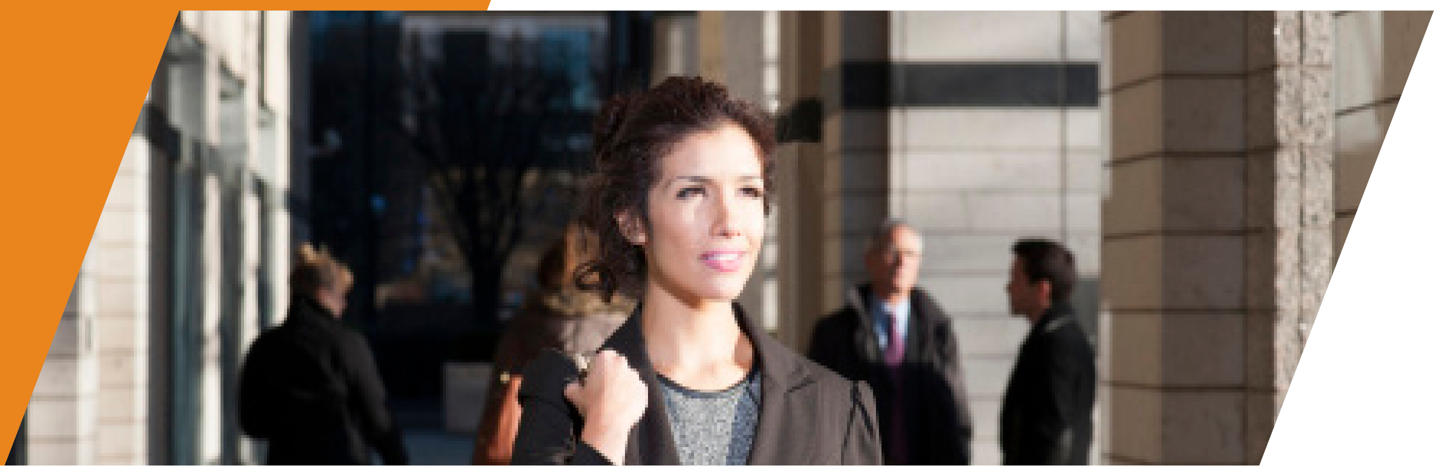
Financial Conduct Authority

Investment and corporate banking market study

Terms of reference

May 2015



Market Study

MS15/1.1

If you wish to make any submissions on the topics raised in these terms of reference, please do so by **22 June 2015**.

For enquiries, please contact the Investment and Corporate Banking Market Study team:

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Contents

Abbreviations used in this document

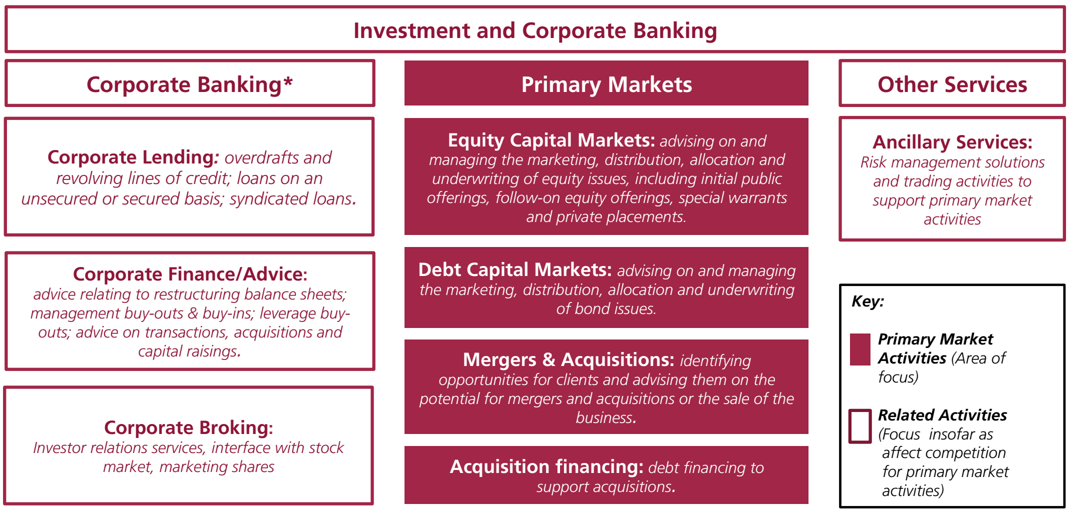
CMA	Competition and Markets Authority
DCM	Debt capital markets
ECM	Equity capital markets
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
FICC	Fixed income, currencies, and commodities
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act
FTSE	Financial Times Stock Exchange
IPO	Initial public offering
M&A	Mergers and acquisitions
MiFID II	The revised Markets in Financial Instruments Directive (2014/65/EU)
PRA	Prudential Regulation Authority
PRIN	Principles for Business
SME	Small and medium-sized enterprises

1. Executive summary

1.1 On 19 February 2015, we published the feedback statement to our wholesale sector competition review.[1] In that review we heard of a number of potential competition issues in investment and corporate banking[2], including some which may affect smaller clients more than larger clients. We said that we would launch a market study on investment and corporate banking in spring 2015. These terms of reference mark the launch of that market study.

1.2 The market study will explore whether competition for investment banking and corporate banking services is working well. Specifically, the market study will focus on primary market and related activities provided in the UK by the investment and corporate banking industry (see Figure 1 for an overview of the types of activities in focus).[3] Primary market activities cover Equity Capital Markets, Debt Capital Markets, mergers and acquisitions and acquisition financing. Related activities (e.g. corporate broking and lending, ancillary services) will be considered insofar as they affect competition for primary market activities. Additionally, to the extent that our analysis finds that ineffective competition for primary market activities is affected by or has an impact in areas that are not the focus of our analysis (e.g. in secondary markets), we may need to investigate these further.

