Financial Conduct Authority

MS15/1.2: Annex 4

Market Study

Investment and corporate banking market study

Interim Report: Annex 4 – Selection criteria

April 2016

Annex 4: Selection criteria

1. In this annex we analyse how clients' preferences drive competition for primary market services. We consider the selection criteria that clients take into account when assessing and appointing providers of each of equity capital markets (ECM), debt capital markets (DCM), mergers and acquisition (M&A) and corporate lending services.

2. Where a market is functioning effectively we would expect a client to be able to appoint a bank or adviser that offers services which best meets its needs. A provider will generally be selected on the basis of a combination of characteristics, including price and quality and other factors. Where banks and advisers have an understanding of the characteristics that clients most value they should be incentivised to compete on that basis.

3. Concern may arise where the competitive dynamic between a client and its bank or adviser is compromised or broken. This may arise in circumstances where:
   - a client has insufficient information or knowledge to be able to assess and select a provider which best meets its needs and requirements
   - a client's requirements substantially limit its choice of available supplier
   - a client is bound to an incumbent supplier
   - the selection criteria adopted by a client drives poor behaviour by banks and advisers

4. In the analysis below, we discuss first clients' selection criteria and second the value proposition used by banks and advisers when targeting clients. We then compare those factors affecting clients' choice of provider with those factors which banks and advisers consider relevant to their value proposition.

Clients' selection criteria

5. For each of ECM, DCM, M&A, other investment banking services and corporate lending we asked clients which characteristics they placed the greatest importance on; ranking these characteristics from unimportant (ranked as one) to extremely important (ranked as five). Only ten clients responded to our request and, given the relatively small sample size, we have supplemented the analysis with evidence we have gathered from our case studies (see Annex 3).

6. Overall, clients select a bank to undertake ECM, DCM and M&A transactions based on three broad but interdependent categories: quality of service, level of fees and broader relationship factors. The most commonly valued criteria are summarised in Figure 2 below.

Figure 1: criteria used by clients when selecting banks for ECM, DCM and M&A services

Type of criteria	Criteria
Service quality related factors	• overall credentials and experience of the bank (including league table position) • knowledge of the client • sector and/or transaction specific expertise • comprehensive research coverage by highly ranked analysts (ECM and DCM only) • good investor coverage, including geographic and sector reach (ECM and DCM only) • where relevant, adequate presence and coverage in other countries and regions • ability to manage potential conflicts of interest • ability to work constructively with the issuer's management to achieve efficient execution
Fees	• proposed fee levels (and how they compare with fees for comparable transactions/fees proposed by other banks)
Broader relationship related factors	• provision of past and ongoing relationship services (most importantly, corporate broking and/or corporate lending)

7. Our analysis of clients' responses to our request for information indicated that clients select and appoint a bank or adviser on the basis of a combination of factors. The relative importance of these factors varies depending upon the nature of the product, the type and size of the client and the size of the transaction. We set out below the criteria considered most important by clients.

- **An existing relationship with the bank or adviser.** For the majority of clients, an existing relationship with a bank or adviser is important and they commonly select a bank or adviser that has provided an efficient service to them in the past. A long-standing relationship with a client allows a bank or adviser to accumulate institutional knowledge of the client's business model and credit risk, helping them provide the best outcome for the client. An on-going relationship between client and bank or adviser is often established following a client's initial public offerings (IPO), with providers seeking to establish and maintain a long-term relationship as the client develops through its life cycle. Three clients noted that a 'good fit' between the bank or adviser and the client's management team is crucial to establishing a successful long term relationship.
- **Knowledge of the sector / client.** Knowledge of the sector/client was identified as a key criterion across each of the relevant services. Whilst knowledge is typically accumulated throughout the banking relationship, before such a relationship is established, banks and advisers need to be able to demonstrate their knowledge of the relevant sector. Two sovereign, supra-national and agency (SSA) clients and three other clients indicated that they measure a banks relevant experience by assessing their track record in the context of previous successful transactions.
- **Capabilities including investor contacts and distribution reach / platform.** The ability to execute an issue successfully, including investor contacts and sufficient distribution, was identified as particularly important in the context of IPOs and debut DCM issues. The majority of clients noted that they compare capabilities when appointing banks. With regard to ECM, many clients place significant value on a bank's investor contacts, including the ability to generate a

favourable investor base. In respect of DCM, many clients consider distribution reach and platform to be a key consideration.

