Financial Conduct Authority

MS15/1.2: Annex 1

Market Study

Investment and corporate banking market study

Interim Report: Annex 1 – Glossary of investment and corporate banking services

April 2016

Annex 1: Glossary of investment and corporate banking services

1. In this Annex we set out some background on investment and corporate banking services and include a glossary of relevant services and products.

2. Corporate and investment banking comprises two main activities: corporate banking and investment banking. There is no one legal or governance structure that is universal to all wholesale banking activities and firms vary in the way in which they organise their loan and asset financing business areas. For example, some firms undertake financing as part of their investment banking activities (e.g. leverage or acquisition finance products may operate alongside M&A or ECM); others undertake these as part of their corporate banking, or both areas. However, one feature underpinning the provision of corporate and investment banking services is the capital commitment made by banks. This capital commitment may be on a short-term or long-term basis and may encompass a range of activities from lending through to underwriting and secondary trading activities.

3. In the annex we consider:

    - corporate banking
    - corporate broking
    - sponsor/NOMAD services
    - investment banking services (including relevant ancillary services)

Corporate Banking

4. Corporate banking is primarily a core relationship driven business encompassing day-to-day transactional services and the overall financing needs of the client. The provision of corporate banking services encompasses a broad suite of services, including lending, specialised and event-driven lending and transaction banking. These services are often provided by corporate bankers alongside product specialists.

Lending

5. As a lender, a corporate bank will provide to clients overdrafts and revolving lines of credit. Loans may be:

- committed and uncommitted facilities
- bilateral or syndicated
- secured or unsecured

Committed and uncommitted facilities

6. Lending facilities may be uncommitted in that the bank has discretion as to whether or not to lend. These facilities are payable on demand and may be cancelled without prior notification to the borrower. They are usually short term arrangements and the most common form is an overdraft.

7. Lending facilities may also be committed in that the bank enters into an obligation to provide funds upon request by the borrower. The most common form of this type of lending is a bank loan whereby the bank provides the borrower with money, property or other assets on the basis that the borrower agrees that the loan will be repaid with interest and finance charges. A bank loan usually take one of three main forms as summarised in Figure 1.

Figure 1: Types of bank loans

Loan type	Description
Revolving Credit Facility	A revolving credit facility (RCF) is a line of credit that is available to a company that can be drawn, repaid and re-drawn. The facility is often used for operating purposes and will be fluctuating depending upon the companies' cash flow needs. The term of the RCF is typically three to five years as a floating interest rate instrument with a margin over LIBOR. They are also characterised by a commitment fee (i.e. the fee applied when the utilisation is zero per cent and may be up to a prescribed percentage of the margin) and a utilisation fee (i.e. if the facility is two thirds drawn, an additional fee may apply). An up-front fee may also be payable. Large corporate clients will generally have a large RCF with a number of banks that acts as a liquidity backstop. Such loans are often offered by a bank to corporate clients on a relationship basis.
Term Loan	Under a term loan the bank will provide a company with a specific amount that has a specified repayment schedule. A term loan cannot be drawn, repaid and re-drawn. Like an RCF, term loans are typically a duration of three to five years also with a floating interest rate with a margin over LIBOR. An upfront fee may be payable although there is no commitment fee as the margin reflects the all-in cost. Where there is a term loan, the originating lender may sell participations in a single-tiered loan, or it may divide a large loan facility into different tranches with different maturities. Each tranche is identified by a letter of the alphabet: A, B, C etc. Tranches of senior debt (i.e. debt that is not subordinate, for example, either a bilateral or syndicated loan that is intended to rank ahead of other unsecured and unsubordinated debt on the insolvency of the borrower) which are repayable after the principal tranche of conventional senior debt is often referred to as the 'A tranche'.
Bridge Loan	A bridge loan is a short-term loan pending the arrangement of larger and/or longer term finance and is primarily used in acquisition financing. Bridge loans are generally provided by a few banks and then syndicated to a larger group on announcement of the transaction.

