

Investment and corporate banking: prohibition of restrictive contractual clauses

Policy Statement

PS17/13

June 2017



This relates to

Consultation Paper 16/31
which is available on our website at
www.fca.org.uk/publications

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1 Overview

Introduction

- 1.1** We are publishing Handbook rules banning the use of clauses that restrict a client's choice of future providers of primary market services (debt capital market (DCM) services, equity capital market (ECM) services and merger and acquisition (M&A) services).
- 1.2** With effect from 3 January 2018, firms will be banned from entering into agreements with a provision that gives them a right to provide future primary market services to their clients. The ban excludes future service restrictions in bridging loans – a type of loan that is provided on the expectation that the client will replace it with longer-term financing, typically a bond issue, an equity issue or a term loan.
- 1.3** Except in the case of bridging loans, we have not identified any clear benefits to clients from these clauses. We believe banning them will provide clients with greater choice of providers for future services, as well as more competitive terms. We want to see firms competing on the merits of their services and terms rather than restricting clients' choice.
- 1.4** This rule is being introduced as a result of the findings in our market study of Investment and Corporate Banking¹. We published our final report in October 2016. Most primary market service providers follow a 'universal banking' model, which involves the cross-selling and cross-subsidisation of services. Banks and advisers seek to establish relationships with clients, mainly by providing corporate broking and corporate lending, expecting to cross-sell further services such as ECM, DCM and M&A services.
- 1.5** Many primary market clients, particularly large corporate clients, feel this model works well. However, we were concerned that some clients, especially smaller clients, face pressure to reward their relationship/lending bank or corporate broker with future primary market services even where they might be better off with an alternative supplier. In particular, firms use clauses in contracts, mandates or engagement letters that seek to restrict a client's future choice of supplier ('Restrictive Clauses'). The most restrictive types of clauses are:
- 'Right to act' clauses which give the right to provide future primary market services to the client, and
 - 'Right of first refusal' clauses which give the right to provide future primary market services to the client before the client is able to accept any offer from a third party to provide those services.

1 www.fca.org.uk/publications/market-studies/investment-corporate-banking



- 1.6** We found that 86% of firms in our sample had used such clauses at least once in 2014 and 2015. These restrictive clauses were used by 43- 75% of the providers, depending on the service. We were told of three instances where clients had accepted such a clause and had to pay a penalty for breaking the clause. One firm told us that in two of these cases the clients had not been aware that they had accepted such a clause in the first place.
- 1.7** We concluded that these types of clauses, whether technically enforceable or not, can restrict a client's choice in future transactions and may as a result hinder effective competition in the interest of those clients.

Who does this affect?

- 1.8** The ban will affect firms that provide primary market services and clients of these firms.

Is this of interest to consumers?

- 1.9** The ban does not have a direct impact on retail consumers as corporate clients are the recipients of primary market services.

Summary of feedback and our response

- 1.10** We published our proposed rule changes in CP16/31. We received eight responses to our consultation. These responses were from firms and trade bodies. They primarily focused on the scope of the prohibition – specifically which services and what geographic location of clients or firms should be subject to the ban. Particular attention was also given to the definition of a bridging loan, a type of arrangement that we proposed should be excluded from the ban.
- 1.11** We have considered stakeholder feedback and outlined our response and final rules in this document.
- Annex 1 lists the names of non-confidential respondents.
 - Appendix 1 sets out our final rules.

Equality and diversity considerations

- 1.12** We have considered any equality and diversity issues that may arise from the proposals in this Policy Statement (PS).
- 1.13** Overall, we do not consider that the proposals in this PS adversely impact any of the groups with protected characteristics i.e. age, disability, sex, marriage or civil

partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

What do you need to do next?

- 1.14** The final rules come into effect for agreements entered into after 3 January 2018. If your firm is affected by these changes, you need to ensure procedures are in place to ensure that you do not enter into these types of clauses in any written agreements with clients. This could include amending your templates for contracts and engagement letters, and updating any guidance, policies and training around the terms that you are able to agree with clients.

What will we do?

