THE
INVESTMENT
ASSOCIATION

TRANSACTION GUIDELINES

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Registered office: The Investment Association
65 Kingsway, London, WC2B 6TD
The Investment Association is a company limited
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Following the merger of ABI Investment Affairs with the IMA on 30th June, 2014, the enlarged Investment Management Association (IMA), which was renamed The Investment Association in January 2015, has assumed responsibility for guidance previously issued by the ABI.

This guidance sets out the expectations and views of The Investment Association's members as institutional investors on various aspects of equity capital market transactions. These views build on the key recommendations published in the ABI's 'Encouraging Equity Investment' Report, July 2013, and 'Improving Corporate Governance and Shareholder Engagement', July 2013.

The guidance below is structured under the three headings of "Initial Public Offerings" (IPOs), "Secondary Offerings", and "Corporate Governance during Corporate Transactions".

1. INITIAL PUBLIC OFFERINGS (IPOs)

1.1 Syndicate Size

Syndicates provide the required access and distribution to an investor base, which will ultimately make up a stable shareholder register for a company undergoing an IPO. Maintaining a balance between achieving depth of distribution to a wide range of investors and avoiding duplication of investor opinion from across and within the various categories is essential to an efficient IPO process.

1.1.1 The Investment Association believes that, as a rule of thumb, no more than three book-runners should be appointed for large transactions (i.e. above £250m excluding any over-allotment option). Below this issue size, there should generally be no more than two book-runners.

1.1.2 Issuers should ensure that any additional members of the syndicate are included based on their sector expertise or distributional reach.

1.1.3 We discourage the inclusion of syndicate members who are present solely on the basis of past or future services to the issuer or vendors. Nonetheless, we acknowledge that vendors and/or companies may occasionally need to appoint more banks to the syndicate due to on-going relationships. In these instances, companies should clearly specify the roles and responsibilities of each syndicate member, including those with entirely passive roles in relation to the transaction.

1.1.4 Issuers, with the assistance of independent advisers if appropriate, should scrutinise the allocations carefully, to ensure that shares are being distributed to those most likely to be long-term shareholders.

1.1.5 We encourage issuers and vendors to consider including a retail tranche when listing in the Premium segment.

1.2 Fees

IPO fees in the UK vary widely depending on a number of factors, including size of issue; size of company; identity of vendor; complexity of the transaction; likely breadth of distribution;

and desirability of mandate. There remains amongst new investors at the IPO a significant concern with the overall level of fees.

1.2.1 There should be, as a matter of good practice, greater disclosure in the prospectus of all the fees paid for an IPO, including the maximum incentive fee, if any. This should include a breakdown of fees as a percentage of the size of the offering, and those fees that are independent of size, such as, but not limited to, independent advisers', lawyers' and accountants' fees. Syndicate members' individual fees should also be disclosed.

1.2.2 The final determination and payment of incentive fees in an IPO should be made either at the release of the first quarterly results of the issuer as a listed company or three months after listing (whichever of the two events occurs later). The amount paid should be disclosed to the market at the time of award.

1.2.3 The following criteria should be taken into consideration when awarding the incentive fee:

- the stability of the share price in the newly listed environment;
- the allocation of the shares of the issuer to a predominantly long-term shareholder base, as evidenced by the stability of the share register in the aftermarket;
- the extent and quality of the syndicate research both during and after the IPO, in the eyes of the investor; and
- the continuity of research coverage post IPO.

1.2.4 A mechanism should be established for investors to give input into the allocation of the incentive fee, but on an anonymous basis.

1.3 Prospectus

Market views on prospectuses include that they:

- are too detailed to be understood by retail investors;
- contain too many generic or boiler plate risk factors that obscure the most important risks and opportunities; and
- are too time consuming to fully consider, given the short time between the Pathfinder prospectus being issued and investors' meetings with management as part of the roadshow, resulting in some investors feeling ill-prepared for the company meeting.

1.3.1 We are strongly supportive of the UKLA's aim to reduce the amount of generic information in the prospectus. We encourage issuers, their Sponsors and lawyers to work with the UKLA to provide a document that is more succinct in providing the important information relevant to an investment decision.

1.4 Sponsor Regime

The Sponsor regime is fundamental to ensuring the effectiveness of the Premium equity market by:

- considering whether an issuer is suitable for admission and that admittance will not be detrimental to investors' interests;

- ensuring that issuers seeking a Premium listing understand the regulatory framework that they operate in; and
- providing the UKLA with assurance that the relevant rules have been complied with and that the issuer has established appropriate procedures and therefore meets the UKLA's eligibility criteria.

1.4.1 The Investment Association's members as institutional investors therefore expect:

- clarity on the role of the Sponsor in an IPO process so that the appointment is clear to market participants and distinguishable from the role of the lead book-runner(s);
- Sponsors to consider including an institutional 'stamp of approval' in relation to the suitability of the company for listing;
- any potential conflicts of interest that may arise if a Sponsor is also one of the lead distributors of an IPO, and so may be conflicted if there are any contentious issues with the company, to be managed and mitigated; and
- the Key Adviser for issuers who seek a flotation on the High Growth Segment of the Main Market should already be an approved Sponsor under the UK Listing Rules.

