FCA Consultation Paper 16/31 – AFME and BBA Response

The Association for Financial Markets in Europe (AFME) and the British Bankers' Association (BBA) wish to comment on the FCA Consultation Paper 16/31 on Investment and Corporate Banking: Prohibition of Restrictive Contractual Clauses (CP 16/31).

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME advocates stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

The BBA is the leading association for the United Kingdom banking and financial services sector, representing over 200 banks which are headquartered in 50 countries and have operations in 180 countries worldwide. Its members manage more than €10 trillion in banking assets, employ nearly half a million individuals, contribute some €100 billion to the economy each year and lend some €200 billion to businesses.

Introduction

AFME and the BBA value the opportunity to respond to the proposed prohibition on restrictive contractual clauses in advance of the publication of a policy statement.

The FCA will be aware that our members do not agree that a ban on restrictive clauses is required. However, we note that the FCA concluded in its final report that such a ban is necessary. We are therefore providing comments on the basis that a prohibition will be implemented. With this in mind, please note the following.

We consider that the general approach that the FCA has put forward to implement such a ban by way of a change to the FCA handbook is reasonable, subject to the need to address a number of key points. In particular, the scope of the prohibition as reflected in the definitions used in the draft instrument. We believe that further consideration and analysis by the FCA is required.

We have therefore prepared a mark-up of the instrument which is attached to this response showing the amendments we would propose. We set out below some general observations about the scope of the prohibition and additional commentary on the specific proposed amendments to the instrument. In preparing this mark-up and commentary we have taken

as our starting point the stated aim of the study, namely to improve competition for primary market services in the U.K. market.

In addition, we have responded in brief to questions 1 to 5 set out in CP 16/31.

We would welcome the opportunity to discuss our comments and the mark-up with the FCA.

Future Services Restrictions Instrument 2017

General Comments

We believe that there are two important perimeter questions to address in the definitions section - the types of services in respect of which a restriction is prohibited and the jurisdictional scope of the prohibition.

First, we consider that the scope of the prohibition should be future service restrictions relating to those services that were the focus of the market study, i.e. primary market services. As specified in paragraph 1.1 of CP 16/31, these are equity capital market services, debt capital market services and merger and acquisition services. We also consider that the prohibition should only apply where the restriction is contained in an agreement relating to primary market services and/or related services, noting that the market study focused on a review of these agreements only.

We also note that the FCA, in its August 2016 information request letter seeking further information from banks, acknowledged this distinction between the restrictive clauses it focused on (i.e. clauses covering future primary market services) and the types of engagement letter that it reviewed as part of the market study (i.e. engagement letters relating to primary market and related services). The August 2016 letter, consistent with the above-mentioned paragraph 1.1. of CP 16/31, defines “primary market services” as equity capital market services, debt capital market services and merger and acquisition services and defines “related services” as corporate broking, lending, and NOMAD/Sponsor Services. We agree with how the FCA has defined these terms.

In our mark-up we are therefore proposing to introduce two new definitions, “primary market services” and “related services”, the definition of “primary market services” replacing the definition of “corporate finance services”. These two new definitions track the definitions used in CP 16/31 and the August 2016 letter. The opening paragraph of the definition of “future service restriction” is amended so that it applies to provisions contained in agreements relating to "primary market services" and/or “related services”. The future service restrictions which are prohibited, as set out by the FCA in paragraphs (1) and (2) of the definition of “future service restriction”, have been amended to refer to “primary market services”.

With respect to the term "corporate finance business", we note that this term is currently used in the FCA handbook within the definition of “corporate finance contact”, which in turn is a category of person excluded from the definition of “client”. It is therefore used in defining a category of person that is not to be treated as a client for the purposes of the FCA handbook,

and the services included in the definition of corporate finance business reflect that purpose and not the purpose of the prohibition (i.e. furthering competition in primary market services). We do not therefore believe that it is the appropriate foundation for defining those services which are to fall within the prohibition. In addition, the definition of "corporate finance business" is very broad and complex and we consider that its use would likely result in considerable uncertainty. For example, the use of this term would potentially extend the prohibition to services that were not the subject to the market study (such as secondary market services, including hedging) and have therefore not been subject to the detailed analysis, including the cost-benefit assessment, of the market study. Further exceptions to the new rule may be required if the prohibition retains its current breadth.