- **Analyst's ranking / research capabilities**. With regard to ECM, particularly in the context of IPOs, four clients identified an analyst's ranking as an important criterion in the selection process. Similarly, in relation to DCM, research capability was also acknowledged by clients as being a relevant consideration.
- **Fees.** Only three clients noted that the level of fees is an important factor in the selection process, albeit they rated them as less important than quality-related criteria. Several clients expressed the view that fees are less of a decisive factor than quality given fees are perceived to be market standard.
- **League table positions**. League table position in combination with other qualitative factors is also a criterion used by clients to compare banks. The importance of league table position typically varies depending upon client type. More weight is typically placed on league table position by new clients and/or those who infrequently access capital markets. This is because league tables are perceived as an objective indication of a bank's capabilities, sector knowledge and experience. Conversely, less weight is often attached to league table position by existing clients and/or clients who are sophisticated and frequently access capital markets. For these clients, greater emphasis is placed on their knowledge of a bank's past performance.
- **Location / coverage in other jurisdictions**. For each of ECM, DCM, M&A and corporate lending services, the importance of the bank's location depends on the principal jurisdiction from which the client executes its transaction. The majority of the clients indicated a preference for appointing a bank active in the UK for their UK transactions and generally a local provider for other internationally originated transactions. This is because clients consider location to be a proxy for market knowledge and distribution reach (particularly, with regard to DCM services). The relative importance of an established presence in other jurisdictions depends upon the nature of the transaction and the requirements of the client. Broadly speaking, jurisdictional reach is more relevant for larger issuers that are seeking to attract a global investor base or where a client is seeking to expand an established business into a number of jurisdictions.

8. Based on the evidence from clients' responses, we have found that:
   - Clients' choice of bank or adviser is aimed at ensuring a higher quality of the service ahead of lower fees.
   - In order to assess quality, clients take into account a combination of factors, including knowledge of the sector/client, investor base/distribution capabilities and an analyst's ranking/research capabilities. Location/coverage in other jurisdictions may be taken into account in certain transactions. The importance of league table position varies by client type. For a new client, it can be a significant influencing factor.
   - An existing relationship with the bank or adviser is important because it generates trust, in-depth knowledge of the client and a good fit with the client's management team.

Banks' and advisers' value proposition

9. We asked banks and advisers which characteristics they placed the greatest importance on when setting out their value proposition to new clients (i.e. engaging with the bank or adviser for the first time[1]) and existing clients. We asked the banks and advisers to rank these characteristics from unimportant (ranked as one) to extremely important (ranked as five). We asked them to do this for each of ECM, DCM, M&A and corporate lending. 66 banks and advisers responded to this part of our request (see Annex 2 for further details). Our sample of 66 banks and advisers includes:
   - 48 providers of ECM services
   - 35 providers of DCM services
   - 53 providers of M&A services
   - 28 providers of corporate lending services

10. We have first set out our analysis for each of ECM, DCM, M&A and corporate lending so the relevant factors can be compared against one another within each service. The summary statistics set out in the graphs below show the average scores for each factor by client type and service. We then consider the most important specific factors and compare them between different types of services.

[1] A client can also be a new client for the specific product considered but still an existing client of the bank or adviser.

