ECM 2020: trends, predictions and recent changes

by Practical Law Capital Markets

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This article highlights the key themes arising from a seminar organised by the Forum for US Securities Lawyers in London, together with the Practical Law Capital Markets team, on ECM trends, predictions and recent changes, including the UK IPO reforms that came into effect in 2018.

Breakfast seminar: ECM 2020

On 22 January 2020, the Forum for US Securities Lawyers in London, together with the Practical Law Capital Markets team, held an ECM seminar during which speakers from the London Stock Exchange and various investment banks discussed IPO trends in 2019, predictions for 2020 and recent changes, including the impact of the UK IPO reforms that came into effect in 2018. The seminar was hosted by Reed Smith LLP.

The speakers at the seminar were:

- Daniel Winterfeldt, Partner, Global Capital Markets, Reed Smith LLP (Moderator for panel discussions).
- Edward Bibko, Managing Director and General Counsel for EMEA and Asia, Jefferies (Moderator for panel discussions).
- Rosie Donachie, Group Head of Government Affairs and Regulatory Strategy, London Stock Exchange Group.
- Nicholas Baumgartner, Director and Head of ECM Legal for EMEA, Citi.
- Mark Bicknell, Managing Director and Associate General Counsel, and Head of ECM Legal, Bank of America.
- Deborah Smith, Executive Director and Senior Counsel, Investment Banking Legal, Goldman Sachs.

Main topics discussed

The discussions at the seminar focussed on the following main areas:

- IPO trends and challenges during 2019 (see *Overview of 2019*).
- Outlook for ECM transactions in 2020 (see *Predictions for 2020*).
- Impact of the UK IPO reforms that came into effect in 2018 (see *UK IPO reforms*).
- Attendance by bankers at prospectus drafting sessions (see *Attendance at prospectus drafting sessions*).

- Unicorn companies and the difficulties they encounter when wishing to pursue an IPO (see *Unicorn companies*).
- Alternatives to IPOs, such as direct listings (see *Direct listings*) and private placements (see *Private placements*).
- Rise in cryptoassets and block chain technology in capital markets (see *Technology in capital markets*).

This article sets out in more detail the main areas discussed by the speakers.

Overview of 2019

In terms of IPO trends and the challenges that companies faced during 2019, it was noted that:

- There were very few IPOs in the UK last year when compared with previous years and that, generally, global IPO activity was also down in 2019.
- The decrease in IPOs can be attributed to political uncertainty, which was dominated by Brexit but which was also caused by political unrest in Hong Kong and trade tensions between the US and China.
- Many IPOs failed last year, including several high-profiled failed IPOs among unicorns (that is, privately held startup companies valued at $1 billion or more), as investors are becoming more discerning, sceptical, rigorous in their decision-making and critical of companies that do not meet standard corporate governance expectations (see *Unicorn companies*).
- In terms of the successful IPOs last year, technology and healthcare companies featured strongly.
- The new practices resulting from the 2018 UK IPO reforms seem to have bedded down and have been embraced by the market (see *UK IPO reforms*).

Predictions for 2020

In terms of the outlook for ECM transactions in 2020, the general view of the speakers was that:

- Although the UK will now definitely leave the EU on 31 January 2020, there is still a prevailing sentiment of uncertainty. The task of negotiating a Free Trade Agreement with the EU and the requirement for 40 equivalence decisions from the European Commission should not be underestimated.
- Following the decisive result of the December 2019 general election, however, there is more optimism in the UK market, especially as regards the first six months of this year.
- The importance of sustainable finance and socially responsible investment, taking into account environmental, social and governance (ESG) factors, will continue to grow and play a significant part in investment decisions. For more information on ESG, see *Practice note, Environmental, social and governance (ESG): an introduction*.
- Cryptoassets and block chain technology in capital markets are not considered to be an immediate regulatory threat but these areas are constantly evolving and regulators in the UK, US and the EU are aware of the risks they pose. Consequently, they are likely to be increasingly regulated in the future (see *Technology in capital markets*).

- There may be an increase in companies pursuing direct listings (without an accompanying fundraising) and seeking investors through private placements, as alternatives to an IPO (see *Direct listings* and *Private placements*).