- 1.15** We have developed this policy in the context of the existing UK and EU regulatory framework. We will keep the policy under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.
- 1.16** We will monitor, as appropriate, the adequate implementation of the ban. We also remain open to extending the ban to other wholesale market services if we see evidence that the clauses are being used to the detriment of clients for such services. Firms should be clear that we will not tolerate restrictive clauses that adversely affect competition and are not clearly beneficial to clients.



2 Our response to consultation feedback

- 2.1** In CP16/31, we sought views on our overall approach of banning the restrictive clauses, and on discrete issues around scope, design and drafting of the rule and guidance. We were also keen to understand whether stakeholders agreed with our cost benefit analysis (CBA).
- 2.2** This chapter is structured according to the consultation questions. We consider:
- Our decision to introduce the ban
 - The scope, design and drafting of the rule and guidance
 - The CBA
- 2.3** We summarise below the views received from the eight responses to our consultation and we set out our response to these comments.

Our decision to introduce the ban

- 2.4** In CP16/31, we asked whether respondents agreed with our proposal to introduce the rule to ban restrictive clauses, and if not, what we should do as an alternative.
- 2.5** While some stakeholders agreed with our approach, others did not. Of those who agreed, one respondent stated that restrictive clauses may prevent clients from appointing the firm that is best placed to provide either the highest quality or the lowest cost service. The respondent said that smaller corporate clients in particular may feel unable to negotiate such clauses and could feel forced to reward a lending bank or corporate broker by appointing them, even where they would not have done so otherwise.
- 2.6** Among those that disagreed with our proposal, a recurring theme was the perceived risk to the competitiveness of UK-based investment and corporate banking service providers against their international counterparts, mostly due to the international dimension of the investment banking industry.

Our response

We confirm our intention to proceed with the proposed ban. We do not believe the arguments raised are compelling enough for us to change our position on the merits of the ban, in particular, for smaller corporate clients. The arguments on competitiveness were raised in high-level terms and did not provide specific or tangible evidence of the potential negative effects that these reforms would have on UK firms' ability to compete for business. In addition, as we had observed no evidence of these clauses providing benefits to clients, we did not agree that the loss of these clauses would reduce the competitiveness

of UK banks against non-UK banks. We consider the issue of competitiveness further below when discussing the geographic scope of the ban.

Scope, design and drafting of the rule and guidance

2.7 In CP16/31, we asked for views on the scope, design and drafting of the rule and guidance. The comments we received focused primarily on specific features of the ban, the types of services in scope and its geographical reach.

2.8 We consider each point in turn:

- Which types of clauses should be banned?
- Whether any types of clients should be exempted?
- Which types of services should be banned?
- How should bridging loans be defined?
- What should be the geographic scope of the ban?
- What time period should be given for implementation of the ban?

Which types of clauses should be banned?

2.9 We proposed to apply the ban to any arrangements containing restrictive clauses. Most respondents commented that the ban should apply only to future service restrictions in *written* agreements because otherwise compliance costs would be disproportionate and it might have an adverse impact on legitimate discussions with clients.

2.10 We said that the ban would apply to restrictive clauses covering unspecified future services (e.g., in an engagement letter for an initial public offering (IPO) the right to act on/provide M&A advisory services, should the client need them in the next 24 months). Some respondents suggested that the apparent 'exceptions' for 'specified' and/or 'certain' transactions should be clarified because there may be uncertainties around the edges of what could be considered as 'specified'/'certain' future services, particularly in relation to the terms and scope of the future services.

2.11 We said that restrictive clauses comprised 'right to act' and 'right of first refusal' clauses, which we defined respectively as:

- the right to provide any future corporate finance services to the client, and
- the right to provide future corporate finance services to the client before the client is able to accept any offer from a third party to provide those services.

2.12 We proposed to exclude from the ban rights or opportunities to: (i) pitch for future business; (ii) be considered in good faith alongside other providers for future business; or (iii) match quotes from other financial institutions (but not the right to be



automatically awarded the business if relevant terms are matched). We made clear our rationale for the exclusion of such provisions from the ban: they do not oblige the client to use the firm and, as such, should not be considered as future service restrictions.

