus and it will be very clear, if the size and/or price are lower than the published range, that the deal has not been as successful as originally anticipated.

Whilst the new rules do not require issuers to publish a price range prospectus in connection with an IPO, there was a belief, as expressed in AFME's **Q&A in relation to COBS 11A**, that the FCA wanted issuers to move away from using a pathfinder document for institutional-only offers and to use a price range prospectus instead. As a result, in 2018, all the completed Main Market IPOs under the new rules used a price range prospectus. Of these, all but one had a retail offer in any event so needed a price range prospectus. It is difficult to know whether they would have had a retail offer if a pathfinder document had been considered a viable option.

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Pathfinder vs. price range prospectus (continued)

But practice has moved on. Only three of the IPOs executed under the new regime in 2019 and 2020 have used a price range prospectus. It is not clear what the circumstances were that led issuers to publish a price range prospectus, but none of those IPOs involved a retail offer so the public offer requirement was not the motivation. However, what is significant is that the market seems to be reverting to the approach adopted before the new rules.

Announcements

As the public phase now starts with publication by the issuer of a registration document, there was some uncertainty as to when the ITF, which had previously been the first public announcement of the IPO, should be made.

The consensus appears to be that the content of the ITF should now be in a "potential" or "expected" ITF made at the time the registration document is published. This can also be used to rectify some of the disclosure in the registration document which, as discussed, does not necessarily reflect the corporate structure and governance of the business at IPO. It can also provide some of the proposed parameters around the structure of the IPO.

On the date the connected research is published a "confirmation" ITF is published, which is a short announcement confirming the structure of the IPO and providing any further updates.

If the trend continues of front-ending the disclosure in announcements, it is possible that the "confirmation" announcement may disappear in its entirety.

PITCHING

The new regime was intended to draw a clear line for banks in their split role of providing support as underwriters and placing agents and publishing independent research on an issuer pre-IPO. As a result, under **COBS 12**, independent analysts are restricted from interacting with an issuer and its shareholders when the bank for which they work for is pitching for a role as underwriter on the IPO. This is to remove any perception that a bank may secure a role on an IPO because its research analyst has indicated that a report will be supportive of the company's strategy and prospects.

There will always be a grey area between when a bank is engaging with a company or its shareholders in a general way about over strategy for an exit and when those discussions start to firm up around executing an IPO. Whilst AFME's **Q&A in relation to COBS 12.2.21AG** provides helpful guidance, some market participants consider that the new rules have led to banks taking an understandably conservative view as to when it has become inappropriate for an analyst to engage with a private company and its shareholders. To some, this has meant that companies and their shareholders are missing out on having constructive discussions with analysts who can provide invaluable market insight.

The changes only require analysts who prepare "independent" research to be excluded from communications when a pitching process is underway. Some banks in the London market do not prepare independent research (but non-independent research that must be clearly identified as marketing material) and can therefore continue to engage during a pitching process so long as they comply with the regulatory constraints around conflicts of interests. Some consider that this has created an uneven playing field for banks during a pitching process.

MOVE AWAY FROM THE 2/2 MODEL?

One of the major perceived drawbacks of the new regime was that the seven-day period required for the unconnected analyst process meant that a typical UK IPO process would be "in the market" for five weeks (one week for the analysts followed by the customary two weeks for PDIE and then two weeks for the management roadshow).

Whilst this has been the case for several IPOs conducted under the new regime, there is evidence that issuers and the underwriting banks have sought to make time up in the public phase by shortening PDIE and the management roadshow. This is evidently easier now that it has become commonplace that analysts and management teams conduct these meetings virtually.

It has also been made possible because of the increased number of pre-marketing meetings that are taking place before publication of the registration document. It is typical on an IPO for management to offer key investors several opportunities to engage during the private stages of an IPO. As a result, the management roadshow is, in many cases, used for firming up offers of participation rather than meeting accounts for the first time.

CONCLUSIONS

Whilst undoubtedly market practice will continue to evolve, there are some noteworthy trends:

1. Connected and unconnected analyst processes will, in most cases, be run separately and there will be a delay of seven days from publication of the registration document before connected research is made available

2. Market participants have a clear and well- understood process for contacting analysts and sharing information

3. Unconnected analysts have shown little interest in participating in pre-IPO meetings and writing pre-IPO reports, blunting the intended effect of the rules.

4. Pathfinder documents remain the most popular way of sharing the company's disclosure before and during the management roadshow

5. The additional seven days at the start of an IPO's public phase has put pressure on the traditional 2/2 format, leading to examples of shorter periods of PDIE and management roadshows (assisted by using virtual meetings and increased pre-marketing)

The rules do not appear to have stifled IPOs in London nor made the process so unwieldy that it has disincentivised prospective IPO candidates, as originally feared. Whilst we have seen relatively low numbers of companies coming to market since mid-2018, this has not been as a result of the new rules, but instead the sustained period of market volatility and the ready supply of private capital.

It appears, instead, that market participants have generally adapted well to the changes and, whilst not working perfectly, the rules are now well enough established that they don't present material additional execution risk for IPO candidates and their advisers.

A NOTE ON AIM...

The new rules do not apply to AIM companies, although the FCA encouraged larger AIM issuers to also seek to comply with the restrictions. It is perhaps unsurprising that none of the nine +£100m companies that have been admitted to AIM since the new rules came into effect have sought to comply with these rules.

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