

UKLA Publications LIST!



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Introduction from David Lawton, Head of Policy, Markets Division

This is a short supplement to the eleventh edition of List! which we published in September. Here, we highlight information about a few issues which we felt we needed to tell the market about immediately, rather than waiting until our next full edition.

One topic we consider here relates to competitive Initial Public Offerings (IPOs). Potentially, these put considerable strain on firms' systems and controls when they are applying our rules, and so could raise concerns about firms' management of conflicts of interest. This practice affects not only our Listing Rules but also the FSA's conduct of business rules. We also give you important information about the Prospectus Directive, on determining the home Member State for non-EU issuers, and employee share plans.

Guidance

In this newsletter we have tried to provide a broad coverage of topical issues of both a technical and non-technical nature. We are limited in the way we can address technical matters by the requirements of the Financial Services and Markets Act 2000 (FSMA) which restricts the scope for us issuing guidance without prior consultation.

It is important to understand that the contents of this newsletter are not intended to be guidance as contemplated by FSMA, and the contents should neither be interpreted, nor relied upon, as guidance. You should refer to the Listing Rules, Prospectus Rules, Disclosure Rules or the appropriate part of the FSA Handbook for general

guidance and, where you need individual guidance, approach us. The technical explanations in this newsletter are illustrative only and are intended to provide an indication of how we may expect certain issues to be addressed.

Competitive Initial Public Offerings

We have identified a new style of syndicate selection system that has been employed in recent Initial Public Offerings (IPO). This process, commonly known as a competitive IPO, appears to exacerbate the conflicts of interest inherent in such public offerings. We have considered the emerging practice of competitive IPOs, and concluded that, although our rules adequately deal with this matter, firms and issuers would benefit from a timely reminder of our rules and published guidance on managing conflicts of interest. This is so that when they are involved in a competitive IPO, firms and issuers can avoid any detriment to either markets or investor protection. We have set out below some issues and concerns that we have identified.

Background

In a standard IPO, the lead manager and other brokers involved in the IPO are appointed at a very early stage of the process, forming a syndicate of brokers. Under competitive IPOs, the syndicate members, their roles and remuneration are not defined until late on in the process. This maintains competitive pressure on the potential syndicate members as not all the firms involved in the competitive IPO process will be appointed to the syndicate after the initial 'beauty parade'. This may create 'pressure points' and new conflicts of interest – particularly around the preparation of

pre-deal research and pre-marketing activities. We understand that one of the reasons issuers favour competitive IPOs is that it gives them greater control over the IPO process and greater leverage over the firms involved.

In a competitive IPO the issuer may be able to exert pressure on the competing firms, directly or indirectly, to produce research that is favourable or which justifies a higher valuation range. This is because firms could be providing their draft research to the issuer in circumstances where the firm is still trying to win a role in the syndicate. In a competitive market, firms may find it difficult to resist such pressure. Even where individual firms have some reservations about the process, they may feel compelled to participate so they are not excluded from transactions.

Firms' regulatory responsibilities

FSA guidance (COB 7.16.14) sets out that a firm should consider whether its other business activities could create the reasonable perception that its investment research is not impartial. So firms are obliged to consider whether their existing conflicts policies are adequate to ensure that they meet the relevant regulatory standards for managing the exceptional conflicts of interest around the production and distribution of investment research in the circumstances of a competitive IPO.

Firms taking part in a competitive IPO are also required to ensure that research that they publish is not held out in a way that could be misleading to the intended recipients. It would be misleading for a connected firm to label or hold out their research about an issuer as being 'objective', 'impartial' or 'independent', where such a representation would be inaccurate in light of COB 7.16 and a firm's responsibilities to clients and customers under Principle 8 of the FSA Principles for Business. So firms have an obligation to ensure that, where research is not impartial, they have not held it out as such and that this fact is clear to the intended recipients.

Firms should also ensure that they adequately meet the disclosure requirements in COB 7.17; in particular, whether the circumstances of the IPO process may reasonably be expected to

impair the objectivity of their research (COB 7.17.10(1)(a)) and whether the firm is party to an agreement with the relevant issuer about the production of the research recommendation (COB 7.17.11(1)(f)).

Reminder to issuers

We also take this opportunity to remind all issuers, listed and unlisted, that it is not appropriate, directly or indirectly, to exert pressure on firms to act inconsistently with their responsibilities as described above. In the August 2004 edition of List! we highlighted some concerns we had in relation to issuers' interaction with analysts. We stated that COB 7.16.12 obliges firms issuing research and holding it out as objective or impartial, not to permit issuers to review drafts, except to check the facts. We are concerned that issuers may apply undue pressure on firms to include a valuation in their draft research.