UK IPO reforms

Background

On 1 July 2018, new rules came into effect with the intention of improving the range, quality and timeliness of the information that is made available to market participants during the UK equity IPO process. In particular, unconnected analysts (that is, analysts in firms that are not part of the syndicate of underwriting banks on an IPO) must now be given the same access to, and information about, the IPO candidate as connected analysts (that is, analysts in the research divisions of underwriting syndicate members).

The approach that has emerged as standard in the market is for unconnected analysts to be given the information after it has been given to connected analysts and for there to be a seven-day period following publication of the approved disclosure document (for example, a registration document or prospectus) before connected research can be disseminated.

For more information, see *PLC Magazine article, Initial public offerings: changes coming down the track (March 2018)* and *Article, UK IPO reform: update on implementation and market practice*.

Same information to connected and unconnected analysts

In response to a general question about the impact of the reforms, it was noted that:

- The reforms (i) enhance the perception of the independence of syndicate analysts and (ii) encourage greater numbers of non-syndicate analysts, as they have access to all of the same information as syndicate analysts.
- The reforms have been seen as successful by the market as they facilitate non-syndicate analyst views earlier in the IPO process based on the same information that is provided to all approved analysts at the same time. However, there has not been much take-up among unconnected analysts to write pre-deal research notes. Indeed, their numbers have been relatively low, possibly due to the challenge of vetting unconnected analysts.
- To ensure that connected and unconnected analysts have access to the same information, all information provided to any analysts (including presentations, Q&A and any follow-up queries) should be transcripted, with the same transcripts being given to all the connected and unconnected analysts. Informal interactions with analysts which are not scripted should be avoided.
- The majority of issuers follow the *AFME guidance* (see *Legal update, IPOs: AFME guidance on providing issuer access for unconnected analysts*).

Timetable

In terms of the effects of publishing an approved disclosure document before connected research can be disseminated, it was noted that:

- As a result of publishing a registration document at an earlier stage in the IPO process, there is now pressure on the company to make a draft of the registration document or prospectus (or parts of it) available earlier. Having thought that, by publishing a registration document earlier than previously required this would avoid requests for parts of the registration document or prospectus to be made available even earlier, the reverse has actually happened. Instead, potential investors now want (and some companies or sellers want to offer up) draft information even sooner (even before the publication of the registration document).
- Providing early drafts of a prospectus or registration document to investors (ahead of finalising due diligence and verification) can create liability issues.
- Any person receiving drafts of a prospectus or registration document should be required to enter into a hold harmless and confidentiality or non-disclosure agreement and confirm that they will not rely on any draft versions, that they will not hold anyone liable or responsible for such document's accuracy and completeness and that they will invest only on the basis of the information that is contained in the final prospectus.
- Practice may evolve such that, instead of a registration document, a single, complete prospectus might be published at the outset, after which there would be the seven-day waiting period before publication of the connected research.
- To summarise, whereas the availability of an approved disclosure document at an earlier stage in the process has helped with the feedback and pre-marketing stages of an IPO, the whole timetable has shifted with information being made available much sooner.

Attendance at prospectus drafting sessions

As regards attendance by bankers at prospectus drafting sessions, it was noted that:

- Compared with drafting sessions for analysts' and other presentations which all bankers routinely attend, there have been instances of reduced attendance at some prospectus drafting sessions.
- Investment banks require their bankers to be fully engaged and attending prospectus drafting sessions. It was acknowledged that there is mandatory internal training to ensure that bankers are aware of the importance of (i) due diligence and knowing their client or the selling company, as the case may be, and (ii) the prospectus as being vital for proper disclosure, good marketing and risk mitigation for issuers, sellers, underwriters and investors.

Unicorn companies

As regards privately held startup companies valued at $1 billion or more, commonly known as unicorns, it was noted that:

- There was a growing number of unicorn companies generally but also a growing trend in unicorns opting to seek private investment, instead of pursuing an IPO.
- In 2019, there were a number of high-profile failed IPOs by unicorns.

