FINANCIAL NEWS

Banking heavyweights must brace for more competition

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Should investment bank bosses be lying awake at night worried their businesses could be upended by disruptive new rivals? Might they suddenly find the equivalents of Google, Apple or Amazon threatening their very existence?

Until recently, the incumbents have seemed fairly relaxed about the prospect. Sure, they had a long list of things to worry about. But upstarts eating their lunch was nowhere near the top.

It is possible to detect a bit more concern now, however, not least because regulators are keen to encourage the disrupters.

The latest example is the Financial Conduct Authority, which has just revealed the terms of reference of its study into competition, or lack of it, in investment banking. The feeling in Whitehall, if not yet in the City, is that the results could be very significant.

The regulator, with its remit recently extended to include stamping out anti-competitive practices, wants to look at the provision of primary market services, such as handling equity and debt issues or advising on deals. The FCA is worried that the market is not as competitive as it seems.

Not competitive, squeal the bankers? It is so cut-throat you can practically see the blood in the water around Canary Wharf. It is certainly hard to think of an industry where there is a greater battle for market share. JP Morgan, which pipped Deutsche Bank to grab the investment banking fees crown in Europe last year, had a market share of just 7.6%. Hardly a stranglehold.

Yet the FCA fears that the number of players could be deceptive and it must be said there is little evidence of fierce competition on price. The fees banks charge for most primary services have proved remarkably sticky. True, some services are given away cheap or even free. But for the FCA, this is a cause for concern, not celebration. When it comes to competition, you don't want prices to be too high, or too low.

There is a parallel here with retail banking, where competition experts say the UK tradition of free in-credit banking – under which solvent customers are subsidised from the overdrafts charges of the less flush – is a problem because it makes it difficult for new entrants to break into the current account market.

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The FCA points out that many investment banking products are sold in a bundled package, without transparent pricing, which could lead to lack of competition in some of the services. The regulator wants to know whether customers would get a better deal if they shopped around for specialist providers rather than buying lots of services from one long-standing supplier.

Smaller clients unhappy

These questions strike at the heart of the universal bank model, pursued by the likes of JP Morgan, Deutsche Bank and Barclays. This aims to build broad, long-term relationships with customers, hooking them with some keenly-priced products – such as the provision of credit – to sell them more lucrative investment banking services.

But this is exactly what most customers want, reply the banks. And those customers are sophisticated enough to know what they are getting. In any case, there is nothing wrong with bundling in principle – think of the set menu in restaurants. Forcing suppliers to price items individually would simply push up the total bill, bankers warn.

The banks are right that their large corporate customers are not up in arms. But smaller companies, as represented by bodies such as the Association of Corporate Treasurers, do express concern about bundled services and lack of price transparency. And the FCA is listening.

Introducing such transparency can dramatically change the landscape. Just look at what is happening in equity research now that regulators are forcing the industry to make clear the costs of a service that previously had hidden charges.

Or consider the growth of Ingage, a service set up two years ago by a former fund manager, Michael Hufton, that arranges meetings between companies and investors. Traditionally this was handled by brokers from the big banks for "free". But Ingage has signed up some of the world's biggest fund managers and half a dozen FTSE 100 companies prepared to pay for what Hufton says is a better and less conflicted service.

That growth would have been considerably faster with more regulatory intervention, says Hufton, who describes the banks as an oligopoly that the FCA clearly intends to bust up. Other areas the FCA wants to explore are the initial public offering process, including the use of large syndicates, potential conflicts in allocations and the role of independent advisers. Quite rightly, the FCA also wants to explore the extent to which new entrants might face "significant barriers arising from the current regulatory environment".

Joined-up regulation

The banks have some justifiable concerns about the FCA competition study that go beyond sheer regulatory fatigue. They point out that some of the issues are also being looked at by other UK and European studies, including the Fair and Effective Markets Review into the operation of the fixed income market. They urge the FCA to ensure the efforts are joined up. They also warn of the danger that the FCA may take unilateral action that would damage London's attractions as a capital markets centre.

It is true that there may be more pressing issues to be examined in other sectors such as asset management. And there is no doubt that London has among the most competitive primary markets anywhere in the world, certainly compared with New York. But saying that things are worse elsewhere tends not to be a winning argument for sticking with the status quo in finance these days. In any case, there are a number of idiosyncratic UK practices, such as the corporate broking model, that are worth examining.

Some world-weary City folk point out that many of these issues have been looked at before. But none has been examined by a financial regulator keen to flex its new competition champion muscles. The big banks would be well advised to take this very seriously and be prepared for real change. Otherwise they should expect a few more sleepless nights.