Clear Capital™

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Dear Christina,

Firstly, thank you for speaking with refreshing candour at the inaugural meeting of the European Association of Independent Research Providers.

After the panel session on the 20th we briefly discussed the issue of pre-IPO access, and agreed that I should write up my observations. The intention here is to highlight the issues, and if you see some validity, we can make a more comprehensive and formal submission from the European Association of Independent Research Providers.

At the meeting, the Commission, the AMF and the FSA were questioned on this issue of facilitating access for objective research in the pre-IPO phase. Mr McGreevy said he could see the merits of this, but indicated that there was no intention for the Commission to act at this stage. Jean de Demandolx Dedons was understandably the most sympathetic to the issue, given the recent AMF report - "Pour Un Nouvel Essor De L'analyse Financière Indépendante Sur Le Marché Francais" (27th June 2005) – which recommends that there be independent financial analysis in parallel to that of the banking syndicate involved in the distribution of shares, at the time of IPOs or if any company is involved in a significant share issue or capital raising exercise. You indicated during the panel session that the necessary information should be contained within the prospectus itself, but following our more detailed conversation after the panel session you suggested the issue may merit consideration.

As the IPO market has picked up, in particular on AIM, so the issue of IPO quality, pricing and research has become more important again. There have been a number of high profile examples of recently floated companies falling dramatically in the first quarter or so after IPO, as new information has come out.

The responsibility for due diligence rests with the investment bank/banks bringing the company to market, and the fund managers themselves. The failure however is that the incentives for the investment bank are so commercially significant, that there is immense pressure to proceed with as many IPOs as possible, and “due diligence committees” rarely veto them. That leaves fund managers. Clearly they do go through considerable due diligence. However, they are under time pressure, and more importantly, they sometimes lack, or at least struggle to obtain, sufficient objective information to base their decision on. You suggested that the pathfinder contains all the necessary information. Whilst it is unquestionably a comprehensive and important document, it serves a different purpose, and whilst the information is useful, the disclaimers are given considerable prominence. Also, if it did fulfil the purpose entirely, we as Clear Capital would not experience demand for pre-IPO research. In reality there is more demand for pre-IPO research than any other type. The reason is that research serves a distinct function. It provides a summary of the key information, opinions on the merits and valuation of the new issue, management track record, and raises questions that fund managers need to ask management.

Without the thousands of inputs that determine a market price, new issue pricing is based on a valuation range established by the issuing investment bank, whose incentives are aligned with the company in seeking to achieve as high a price as possible. Clearly there is debate, and the ranges can and do come down, but fund managers need a diversity of inputs during this process, including objective research, which helps determine a fair price for the issue.

We have discussed this repeatedly with many clients, and several have stated that they are willing to participate in discussions with the FSA on the issue, as they see it as a serious failure of the current IPO market that it is near impossible to get objective research and analysis in the pre-IPO phase. Fund managers want unconflicted analysts to be provided access to information much earlier in the IPO process to ensure that they can help with insights during the pricing process. I have attached a recent think tank report that highlights how fund managers value independent research on new issues (3.1).

The pre-IPO phase is extremely difficult for fund managers given that the available research comes from the conflicted banks bringing the company to market.

What we are proposing is more equal terms for non IPO syndicate research firms, either independent or other investment banks not involved in the IPO. We suggest that unconflicted firms be permitted:

- Access to the prospectus within an appropriate timeframe so that alternative research can be produced in the pricing phase;
- Access to management

The investment banks bringing the company to market would not be permitted to restrict access, as they currently do.

One of the arguments sometimes presented to counter our suggestions, and cited by Mr McGreevy as a concern, is the issue of access to information during the pre-IPO phase compromising independence. This is not the case. Independence is compromised when there are conflicts within incentive structures. All we are looking for is fair access to information earlier in the process, just as institutional fund managers receive, so that we can properly perform our role as advisors to these fund managers. Access to a prospectus and management compromises us no more than reviewing annual reports and meeting management teams of companies already listed.

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I hope this letter outlines some of the issues. Please let me know your thoughts, and the merits of a more comprehensive submission from the Association. We recognize that the FSA is working on bedding down considerable changes in regulation at present, and formal consultations take time, so we would be happy to help arrange some informal discussions with a mix of market participants (including major institutional fund managers) to initially share ideas on this subject.

Yours sincerely,

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Managing Director