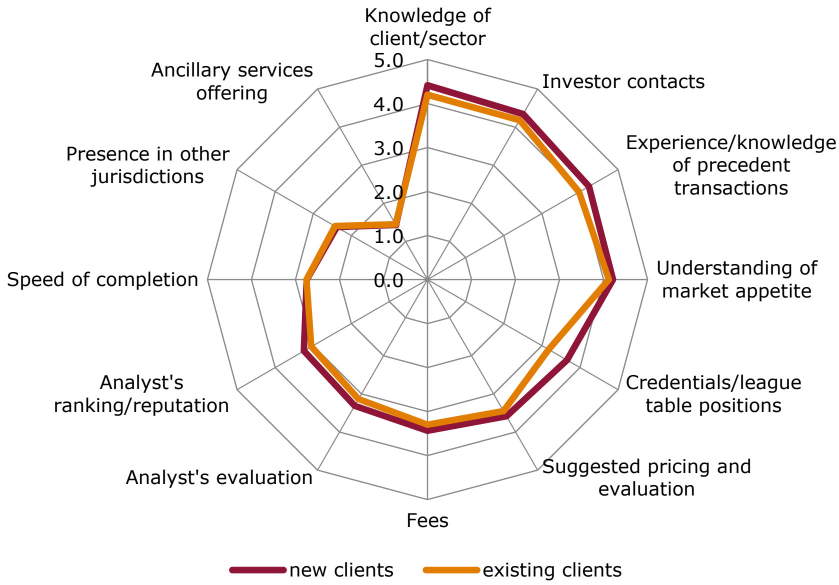
ECM

11. Figure 2 presents the results for IPOs, showing the score of one to five for each relevant factor cited by banks and advisers. It shows that banks and advisers consider the following factors, in descending order of importance, relevant to their client value proposition:

- knowledge of client/sector
- investor contacts
- experience/knowledge of precedent transactions
- understanding of market appetite

12. These results do not differ materially between new and existing clients (as shown in Figure 2) or for follow-on offerings and other ECM transactions. Banks and advisers placed slightly more value on credentials/league table positions for the value proposition for new clients.

Figure 2: Banks' and advisers' value proposition for IPOs – average scores



Source: FCA analysis of data collected from 66 banks and advisers.

13. In addition to the criteria set out above, we also asked banks and advisers to provide an indication of why they considered they had lost a mandate when bidding for IPOs and other equity issuances. The main reasons identified for losing a mandate included:

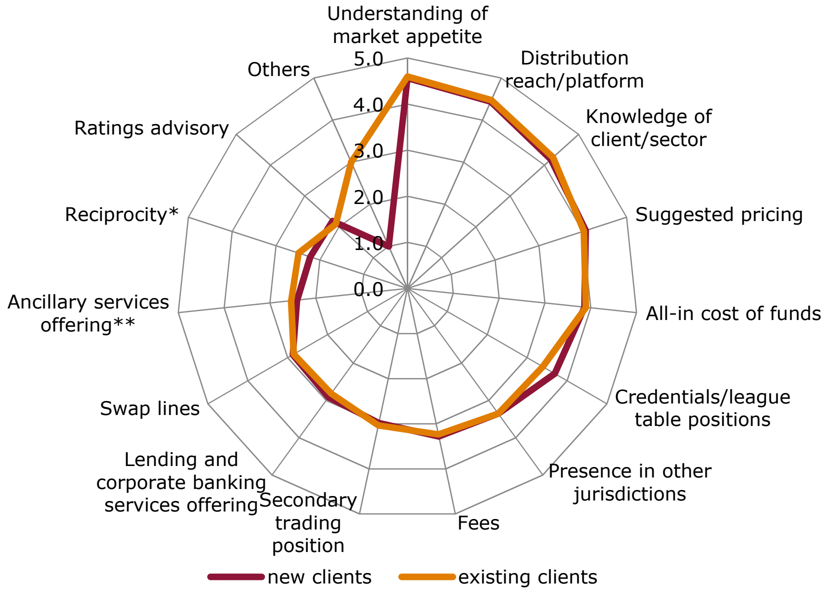
- a lack of geographic knowledge/platform
- a weak relationship/no relationship with the client
- a lack of credentials/experience
- fees and/or price were not sufficiently competitive

DCM

14. Figure 3 shows the results for frequent DCM issues. It shows that banks and advisers consider the following factors, in descending order of importance, relevant to their client value proposition:
    - understanding of market appetite
    - distribution reach/platform
    - knowledge of client/sector

15. Infrequent DCM issues and initial public debt offerings also showed similar results.

Figure 3: Banks' and advisers' value proposition for frequent DCM issues – average scores



Source: FCA analysis of data collected from 66 banks and advisers.