2.13 Some respondents challenged our definitions of 'right of first refusal' clauses (which we said we would ban) and 'right to match' clauses (which we said we would allow). Respondents suggested that:

- our 'right of first refusal' definition might capture their understanding of 'right to match' clauses and should be amended to make clear that the ban would only apply where firms have the right to provide the service before the client is able to request an offer from a third party for those services, and
- our interpretation of 'right to match' clauses, which we proposed to exclude from the ban, was unduly narrow and should instead be broadened to capture situations where clients are obliged to use holders of the rights if they match terms offered by other firms.

Our response

Our intention is for the ban to stop firms using clauses in agreements which oblige their clients to do future business with them. We agree that the ban should apply to written agreements only. This is consistent with what we said in the CP, where we envisaged the ban capturing client contracts, engagement letters and other contractual arrangements. We noted in the CP that a ban extending beyond restrictions that form part of an agreement would be difficult to regulate and monitor. However, we would not expect the ban to mean that firms replace written clauses with unwritten oral agreements and we would be concerned if undue pressure were to be placed on clients by such means.

The ban applies to unspecified and uncertain future services only. This is so that we do not have the unintended consequence of preventing clients from agreeing terms with firms for a specific piece of future business that they know they will undertake.² We consider that the rationale for the ban is clear and we do not consider further guidance would add value as to what is specified and what is certain.

Our decision on which clauses to ban and which clauses to allow has been determined by the effect of those clauses. Our intention is for the ban to leave the client free to decide which firms to do business with, avoiding situations where a client could not approach other firms or would be forced to accept a firm if that firm were to match a third party's terms. We interpret:

- 'Right of first refusal' as a contractual right to be given the opportunity to enter into a business transaction with a company before anyone else can. The client subject to the right is prevented from accepting offers from third parties.

² As set out in the CP, the application to future services ensures that firms can continue to use, for instance, so-called 'tailgunner clauses', which are designed for recuperating fees for work already undertaken by a financial institution if the client decides to use another firm for the same service or transaction.

- 'Right to match' as the right for the firm to be approached following a third-party offer, to match that offer with the client ultimately deciding which firm to select to provide the services.

We consider 'right of first refusal' clauses should be banned and 'right to match' clauses are acceptable. We do not accept the argument that a 'right to match' should be defined to include situations where the client has to accept services from the firm if the firm matches the terms of a third party firm. In that situation, the client is still forced to take services from the firm even if it wishes to go elsewhere, for example, due to other service differences.

Whether any types of clients should be exempted?

2.14 We proposed to apply the ban irrespective of the size of the client. We said that there would be regulatory uncertainty if we attempted to define which clients should be outside of the scope of the prohibition, especially at the margin of any threshold. We also said that we had received conflicting views on whether larger or smaller clients should be exempted.

2.15 Two respondents wanted us to limit the ban to agreements entered into by particular types of clients but these views were conflicting:

- One respondent suggested that the ban should be limited to smaller corporate clients only, giving larger, more sophisticated, corporate clients the freedom to manage their relationship banks as they see fit.
- Another respondent wanted the ban to apply to all clients except small and medium enterprises (SMEs), defined as those businesses with an annual turnover of less than £25m. It said that SMEs were not within the scope of the market study and the existing retail banking undertakings given to the Competition and Markets Authority already prohibit certain types of bundling clauses.

Our response

We do not believe it would be appropriate to segment the market and limit the applicability of the ban to specific client classes for the same reasons as set out in the CP.

We have not seen a marked prevalence of clauses applied only to smaller clients and, accordingly, we consider it important to protect future choice for all clients. Even if larger, more sophisticated, corporate clients may be better able to negotiate the terms of potentially restrictive clauses, we believe it is important that they can also freely manage their choice of banks as they see fit.

Regarding SMEs, we note that they are relatively infrequent users of primary market services. However, in the event they need to use primary market services they are likely to be among the types of clients most at risk from the identified harm and would thus benefit from the ban. A ban which did not capture them would potentially leave them exposed to restrictive clauses imposed upon them.



