UK IPO Reform - Scope of Application of the UK Financial Conduct Authority's Conduct of Business Sourcebook (COBS) 12.2.21A

General Territorial Scope

FCA COBS 12.2.21A, which came into force on 1 July 2018, is FCA guidance on the MiFID II provisions relating to the identification and management of conflicts of interest affecting financial analysts. As such, it is not only relevant to UK IPOs but has a similar scope of application to other MiFID II conduct of business rules.

The basic scope provision is set out at the beginning of COBS 12.1. This provides that the rules in COBS 12.2 apply to a "firm' i.e. a UK authorised firm. It also provides that, as a result of the 'EEA territorial scope rule' COBS 12.2 applies to passported activities carried on by a UK MiFID investment firm from a branch in another EEA member state but will not apply to a UK branch of an EEA MiFID investment firm passporting into the UK.

To Which Financial Analysts Does Restriction Apply?

Recital 56 of the MiFID II Organisational Regulation, to which COBS 12.2.21A is guidance, states that:

"*Financial analysts should not engage in activities other than the preparation of investment research where engaging in such activities would be inconsistent with the maintenance of that person's objectivity. These include participating in investment banking activities such as corporate finance business and underwriting, participating in 'pitches' for new business or 'road shows' for new issues of financial instruments; or being otherwise involved in the preparation of issuer marketing*"

The guidance in COBS 12.2.21A states that:

"*The phrase "participating in 'pitches' for new business" in Recital 56 to the MiFID Org Regulation would generally include a financial analyst interacting with an issuer to whom the firm is proposing to provide underwriting or placing services…, until both:*

(a) the firm that employs the financial analyst has agreed to carry on regulated activities that amount to underwriting or placing services for the issuer; and

(b) the extent of the firm's obligations to provide underwriting or placing services to the issuer as compared to the underwriting or placing services of any other firm that is appointed by the issuer for the same offering is confirmed in writing between the firm and the issuer."

According to this guidance a UK authorised firm which is proposing to provide underwriting or placing services should not allow a financial analyst 'employed' by it to

interact with the issuer before the extent of the firm's obligations to provide underwriting or placing services is confirmed in writing.

For these purposes, the reference to 'employed' should be read consistently with the definition of 'employee' in the FCA Handbook Glossary. This definition is broader than simply where a person has a formal employment contract with the UK authorised firm and would cover an arrangement under which a financial analyst who has an employment contract with an affiliate is providing services under the control of the UK authorised investment firm (for example, where the analyst is seconded to the UK authorised firm). This is not the same as the analyst being a certified person for the UK authorised firm, although there is likely to be considerable overlap between analysts that are certified persons for a UK authorised firm and those that are employed by the UK authorised firm.

The FCA guidance provides a specific example where a UK authorised firm is providing the underwriting or placing service and also 'employs' the analyst. However, on the basis that the focus of the underlying MiFID II provision and the accompanying recital 56 of the MiFID II Organisational Regulation is focused on conflicts of interest that might affect the independence, or perception of independence, of the financial analyst, the FCA is likely also to expect UK authorised firms to apply the guidance where the financial analyst is employed by, and acting for, the UK authorised firm but an affiliate of the firm is to be the underwriter or placing agent.

The application of the guidance is not affected by the jurisdiction of incorporation or location of the issuer or the exchange on which the IPO or other offer is to occur (although these factors may affect whether a financial analyst employed by a UK authorised firm is involved).

Summary of Scope

Accordingly, on the basis of the general scope set out above and the terms of the guidance, UK authorised firms should apply the restriction to financial analysts in the following circumstances:

(a) financial analysts 'employed' by a UK authorised firm where the firm is providing, or expecting to provide, an underwriting or placing service to an issuer (this reflects the FCA's guidance in COBS 12.2.21A);

(b) financial analysts 'employed' by a UK authorised firm where an affiliate of the firm is providing, or expecting to provide, an underwriting or placing service to an issuer (although this is wider than the guidance in COBS 12.2.21A, for the reasons given above, the FCA is likely to consider that the principle applies more widely than just the specific example in the guidance).

The 'financial analyst' would need to be employed by, and acting for, the UK authorised firm from its UK establishment or a branch in an EEA country.

Conversely, the guidance would not apply to financial analysts in the following circumstances:

(i) to financial analysts that are employed by a non-UK authorised firm where a non-UK authorised firm is providing, or expecting to provide, an underwriting or placing service to an issuer;

(ii) to financial analysts that are employed by a non-UK authorised firm where a UK authorised firm is providing, or expecting to provide, an underwriting or placing service to an issuer;

.(iii) to financial analysts that are employed by a UK authorised firm, but who are located in and acting from a non-EEA branch of the UK authorised firm where,

either a UK or non-UK authorised firm is providing, or expecting to provide, an underwriting or placing service to an issuer (provided that the analyst is not providing services under the control of the UK authorised firm such that they would be deemed 'employed' by the UK authorised firm as described above).

The same principles on the scope of the guidance in 12.2.21A apply in relation to dual listings. It does not matter if the primary listing venue is outside the UK and London is only the secondary listing venue. UK authorised firms will need to apply the guidance to financial analysts they employ where the firm, or an affiliate, is pitching to underwrite or place. As a practical matter where the primary listing venue is outside the EEA then there may be no involvement of financial analysts employed by a UK authorised firm. However, the fact that London is only a secondary listing venue does not, of itself, alter the application of the guidance.

Notwithstanding the territorial scope of application of COBS 12.2.21A as set out in (i) to (iii) above, firms should also consider general conflict of interest rules in deciding how to apply the restriction on financial analysts participating in pitches. Firms are required to take all reasonable steps designed to prevent conflicts of interest adversely affecting the interests of clients. UK authorised firms should consider whether there are circumstances in which, notwithstanding the fact that a financial analyst may not strictly be subject to the guidance in 12.2.21A (because for example, the analyst is not employed by a UK authorised firm), the firm should not permit the analyst to participate in pitches. In making this assessment it would be relevant to consider the role of the UK authorised firm in any potential transaction and the nexus of the financial analyst to the UK authorised firm – for example, will the transaction be undertaken by a deal team based in the UK or is the UK authorised firm simply a booking vehicle for a transaction which is being undertaken outside the EEA.

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