1.5 Role of the Independent Adviser

In recent years, there has been an increase in the use of independent advisers ("IAs"). IAs are typically appointed by management teams or vendors who have limited, or less frequent experience of equity capital markets, or require extra resources to help them through the process.

Investors typically have limited contact with the IAs as part of the IPO process. However, they value the importance of a well-run syndicate and proper flow of information.

1.5.1 IAs should ensure that a syndicate is well managed; that the right information and advice is provided both to and by the issuer; and that the syndicate and issuer's interests are protected.

2. SECONDARY OFFERINGS

2.1 Underwriting Capacity and Fees and Discounts

There is sufficient primary and sub-underwriting capacity in the UK market. However, capacity from traditional sub-underwriters in the UK has fallen. Most parties agree that the split of risk and the reward for taking such risk between primary and sub-underwriters could be improved. Greater transparency and unbundling of fees will lead to greater reconciliation of risk with reward.

2.1.1 Companies should use deep discounts in rights issues in order to reduce the level of underwriting fees paid to both primary underwriters and sub-underwriters. They are also encouraged to reduce primary underwriting fees where possible, by getting firm undertakings from sub-underwriters before announcing the transaction.

2.1.2 The gross spread for rights issues and open offers should be unbundled, so that the amounts for advice, including document preparation, primary underwriting and sub-

underwriting are shown separately. These unbundled fees should be fully disclosed in the offering documents, along with disclosure of other rights issue related fees including, but not limited to, lawyers, accountants and independent advisers.

2.1.3 Investors would like to see disaggregated disclosure as a matter of best practice, despite there being no legal requirement for the disclosure of disaggregated fees.

2.1.4 Tendering for both primary and sub-underwriting should be pursued only if the unbundling of fees does not lead to a lowering of the overall fee levels.

2.1.5 We encourage both the buy-side and the sell-side to develop standard sub-underwriting agreements. This will help make the sub-underwriting process more efficient, particularly if institutions are engaged ahead of announcement, which in turn should result in a reduction in overall fees.

2.1.6 The aggregate fees charged, and the discounts to the mid-market price at the time of agreeing the placing, should be disclosed in the pricing announcement for non-pre-emptive placings.

2.2 Timetables

There are two parts to a timetable for pre-emptive issue:

i. Private: before the transaction is publicly announced
ii. Public: the period after announcement in which any general meeting and the offering will take place

2.2.1 Efforts should be made to shorten a pre-emptive timetable even further by examining ways to eliminate the physical distribution of documents and reducing the time needed by custodians to enact their clients' instructions to exercise.

2.2.2 We encourage the UKLA to investigate the feasibility of introducing a fast-track review process for time critical offerings. Issuers should expect to pay higher fees for any extra resources needed for the UKLA to provide this service.

3. CORPORATE GOVERNANCE DURING CORPORATE TRANSACTIONS

The Investment Association believes that non-executive directors are crucial to good governance; we are recommending structural measures to ensure that non-executives can maintain and assert independence during corporate transactions.

3.1 Corporate Transactions and Independence

In the context of a transaction, it is particularly important that non-executives are able to exercise their function of independent challenge effectively. Independence is more than the nature of the non-executive's connections with the company and extends to avoiding circumstances (which may involve a deficiency in internal structures and procedures) which may undermine, or appear to undermine, the ability of non-executive directors to act independently.

3.1.1 Non-executive directors should be given sufficient time and information to give proper consideration to the merits of the transaction in question, as well as the opportunity to provide their views to shareholders when they are first made insiders. This will help to balance the need for the provision of sufficient information to shareholder with the desire to maintain secrecy before announcements and avoid false markets.

3.1.2 Executive directors should inform the appropriate non-executive director of the proposed transaction when an approach is received from a possible bidder or management first actively considers a transaction in respect of which a shareholder approval is to be sought.

3.1.3 The non-executive directors should be provided with a narrative description of discussions between the company and the transaction counterparty and this narrative should be disclosed in summary form in the circular to shareholders.

3.1.4 Non-executive directors should be given direct access to financial and legal advisers to the company on a transaction in order to ensure that information can be rapidly obtained and understood.

3.1.5 We encourage the practice for non-executives, both regularly and in specific circumstances, to have discussions without the executives present. When considering a transaction, the non-executives' group should confirm to the Chairman, prior to publication of any circular or recommendation to shareholders, that they are satisfied they have received sufficient time and information.

3.1.6 Non-executive directors should consider whether it is appropriate to seek separate, independent advice on the merits of the proposed transaction. In these instances, the adviser should be paid on a fixed fee (as opposed to a 'success' or 'incentive') basis.

3.2 Independent Committees

Where a company is subject to a management buy-out or similar transaction, or engaging in a transaction with a controller or a group of controllers, or where a conflict may otherwise arise, a special independent committee comprising only un-conflicted directors should always be formed to consider the transaction.

3.2.1 The committee should always take independent financial and legal advice. It is not acceptable for a 'Chinese Wall' to be established within the existing advisers to the company.

3.2.2 Independent committees formed to consider a transaction should ensure their mandate is clear and is disclosed in any circular to shareholders or annual report, as is currently required. The mandate should normally extend to considering the terms of the transaction and whether the transaction itself (as opposed to the other courses of action) is in the best interests of the company and shareholders as a whole.

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