Which types of services should be banned?

2.16 We consulted on the basis that the ban would affect future service restrictions related to 'corporate finance services', a new glossary definition based on the existing definition of 'corporate finance business' in the FCA Handbook. We said we were interested in whether this existing definition captured any services that should, based on the scope of our market study, be outside of the scope of the ban.

2.17 Respondents commented that the proposed ban would go beyond the scope of the services investigated in the market study and that, in particular, it would extend into secondary market activities, which are covered by the 'corporate finance business' definition. Respondents said that no case had been made for intervening in clauses affecting any secondary market activities, as using clauses in some of these activities (such as hedging) has similar benefits to those we identified for bridging loans. Submissions also stated that the 'corporate finance business' definition is complex and normally used to carve out from (as opposed to apply) existing rules. This lack of clarity as to precisely which services are included in the definition would make compliance with the ban difficult.

Our response

In the light of the feedback, we have aligned the scope of the ban more clearly with that of the market study.

We considered using a carve-out from the 'corporate finance business' definition, but as some of the activities within the existing definition were not clearly aligned with the scope of the market study we have opted for creating a new Handbook definition for primary market services, covering ECM, DCM and M&A activities. The ban would, therefore, apply to clauses affecting future primary market services.³ This scope is consistent with the CBA we conducted in the CP.

Our definition of primary market services used in the instrument is based on relevant definitions for ECM, DCM and M&A services used in MiFID II and the descriptions used during the market study.

Although we have opted for a product scope clearly aligned with the market study, we remain open to extending the ban to other wholesale market services if we see evidence that the clauses are being used to the detriment of clients for such services. Firms should be clear that we will not tolerate restrictive clauses that adversely affect competition and are not clearly beneficial to clients.

How should bridging loans be defined?

2.18 Bridging loans are a type of loan provided on the basis that the client will replace it with longer-term financing, typically a bond issue, equity issue or term loan.

2.19 In the CP, we proposed to exclude bridging loans from the ban because a bank would be unlikely to provide the bridging loan on the same terms (or at all) if it did not also

³ Note that this means the ban does not apply to future services which are a form of corporate lending, so the ban would not apply to, for example, an accordion clause in a loan which would set out the subsequent incremental increase in terms of the loan.

know that it would be able to control the 'take-out' of the bridging loan by receiving a mandate on the subsequent longer-term financing. In the CP, we defined a bridging loan on the basis of its duration - 12 months or less - and on the fact that it is provided on the condition that it will be replaced with longer-term financing.

- 2.20** In the CP we also made clear that warehouse facilities are excluded from the ban. Those facilities are used to finance the origination of new assets (such as mortgages) and are designed to provide relatively short financing with both parties assuming that the original facility will be financed by a capital markets transaction (similar to bridging loans). We said that the definition of bridging loans was intended to cover warehouse facilities.
- 2.21** The majority of respondents considered that the proposed definition of bridging loans would not effectively exclude this type of loan from the ban and made a number of suggestions as to how such a carve-out could be better achieved. The main concerns raised were that bridging loans are:
- often longer than 12-months in duration, and
 - provided not on the condition but on the expectation that they will be replaced with longer term financing because, mostly due to market conditions during the relevant timeframe, there is no certainty of replacement.
- 2.22** Proposals were either to extend the timeframe or to remove it and to move to a definition which related to the commercial intent to replace the loan with funding from a bond issue, equity issue or business disposal.

Our response

In the light of the feedback, we have amended our proposed definition to reflect the fact that, usually, bridging loan contracts do not include specific timeframes for the take-up of the alternative source of finance and that these types of contracts, instead, are signed with the commercial intent of replacing the loan with alternative, normally longer term, funding.

We view the following non-exhaustive characteristics as indicative of a bridging loan:

- it is expressly documented in the terms of the loan that the intention of both parties is that the loan offers a temporary solution until the borrower is able to obtain long-term financing from the capital markets or other future financing
- the loan has a short-term, typically less than four years from signing, or the client is otherwise discouraged from retaining the loan as longer term financing, for example by stepping up the interest rates after an initial short period, and
- the terms contain a provision that the proceeds from the future financing (take-out) are used as mandatory pre-payment on the loan.



