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Key Industry Lessons From the FCA's First Competition Law Case

The FCA found that three asset managers breached competition law by sharing information in relation to securities offerings.

Key Points:

- The decision gives market participants some helpful indications as to what kinds of information sharing the FCA considers are legitimate, both in the context of capital markets transactions and in financial markets more broadly.
- Competitors, such as investors bidding for shares in an IPO or a placing, must not share strategic information that eliminates or substantially reduces uncertainty as to their conduct on the market, *e.g.*, pricing or volume information on their bids.
- Sharing of non-strategic information may be permitted, for example, bookrunners may provide information on the development of the book to investors.
- A two-way flow of information is not necessary to establish an infringement; it is enough that one party discloses strategic information to another.
- If a party does not actively distance itself from a disclosure of strategic information by a competitor, it may be found to have accepted that disclosure.
- If strategic information is shared, even where it does not lead to a subsequent change in behaviour it can result in a breach of completion law if the parties remain active in the market.

Background

The FCA announced in November 2017 that it was investigating four asset managers in relation to a potential breach of competition law. This signalled the FCA's first investigation using its competition law powers, which it gained in April 2015.

The FCA announced in February 2019 that it had fined two of the firms involved. Of the remaining firms, one received immunity, and the other was not fined, as the FCA did not find sufficient evidence of wrongdoing. The full decision was not released at the time, but has now been published.

The infringements consisted of the sharing of strategic information, on a bilateral basis, between the firms during an IPO and a placing, shortly before the share prices were set. The firms disclosed and/or accepted otherwise confidential information on bidding intentions, in the form of the price they were willing to pay and sometimes the volume they wished to acquire.

The FCA separately fined an individual at one of the firms for his part in this activity. The individual had sent emails to contacts at other firms, in an effort to persuade them to cap their orders at the same price limit as his own orders. The enforcement action against the individual was taken under the FCA's usual enforcement powers, rather than its competition law powers, and so the Final Notice did not shed any light on the FCA's competition law analysis of the activities that took place. Consequently, this decision is the first chance to understand the FCA's views on the conduct that occurred from a competition law perspective.

What Did the FCA Find?

The FCA explains its theory of harm in the following terms: asset managers bid for the shares they want in IPOs and placings against competing asset managers, under prevailing market practice. If asset managers share detailed and otherwise confidential information about their bids with each other, they undermine the process by which prices are set. This could reduce the share price achieved by the IPO or placing, and so raise the cost of equity capital for the issuing company, or even make the capital raising unviable.

The FCA acknowledges that asset managers are seeking value for underlying investors, and so want to be sure of bidding at the "right" price. Therefore, they may help each other to seek out information to allow them to form their own valuations of the company. However, the FCA is clear in its view that competing asset managers do not need to know each other's bidding intentions or conduct in any given book-build to form their own valuation (or to counter the bookrunner's optimism in "talking up" the book). The FCA stresses that a competitive book-building process depends on asset managers formulating and submitting bids based on their own knowledge, expertise and requirements; otherwise the issuer would essentially be dealing with a single potential investor, rather than a range of competing investors.

The FCA also accepts that normal book-building processes allow (and require) some information flows between the bookrunner and the asset manager, as a way of reducing the information asymmetries that exist in IPOs and placings. However, the FCA does not consider that the disclosure of individual bidding conduct or intentions between potential investors is appropriate. In the FCA's view, even one bid has the potential in and of itself to affect the outcome of the book-building.

The FCA describes what it sees as the key potential consequences of the inappropriate disclosure of strategic information between asset managers during a book-building process as:

- Asset managers placing lower bids than they might otherwise have placed
- The issuer and bookrunner achieving a lower strike price, and a higher cost of capital
- An asset manager free-riding on the discloser's expertise or research, without undertaking the research or analysis that it otherwise would have done; any bid it subsequently makes is therefore less informative to the bookrunner than it appears to be
- The free-riding asset manager receiving an unjustified allocation of shares, if it puts in a limit bid when its own knowledge and expertise would only have justified a strike bid
- A failed book-building process, if the expected strike price is lowered such that the issuer decides to reduce the size of the issuance or call off the issuance altogether
- The cost of related investments rising or those investments becoming unviable; ultimately, this could also undermine the credibility of the book-building process as a way to raise capital for companies

The FCA notes that it has not seen evidence that supports the need for the sharing of strategic information between potential investors as a mechanism for solving the information asymmetries in IPOs and placings. However, the FCA highlights that it has not found that other types of information sharing between asset managers amounts to a competition law infringement. How much comfort asset managers can or should take from this statement remains to be seen.