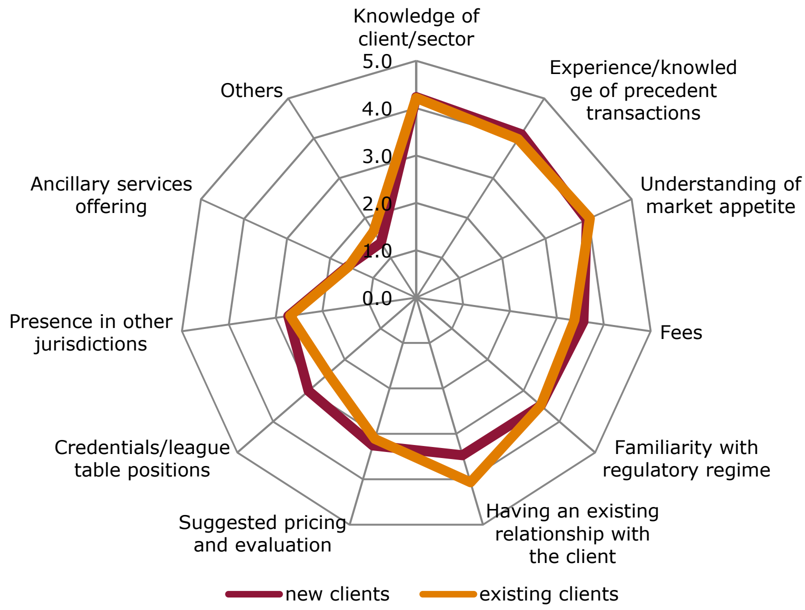
Notes: *where the client is a financial institution;** e.g. hedging products.

M&A

16. Figure 4 sets out the results for M&A. It shows that banks and advisers consider the following factors, in descending order of importance, relevant to their client value proposition:

- knowledge of client/sector
- experience/ knowledge of precedent transaction
- understanding of market appetite

Figure 4: Banks' and advisers' value proposition of M&A – average scores



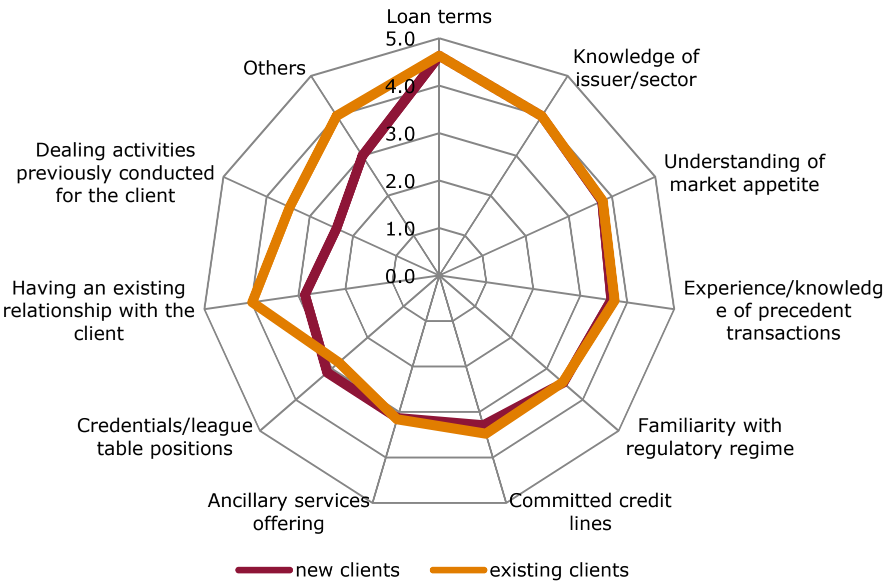
Source: FCA analysis of data collected from 66 banks and advisers.