We also confirm our view in the CP that warehouse facilities (used as a vehicle for a collateralized loan obligation transaction) – where the loan originator is given a line of credit to fund the issuance of mortgages from origination to the time they can be sold into the secondary market (or securitised) – are also excluded from the ban, as these have similar principles as a bridging loan. The characteristics above are intended to capture warehouse facilities as well.

What should be the geographic scope of the ban ?

- 2.23** We proposed that the geographic application of the ban would be in line with the jurisdictional scope of COBS 1.1. We said that this meant the ban would not affect services provided to UK-based clients by firms located outside the UK and would affect services provided by firms' UK establishments to non-UK based clients.
- 2.24** Some respondents commented that the prohibition would apply to a 'UK firm' providing services to a UK client or a non-UK client but it would not affect a non-UK firm whether it was providing services to a UK client or a non-UK client. They argued that the ban would limit the ability of UK firms to compete on a level playing-field with non-UK institutions, particularly in relation to clients based outside of the UK. They said this would be driven mostly by the inability of UK-based firms to use the clauses subject to the ban to secure future work with non-UK clients. It might mean that firms with sizeable footprints outside of London may decide to divert business that would otherwise be booked/transacted in London specifically to avoid the constraints of the prohibition.
- 2.25** As an alternative solution, some respondents suggested that the prohibition should apply only to 'UK-clients' to avoid a loss of competitiveness for UK-based firms.

Our response

The issue of the geographic scope of the prohibition is complex because of the international dimension of primary market services – firms may underwrite the business in the UK but may have distribution capabilities offered by non-UK branches. We have sought to find a solution that addresses the concern we identified and is as practical as possible for firms.

We are not persuaded by arguments that a ban will affect the competitiveness of UK firms. We recognise that these clauses have a role to play in securing future primary markets business (which is why we are seeking to ban them) but we consider that the existence of the clauses should not be an essential element of competition for the initial service - claims that non-UK firms will win business primarily on the basis of the clauses (because they are able to price the initial service more cheaply) seem overstated. In particular, firms were unable to demonstrate to us the benefit of such clauses to clients in either the initial or the future service (except in the case of bridging loans).

We considered carefully the possibility of limiting the application of the provision to UK clients. However, we rejected this approach because:

- Most primary market activities are international in scope and are often conducted from the UK for non-UK clients. Our interim report set out the proportion of ECM, DCM and M&A transactions where the client is based in the UK or in Europe, the Middle-East and Africa (EMEA). It showed that in 2015, transactions for UK clients were typically a small fraction of the value of transactions for EMEA clients (typically no more than 20%).⁴ Limiting the applicability of the ban to UK clients only would, therefore, materially reduce the impact of the ban.
- Any ban specified according to the location of the client could potentially be circumvented by firms entering into contracts with non-UK entities of UK-based client groups.

We have, therefore, finalised the rules in line with our original proposal to apply the ban based on the COBS 1.1 application provision. This means that the ban:

- a. applies where designated investment business or activities connected with designated investment business are carried on from a firm's UK establishment. These services could be part of the services covered by the agreement itself or the future services affected by the restrictive clause.
- b. prohibits a firm from entering into an agreement with its clients which contains the restrictive clauses. This includes agreements entered into by the firm's UK establishment or its overseas branches. It does not capture agreements entered into by the firm's subsidiaries or affiliates.
- c. prevents a firm from using restrictive clauses that require the client to use the firm or its affiliates.
- d. applies irrespective of the location of the client.

What time period should be given for implementation of the ban?

2.26 We did not provide a timeframe for implementation of the ban but we made clear that the ban would not apply to existing agreements.

2.27 One respondent estimated that a period of four to six months would be required to comply with the ban.

Our response

We recognise the need for a short period of time for firms to get procedures in place to ensure that they do not enter into these types of clauses in any written agreements with clients. This could include amending templates for contracts and engagement letters, and

⁴ See interim report, Figures 1 to 3, pages 27 to 29.



updating any guidance, policies and training around the terms that they are able to agree with clients.