Figure 1: Activities within the scope of the market study



Note that this figure provides an illustration of the types of activities the market study will focus on (i.e. primary market and related activities) but it is not intended to provide an exhaustive picture or precise definitions of the activities in scope.

* We have focused on the types of corporate banking services which we consider more likely to affect competition for primary market activities. However, to the extent that our analysis identifies that other corporate banking services provided to clients (such as treasury and transaction banking, deposits and other corporate financing) affect competition for primary market activities these may be included in scope as related activities.

1 www.fca.org.uk/your-fca/documents/feedback-statements/fs15-02

2 We use the term 'investment and corporate banking' throughout this document. We explain what we mean by this in Chapter 3. Different terms are sometimes used by different industry participants and observers (for example, 'corporate and institutional banking').

3 See Chapter 3 for the details of the precise scope of the market study.

1.3 Benefits from effective competition for investment and corporate banking services may arise both as a result of direct improvements for the users of these services – for example, both the corporate issuer and, in the case of primary market offerings, the investor subscribing for an allocation - and indirect gains for (i) customers of clients that use investment and corporate banking services and (ii) UK consumers generally, resulting from improvements to the flow of capital in the economy.

1.4 Taking into account the concerns raised by the wholesale sector competition review, the market study will focus on three separable, but linked topics for primary market and related activities: the choice of banks and advisers faced by clients when selecting services, limited transparency in the provision of services, and the practices of bundling and cross-subsidising services within primary market activities and between primary market and related activities.

i. Choice of banks and advisers

1.5 We propose to consider three areas in particular under this topic:

- First, the **competitive landscape** for investment and corporate banking services. Some banks told us that there is fierce competition to serve large clients but that smaller clients may be less attractive as clients and therefore less well served by the market. We are keen to understand the extent to which this is the case and will consider the types of banks and advisers used by different groups of clients. Whilst there may be good commercial reasons for some banks not to serve some clients, we want to understand how this affects clients' choices. This assessment of the competitive landscape will also allow us to focus on those areas where we have identified that clients are likely to face restricted choices and are most likely to get a worse deal.

- Second, **clients' purchasing behaviour and in particular the impact of syndication**. Some clients told us that they face a limited choice of suppliers because they have specific requirements that only a few firms can meet or because they use a syndicate of banks. For example, some clients may wish to use a bank with which they have an existing relationship, or which has accumulated knowledge or experience in their sector (e.g. as shown by league tables), or which has a research department that can provide accompanying coverage. We are keen to understand how client preferences drive competition, when and why clients opt for syndication, and how this affects the competitive dynamics in the market. In particular, we will examine whether there are circumstances in which syndication restricts instructing or issuing clients' ability to select banks and advisers or to play them off against each other.

- Third, **entry and expansion including the potential effects of regulation**. We will examine how banks and advisers establish a client base and explore the extent to which those new entrants looking to provide services to clients might face significant barriers arising from the current regulatory environment or practices adopted by established banks and advisers (such as bundling or reciprocal arrangements between financial institutions). We will be particularly interested in practices or regulations that may inhibit the establishment of new ways of serving clients or present barriers to serving smaller clients profitably, including barriers to devising innovative approaches to meeting these clients' needs.

ii. Limited transparency

1.6 We propose to consider three aspects of limited transparency:

- First, the **adequacy of information**. Some clients told us that they find it difficult to assess whether their investment bank offers good value, both before and after a transaction/being given advice. This may be because services are bundled, or because it is hard to assess quality of service. We will explore the extent to which clients have access to adequate information and feel well placed to assess value, focusing particularly on the experience of smaller clients who are likely to use investment banking services less frequently than larger clients, and may be less likely to have substantial internal expertise and/or the resources to access and understand expert advice than larger clients.

- Second, the **transparency of the allocation process**. We have heard concerns from issuing clients and investors subscribing for an allocation that when issuing debt or equity issuing banks may favour certain investors. We want to understand whether there is substance to this and whether there are circumstances in which it is difficult for issuing clients to influence and monitor allocations.

- Third, the **impact of established practices, processes or regulations on transparency in the IPO process**. We will examine whether existing rules and practices for disclosing information around IPOs allow information, such as prospectuses and unconnected research, to be released at the appropriate junctures, and whether the timing of publication of connected research gives the bank publishing it a privileged position as the only source of information during the book-building process.

iii. Bundling and cross-subsidisation

1.7 We have heard of a number of concerns from clients and some standalone or boutique investment banks that investment and corporate banking services are often sold together. The concerns are that such bundling and/or cross-subsidisation may restrict clients' ability to switch and create barriers to entry and expansion for standalone or boutique banks.

1.8 We will consider two aspects of this issue:

- First, **whether bundling and/or cross-subsidisation occurs**. We will consider whether and, if so, which primary market activities and related activities are sold together. We will also want to understand whether there is significant cross-subsidisation between primary market activities and related activities or within primary market activities. We will also want to understand whether any such bundling or cross-subsidisation extends beyond primary market and related activities (e.g. to secondary market activities).

- Second, **whether such bundling and/or cross-subsidisation has adverse effects on competition and clients**. We will consider why any such bundling and cross-subsidisation occurs and the circumstances in which these practices might be beneficial for clients and those in which they might raise barriers to entry or enable banks and advisors to exploit clients who are 'locked in' to using their services.

Wider context for the market study

1.9 We will be conducting this market study whilst other work in the sector continues both within the UK and internationally. This includes the Fair and Effective Markets Review, the implementation of MiFID II and the EC's development of a Capital Markets Union. The FCA is closely involved in all three of these and we will ensure that this market study takes these developments into consideration and that we liaise with other relevant authorities as necessary.