Corporate Lending

17. Figure 5 sets out the results for corporate lending. It shows that banks and advisers consider the following factors, in descending order of importance, relevant to their client value proposition:
    - loan terms
    - knowledge of client/sector
    - understanding of market appetite

18. Banks and advisers placed slightly more value on credentials/league table positions than understanding of market appetite for the value proposition for new clients.

Figure 5: Banks' and advisers' value proposition of corporate lending – average scores



Source: FCA analysis of data collected from 66 banks and advisers.

Comparing specific factors between different types of services

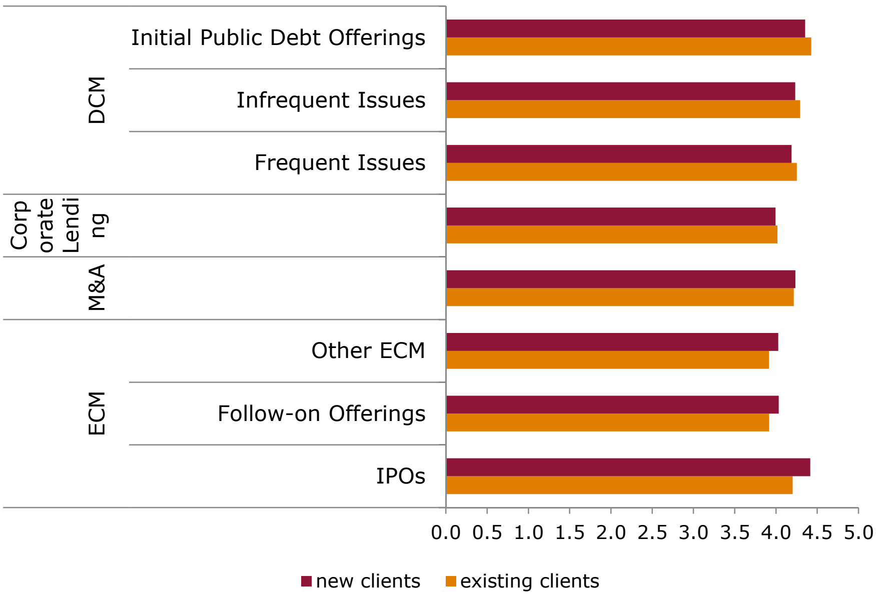
19. We next consider further the following specific factors in banks' and advisers' value propositions:

- knowledge of the sector/client
- capabilities
- having an existing relationship
- fees
- credentials and league table positions

Knowledge of the sector/client

20. As set out above, across each of ECM, DCM, M&A and corporate lending, the majority of banks and advisers place the greatest value on the level of knowledge of the sector/client. Figure 6 below shows that its ranking is not lower than 3.8 out of 5. This factor is given the highest score in the context of IPOs, particularly for new clients. This is also consistent with the views expressed by clients.

Figure 6: Importance of knowledge of the sector/client – average scores

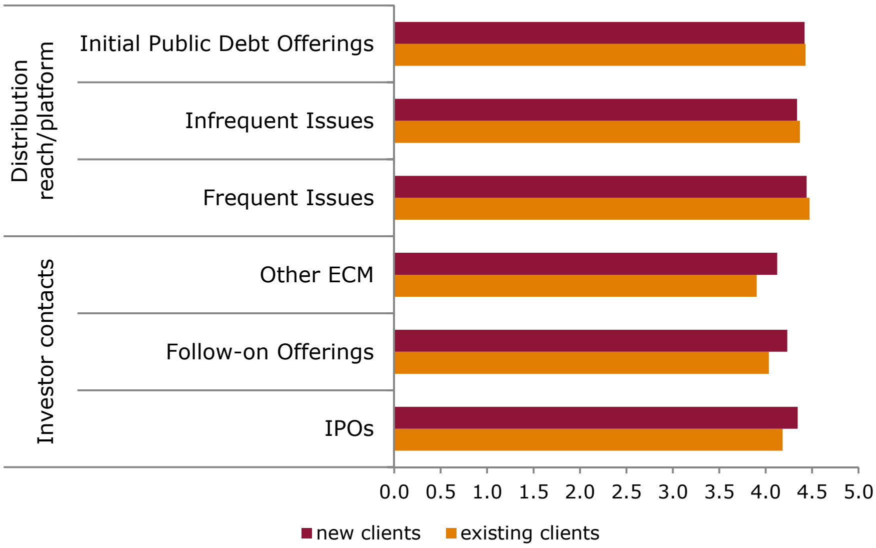


Source: FCA analysis of data collected from 66 banks and advisers.

