To Our Clients and Friends

Memorandum

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Client Alert: FCA bans "future service restrictions"

On 27 June 2017, the United Kingdom Financial Conduct Authority (FCA) announced that it is amending the conduct of business rules to prohibit "future service restrictions" in the context of "primary market and M&A services".[1] This amendment follows a market study of Investment and Corporate Banking carried out by the FCA in 2016.

The changes will prohibit provisions in any written agreement which, in addition to the products or services to which it relates, grants the firm or an affiliate the right to provide future primary market and M&A services, or the right to provide such services before the client is able to accept an offer of services from a third party (i.e. a right of first refusal or a right to act).

The ban is limited in its application to "primary market and M&A services" – defined as either:

(i) services to an issuer comprising structuring, underwriting and/or placing an issue of shares, warrants, certificates representing certain securities or debentures; or

(ii) advice and services relating to mergers and the purchase and disposal of undertakings.

The FCA had consulted on imposing a broader ban but for now application is more limited.

The FCA has said that although the ban is aligned with the scope of the market study undertaken in 2016, it remains open to extending the ban to other wholesale market services, if it becomes evident that similar clauses are being used to the detriment of clients in those areas.

The ban applies to unspecified and uncertain future services only. The restrictions will, therefore, not apply to agreements to provide a specified service (even if it is to be provided in future).

In addition, the ban does not apply to:

- provisions giving firms the right to pitch for future business, be considered for future business or be given the opportunity to match a quotation from another provider as long as the client is not prevented from selecting the other provider;

[1] Policy Statement PS17/13 'Investment and corporate banking: prohibition of restrictive contractual clauses'; the new rules will be published in the FCA's Conduct of Business Sourcebook (COBS).

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- "tailgunner clauses", which are designed to permit the recovery of fees for work already undertaken by a firm if the client decides to go elsewhere for the same service or transaction;
- accordion and incremental lending facilities provided as part of a corporate lending service under a facilities agreement;
- hedging services to be provided in connection with a specified loan;
- "bridging loans" – the following being a non-exhaustive list of characteristics of a bridging loan: (i) a loan provided to a client for the purposes of providing short-term financing, with the commercial intention that it be replaced with another form of long-term financing such as an issue of debt securities or other future financing, (ii) the loan is short term (i.e. typically with a term of less than four years from signing) or the client is otherwise discouraged from retaining the loan as a longer term financing, for example by stepping up the interest rates after an initial short period, and (iii) the terms contain a provision that the proceeds from the future (take-out) financing are used as a mandatory prepayment of the loan. Interim loan agreements entered into pursuant to commitment letters in acquisition financings to bridge the gap to the finalization of long-term financing agreements and bridge-to-bond financings should, therefore, not be caught by the ban; and
- warehouse facilities (used as a vehicle for a collateralized loan obligation transaction).

It is possible that the ban inadvertently catches a wider class of firms than the corporate and investment banking firms forming the subject of the market study, but this will be very dependent on the facts and the services provided. Where a firm has an ongoing general mandate which includes the provision of future services, including services which may not be specifically identified, this would probably not be prohibited by the FCA rules. However, if the mandate relates to a specific current project and seeks to include unspecified future projects, then this may be prohibited.

The restrictions come into force from 3 January 2018 and the FCA has confirmed that new agreements will need to comply by this date, but that existing agreements are "grandfathered" and will not need to be revised.

The restrictions will apply to UK authorised firms and their overseas branches, irrespective of where their clients are based. They will not apply to non-UK authorised firms, even ones that provide services to UK clients, since this would fall outside the scope of the FCA's regulatory perimeter.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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