For more information about the FSA policy on analysts' research and conflicts of interest please contact Matthew Shanahan, Institutional Business Policy, on 020 7066 5416 or email matthew.shanahan@fsa.gov.uk in the first instance.

Sponsors' responsibilities

Sponsors are reminded of the important role they play in helping to ensure that listed issuers meet the required standards in relation to major transactions. Sponsors who are appointed to act on competitive IPO type transactions should consider carefully their ability to discharge their obligations under the Listing Rules independently and with due skill and care. We would encourage sponsors to discuss how they intend to manage transactions giving rise to these kinds of issues with us at the UKLA at an early stage.

Sponsors have an important role to play in transactions involving an application for admission to listing, including providing comfort on certain issues to us such as the working capital position of the issuer; the issuer's financial reporting procedures; and the adequacy of the issuer's systems and controls. Following the Listing Review, we also expanded the provisions relating to a sponsor's systems and controls to include:

- management of conflicts of interest;
- the requirement to keep records for six years and to regularly review its systems and controls; and
- to set out more clearly the requirements about sponsor independence.

For more information on the Sponsor regime please contact our Sponsor Supervision helpline on 020 7066 8333 option 5.

Prospectus Directive

Determining Home Member State for third country issuers

Article 30 (1)

The EU Commission Internal Market DG issued a clarification recently on interpreting the transitional provision in Article 30 (1) of the PD and how a non-EEA issuer of securities in the EU may determine its Home Member State under the PD. The Internal Market DG has clarified that this provision only applies to third country issuers with equity securities or low denomination securities trading on an EU regulated market on 1 July 2005. If Article 30(1) applies, that issuer must then notify its decision to its chosen home Member State by 31 December 2005 in accordance with Article 2(i)(m)(iii).

The EU Commission Internal Market DG has stated that such a non-EEA issuer may choose either that Member State where it has securities trading or the state where that it first publicly offers its securities between the PD coming into force (31 December 2003) and the date by which an issuer must make its election under Article 30(1) (31 December 2005). Where an issuer has securities trading on more than one regulated market in the EU, the issuer may choose any of those Member States in which the regulated markets are situated. Representatives of the EU Commission Internal Market DG have also stated elsewhere that where an issuer simultaneously offers its securities in several Member States, then it may choose between any of those states.

The full text of the EU Commission's clarification is at:

www.europa.eu.int/comm/internal_market/securities/docs/prospectus/art-30-1_en.pdf

A number of issuers wrote to us before the PD was implemented to elect the UK as their Home Competent Authority under Article 30(1). We would urge those issuers who have already written to us to re-evaluate their positions to determine whether they need to take any further action following the Internal Market DG's guidance note. If we do not hear from such issuers by 31 December 2005, we will assume that they consider that the election they made under Article 30(1) is still valid. We would also urge those who have not written to us but wish to make such an election to write to us by 31 December 2005, in particular confirming that they were trading on an EU regulated market on 1 July 2005.

Employee Share Schemes

Further to the clarification we provided in relation to employee share schemes in the tenth edition of List!, we recognise that there are still some unresolved issues causing uncertainty in the market. We set out our views on some of these matters below:

- **Quantification of the €2.5m threshold**

We have noted that there is some uncertainty in the market about whether the €2.5m threshold for offers to fall outside the scope of the PD in schedule 11 of FSMA should be calculated only in relation to the UK or on an aggregated basis across all the relevant EU States, where a simultaneous offer of securities is made across several EU States. We think it is doubtful whether the €2.5m threshold can be calculated only in relation to offers in the UK where there is an offer of securities across several member states.

- **Private companies**

We have been asked whether an offer of shares in a private company constitutes an offer to the public and will necessitate a prospectus, especially in the light of the restriction in section 81 of the Companies Act 1985. Our view is that this will depend on whether the shares of that company are

transferable securities within the meaning of the PD. The PD generally contemplates that shares (whether in public or private companies) which are capable of being negotiated on the capital markets should fall within the PD's ambit.

- **Individual schemes**

We have received specific requests on whether particular plans or schemes fall under the ambit of the Prospectus Directive and whether a prospectus needs to be published for such schemes. In line with our policy not to provide legal advice on matters, we do not consider that it is appropriate or indeed possible for us to provide advice on each individual scheme. We believe that it is up to the issuer and its advisers to consider, in relation to any particular scheme, whether an offer of transferable securities has been made to the public and whether they are exempt from producing a prospectus.

For more information on the issues raised in this part of the newsletter, please contact **Adetutu Odutola** (adetutu.odutola@fsa.gov.uk) on 020 7066 8204. To discuss applying the Prospectus Rules to a particular transaction, please call the UKLA helpdesk on 020 7066 8333 (Option 2).