Next steps

1.10 This document marks the launch of our market study. Throughout our study, we are keen to hear from clients of different sizes about their experiences. We are not formally consulting on these Terms of Reference but we would welcome any comments on the issues raised in this document by 22 June 2015. To hear views, we will also host a number of roundtable and/or bilateral meetings with stakeholders. We will shortly also be approaching market participants for information and data to enable us to assess the issues we have set out above.

1.11 We aim to publish a report setting out our interim findings and any proposed remedies (if required) around the turn of the year and our final report in spring 2016. Our interim report will set out those areas which we consider raise concerns and those in which we have found have few or no problems.

1.12 If we conclude that competition is not working well, we may intervene to promote effective competition using a number of possible measures. As with any market study these include rule-making, publishing general guidance or proposing enhanced industry self-regulation. Alternatively, we may decide to take no further action for the time being. This could be because our concerns are likely to be satisfied by upcoming legislative measures, action by the relevant firms or other circumstances. In such cases, we may continue to monitor the market in case our concerns are not addressed.

2. Introduction

Background

2.1 In July 2014, we published a call for inputs, which launched the wholesale sector competition review.[4] We sought views and evidence from stakeholders on areas of wholesale finance where competition might not be working effectively. The review aimed to identify whether there were any issues that may warrant further investigation in a market study.

2.2 Market studies are the principal way in which we investigate markets to see how well they are working for consumers.[5] We have powers to conduct market studies either under FSMA or under our concurrent functions and the provisions of the Enterprise Act 2002.

2.3 We carry out market studies when we have identified that there might be competition issues in a market. We do not begin with a decided view about whether or not we need to intervene.

2.4 We received feedback to our call for inputs from a range of industry stakeholders, including market participants, clients, trade bodies and academics. This, along with our own analysis, highlighted some potential competition concerns within investment and corporate banking services. We considered this and explored relevant academic research and industry publications. We then considered each of the potential competition issues against a set of prioritisation criteria.[6] The prioritisation criteria included the prospects for and likely impact of any intervention in the market, how the issue fits with forthcoming regulatory or market developments and the likelihood of a successful outcome.

2.5 The review concluded in February 2015 and we set out our intention to undertake a market study into investment and corporate banking.

Why are we conducting an investment and corporate banking market study?

2.6 The wholesale sector competition review identified that there are areas of investment and corporate banking where competition may not be working effectively and that would benefit from further investigation. These included issues around transparency of the services provided by banks and concerns about the bundling of services and the impact this has on transparency and the ability of competitors to enter or expand into the market.[7]

4 Financial Conduct Authority, 2014, Wholesale sector competition review – Call for inputs, Available at: www.fca.org.uk/static/ documents/market-studies/wholesale-sector-competition-review-call-for-inputs.pdf.

5 In the markets for investment and corporate banking, consumers could refer to those who use the services of investment and corporate banks, or end consumers (i.e. individuals).

6 See Call for inputs, pages 12-13.

7 See paragraph 2.40 of the wholesale sector competition review 2014-15 feedback statement.

2.7 In deciding to launch a market study into the investment and corporate banking sector we considered:

- The potentially significant benefits that could be gained from improvements in the way competition works. This was partly due to the size of the market[8], but also due to the reach and impact of the role of these entities and the services they offer on the wider economy.

- Our ability to intervene effectively at a UK level. While many of these services are global in nature, several of the issues raised could be considered at a national level. Some of the issues were unique to the structure of the UK market.

- The competition issues in investment and corporate banking services identified have not previously been the subject of FCA investigation at a market-wide level.

Interaction with other initiatives

2.8 Throughout our market study we will keep abreast of other initiatives affecting the investment and corporate banking market study. In particular, this will include: the Fair and Effective Markets Review, the Capital Markets Union and MiFID II.

Fair and Effective Markets Review

2.9 The FCA is one of three bodies (along with the Bank of England and HM Treasury) jointly conducting the Fair and Effective Markets Review which was set up to restore confidence in the operation of Fixed Income, Currencies and Commodities (FICC) markets and to influence the international debate on trading practices.

2.10 When its findings are published, we will review any recommendations from the review and decide whether they need to be incorporated into the terms of reference of this market study or pursued separately.

Capital Markets Union

2.11 The Capital Markets Union aims to create deeper and more integrated capital markets in the EU where investors are able to invest their funds without hindrance across borders and businesses can raise the required funds from a diverse range of sources, irrespective of their location. To achieve these objectives the European Commission is currently exploring ways of reducing fragmentation in European financial markets, diversifying financing sources, strengthening cross-border capital flows and improving access to finance for businesses through both legislative and non-legislative means.

2.12 While the precise areas where action will be taken have not yet been decided, the goal of establishing a genuine single capital market in the EU could have a significant impact on competition in UK and European financial markets. We will consider the impact of any changes insofar as they affect the markets we are examining as part of the market study.

8 As set out in the wholesale sector competition review feedback statement, revenues received from investment and corporate banking services, provided to corporate clients in the UK, in 2013 totalled £10bn. This figure does not include services provided to corporate clients based outside the UK nor to institutional clients.

MiFID II

2.13 MiFID II will apply from 3 January 2017. It will affect firms that participate in primary market activities and operate in the investment and corporate banking sector. There are some areas of MiFID II relating to transparency and bundling that may address some of the issues that have been raised in relation to these sectors.[9]

2.14 It is still too early to gauge the effect of these changes and how far they will go in addressing concerns identified in this sector. However, we will carefully consider the impact of MiFID II when considering the competition concerns identified and any remedies, if necessary.

How would consumers benefit from effective competition for investment and corporate banking services?