Bilateral and syndicated loans

8. Loans may be bilateral between the lender and borrower or syndicated amongst a number of banks. For a large loan a single bank may not be able (for example, because of regulatory reasons) or, given the risk profile, unwilling to lend the whole amount. Under a syndicated loan two or more lenders will each contribute to a

proportion of the loan. The bank (or banks where more than one arranging bank is appointed) originating the loan will generally manage the syndicate as the lead manager(s). The managing bank will underwrite the majority of the loan while inviting the other syndicate banks to underwrite the remainder.

Secured and unsecured loans

9. Loans may also be secured (through posting some form of collateral) or unsecured. Where the borrower is able to support the loan on the basis of its creditworthiness rather than by some form of collateral, the loan will be unsecured.

Specialised and event-driven lending

10. In addition to general corporate lending there is also a variety of specialised and event driven lending. The most common among them is **acquisition finance**. In its basic form, acquisition finance is a loan made to a borrower to allow them to acquire other companies. In complex transactions, M&A activities may be funded by short term bonds issues with high coupons (i.e. a high yield bond) rather than loans with a view to being refinanced at a later date. Such transactions are, therefore, highly leveraged and may also include securitisation of a whole business. Other forms of specialised or event driven lending are summarised in Figure 2.

Figure 2: Other forms of specialised and event-driven lending

Form of lending	Description
Project Finance	Through project finance, a corporate bank can fund projects based on the income stream of that project rather than the general assets on the balance sheet of sponsoring entities. Banks may participate as part of a syndicate providing loans for the project's construction, secured by the assets of that project.
Asset Finance	Asset finance, such as in relation to aircrafts, trains and ships, is a more specialised form of project finance. A corporate bank may be involved in a syndicate providing a loan to finance the asset, or be involved in creating structures to purchase and lease the asset to the client, often to benefit from tax and accounting treatment.
Trade Finance	Trade finance (and related services such as guarantees) is provided to buyers and sellers involved in international trade. For example, corporate banks will provide finance to buyers of goods in the form of letters of credit where they guarantee payment on behalf of the buyer to the seller of the goods (or in other words, guarantee payment to the banks of the seller of the goods); or operating on the opposite side of a transaction a bank will act on behalf of the seller and collect the payment proceeds from the buyer through import bills for collection. This is further specialised through structured trade and commodity finance products. Traditional forms of financing trade receivables, such as factoring and securitisation, may also be provided in the context of the provision of trade finance.

Transaction Banking

11. Under transaction banking, a corporate bank will provide cash clearing services whereby it matches buy and sell orders and acts as an intermediary. Some firms will offer securities clearing within equity trading. Through the provision of payment solutions corporate banks manage the transfers of funds. In the context of trade

financing, corporate banks reconcile risk management and payment between buyer and seller. Custody activities involve safe guarding assets (such activities are typically undertaken within equity trading).

12. Corporate banks provide a number of ancillary services in connection with cash management and cash payments. These services include treasury and liquidity management, which covers cash sweeping, cash pooling, interest optimisation and liquidity provision (such as overdrafts). Sweeping and pooling refers to activities that relate to accounts at one firm and it does not refer to payments between different financial institutions, which are covered by cash payment services. Other related services may include automatic foreign exchange conversions for clients with a variety of currency accounts, and automatic dispersion of cash from a pooled account to sub-accounts at set intervals, such as the morning following overnight sweeping. Interest optimisation services are designed to assist clients to optimise their internal cash by matching asset and liability maturity profiles across multiple bank accounts.

Corporate Broking and Sponsor and NOMAD services

Corporate broking

13. Corporate broking is provided largely in the UK following a corporate client's listing. Corporate broking is a retained advisory service (i.e. a non-transactional client service). The provision of corporate broking encompasses advice on dealing with shareholders and investors. These services also include advising on how to raise equity in the form of an IPO or rights issue, acting as a go-between for listed companies and their shareholders in respect of share price movements, general investor views, market expectations ahead of result announcements, investor reaction to results/other announcements, gathering feedback following meetings with institutional investors, advising companies on public M&A and advising listed companies on regulatory issues.