Secondly, we believe that the prohibition should only apply to services which are provided to a U.K. client and should not be extended to non-U.K. based clients. We take this position because the proposal will have a negative impact on the ability of banks' U.K. establishments to compete for future work abroad, including for transactions without any nexus to the U.K., impacting the competitiveness of banks' U.K. establishments. In addition, and subject to the below, whilst we accept a prohibition on future service restrictions applying to "primary market services" provided by a bank's U.K. establishment to clients located in the UK, we note that this still puts banks operating from non-U.K. establishments at a competitive advantage when competing for future mandates from U.K. clients. In particular, they will be able to price the original services more competitively having regard to the possible provision of future services. Accordingly, we consider that the definitions of the terms "primary market services" and "related services" should refer only to services received by clients that are located or established in the U.K.

We separately note that the COBS rules apply to activities "carried on from an establishment in the United Kingdom". We have concerns that this general COBS scope could cause uncertainty and other unintended consequences. We would welcome further analysis by or guidance from the FCA.

In particular, it is not clear:

- whether the service that has to be carried out from an establishment in the U.K. relates to the "original" service or the "future" service"; and

- how much of the activity in relation to a particular service must take place from an establishment in the U.K. For example, would the fact that a small number of individuals who are part of a much wider deal team are located in the U.K. cause a restriction to be subject to the prohibition? Similarly, would it be triggered by the fact that a London sales force or syndicate desk is (or may become) involved?

This uncertainty would make the restriction difficult to apply in practice, especially given that it might not be clear at the time of signing an agreement for the original service exactly where all activities relating to the future service would be conducted from. For example, in respect

of an IPO it may not be certain which listing venue will be chosen and the choice of the listing venue may impact on where the relevant teams are located.

These difficulties may result in firms having to apply the prohibition more broadly in order to avoid breaching it inadvertently, potentially including to their non-U.K. affiliates transacting with non-U.K. clients. Not only does that go beyond the scope of the market study, it also risks the restriction coming into conflict with rules governing the same subject matter in other jurisdictions.

In order to address the difficulties potentially caused by the general COBS scope, we would suggest that, in determining whether the activities are carried on from an establishment in the U.K., it is the location from which the future services are to be provided which is the correct test. In addition, we also suggest that the FCA consider that the future service must be intended to be principally performed from the establishment in the U.K. This would assist in addressing the difficulties created by having services performed from multiple locations and recognises that the location from where the services may be provided may change following entry into the agreement.

Additional specific changes

Definition of "future service restriction"	The amendments made in the opening section are clarificatory and are in addition to the general comments on scope of the prohibition made above. We have expanded the drafting in sub-paragraphs (1) and (2) so that they more clearly and accurately describe a "right to act" clause (in the case of sub-paragraph (1)) and a "right of first refusal" clause (in the case of sub-paragraph (2)). In particular, we believe that a "right of first refusal" clause should be defined by reference to the client being prevented from seeking an offer from a third party as a way of distinguishing it from a "right to act" clause.
Definition of "bridging loan"	We have deleted the reference to a time period. As bridging loans are often tied to specific transactions, clients frequently seek maturities of greater than 12 months for various reasons. For example, an extended competition review in the context of an acquisition or to allow sufficient time for the preparation of financial statements required for the securities offering intended to refinance the bridging loan. What is important is the "bridging" characteristic of the loan, not an arbitrary

period of time. We believe that clients will benefit from this flexibility.

Whilst we don't believe that there should be any time period, were there to be a time period, the following considerations should be noted:

- Clients frequently seek the ability to extend a bridging loan. Any definition that includes a term would need to capture this ability to extend.

- Any term limit would need to be calculated from the date the bridge loan is advanced, not the date that it is executed. A bridge facility may not be used for a period following its execution.

In addition:

- Bridging loans, in particular warehouse loans, will rarely be provided on the condition that they be replaced, as that will not allow the borrower to give a "certain funds" assurance. Rather, there may be an expectation that they will be replaced, subject to market conditions. We have therefore suggested replacing "on the condition" with "with an expectation".

- We have suggested adding reference to a refinancing of a loan facility. This is because warehouse facilities can be revolving, such that the warehouse facility may be used to warehouse more than one portfolio (e.g. following the refinancing of one portfolio in a securitisation transaction, allowing further assets to build for a second transaction based on the same warehouse).

- We have suggested replacing the reference to "longer-term financing" with a reference to "another form of financing". In the context of a conventional leveraged finance bridge to bond, although such a bridge will have an initial maturity of 12 months, it will then automatically extend to a maturity that coincides with the target maturity date of the targeted replacement financing (i.e. the financing

	that replaces it is not necessarily longer term financing).
Title of additional section	We have changed "exclusivity provisions" to "future service restrictions", which is, we believe, a logical amendment in light of the definitions.
18.3.5 R	These amendments are consequential in light of the above comments.
18.3.6 R	These are clarificatory changes only.
18.3.7 G (1) and (2)	We understand *that the important distinction which 18.3.7 G (1) and* (2) is making is between: • a mandate for services which the firm has agreed to provide, potentially covering both services which are to be provided immediately and closely-linked services to be provided at a future date. The services envisaged to be provided are part of the primary mandate; and • services for which the bank is not currently appointed to act but which may be later required by the client. We have proposed the word “envisaged” as we believe that this encapsulates the requisite degree of certainty / expectation that such services may be provided in the future, without requiring certainty that they be provided or when they may be provided. Not all the services that may be provided in the future under the terms of the engagement letter will be "certain". For example, a firm may be appointed to act for a client on a bid defence when it is not certain that a bid will be made or, if made, when it will be made. In addition, a service may not be provided if its provision is subject to the satisfaction of pre-conditions or if the engagement is terminated prior to the provision of such services. Notwithstanding our proposed changes to the text, we recognise that the term “envisaged” may not in itself provide sufficient clarity and that additional guidance notes interpreting “envisaged“ in specific contexts will be needed in order to distinguish between existing and future appointments.

18.3.8 G (1) and (2)	We understand the purpose of 18.3.8 G (1) and (2) is to clarify that future payment of fees for services provided are not caught by the prohibition. We have reflected this understanding in the mark-up. Also: • We have suggested adding "undertaken or agreed to be undertaken" as a clause may be enforced when not all elements of the services have been performed. • We have added "including" as there may be circumstances where the appointment is terminated and the client benefits from the services provided but does not appoint another firm to provide the services. • We have added "or similar" given that no two transactions are identical.
18.3.9 G (1) and (2)	In sub-paragraph (1) we believe that in the context of exempting a right to match it is important to include this wording. In sub-paragraph (2) the amendments in (c) cover the same point and is a clear contrast to the definition of a "right of first refusal" in sub-paragraph (2) of the definition of "future service restriction. Overall, we believe it is important to amend this section in order to set out what is meant by a "right to match". A firm that has a "right to match" provision in an engagement letter should have the right to join a syndicate of service providers if it matches quotations from other firms. If this is not the case and the client can decide not to engage that bank, it merely has a right to pitch.

Responses to questions

In response to the specific questions set out in CP 16/31, please note the following.

Q1. The AFME/BBA position remains that the market for investment banking services is competitive and that clients do not need to rely on the FCA to intervene to prohibit certain clauses. AFME/BBA believe that contracting parties should be entitled to agree amongst themselves contracts for the provision of investment banking services. As stated in our response to the interim report, an attempt to prohibit the use of certain clauses will potentially be time-consuming given the difficulty in determining the scope of any prohibition. We believe that this difficulty is shown by the general comments we have made

on the draft instrument and our multiple requests for clarification. However, as already indicated above, if a decision has been taken to prohibit certain clauses, we do not see an alternative to the general approach taken by the FCA in the CP 16/31.

Q2. and Q3. As set out above, we have made detailed comments on the scope, design and drafting of the draft instrument and proposed clarifications to the guidance to make the proposal workable and remove unintended consequences.

Q4. and Q5. We do not think that clients will benefit from the prohibition. If the issues raised in this response are not addressed, we believe the lack of clarity will be disruptive and increase administrative costs.

16 December 2016