Capabilities, including investor contacts and distribution reach/platform and analyst ranking

21. As set out in Figure 7 below, investor contacts in ECM and distribution reach/platform in the context of DCM play an essential role in banks' value propositions. In ECM, investor contacts are particularly important for new clients. In DCM (shown as frequent and infrequent issues), distribution reach/platform is of equal importance, ranking almost 4.5 out of 5. The importance of demonstrating sufficient capabilities is also consistent with the views expressed by clients.

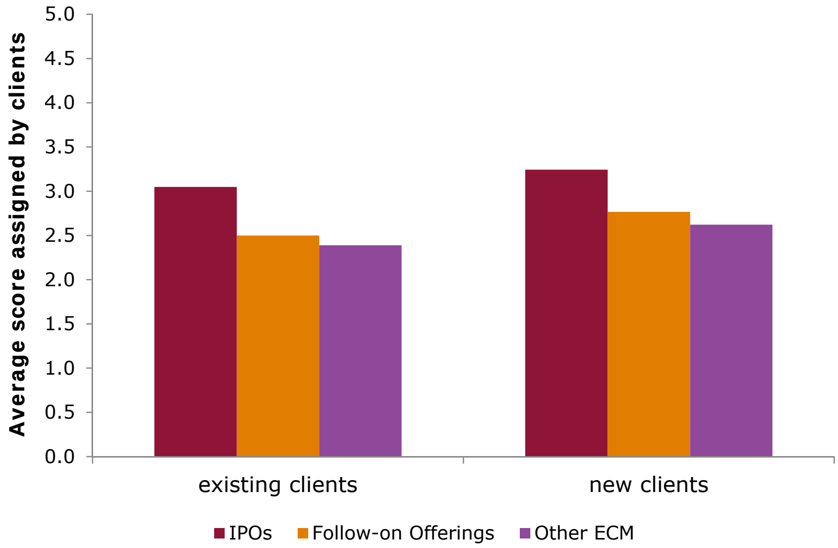
Figure 7: Importance of capabilities – average scores



Source: FCA analysis of data collected from 66 banks and advisers.

22. With regard to ECM, the views of banks and advisers on the relative importance of analyst ranking and reputation are consistent with those of clients, particularly where the client is new. As set out in Figure 8 below banks and advisers identify analyst ranking as being more important in relation to IPOs than follow-on offerings and other ECM.

Figure 8: Importance of analyst ranking and reputation – average scores

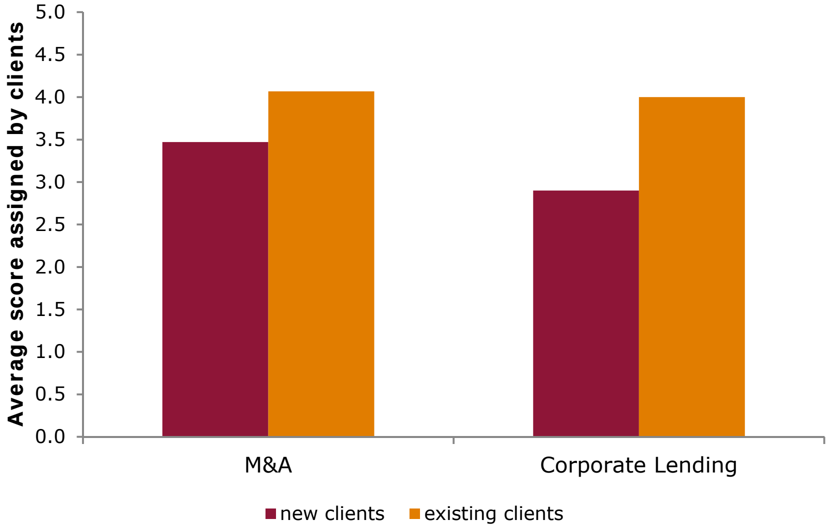


Source: FCA analysis of data collected from 66 banks and advisers.

