Association française des marchés financiers

FINANCIAL MARKET PROFESSIONALS

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IOSCO CONSULTATION

Conflicts of interest and associated conduct risks during the equity capital raising process

AMAFI comments

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It mainly acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has more than 140 members operating for their own account or for clients in equities, fixed-income products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the opportunity to comment on IOSCO proposed Guidance to address conflicts of interest in the equity capital raising process and wishes to provide some general remarks on the content of this report before answering the question on whether AMAFI agrees that the Guidance as set out is appropriate, measure by measure.

GENERAL REMARKS

Generally speaking, AMAFI agrees with the Guidance set out in the Report and believes that the proposed measures are indeed appropriate to address the potential conflicts of interest and associated conduct risks arising in the equity capital raising process and resulting harm identified in Section 3 of the report.

As a matter of fact, most of the measures are already applied by French financial firms involved in Equity capital raising process and providing Equity Capital Market (ECM) activities to issuer clients. That is because either the relevant measure is an existing standard or good market practice or it is already required by existing regulation, namely MiFID 2. As far as the former is concerned, those standard market practices are often relayed by way of standardized contractual commitments of the firm towards the issuer called “research Guidelines” that manage conflict of interests raised by the Research produced by - what the Report refers as - “connected analysts”. Those research guidelines generally and broadly cover measures 1 to 3. For the latter, MiFID 2[1] recently introduced formal requirements that already and correctly address conduct risks as regards the pricing and allocations of securities as well as personal transactions[2] (already addressed in the former MiFID 1) and therefore already cover measures 5 to 8.

Nevertheless, AMAFI wishes to outline the following points from the report:

[1] See Delegated regulation 2017/565 completing MiFID 2, articles 38 to 43.
[2] See Delegated regulation 2017/565 completing MiFID 2, articles 28 and 29.

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1. Conflicts of interest and alleged pressures on connected analysts

First, AMAFI considers that those risks are, in its view, already correctly managed by standard good market practices. Our members already prevent analysts from participating in their firm's pitches to win a mandate to manage securities offering. However, we would very much insist on the fact that such measure cannot forbid analysts to meet issuers and collaborate internally with ECM departments since it would be very detrimental, at the end, mostly for issuers. They need to have access to analysts' knowledge and perception of the market and their view on their listed competitors for instance. ECM departments and staff are the natural link between those issuers and the Investment firms, and notably analysts. For example, it is established practice in France that an analyst can accompany an ECM representative to meet a client issuer to provide him with general information and his perceptions of the market context. However, it is as well established that the analyst does not participate in the pitch itself to win a mandate and is generally required to leave the room before any foreseen or potential transaction may be discussed. Depending on internal compliance policies, compliance staff may be "chaperoning" those exchanges or be debriefed afterwards to take any appropriate measure to prevent the analyst from being influenced and/or from receiving any non public information. This is why, if we do support measure 1 as described in the report, we would like to insist on the fact that pitches precisely relate to the exchange between the issuer and ECM staff on a possible mandate to manage a transaction and not any exchange or meeting between the issuer and the bank.

On the issue of the possible bias of the connected analyst and the alleged pressure that is described in the Report, AMAFI wishes to outline that analysts have to manage a greater reputational risk if they do decide to act upon that bias and be influenced to give a favourable view on the issuer. Indeed, the value of the analyst is the credibility of his opinion and neither he – nor his employer – have any interest whatsoever in giving a favourable view if they actually have a negative one. Let's take for instance an example of an IPO where the connected analyst gives an over estimated value. Later on, investors and the market will obviously notice the difference between the actual market value of the security and the one estimated by the analyst. Such difference will eventually be sanctioned by the fact that this analyst opinion will no longer be trusted and he will lose its credibility and value. No issuer will further "vet" him anymore for their equity capital raising since investors will not trust his opinion. The bank itself has no interest in having not well scored analysts: investors' clients would not value his production and issuers' clients would not "vet" him for ECM business. This natural balance of interests should be acknowledged as it contributes directly to mitigating the risks mentioned in the Report.

Finally, if AMAFI understands why the Report would like to encourage so called "independent research providers" for equity IPO considering the possible bias of the connected analyst, we would like to point out that despite recurrent and numerous regulatory initiative to promote it, it has not spread out – at least in France – since the connected research is actually the only available research for IPO. It should be noted that neither issuers nor, above all, investors are currently seeking for unconnected analysts among independent research providers. As far as the sponsored research is concerned (where the research provider is hired by the issuer), one can wonder as well how that is better in terms of possible pressure or bias to provide a favourable view or coverage on the issuer who paid the provider for the research.

2. MiFID 2, for Europe, already covers most of the measures proposed in the Report

AMAFI believes that MiFID 2 already addresses measures 5, 6 7 and 8 as proposed in the Report. In that perspective, we confirm that those measures are appropriate and relevant. We would nevertheless wish to provide comments on the content of that Guidance since we disagree with some of the assumptions.

(i) Allocations of securities

The Report mentions that firms "*exercise significant discretion in allocating securities on a transaction-by-transaction basis*". Examples are provided to illustrate that remark (see (i) to (v) p. 12 of the Report). It added "*some of these types of allocation practices may indicate that allocation decisions can be influenced by conflicts of interest* [...] *in a way which could potentially be inconsistent with the interests of the firm's issuer client at the relevant time*". Such sentences imply that exercising discretion in allocating securities is under the influence of conflict of interests. That is not accurate in our view. Allocation policies are determined beforehand by the firm, in accordance with compliance internal policies, and agreed with the issuer client as well for each relevant transaction. In the European Union, this is required by MiFID 2 anyway. Allocations are determined according to objective criteria (including the level of the client contribution (as stated in example (ii)) that could be seen as a kind of discretion but are not actually arbitrary and legitimate. Results of an allocation may be seen as positive for "valued clients" (see example (i)) of the firm but those clients may be at the same time the ones that fit the better the Allocation policy including issuer client wishes (long only, European only, etc...).