We will allow a six-month period for this implementation, with the ban applying to agreements entered into from 3 January 2018.

Cost benefit analysis

- 2.28** In the CP we set out the benefits and costs of the proposed ban.
- 2.29** We noted that the direct benefits of the proposed ban were likely to be modest as such clauses are not universal in client engagement letters. However, we recognised that the ban would bring further benefits by sending a clear signal that we are unwilling to tolerate such behavior where it is not clearly beneficial to clients.
- 2.30** Regarding costs, we said we did not expect the proposal to create significant compliance costs for firms or create other significant unintended consequences.
- 2.31** We asked for views on the CBA and whether there were other costs that we had not considered.
- 2.32** Only one respondent challenged the CBA raising in particular the following issues:
- a.** these clauses are used in only a small proportion of transactions and there is no evidence that such clauses act as any material form of barrier to entry or expansion
 - b.** if a client has made an informed choice before signing up to a clause then 'no concerns can realistically arise'
 - c.** the assessment of costs and benefits is not fully quantified, and
 - d.** we have not compared the relative differences in costs between a disclosure remedy and an outright ban.

Our response

We consider that our CBA in CP16/31 sets out a clear analysis of the costs and benefits that would arise and estimates those costs and benefits unless it is not reasonably practicable to do so. The refined product scope of the ban also aligns with the CBA and the instrument in Appendix 1 does not differ from that in CP16/31 in a way that affects the CBA.

We do not agree with the arguments raised by the respondent.

On prevalence, in CP16/31, we found that 86% of banks in our sample had used such clauses at least once in 2014 and 2015. These restrictive clauses were used by 43- 75% of the providers, depending on the service.

We were told of three instances where clients had accepted such a clause and had to pay a penalty for breaking the clause. One firm told us that in two of these cases the clients had not been aware that they had accepted such a clause in the first place. We do not consider this evidence to be consistent with these clients making a fully informed choice.

We do not argue that these clauses act as a material barrier to entry but that they may reduce competition and produce sub-optimal outcomes by:

- clients not being able to appoint a bank or provider that is better placed to provide the subsequent service and, as a result, receive a lower quality service and/or incur a higher fee, and
- leading to insufficient competitive pressure on fees and/or quality for these subsequent services.

We consider that a remedy that discloses the existence of the clauses would have little or no effect in these circumstances, as clients who are made more aware of them may still be unable to negotiate to exclude the clauses.



Annex 1

List of non-confidential respondents

British Bankers' Association and Association for Financial Markets in Europe

Loan Market Association

Investment Association

Royal Bank of Scotland

HSBC

Barclays

Lloyds Banking Group

Citigroup

Annex 2

Abbreviations used in this paper

CBA	cost benefit analysis
CP	Consultation Paper
DCM	debt capital markets
ECM	equity capital markets
M&A	mergers and acquisitions
PS	Policy Statement
SMEs	small and medium enterprises

We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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Appendix 1

Made rules (legal instrument)

FUTURE SERVICE RESTRICTIONS INSTRUMENT 2017

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of:
- (1) the following powers and related provisions in the Financial Services and Markets Act 2000 (the “Act”):
 - (a) section 137A (The FCA’s general rules);
 - (b) section 137T (General supplementary powers);
 - (c) section 138D (Action for damages); and
 - (d) section 139A (Power of the FCA to give guidance); and
 - (2) in relation to the Glossary of definitions, the other rule and guidance making powers listed in Schedule 4 (Powers exercised) to the General Provisions of the FCA’s Handbook.
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 3 January 2018, immediately after the Conduct, Perimeter Guidance and Miscellaneous Provisions (MiFID 2) Instrument 2017.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Future Service Restrictions Instrument 2017.