The FCA also notes in the decision that its description of the book-building process in relation to IPOs and placings is not an endorsement by the FCA of any specific model or of the practices described. Therefore, this description is not particularly enlightening for participants in securities offerings as to which types of information sharing are permitted. However, market participants can gain a good sense of what is likely to be the right side of the line from the detailed discussion of the conduct in question. Further, the FCA describes one example of permitted information sharing by a bookrunner, which is discussed below.

What Can Market Participants Learn?

There are some useful learnings for both participants in capital markets, and financial services firms more broadly. For those not as familiar with the competition law analysis, it is worth taking note of what will result in an infringement.

In this case, the FCA found there was a “concerted practice”, which consists of the following elements:

- Discussions involving one-way or two-way disclosure of strategic information
- Between two or more actual or potential competitors
- Subsequent conduct on the market
- A relationship of cause and effect between the discussions and that conduct

Further analysis of the key aspects is included below. The main points to bear in mind are:

- A two-way flow of information is not necessary; it is enough that the information is disclosed by one party to another
- In the context of an IPO or a placing, is not necessary in every case for information to relate to both valuation and volume for it to be strategic
- Not actively distancing oneself from a disclosure of strategic information is enough to show that the information was “accepted”
- As long as the recipient of strategic information remains active in the market, there is no need to demonstrate a change in behaviour by the recipient

The FCA found that the exchange of information in this case involved a “by object” infringement of competition law; meaning the information sharing was, by its very nature, harmful to the proper functioning of normal competition. Thus, it was considered to reveal a sufficient degree of harm to competition without the FCA needing to examine the actual effect on competition. Notably, an object infringement can be found even if the parties can show that restricting competition was not their aim, or that they had other laudable motives (for example, the asset managers claimed that they had merely been trying to obtain the best value for underlying investors).

One-Way Disclosure

A two-way flow of information is not necessary; it is enough that one party discloses strategic information to another.

Further, even a one-off disclosure of information is enough. In particular, the FCA considers that in the context of a book-building process, repeated contacts disclosing strategic information may not be necessary, as a one-off disclosure of strategic information is sufficient to undermine the competitive uncertainty between bidders for shares.

Strategic Information

The FCA considers that, in the context of an IPO or a placing, what constitutes strategic information depends on several factors. Strategic information is information that reduces uncertainty by allowing parties to know how their competitors (*e.g.*, other asset managers) are likely to behave. Since the main parameters on which asset managers compete are the price and volume of a bid, these are the key pieces of strategic information, even if there are other information flows between those asset managers and brokers. The more granular the information provided to a competitor about an intended or actual bid, the more likely it is to be strategic information.

The timing of the disclosure is also important in an IPO or a placing. The shorter the period between the disclosure about a bid and the time the book closes, the more likely that the information disclosed is strategic, as bids are less likely to be withdrawn or changed as the deadline approaches. The FCA also stresses that the fact that a disclosed intention is different from a final bid does not prevent the information disclosed from being strategic.

It is not necessary in every case for information to relate to both valuation and volume for it to be strategic; one or the other can be sufficient. In particular, either valuation or volume information disclosed on the day the books are due to close is very likely to be sufficient to reduce or substantially eliminate strategic uncertainty between competitors. The FCA also considers that information about just one bid can be strategic; a discussion between only two bidders on a market in which there are many sources of information available does not preclude the information from being strategic.

The FCA gives some examples of disclosures made by a bookrunner in one case, which it considers were not sufficiently detailed so as to amount to strategic information. These include statements such as "There are orders in the book higher and lots of orders at strike and things like that but, you know, the bigger orders, yours and few others have said 270." This is somewhat surprising given the sorts of disclosures that the FCA considers to be problematic, and it is unclear what the FCA's analysis would be in terms of whether this constitutes inside information for the purposes of MAR.

The decision also examines certain conduct in the context of a second IPO, in relation to which the FCA found that there had not been an infringement, as there had been no sharing of strategic information. In particular, the firm in question disclosed a price range rather than a specific price, the ranges varied significantly and amounted to a changing picture that did not give a clear idea of where the firm was proposing to bid, and the disclosures were made well before the books closed.

Knowing Cooperation

To establish a concerted practice, there must be "knowing" substitution of practical cooperation between the relevant parties for the risks of competition. The FCA explains that, as regards the discloser, their disclosures must be deliberate rather than inadvertent, and they must have knowledge and awareness that such disclosure might affect the competitive conduct of the recipient.