2.15 Benefits from effective competition for investment and corporate banking services may arise both as a result of direct improvements for the users of these services and indirect gains for (i) customers of clients that use investment and corporate banking services and (ii) UK consumers generally, resulting from improvements to the flow of capital in the economy.

2.16 There is a range of direct consumers of investment and corporate banking services. For example, both the corporate issuer and, in the case of primary market offerings, the investor subscribing for an allocation, are direct consumers of these services. Ineffective competition may directly raise these firms' costs or result in their not being able to buy the services that best suit their needs. Improvements to the effectiveness of competition could consequently benefit these firms directly.

2.17 Although retail customers seldom interact with wholesale markets directly, to the extent that ineffective competition raises clients' costs, these higher costs may be passed on to retail customers of these clients. Similarly, improvements to the way in which competition works for these services may be passed on to end customers in the form of lower prices.

2.18 As investment and corporate banks are a key conduit for the flow of capital throughout the economy, any improvements in the efficiency of this sector are likely to benefit the economy as a whole. For example, the cost and quality of services provided by investment and corporate banks play a vital role in supporting corporate investment. If corporate clients requiring investment or corporate banking services fail to raise necessary capital or the client pays more for financing and advisory services than it should, it could have a significant impact on their ability to operate or undertake investments.

The powers and procedures we will use to conduct this market study

2.19 We will conduct this market study using our FSMA powers rather than concurrent Enterprise Act 2002 powers.

9 For example, MiFID II contains three aspects pertaining to bundling in investment banking:
1. Article 24(11) requires that firms inform clients whether it is possible to buy bundled services separately and to provide separate evidence of the costs and charges of each component (this would not apply where an investment bank is dealing with an eligible counterparty under the MiFID client categorisation regime).
2. ESMA has set out in its technical advice to the European Commission on MiFID II/MiFIR's delegated acts that payment for research should be separated from payment for execution services.
3. ESMA has set out in its technical advice to the European Commission on MiFID II/MiFIR that new conflicts rules on underwriting should be introduced which would, amongst other things, seek to prevent a situation in which there is implicit bundling of certain services.

2.20 Although some of the activities we are focusing on (see Figure 1) fall outside of the FSMA regulatory perimeter, we are interested in whether such non-regulated activities are being provided as part of a bundle with regulated activities or whether such non-regulated activities are having a direct impact on competition in the provision of the regulated activities. We consider it would be appropriate as necessary to use our FSMA powers to gather information in relation to regulated activities and the related non-regulated activities that are carried out by authorised persons.[10]

2.21 Our procedures for market studies are set out in our market study guidance.[11]

2.22 We will shortly begin gathering information from stakeholders. We will be seeking data, information and/or views from corporate and investment banks, their clients and potential entrants. Throughout our study, we are keen to hear from clients of different sizes about their experiences. We are not formally consulting on these Terms of Reference but we would welcome any comments on the issues raised in this document by 22 June 2015. To hear views, we will also host a number of roundtable and/or bilateral meetings with stakeholders.

2.23 We aim to publish a report setting out our interim findings and any proposed remedies (if required) around the turn of the year. Our interim report will set out those areas which we consider raise concerns and those which we have found have few or no problems. This will provide stakeholders with an opportunity to comment prior to publishing our final report in spring 2016.

2.24 As set out in our market study guidance, should we conclude that competition is not working well and that there is a need to take action, we may intervene to promote effective competition using a number of possible measures, which as with any market study include:

- Market wide remedies, including (but not restricted to):
  - Rule-making, including changing or potentially withdrawing existing rules and making recommendations to the PRA to change or withdraw rules.
  - Publishing general guidance.
  - Proposing enhanced industry self-regulation.
- Firm-specific remedies. This includes using own initiative variation powers or own initiative requirement powers, cancelling permissions, public censure, imposing financial penalties as well as filing for injunction orders or restitution orders.
- Making a market investigation reference to the Competition and Markets Authority.

2.25 Alternatively, we may decide to take no further action for the time being. This could be because our concerns are likely to be satisfied by upcoming legislative measures, action by the relevant firms or other circumstances. In such cases, we may continue to monitor the market in case our concerns are not addressed.

10 See the FCA Handbook - PRIN 3.2, which sets out that that our information gathering powers are available in relation to "ancillary activities [in relation to designated investment business, home finance activity, credit-related regulated activity, insurance mediation activity and accepting deposits.]"

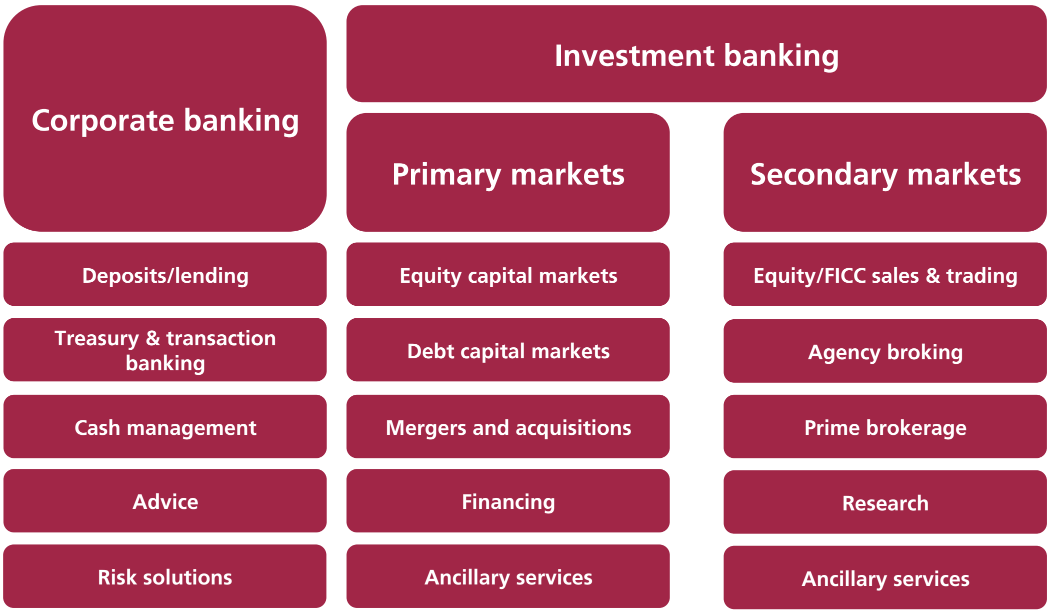
11 See CP15/01 for the draft market study guidance.