By order of the Board
22 June 2017

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

- | | |
|--|--|
| <i>future service restriction</i> | <p>any provision in an agreement between a <i>firm</i> and a <i>client</i> which, in addition to the products or services to which the agreement relates, grants the <i>firm</i> or an <i>affiliated company</i> of the <i>firm</i>:</p> <ol style="list-style-type: none"> (1) the right to provide any future <i>primary market and M&A services</i> to the <i>client</i>; or (2) the right to provide future <i>primary market and M&A services</i> to the <i>client</i> before the <i>client</i> is able to accept any offer from a third party to provide those services. |
| <i>primary market and M&A services</i> | <p>(in <i>COBS</i> 11A.2) services that constitute <i>designated investment business</i> or <i>MiFID business</i> and that are either:</p> <ol style="list-style-type: none"> (1) services provided to an <i>issuer</i> comprising structuring, underwriting and/or placing an issue of <i>shares</i>, <i>warrants</i>, <i>certificates representing certain securities</i> or <i>debentures</i>; or (2) advice and services relating to mergers and the purchase or disposal of undertakings. |

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

After *COBS* 11A.1, insert the following. The text is new and is not underlined.

11A.2 Prohibition of future service restrictions

- 11A.2.1 R Unless exempted in *COBS* 11A.2.2R, a *firm* must not enter into an agreement in writing with a *client* that contains a *future service restriction*.
- 11A.2.2 R *COBS* 11A.2.1R does not apply to *future service restrictions* that:
- (1) are included in an agreement in writing for the *firm* to provide a bridging loan; and
 - (2) only involve the *firm* providing the *primary market and M&A services* to which the bridging loan relates.
- 11A.2.3 R For the purposes of *COBS* 11A.2.2R, “bridging loan” means a loan provided to a client for the purpose of providing short-term financing, and with the commercial intention that it be replaced with another form of financing (such as a *debenture* issue or a *share* issue).
- 11A.2.4 G A loan could be considered a bridging loan for the purposes of *COBS* 11A.2.3 when, for example:
- (1) it is expressly documented that the intention of both parties is that the loan offers a temporary solution until the client is able to obtain longer-term financing from the capital markets or other future financing;
 - (2) it has a short term, typically of less than four years from signing, or the client is otherwise discouraged from retaining the loan as longer term financing, for example by stepping up the interest rates after an initial short period; and
 - (3) the terms provide that the proceeds from the future financing are used as mandatory pre-payment on the loan.
- 11A.2.5 G
- (1) Agreements for the provision of a specified or certain *primary market and M&A service* by the *firm* to the *client* are not prohibited by *COBS* 11A.2.1R, even where that service will take place in the future.
 - (2) *COBS* 11A.2.1R prohibits *future service restrictions* related to *primary market and M&A services* which may be required in the

future but which, at the date of the agreement, are not yet specified or certain. *Future service restrictions* are prohibited because they prevent a *client* from freely deciding, as and when the need for *primary market and M&A services* arises, which *firm* to appoint to provide those services.

- 11A.2.6 G (1) The *future service restrictions* prohibited by COBS 11A.2.1R relate to services that will be provided in the future.
- (2) An example of restrictions that would therefore not be caught are those which relate to the recuperation of *fees* for work already undertaken by a *firm* in relation to a particular service or transaction when the *client* decides to use another financial institution for the same service or transaction ('tailgunner clauses').

- 11A.2.7 G (1) *Future service restrictions* bind the *client* to use the *firm* (or an *affiliated company*).
- (2) Provisions in an agreement that only give a *firm* the right or opportunity to:
- (a) pitch for future business; or
 - (b) be considered in good faith alongside other providers for future business; or
 - (c) match quotations from other providers, but which do not prevent the *client* from selecting the other providers,
- are not *future service restrictions*. In these cases, the *client* is not obliged to use the *firm* (or an *affiliated company*).

Amend the following as shown.

18.3 Corporate finance business

...

Corporate finance business - non-MiFID business

- 18.3.3 R Only the provisions of COBS in the table apply to *corporate finance business* carried on by a *firm* which is not *MiFID* or *equivalent third country business*.

COBS	Description
...	

11.7A	Personal account dealing
<u>11A.2</u>	<u>Prohibition of future service restrictions</u>
...	

...