Having an existing relationship

23. Banks and advisers also identified the importance of a long-standing relationship as a key factor in their value proposition for M&A and corporate lending (see Figure 9).

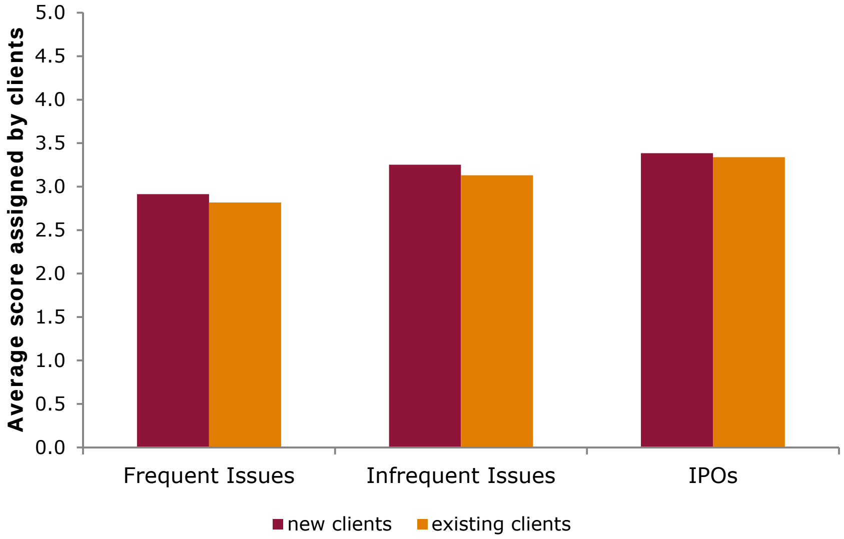
Figure 9: Importance of having an existing relationship – average scores



Source: FCA analysis of data collected from 66 banks and advisers.

24. In the context of DCM services, banks and advisers indicated that the provision of lending and corporate banking services was not a crucial factor in the context of their value proposition. The summary statistics in Figure 10 below set out average scores as between frequent and infrequent DCM issues and IPOs.

Figure 10: Importance of lending and corporate banking services offering – average scores



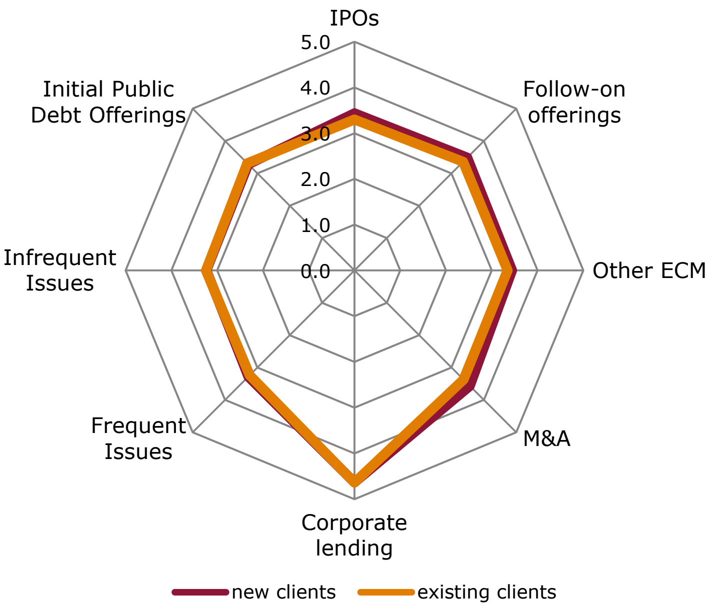
Source: FCA analysis of data collected from 66 banks and advisers.