- Whereas previously such companies were technology companies primarily based in California, they now operate in a variety of sectors including healthcare, financial services, telecommunications and retail and are based across the US, as well as Germany, the UK and China. Indeed, China is thought to be an area to watch, especially as the valuations of Chinese unicorns are generally bigger than those in the US.
- Unicorns often have a strong brand, accompanied by a charismatic and entrepreneurial founder. It can be very hard to change the culture of these companies and the individuals at their helm can often be a blessing as well as a curse. Corporate governance compliance can, therefore, be an issue for these companies wishing to launch an IPO, especially as investors are becoming ever more discerning, sceptical, rigorous in their decision-making and critical of companies that do not meet standard corporate governance expectations.
- Bankers and advisers to unicorns should work together to manage such companies and ensure that corporate governance expectations are explained and understood very early on in the IPO process. This can be difficult and there may well be a conflict between wanting to get the deal done and making sure that it is credible.
- In some circumstances, an IPO may be purely driven by one charismatic founder and there may not be a need for the unicorn to actually raise any funds. If this is the case, as an alternative to an IPO, the company could consider pursuing a direct listing (see *Direct listings*).

Direct listings

As regards direct listings, that is a listing of a company where there is no accompanying IPO or fundraising (historically referred to as an introduction and admission to listing), it was noted that:

- Although it is unlikely that there will be a significant number of direct listings in the UK in 2020, it is thought that there may be developments in the regulatory landscape relating to direct listings.
- From a company's perspective, if it does not need an equity injection but wants liquidity, it may wish to direct list to reduce the risks of an offering to the public in a jurisdiction where, if things go wrong, it could end up in an expensive law suit, for example, the US. A direct listing could also shorten the timetable, as the banks would not undertake any marketing, placing or underwriting and there would be no research. The UK IPO reforms would not apply (see *UK IPO reforms*).
- There is still a major role for banks on a direct listing (for example, as sponsor and financial adviser), however it was acknowledged that only a limited number of banks would need to be involved, much reduced by comparison to many IPO underwriting syndicates. The banks involved would expect that, initially at least, the trading in the company's shares post listing would be effected through them.
- From a bank's perspective, a direct listing is far less risky than an IPO but there are still reputational risks and potential legal risks associated with it and so the amount of due diligence that a bank would want to carry out would be similar as for a company pursuing an IPO.
- The challenge for a company wishing to direct list is that its shares must be sufficiently widely held prior to listing, with enough private trading to establish a price.
- Although direct listings are a useful mechanism, it is not thought that they will ever replace, or materially reduce the number of, IPOs.

Private placements

As regards private placements, whereby shares are sold through a private, as opposed to a public, offering, it was noted that:

- Although the practice of private placements is very established in the US, private placements are not very common in the UK and there is no well-trodden equivalent to a US-style private placement in the UK. Nevertheless, recently there has been an increased demand for private placements in the UK, particularly from private wealth investors and sovereign wealth funds, and this is thought to be partly in response to the lack of ECM deals to invest in.
- Whereas historically a private placement involved two or three new strategic investors, the recent trend has been to increase that number, with early stage outreach often involving contacting up to 20 or more. This has, however, frequently resulted in difficult price discussions and a long-drawn-out process, with often the only solution being for a white knight investor to emerge and offer to buy the whole stake. It seems, therefore, that the tide may turn again, as investors are discovering that they need a meaningful stake for them to want to invest and a small interest with 20 or 30 others is not ultimately so attractive.
- As private placements are effectively similar to an M&A deal, non-strategic investors in private placements need to be educated on the process and the differences to ECM deals, and to accept the signing of strong investor rep letters as per standard market practice in the US.

Technology in capital markets

As regards digital assets and technology in capital markets, it was noted that:

- While technology in capital markets may not yet be fully established, it is only a matter of time. Some large institutions have already started using block chain technology for settlement purposes.
- Cryptoassets, including tokens and pre-tokens on initial coin offerings (ICOs) and initial exchange offerings (that is, offerings administered by a crypto exchange) (IEOs), are constantly evolving and they are understood to be areas of focus for US, EU and UK regulators. As a result of the risk of fraud, the general lack of investor protection and impact on market integrity associated with cryptoassets, they are likely to be increasingly regulated and, indeed, in December 2019, the Commission published a *consultation* seeking views on the suitability of the existing regulatory framework for cryptoassets (see *Legal update, European Commission consults on framework for cryptoassets*).

For more information, see:

- *Article, FinTech series: blockchain (September 2017)*.
- *Article, Initial coin offerings: the good, the bad, and the ugly (March 2018)*.
- *Practice note, FinTech: EU financial services regulatory overview*, which includes sections on *Blockchain and distributed ledger technology (DLT)* and *Cryptoassets and ICOs*.

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