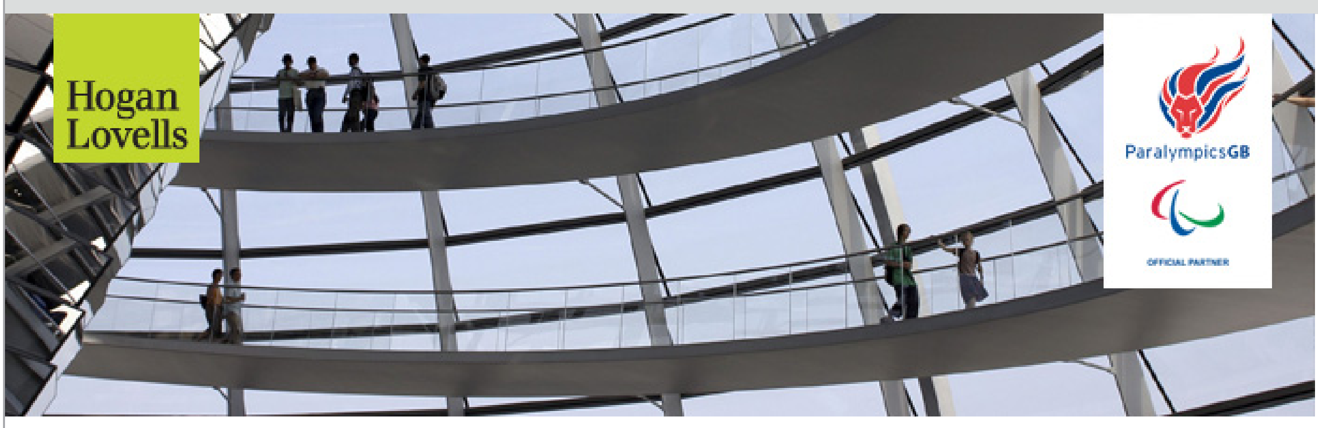

FCA publishes package of measures to ensure effective competition in the investment banking sector

On 18 October 2016, the Financial Conduct Authority (FCA) published its final report of its Investment and corporate banking market study (Market Study) and set out a package of measures designed to enhance competition in the market.

Scope of the Market Study

In April 2016, the FCA published its interim report of the Market Study. The report looked at the effectiveness of competition in primary market activities in the UK, being equity capital market, debt capital market and mergers and acquisition services. Following consultation, the FCA confirms that its interim findings are final and proposes a package of measures to address its concerns.

What are the measures?

- **A ban on restrictive contractual clauses in engagements letters and contracts**. Banks must 'compete on the merits', rather than restricting choice for clients - and consequently, the FCA sees no justification for the use of restrictive contractual clauses over future client services. The proposed ban will prohibit the use of 'right of first refusal' and 'right to act' clauses relating to *future* corporate finance services carried out from a UK establishment. However, the ban will not extend to future services relating to bridging loans - as practically, it would be difficult for a bank to agree to provide a bridging loan if it did not know that it would be mandated on the subsequent long term financing. Warehouse facilities will also not be subject to the new prohibition and will be covered by the definition of a 'bridging loan' in the new rules. The FCA considers that these facilities, which are used to finance the origination of new assets (such as mortgages), have similarities to bridging loans as both are designed to provide short term financing on the assumption that the original facility will be financed by a capital markets transaction.

- The FCA has published a consultation paper on the proposed prohibition and responses are requested to be submitted by 16 December 2016. The new rules, which will be included in the Conduct of Business Sourcebook (COBS), are expected to be published in early 2017. Note that the prohibition will only apply to contracts or engagement letters entered into after the rule comes into force – existing engagements letters and contracts will not be affected.

- **Ending league table misrepresentation in banks' pitches to clients.** There is concern that some banks may present league tables during client pitches in a way that inflates their own position. The FCA is working with the BBA and AFME so that they can adopt industry guidelines to improve the way that this information is presented.

- **Removal of incentives to conduct loss-making deals to climb league tables.** The report notes that some banks may undertake loss making transactions in order to climb league tables. This practice distorts league table rankings and impacts on consumers' ability to make informed choices when instructing banking services. The FCA has asked league table providers to consider whether their recognition criteria can be improved to reduce incentives for banks to undertake these practices.

- **Supervisory work on IPO allocations.** In April 2016, the FCA published its Occasional Paper 15 'Quid pro quo? What factors influence IPO allocations to investors? (updated on 18 October 2016 to include further robustness checks in its analysis). The paper sets out the FCA's findings from its review of the transparency of the allocations process on equity issues. The FCA found evidence that syndicate banks make favourable allocations to investors who provide them with information which is likely to be useful when pricing the IPO. There was also evidence to suggest that bookrunners make favourable allocations to investors who also generate the greatest revenues from the banks' other business services (for example, through trading commissions). In the run up to the implementation of MiFID II, the FCA will carry out work with firms identified as having shortcomings in their allocation policies and practices so that they are able to comply with existing regulatory requirements and those requirements that will be introduced under the MiFID II delegated regulations.

- **Improvements to the IPO process.** In April 2016, the FCA published a discussion paper, Availability of information in the UK Equity IPO process which discusses the timing and sequencing of information flow in the IPO process and whether there is scope for improvement. Amongst other things, the FCA looked at the market practice of the 'blackout period' which is the period between the publication of connected research by syndicate banks and the distribution of a pathfinder prospectus. The FCA found that this practice (which results in both the pathfinder and the approved prospectus being made available late in the process), together with a lack of access to the issuer's management, meant that there was insufficient information provided to independent research providers and consequently, investors only had access to connected research during a crucial stage of the IPO process. In the Market Study, the FCA highlights its concern that syndicate analysts, who are connected to the deal, may be influenced by corporate finance advisers and consequently, there is a risk that connected research is biased. In its Market Study, the FCA notes that it will address this concern in its ongoing work on the IPO process. The FCA expects to publish a consultation paper with policy proposals in late 2016 / early 2017.

Overshadowed by Brexit?

The FCA has designed a package of remedies to boost competition in the market, particularly for the benefit of smaller firms and clients. Any impact of these measures is likely to surface in the medium to long term – but it may be distorted by the effects of an impending Brexit which may have a more significant effect on how firms provide primary market activities in the UK. The FCA acknowledges that Brexit may affect the competitive dynamics in the markets investigated in its Market Study and notes that it will continue to monitor the markets over the coming years.

If you have any queries on the FCA's review of the investment and corporate banking sector or on its work on the IPO process, please contact your usual contact at Hogan Lovells or one of the listed contacts.

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