Fees

25. As set out above, clients indicated that whilst fees are a relevant factor in selecting banks and advisers, other quality related factors are considered more important. A number of clients stated that fees are less of a decisive factor than quality given fees are perceived to be market standard. This is also consistent with the views expressed by banks and advisers and advisers. Two banks noted that the importance of fees varies depending upon the needs and sophistication of the issuer. For some issuers, fees will be the most important factor while others will take a holistic view of the execution of the transaction, particularly in the context of IPOs and debut debt issuances. In the context of an IPO, fees may be dictated by the vendor/company whereas in follow-on transactions, particularly those which are conducted on an accelerated basis, fees can be the difference between winning or losing a mandate.

26. As set out in Figure 11, the importance of fees (or terms) to a bank or adviser's value proposition appears to be greater in the context of corporate lending than in ECM, DCM and M&A. The relative importance of fees does not differ materially as between new and existing clients. One bank commented that fees are of greater importance for public sector client processes. It also noted that existing clients are also often able to negotiate fees downward based on the fees paid for previous transactions.

Figure 11: Importance of fees by product – average scores



Source: FCA analysis of data collected from 66 banks and advisers.

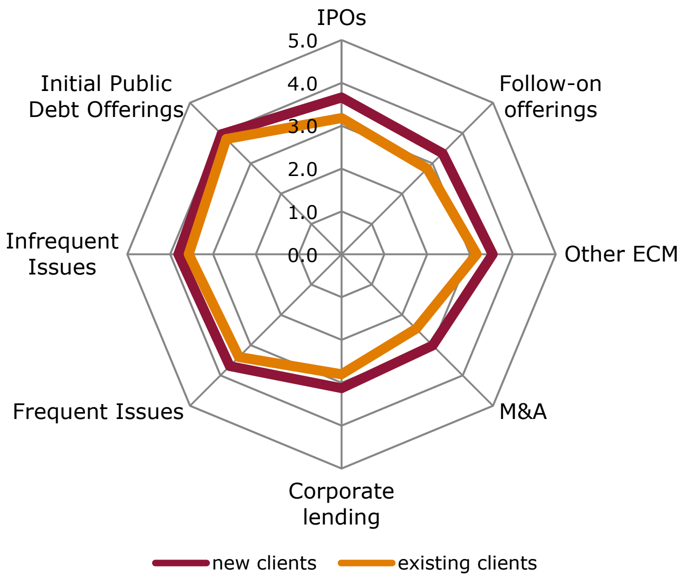
Notes: IPOs, follow-on offerings and Other ECM are ECM products. Frequent issues, infrequent issues and initial public debt offerings are DCM products.

Credentials and league table positions

27. Banks and advisers suggested that new clients may give greater consideration to league table position as part of the due diligence they undertake prior to selecting and appointing a bank or adviser. This is because they are perceived to provide new clients with a comparable measure of a bank's relevant experience and expertise. Conversely, existing clients of a bank or adviser are perceived to be more readily able to judge the experience of a bank based on previous experience.

28. Figure 12 below sets out summary statistics which presents the average scores attached to credentials/league tables by providers. Credentials/league table positions are ranked most highly in DCM and IPOs and more generally where the client is new.

Figure 12: Importance of credentials/league table positions – average scores



Source: FCA analysis of data collected from 66 banks and advisers.

Notes: IPOs, follow-on offerings and Other ECM are ECM products. Frequent issues, infrequent issues and initial public debt offerings are DCM products.

Comparison between clients' selection criteria and banks' value propositions

29. Our analysis of clients' selection criteria and banks' and advisers' views on their value proposition suggests that:

- Clients' selection criteria and banks' and advisers' value propositions appear reasonably well aligned.
- Clients' choice is focused on higher quality rather than lower fees, and banks and advisers are aware of this. Clients assess quality by taking into account a combination of quality-related factors such as sector knowledge, investor contacts and distribution capabilities. Banks and advisers place weight on these same factors in presenting value propositions to clients.
- Having an existing relationship is a key criterion for both clients and banks and advisers.
- League table positions are taken into consideration by clients in combination with other factors. Banks and advisers' evidence confirms that league table positions are also a factor in their value proposition, although general credentials and experience of precedent transactions may be more important.

Financial Conduct Authority

25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk