
Briefing Note

Application of the MiFID II Telephone Taping Requirements to certain Equity Capital Markets Transactions

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1. Introduction

- 1.1 This note considers the application of the FCA's telephone taping rules set out in PS17/14 (issued in July 2017) to the activities of investment banks relating to certain equity capital market transactions.
- 1.2 The Association for Financial Markets in Europe (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. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.
- 1.3 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.
- 1.4 The ECM transactions covered by this note (*ECM transactions*) are:
 - (a) IPOs;
 - (b) secondary offering by accelerated book build (Secondary *ABB*);
 - (c) share buy-back; and
 - (d) stakebuilding.
- 1.5 This note considers both the scope of application of the taping rules, and also the point in time when the recording obligation arises where the obligation applies.

2. General

- 2.1 The scope of the telephone taping rules is set out in SYSC10A.1.1, which is in force from 3rd January 2018. Broadly, the rules apply to UK MiFID investment firms (and other categories of firm) that carry on one of a number of regulated activities in relation to 'financial instruments' (as defined in MiFID II).
- 2.2 In relation to the ECM transactions the potentially relevant regulated activities are:
 - (a) arranging (bringing about) deals in investments;
 - (b) dealing in investments as agent; and
 - (c) dealing in investments as principal.

- 2.3 These regulated activities reflect the MiFID investment services of reception and transmission of orders (arranging (bringing about)), executing orders on behalf of clients (dealing as agent and dealing as principal) and dealing on own account (dealing as principal).
- 2.4 SYSC 10A1.4R (4) contains specific exemptions for activities which comprise:
- (a) underwriting of financial instruments on a firm commitment basis; and
 - (b) placing of financial instruments with or without a firm commitment basis.
- 2.5 As a result of the exemptions, telephone conversations which occur as part of underwriting or placing activity fall outside the telephone taping obligation even if these activities would also constitute the regulated activities within paragraph 2.2.

3. **IPOs and Secondary ABBs**

In relation to IPOs and Secondary ABBs, the key question for firms will be whether they are carrying out the regulated activities of arranging (bringing about) or dealing (whether as principal or agent) and, if they are, whether they are carrying out the MiFID investment services of underwriting or placing.

- 3.1 This question will, in turn, require an assessment of who is the firm's client on the transaction. Where the firm is acting solely for the issuer/seller in underwriting the offer and/or in placing the financial instruments with investors then the telephone conversations which relate to these activities will not need to be recorded because, although the services that the firm provides to the issuer/seller are likely to constitute the regulated activities of "arranging" or "dealing on own account", they will also amount to the investment service of underwriting or placing under MiFID. The FCA stated in PS17/14:

*"...in a capital-raising context there will be conversations and communications between the syndicate banks, issuer and/or investor clients about pricing and allocating securities. Firms providing underwriting and placing services are not within the scope of the taping requirements unless the firm is involved in providing client order services alongside these [emphasis added]. Such client order conversations and communication will be in scope of Article 16(7)."*¹

- 3.2 Accordingly, conversations between the firm and its issuer/seller client relating to the underwriting agreement, or the pricing and allocation of financial instruments need not be recorded where the firm is acting for the issuer/seller alone.²
- 3.3 Furthermore, if the firm is not providing a separate service to the investors with whom financial instruments are placed then telephone conversations between the firm and investors, which relate to the placing of financial instruments will also not need to be recorded, although firms should note the FCA comment set out below.³

¹ PS 17/14 p.123.

² Secondary offerings structured as a 'bought deal' where the firm, as principal, acquires the selling shareholders shares and then sells them to investors would legally involve the firm providing the service of execution of orders to both the offeror and the investors. In this case the telephone taping obligation is likely to apply. However, we understand that bought deals are now extremely rare in practice. As regards secondary offerings not structured as bought deals, the same analysis should apply as for primary offerings.

³ In PS 17/14 the FCA stated that it considered it good practice for firms to record conversations relating to the pricing and allocation of securities offerings whether or not they are subject to the taping obligation: "If conversations and communications relating to these services are not already

3.4 If, however, the firm is providing an order service to the investors with whom financial instruments are placed (for example, reception and transmission of orders or possibly execution of orders) then conversations between the firm and its investor client will need to be recorded. Which conversations need to be recorded is considered further below.

3.5 Whether the firm is providing an order service to investors will have to be assessed by the firm. In circumstances where the firm can treat investors as corporate finance contacts, then it will not be providing such services to those investors.

3.6 To the extent that investors are considered to be receiving order services, firms should note that, in PS 17/14 the FCA stated:

"The focus of the recording requirement is on the end of the process leading to a transaction where the transaction is agreed or there is a reasonable prospect of the transaction being agreed.

...As the focus of the recording requirement is on the end of the process, in practice this is likely to be limited to communications in relation to the key elements of the final intended transaction such as price."

3.7 On the basis of this statement the calls which would need to be recorded would be those at the very end of the process leading to a transaction (which could be the allocation call from the bank to the investor).

4. Buy-backs

4.1 In a buy-back the firm acts on behalf the issuer in buying securities. The buy-back may involve the firm dealing as principal if it buys securities in the market as principal (including as riskless principal) and then sells the securities as principal to the issuer, or (less commonly) as agent where it buys securities in the market as agent for the issuer. In either case, the firm will be providing services to the issuer which comprise regulated activities falling within the scope of the telephone taping obligation.

4.2 The key issue in relation to buy-backs is the time at which the recording obligation will apply. Following the FCA's approach in PS 17/14 (as set out above) only those conversations at the end of the process need be recorded. Initial discussions with issuers about undertaking a buy-back programme would not need to be recorded, for example.

4.3 Where the issuer gives an irrevocable general authority to undertake buy-backs up to a certain level and subject to certain price parameters, but the firm then has discretion as to the execution of transactions within those parameters, then it is arguable that these discussions do not relate to the final terms of the individual transactions but only the general parameters within which such transactions may be effected by the firm. However, given that these do set the parameters within which transactions will be effected it would be prudent to record telephone discussions relating to the final terms of an irrevocable authority unless (as is often the case) the irrevocable is actually agreed in a written agreement which will set out the final terms. Where a general authority is not recorded in a written agreement (which is often the case where the authority is revocable) then it would be necessary to record calls relating to the final terms of the authority.

directly caught by the telephone recording requirements, we would encourage firms to consider whether...they could be captured in a manageable way."
p.124 PS 17/14.

- 4.4 Where an issuer gives instructions by phone to the firm in relation to individual transactions then these conversations would need to be recorded.
- 4.5 Where the issuer does not give instructions by phone, but only does so by e-mail then clearly there is no phone call to record. Firms should, however, retain the e-mail as the record of the transaction instruction.

5. Stakebuilding

- 5.1 Stakebuilding (whether or not in connection with an M&A transaction) will involve the regulated activities of dealing as principal or as agent and the investment services of reception and transmission of orders and/or execution of orders. Telephone conversations relating to these activities are subject to the telephone taping obligation. As is the case with buy-backs, the key question is the point in time that the conversations must be recorded.
- 5.2 Following the FCA's approach in PS 17/14 conversations relating to the final terms of the stakebuilding transaction should be recorded. Consequently, discussions with a corporate client regarding stakebuilding as a possible strategy in an M&A transaction need not be recorded.
- 5.3 Where the client provides the firm with the final general parameters for trading (i.e. to purchase securities up to a certain percentage and within specified price parameters) then, although this is not the final terms of any particular transaction, because it does set the parameters within which transactions may be undertaken calls which discuss the final parameters should be recorded. These calls will often be made to employees who would be using tape recorded lines in any event and firms should take reasonable steps to try to ensure clients do contact employees with recorded lines. However, if a call relating to the final terms of a stakebuilding authority is made to an M&A banker on a non-recorded line then alternative record-keeping arrangements would need to be made, such as requiring the banker to confirm the content of the discussion with the client by e-mail.
- 5.4 If the client gives the firm instructions in relation to specific individual trades then these conversations would need to be recorded. Where the instructions are not given by phone, but are sent by e-mail, for example, then there is clearly no telephone conversation to record. Firms should, however, retain the e-mail as a record of the transaction instruction.

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