(ii) Pricing of securities offering with underwriting risk

The Report states that "*Where a firm is providing underwriting services on a firm commitment basis, it may have an interest in ensuring that all securities are subscribed to by investors. This can mean that the way in which securities offerings are priced is inconsistent with the interests of the issuer client*". To us, this assumption is inaccurate. Indeed, where a firm is providing underwriting services on a firm commitment basis, the price is always formally agreed beforehand with the issuer client so it cannot be inconsistent with his interests. Once the offering is done, the issuer client received the proceeds of the offer basis on the agreed price whatever the offering price is and the amount is actually allocated to investors. After, the investment firm holds the remaining securities at its own risk. Therefore, the firm will manage its position like it suits him/her. There is no conflict of interest anymore.

3. Missing points in the Report?

If AMAFI generally agrees with the measures proposed, we wonder about some points that could be considered as missing in the Report. In the context of research for instance, one can wonder why the Report does not mention existing tools that are used today to address conflicts of interest issues such as Research Guidelines (as mentioned above) or information barriers within investment firms. Also, one can raise the issues of the status of this connected research after the transaction or offering is terminated: do restrictions apply in application of measures 2 and 3 after the offering? For how long should it last? Wouldn't it be useful to have more standardized practices on those issues among IOSCO jurisdictions?

COMMENTS ON PROPOSED POLICY MEASURES

***Measure 1**: In the context of pitches to secure a mandate to manage an equities securities offering, regulators should consider requiring firms to take reasonable steps to prevent their analysts from coming under pressure to take a favourable view on the offering from the issuer's representatives.*

AMAFI wishes to outline that the notion of "pitches" used in that measure should be carefully defined and more precisely than the Report currently does. As explained in general comment (1) above, pitches in that context should be strictly limited to a meeting or an exchange that has for sole purpose for the financial firm and the issuer client to discuss forthcoming or potential offering transaction and where the firm is trying to win the mandate to manage the transaction. Otherwise, it could have a high detrimental effect to prevent the issuer client to have access to analysts whereas they ask for it and need it: (i) to stay connected to market trends and colours; (ii) since they wish to "vet" themselves analysts that will cover

the Offering considering the "*intuitue personae*" dimension of the analyst. As explained in general comment (2), such request does not mean that the issuer wants to pressure the analyst to get a favourable opinion but rather that he wants and is legitimate to check his value and reputation among investors.

***Measure 2**: Regulators should consider requiring that, once an underwriting or placing mandate has been awarded, firms take the reasonable steps to prevent a connected analyst's views and research on the equities securities offering from being improperly influenced and to ensure that the analyst remains objective.*

AMAFI agrees with that measure and thinks that it's already applied in France.

***Measure 3**: Regulators should consider requiring that, once an underwriting or placing mandate has been awarded, firms have appropriate controls to manage potential conflicts of interest and associated conduct risks arising from connected analysts performing an internal advisory role within the firm in the context of an equity securities offering.*

AMAFI feels that the exact scope and purpose of that measure should be clarified. If this measure 3 corresponds to the implementation, internally within the firm, of measures taken upon measure 2 required above (?) as, for instance, the fact that the analyst is "restricted" on the stock (*i.e.*, he cannot write or give recommendation other than "business as usual" comments), then we agree with it.

***Measure 4**: Regulators should consider requiring firms to support the provision of a wide range of independent information to investors in a timely manner, where distribution of such information is permitted under local law.*

AMAFI is not sure to understand this measure and what is meant by "Independent information". If by information, the measure means research, we understand the purpose of the measure but question the reality of such existing "independent research", as explained in general comment (1). If other information is concerned by measure 4, we do not see what it is and why it should be required. Above all, such measure implies that financial firms would have to comply with this requirement to provide independent information about issuers. It is neither the role nor the purpose of financial firms to do so. Firms can provide its research on issuers and shall distribute it to investors (but still in accordance with MiFID 2 restrictions). Factual "independent" information on issuers can always be provided by issuers themselves.

***Measure 5**: Regulators should consider requiring firms to maintain an allocation policy that sets out their approach for determining allocations and that provides the issuer with an opportunity to express their preference during the process.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement. However, we would insist on the comments provided above in general comment (2) that discretion does not mean conflicted decisions.

***Measure 6**: Regulators should consider requiring firms to maintain records of the allocation decisions to demonstrate that any conflicts of interest are appropriately managed.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement.

***Measure 7**: Regulators should consider requiring firms to manage any conflicts of interest that arise in relation to pricing an equity securities offering, keep the issuer informed of key decisions or actions which can influence pricing outcome, and give the issuer an opportunity to express preference regarding the pricing of an issue during the pricing process.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement. However, we would insist on the comments provided above in general comment (2) that pricing defined for underwritten are necessarily consistent with issuer clients interests.

Measure 8: *In the context of a securities offering, regulators should consider requiring firms to prevent any employees who have access to confidential information on the issuer from entering into or causing any personal transactions in situations where it involves misuse or improper disclosure of the confidential information. Regulators should also consider requiring firms to prevent any employees from entering into personal transactions where it otherwise gives rise to any conflicts of interest.*

AMAFI does not have any remark on this proposed measure as it is a MiFID 2 requirement. For the sake of clarity, we would suggest to remove the notion of "confidential information" and rather use the term of "non public information" that include inside information without ambiguity.