FINANCIAL NEWS

Writing is on the wall for a bank oligopoly

By Michael Hufton, 27th October, 2014

Since the Financial Conduct Authority came into existence in 2013, its initials have been blazoned proudly on the wall inside the entrance to its headquarters in Canary Wharf in east London.

While passing through reception, the occasional visitor may have wondered: “Why is the C a different colour in the logo?” For the first year, the answer would have been easy: “It’s a spotlight on conduct.”

This summer, things got more complicated. A second C was strung onto the FCA’s bow - competition – and in the last six months the spotlight on wholesale competition has been no less piercing, yet many in the City have not appreciated the extent of the regulator’s new remit. That is about to change.

Firmly in the FCA’s sights is investment banking. Its latest consultation, “Wholesale sector competition review – Call for inputs” closed on October 9. The gun is being loaded. The FCA has clearly signposted that it thinks there are uncompetitive practices in investment banking.

At the end of September, the FCA hosted a roundtable at its Canary Wharf offices for an invited audience of 15 of the top investment banks. On the agenda were a number of different issues, all of which affect competition in the industry. These included the bundling of liquidity with other services, equity underwriting and debt issuance, client order execution andcorporate banking.

The problem was that while the FCA had a team of investigators asking the questions, the industry sent, not practitioners, but compliance officers programmed with the “everything is fine” message. It didn’t wash.

The wholesale markets have not woken up to the fact that the FCA intends to break open this market and promote competition, forcibly if necessary.

A moment of background. From the dotcom crisis of 2000 the UK corporate broking market morphed from a retainer model to a “free” model where fees for mergers and acquisitions and underwriting are subsidising corporate broking investor relations services offered at no charge.

Nowhere else in the world does it like this.

There is no such thing as a free lunch, of course, and the end result is the market distortion the FCA has now spotted. We got here because investment banks have been competing so fiercely with each other that they have created an anti-competitive oligopoly that crowds everyone else out of an entire market segment. The result is a lack of innovation and ultimately a mummified service.

The FCA's wholesale competition review paper lines up the targets. The paper requested submissions on (and I quote): "Exploitation of market power including exclusionary behaviour. Barriers to entry. Barriers to switching. Problems in the flow of information, and/or principal/agent problems and conflicts of interest." Everyone in the City and many in corporate boardrooms will recognise some or all of these issues, so it is safe to assume that there is a storm coming.

Looking behind the scenes, it is clear why competition is such an important issue to the FCA. "Spend clients' money as if it were your own," is the new buzz-phrase from the regulator, and the whole financial services industry is under scrutiny to control and cut costs. Focusing on the anti-competitive practices in investment banking that have led to a stifling of innovation and created barriers for alternative players wanting to enter the market offering a lower cost service than the banks is just the start.

In order to keep on the right side of the FCA, the investment banks will need to review their business models – bundling in particular. No easy task, and one they do not seem keen to grasp. How far the FCA will go to prise open the oligopoly and ensure that the benefits of a competitive market are available to UK investor relations teams and flow through to end investors remains to be seen. Whether by a little or a lot, practices will need to change. The battle lines are being drawn.

Michael Hufton is the founder of ingage, an independent corporate access business.

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