3. Scope of the market study

Investment and corporate banking services

3.1 Figure 2 broadly summarises the activities that comprise investment banking and corporate banking. Some banks may provide a wide range of investment and corporate banking activities to clients, whereas others may specialise in a narrower group of activities.

Figure 2: Investment banking and corporate banking activities



This figure provides a broad description of the types of activities that comprise investment and corporate banking. However, we note that this is a simplification and will not represent the way in which activities are organised across service providers who may adopt differing internal structures and strategies.

3.2 Investment banking activities can be separated into two broad areas: activities in primary markets and activities in secondary markets.

- Primary market activities involve providing advice and finance for raising new capital for clients. Clients have a range of options available to them when seeking finance, such as issuing equity or bonds, or taking a bank loan. An investment bank can advise on which form of finance is most suitable for the client and facilitate such a transaction. Similarly, investment banks provide advice to clients when they are seeking to merge with or acquire another company (or when they are subject to a potential takeover) and can facilitate the provision of finance to fund such a transaction.

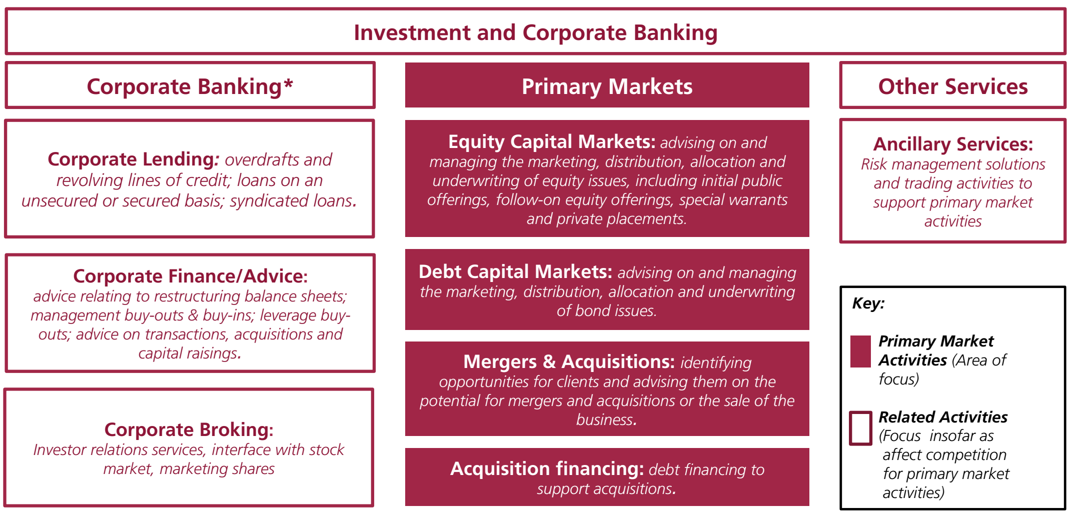
- Secondary market activities generally deal with instruments that have already been issued and are being actively traded. Banks may act as market maker for various securities, including equities, bonds, currencies, commodities and their related derivatives. They also provide asset managers with access to their trading infrastructure, and produce research on securities, as well as other services, that their investor clients may be interested in.

3.3 Corporate banking activities largely consist of day-to-day transactional services to clients, for example deposit services, traditional loans and overdrafts, and access to payment services. Corporate banking also includes products to meet the overall financing needs of the client such as acquisition finance, trade finance, project finance and syndicated finance.

What we will focus on

3.4 Figure 3 illustrates, broadly, which activities will and which activities will not be the focus of the market study. Although different banks will structure themselves in different ways, we are interested in the activity rather than where it sits in any particular bank.

Figure 3: Activities within the scope of the market study



Note that this figure provides an illustration of the types of activities the market study will focus on (i.e. primary market and related activities) but it is not intended to provide an exhaustive picture or precise definitions of the activities in scope.

* We have focused on the types of corporate banking services which we consider more likely to affect competition for primary market activities. However, to the extent that our analysis identifies that other corporate banking services provided to clients (such as treasury and transaction banking, deposits and other corporate financing) affect competition for primary market activities these may be included in scope as related activities.

3.5 The central focus of the market study will be primary market activities, in particular:

- Capital raising in equity capital markets (ECM) and debt capital markets (DCM). Primary market activities in capital markets include: advising issuer clients on valuation, pricing and marketing of an issue; syndication; arranging the placement of an issue; and providing underwriting services.

- Merger and acquisition transaction services, such as identifying potential M&A opportunities and advising on restructuring and corporate recapitalisation.

- We will also consider corporate advisory services to clients seeking to engage in M&A and capital raising activity such as advice on capital and legal re-structuring, and acquisition financing services, such as the provision of debt financing services to support planned acquisitions.

3.6 We have chosen to focus on primary market activities because issues in these areas were raised in the wholesale sector competition review (see Chapter 4). Issues in secondary markets and the infrastructure which supports these markets were also raised (for example, concentration in the number of clearing providers and the vertical integration model of central counterparties and trading venues) but changes to European legislation may affect competition in those areas, so now is not the right time to pursue them. However, we may need to investigate secondary markets if our analysis finds that ineffective competition for primary market activities is affected by or has an impact in secondary markets.

3.7 In assessing how competition works for these primary market activities, we cannot look at these services in isolation. We will therefore also consider related activities and the links between primary market activities and related activities, including:

- how clients access primary market activities. In particular we will explore whether services such as corporate lending and corporate broking access create incumbency advantages for banks when selling primary market services. We want to understand the extent to which a client's existing corporate financing arrangement or ongoing relationship with an investment bank influences how and whom they approach for primary market activities.

- how competition in primary market activities affects related activities. In particular, we will consider other services that are sold alongside primary market services, including ancillary services such as foreign exchange contracts or interest rate hedging products when sold alongside a debt issue or M&A transaction.

3.8 Additionally, to the extent that our analysis finds that ineffective competition for primary market activities is affected by or has an impact in areas that are not the focus of our analysis, we may need to investigate these further.

Geographic scope

3.9 There are many international aspects of investment and corporate banking. We will take this into account both in our analysis of how competition works and in any interventions we consider.

3.10 The market study will cover investment and corporate banking services, specifically primary market and related activities, provided in the UK.

3.11 When identifying UK services we will focus on the location of the activity, and will include within our geographic scope all activities undertaken in the UK, regardless of the location of the client or the legal entity into which the activity is booked for accounting reasons. This would mean that we would include within scope all services provided from the UK to either a UK or non-UK client or for a UK or non-UK transaction. We would not include services supplied from outside the UK to either UK or non-UK clients or for UK or non-UK transactions (although we will be mindful of how these services affect competition to supply services from the UK).

Investment and corporate banking firms in scope

3.12 The market study will cover firms that provide investment and corporate banking services. Even though our focus is on primary market activities, we want to understand whether any other firms which could potentially offer these services (such as standalone corporate banks or entrants with new business models) have considered entering primary market activities but been otherwise deterred from doing so due to structural or regulatory barriers to entry.

3.13 A wide range of firms, with different business models and client profiles, are involved in the provision of investment banking and corporate banking products and services. We want to hear from all these types of firms.

- **Universal, integrated, or 'full service' banks** offer both investment and corporate banking services as well as offering other financial services including, for example, asset management, insurance and retail banking. These banks are often large international banking groups with large scale asset financing and working capital.
- **Standalone investment banks** are firms that primarily offer investment banking services, such as underwriting securities and trading and brokerage services, but are not associated with a commercial banking arm.
- **Standalone corporate banks** are firms that are deposit takers and loan makers for corporates and large businesses. These firms often have a home bias, i.e. they only serve the domestic market in which they are based, and clients may include smaller corporates.
- **Boutique investment banks** are firms that may specialise in a specific service, client type, industry or aspect of investment banking and usually do not offer a secondary market service. They may have a smaller or more specialised client base than in the above models.
- **Advisers** provide advice to corporate clients to complement any advice or service they may receive from an investment bank.

Clients of investment and corporate banks

3.14 The scope of our work will not exclude any types of client but in the case of primary market offerings our focus will be on the services provided to issuing clients. We are keen to hear from as many different types and sizes of clients (public and private sector, large and small) as possible about their experience of using investment and corporate banking services, particularly in relation to primary market activities.

4.
Topics to be explored

Potential competition issues to be explored

4.1 A large number of competitors does not necessarily mean there is effective competition. Effective competition implies that investment and corporate banks have sufficient incentives to identify and satisfy clients' demands as efficiently as possible and constantly seek to win business of clients who use rivals' services. The benefits from achieving effective competition include lower prices for clients, better quality service and/or greater innovation.

4.2 We have identified three potential competition issues for primary market and related activities that warrant more detailed investigation. These are:

- Choice of banks and advisers.
- Limited transparency.
- Bundling and cross-subsidisation.

4.3 We explain the scope of these three issues in more detail in this chapter.

4.4 There are two specific potential issues that were raised in the wholesale sector competition review that we are not proposing to cover in the market study, which are:

- Best execution of client orders – We have decided that investigating best execution of client orders is not suitable at this point in time because we considered the issue in our recent thematic review.[12] There are also regulatory changes coming into effect in MiFID II.[13] We believe it is best to wait until these changes are finalised before considering whether we need to examine best execution of client orders further.
- Barriers to entry in corporate banking – We have also decided that an investigation into barriers to entry in corporate banking is not suitable at this point in time because significant changes have been made in the authorisation process and the level of capital required for new entrants[14] and the CMA is investigating barriers to entry in the SME banking industry.[15] However, we will consider whether any practices by banks or market practices raise barriers to entry or expansion for primary market activities.

12 Financial Conduct Authority, 2014, Thematic Review, Best execution and payment for order flow, Available at: www.fca.org.uk/static/documents/thematic-reviews/tr14-13.pdf

13 MiFID II introduces several changes for investment firms executing client orders. The execution policy must be provided in sufficient detail and in clear, easy to understand language. Investment firms must summarise and make public, for each class of financial instrument, the top five execution venues where they executed client orders in the preceding year and provide information on execution policy. Firms should not receive any remuneration for routing clients' orders to a particular trading or execution venue if this is not compliant with conflicts of interest and inducements rules. See: www.esma.europa.eu/page/MiFID-II-application

14 See Bank of England and FSA (2013), A review of requirements for firms entering into or expanding in the banking sector, www.fca.org.uk/your-fca/documents/barriers-to-entry

15 For more information, see: www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk

Choice of banks and advisers

4.5 We propose to consider three areas in particular under this topic:

- The competitive landscape
- Clients' purchasing behaviour, including the impact of syndication
- Entry and expansion, including the potential effects of regulation

The competitive landscape

4.6 Some banks have told us that there is fierce competition to serve large clients but the smaller clients may be less attractive as clients and therefore less well served by the market. To assess whether this is the case, we will build a detailed picture of the competitive landscape for primary market and related activities, looking at the clients that are using these services and the types of banks and advisers that they can select to provide services.

4.7 We will consider how the competitive landscape varies across different types of clients or services and examine whether the composition of the sector suggests that there are any areas where clients may face limited choice. We will explore:

- Whether certain groups of clients (such as small/mid-sized or lower rated companies) face restricted access to particular services.
- Whether smaller clients face less choice because banks, for commercial reasons, are unwilling to engage with clients which are likely to generate less revenue than larger clients.
- Whether the major banks and advisers typically differ by sector, service or client type and whether the major players in each have changed over time.

4.8 We note that there may be good commercial reasons why some banks may choose not to offer all services/products to all clients (for example, they may be restricted by their capital strength or they may not wish to provide services to some smaller clients because such services may seem unprofitable) and all clients may not be able to access all services/products (for example, due to their size and needs). Such specialisation by banks may be consistent with a competitive market that works well, but we want to understand how any narrowing of choice affects clients.

Clients' purchasing behaviour, including the impact of syndication

4.9 Some clients told us that they face a limited choice of suppliers because they have specific requirements that only a few firms can make. For example, some clients wish to use a bank with which they have an existing relationship, or which has accumulated knowledge or experience in their sector, or which has a research department that can provide accompanying coverage.

4.10 We want to understand demand-side practices – which individuals make the decisions on procurement and what incentives they have. We will explore whether the range of banks and advisers available to a client might be restricted as a result of the nature of the client's requirements, such as the need for:

- **An existing relationship with the client:** some clients may be unwilling to use banks and advisers with whom they do not already have established relationships. This could occur because long-standing relationships enable providers to accumulate knowledge specific to their clients' business or to build trust and it may be costly for clients to establish a new relationship.

- **Accumulated knowledge and experience:** some clients may require that their bank or adviser has significant experience of providing services to other clients with a similar profile to themselves. For example, this could be the industry in which the client operates, the type of service being provided, the size and sophistication of the client, and the geographic territories in which the client operates.

- **An established reputation:** some clients may only choose a bank or adviser that has a reputation for providing a good service. We want to understand what metrics clients use to consider reputation and how use of these metrics affects competition (for example, the use of league tables).

- **Accompanying research coverage:** some clients may feel it is essential to gain research coverage as part of a bundled service – therefore if some banks explicitly or implicitly promise to publish accompanying research on the issuer client, this may limit the choice of bank.

4.11 We will also consider whether any restriction in choice is mitigated by potential benefits to clients of using banks with whom they have an existing relationship.

4.12 We also want to understand further whether the choices clients face are affected by the practices and processes they adopt when selecting banks and advisers including:

- **The use of competitive tenders:** we intend to explore whether clients typically appoint banks and advisers on the basis of existing relationships when procuring investment and corporate banking services or whether clients often seek to encourage competition among banks and advisers by using a competitive tender process.

- **The extent of multi-sourcing:** we will examine whether clients often have relationships with more than one bank and whether this enables them to negotiate more effectively when procuring investment and corporate banking services.

- **The use of advisers:** we will consider whether clients that use third party advisory firms to select a bank benefit from that advice and are better at driving competition between banks.

4.13 One particular area we wish to understand further is syndication. Syndicate sizes, particularly for equity IPOs, have been gradually increasing over recent years. The effect that syndication has on competition may vary depending on the type of transaction being undertaken. We want to understand whether there are differing processes of syndicate formation (for example, in bond, equity and loan syndicates) and how these affect competition between banks.

4.14 We want to understand when and why clients opt for syndication, and how this affects the competitive dynamics in the market. We will consider the extent to which syndicate sizes are determined by the client and we will take into consideration benefits to the client, such as access to a wider investor network. In particular, we want to understand whether there are circumstances in which the syndication process restricts instructing or issuing clients' ability to select preferred banks and advisers or to play them off against each other. For example, if it is necessary to include multiple banks as part of a syndicate, the choice for a client may be reduced and competition between banks affected.

Entry and expansion, including the potential effects of regulation

4.15 We will examine how banks and advisers establish a client base and explore the extent to which those looking to provide services to clients might face significant barriers to doing so.

4.16 The threat of potential new entrants entering the market, or the threat of more efficient rivals expanding their market share, may incentivise firms to offer higher quality services at a more competitive fee. For example, the threat of small boutique firms taking market share may act as a constraint to traditional investment banks.

4.17 We will examine whether the entry and expansion of providers of investment and corporate banking services has affected incumbents' offerings to clients and whether potential entrants face any significant barriers arising from the current regulatory environment or practices adopted by established banks and advisers. To inform our assessment we are particularly keen to hear from firms which have considered entering primary market activities but been otherwise deterred from doing so due to structural or regulatory barriers to entry.

4.18 One aspect we propose to explore is whether reciprocal arrangements between banks providing investment and corporate banking services might restrict the entry or expansion of firms which are not party to these arrangements. Such reciprocal arrangements may include banks bringing rival banks into a syndicate for one issue in exchange for inclusion in a syndicate in another issue.

Limited transparency

4.19 Some clients told us that limited information and transparency means that they find it difficult to select the bank that is best able to serve their interests or that they may end up with outcomes that are not best suited to their needs.

4.20 Specific areas we propose to consider under this topic are the adequacy of information, the transparency of the allocation of equity and debt issues and the impact of established practices, processes or regulations on transparency in the IPO process.