As regards the recipient, they must request, or accept, the information. In this context, "acceptance" entails receipt of, and knowledge and awareness of, the disclosed information by the recipient. Acceptance can be shown by the recipient thanking the discloser, continuing discussion with the discloser after receipt (therefore endorsing or encouraging the disclosure), agreeing to consider the information, or providing information in return. Importantly, the FCA also states that evidence that the recipient did not distance themselves from the information, reject the information, or report its receipt to regulators or internal compliance officers can also support a finding of acceptance.

Consequently, if a party is involved in a meeting or conversation of a manifestly anti-competitive nature, they must be able to produce evidence to establish that they indicated opposition to the anti-competitive arrangement to their competitors. Mere silence is not enough.

Another important point is that competition law here applies at the entity (not individual) level. However, it is not necessary for the managers in the entity concerned to have any knowledge of the illegal conduct of its employees for the entity to be held liable; action by a person who is authorised to act on behalf of the entity suffices.

Presumption of Causation

For a concerted practice to be established in the context of an information sharing case, the parties must remain active on the relevant market and not exit the market. Remaining active on the market might include making or revising bids, but equally it can constitute maintaining a bid made before strategic information was accepted, in the knowledge of a competitor's intentions. Therefore, there is no need to demonstrate a change in behaviour following the disclosure and acceptance of strategic information, and it is certainly not necessary for the recipient to commit to a certain strategy.

This is due to a presumption that an entity takes account of information disclosed by its competitor for the purposes of determining its conduct on the market, provided that the recipient remains active on the market. The presumption may be rebutted by, for example, the recipient distancing themselves and rejecting the receipt of information, and reporting the receipt of the information to regulators or internal compliance. It can also be rebutted by means of contemporaneous evidence that the entity made an independent decision disregarding entirely the disclosed information.

Notably, in these cases the asset managers could not rebut the presumption, despite the fact that they did not necessarily alter their bidding strategies following the discussions.

Penalties

Interestingly, although the fines themselves (£306,300 and £108,600) are not particularly large by the FCA's usual standards, when calculating the level of the fines, the FCA determined that these were serious infringements, taking a percentage of relevant turnover reserved for only the more serious cases. This is typical in competition law infringement cases where the enforcer is seeking to establish a principle in a sector for the first time.

The FCA goes so far as to state that it is "determined to ensure that the starting point is sufficient for general deterrence", having found that "competition law awareness can be low in more transparent markets which are characterised by frequent exchanges of non-strategic information. During this investigation, the FCA found there was limited awareness of competition law among the participants it interviewed. The starting point for penalties in this case should therefore show that participants on such markets should be alert to the competition law risk whenever engaging with competitors".

Wider Impact

This is a significant case for the FCA. Since the FCA gained its concurrent competition law powers it has been steadily increasing its competition law capabilities. It was only a matter of time before an enforcement case came to fruition. Interestingly, the conduct in question took place in 2015, suggesting that the FCA wasted no time in starting to make use of its new powers, although of course it has taken the FCA quite some time to get its result.

The FCA has been keen to stress that financial services firms' knowledge and appreciation of competition law risk could be much improved. Particularly so in the asset management sector, in which the FCA used its Asset Management Market Study to emphasise that it feels there is a general lack of awareness about competition law amongst firms.

In light of this case, firms are encouraged to consider their competition law risk frameworks and how they can ensure that they are meeting regulatory expectations in this area. The Annex of the Bank of England's Fair and Effective Markets Review Final Report sets out a useful guide to competition law awareness in wholesale markets.

In a statement accompanying the decision, the FCA stresses that firms should assure themselves that their employees know about competition law and understand that disclosing information to and/or accepting it from competitors could be illegal. Firms should also ensure that they have appropriate training and compliance procedures so that employees can identify strategic information and know how to handle it in line with competition law and other legal requirements.

Key Considerations for Firms

This represents a very clear message from the FCA, and firms need to ensure that they are meeting regulatory expectations concerning compliance with competition law. The following questions may be particularly useful for firms to consider:

- Are you able to articulate clearly the competition law risks inherent in your business?
- When were these risks last assessed? How can you show this?
- What are your greatest competition law risks?
- How do you manage these risks in practice?
- Is competition law considered specifically as part of your firm's risk assessment/control framework?
- Do employees receive specific training on competition law and what to do if a competition law issue presents itself?
- Are you confident that employees understand the competition law risks associated with their role, and have a solid comprehension of what is likely to fall on the wrong side of the line?

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