Adequacy of information

4.21 We will consider the adequacy of the information that is revealed to clients, considering whether banks and advisers disclose sufficient and appropriate information to enable clients to make informed choices and whether established practices, processes or regulations serve to reduce the transparency of banks and advisers' propositions.

4.22 Our examination of the adequacy of the information will take into consideration that the necessary information may differ both according to the nature of the service the client is using and the experience and sophistication of the client themselves:

- **Experience and sophistication of the client:** Infrequent users of investment and corporate banking services may be more susceptible to the effects of limited information and transparency. Large and sophisticated clients (such as private equity groups) are likely to have more experience of raising finance compared with smaller corporates, potentially allowing them to negotiate more effectively. For example, a small, family-owned corporate client seeking an IPO is likely to have no experience of raising capital via an IPO[16] compared with a private equity owned corporate client seeking an IPO.

- **Range and complexity of the service:** Banks and advisers provide a wide range of capital raising options to clients, each of which can be complex and may require specialist knowledge or experience to understand. Some groups of clients (such as fledgling companies) may not have this specialist knowledge and may find it more difficult than other types of client (such as governments or FTSE 100 companies) to decide which form of financing best fits their needs and may not fully understand the services they are acquiring.

16 Unless the owners have conducted an IPO on another business.

4.23 We will examine whether banks and advisers reveal sufficient information to enable clients to make informed choices. For example we will consider whether banks and advisers are sufficiently transparent about their fee structures, particularly where multiple services are provided to a client for a single fee, including whether they typically provide a breakdown of charges for any bundled products (see paragraph 4.31 below for a definition of bundling).

4.24 We will also explore whether there are any restrictions, including those arising from existing regulations which limit the information that banks and advisers are willing and able to reveal to clients or the extent to which clients can make use of this information. We are particularly interested to hear from stakeholders with experience of such issues and concerns.

Transparency of the allocation process

4.25 We have heard concerns from issuing clients and investors subscribing for an allocation that when issuing debt or equity issuing banks may favour certain investors.

4.26 Potential conflicts of interest could arise when issuing debt or equity that could result in banks who manage new issuances showing preference to their favoured investor clients when deciding on final allocations. This might go against the interests of the issuer client who may, for example, be best served by having a set of long-term shareholders. If the allocation process is not clear, the issuing client may find it difficult to monitor whether the bank is showing preference to its favoured investor clients or whether the issuer's requirements are being taken into consideration.

4.27 We want to understand whether clients are given both contractual and actual final approval of allocations and whether there are circumstances in which it is difficult for clients to monitor allocations. This may be different for different types of debt and equity issues.

4.28 We also want to understand whether there are any potential detrimental effects from any lack of transparency and/or from reduced long-term participation in the new issues market if certain investor clients are favoured.

Impact of established practices, processes or regulations on transparency in the IPO process

4.29 We will examine whether existing rules and practices for disclosing information around IPOs allow information, such as prospectuses and unconnected research, to be released at the appropriate junctures. This will include an examination of whether the prospectus is available early enough to serve as a meaningful source of information to potential subscribers to the offering, and whether during the book-building process the information that is available is limited to only that which has been published by the banks connected to the deal.

Bundling and cross-subsidisation

4.30 We have heard of a number of concerns from clients and some standalone or boutique investment banks that investment and corporate banking services are often sold together.

4.31 Bundling, cross-selling and tying refer to the provision of two or more services in a package as opposed to being sold separately, such as:

- **Pure bundling** – two or more services are provided as part of a package and these services are not available separately.

- **Mixed bundling** – two or more services are provided together in a package, although each service can be acquired separately. However, if a customer were to acquire each individual service separately, the overall fee would exceed that of the bundle. Therefore, the customer is incentivised to acquire the bundle.

- **Tying** – a special case of mixed bundling that occurs when two or more services are provided together in a package, but at least one of these services is not provided separately.

- **Cross-subsidisation** – when the margins from one service are used to enable another service to be provided at a lower price.

4.32 We will consider whether and, if so, which primary market activities and related activities are sold together. We will also want to understand whether there is any cross-subsidisation between primary market activities and related activities or within primary market activities. We will also want to understand whether any such bundling or cross-subsidisation extends beyond primary market and related activities (e.g. to secondary market activities). We will consider why these practices occur (for example, whether these practices are driven by existing regulations) and whether either of these practices might be beneficial for clients or whether they might inhibit the effectiveness of competition.

Bundling

4.33 We will explore two ways in which the practice of bundling might reduce the effectiveness of competition in investment and corporate banking:

- **Restricting switching:** by acquiring the initial service, clients may also be tied into acquiring follow-on services from the same bank. This tying can be explicit, i.e. through legally binding contracts, or implicit with the banks communicating that they expect clients to acquire follow-on services from them and not from rival banks.

- **Creating barriers to entry/expansion:** Demand for bundled services may increase barriers to entry for certain investment and corporate banking services, which in turn could lead to higher concentration in the market for those services. This is especially likely to occur when banks are tying or using pure bundling. For example, during equity issuances, some banks bundle advice, underwriting services, sponsor services and other services together. This may create barriers to entry for smaller boutique providers who offer these individual services and potentially reduce the level of effective competition within the market.

Cross-subsidisation

4.34 We will explore two ways in which the practice of cross-subsidisation might reduce the effectiveness of competition in investment and corporate banking:

- **Raising barriers to entry and reducing incentives to innovate:** Firms may be inhibited from competing in the service being used as a loss leader. This may harm clients if the rival could improve the quality of the service through innovation.

- **Clients using more or less of services than they otherwise would:** including the overuse of services that are provided below cost or free of charge and/or the underuse of services on which a higher margin is gained.

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