Sponsor services

14. In the UK, firms may also act as a sponsor, following approval from the FCA. Issuers with or seeking a premium listing are required to use a sponsor in certain circumstances such as where the issuer is undertaking an IPO or where a listed issuer enters into a transaction that may be classified as a Class 1 transaction[1] or reverse takeover. While issuers are responsible for their compliance with the Listing Rules, sponsors assist by advising them on their obligations. They also help the FCA to meet its regulatory obligations by providing assurances that issuers have complied with the Listing Rules. The sponsor plays an important role in the listing process and the choice of sponsor for a client is therefore an important decision.

NOMAD services

15. When companies are active in the Alternative Investment Market (AIM) they are required to appoint and maintain a nominated adviser (NOMAD) and nominated broker. Firms may act in the role of a NOMAD where they have satisfied the relevant regulatory requirements, have sufficient experience and are classified as 'competent' to act. NOMADs provide advice to corporate clients that have or intend to have

[1] A Class 1 transaction is a transaction outside the normal course of business (usually an acquisition or disposal) that accounts for more than 25% of the size of the existing company. Companies must publish a circular to shareholders for Class 1 transactions and need shareholder approval before proceeding.

securities admitted to trading on the AIM. A company admitted to the AIM is required to have a NOMAD at all times whilst it has securities admitted to trading. The NOMAD advises on the compliance of the company's admission documents with the relevant rules and provides on-going support to the company in respect of its compliance with the AIM rules.

16. In addition to NOMADs, companies listed on AIM must also have a nominated broker. The nominated broker advises on the level of investor interest in a company's AIM securities at admission and in relation to any further issuance. They also provide advice on market and trading as well as the pricing of shares and investment opportunities. Like NOMADs, nominated brokers are retained throughout the company's listing on the AIM.

Investment Banking

17. Investment banking services support clients as they grow and develop their businesses. An investment bank acts as the intermediary between the client/issuer and investors and has two principal roles. The first is the provision of advice by working with clients to develop and execute their strategic objectives, such as whether to acquire or divest companies or assets, strategies in relation to restructuring finance as well as where and how to invest capital. The second is to assist clients in raising capital in the debt and equity capital markets (DCM and ECM).

18. DCM and ECM are primary market activities whereby investment banks specialise in assisting borrowers such as corporates, financial institutions, state agencies, local government authorities, sovereigns and supra-nationals to raise capital or borrow funds through the issuance of new securities in equity or debt. In the issuance process, the investment bank acts primarily as the intermediary between the issuer client and investors (where its primary duty is owed to the issuer client). Banks may and often assume capital commitment risk through:

- retention of unsold securities that it has guaranteed to underwrite (though this is increasingly less common as banks seek to distribute by lining up investors through the book-building process)
- taking other positions when hedging its own deal related exposure
- stabilisation and other risk adjusted trades packaged as part of the deal such as interest rate and currency swaps

19. Firms may also generate revenue from secondary market activity resulting from investors buying new securities in exchange for others. Banks are also obliged to take positions as a consequence of a holding primary dealer status for government securities, for example the gilt-edged market makers (GEMMs) in the UK.

Equity Capital Markets

20. Investment banks advise private and public companies, governments and financial sponsors for the issue and placement of equity, including providing advice, sponsor/NOMAD services (see paragraphs 14 to 16), structuring and execution as well as underwriting services. Research activities are also often provided through an investment bank's ring-fenced research function.

21. The products and services offered within the scope of ECM are shown in Figure 3:

Figure 3: ECM services

ECM service	Description
Initial Public Offering (IPO)	Whereby a company issues shares on a stock market for the first time.
Follow-on offerings	Where new shares are issued for a company already listed or publicly traded on an exchange. A follow-on offering may take place through a rights issue in which the existing shareholders are offered the new shares in proportion to the percentage of the shares issued that each investor already holds.
Accelerated equity offerings	Involves offering shares within a short period of time with minimal or no marketing. One example of this is a block trade - a non-risk deal. A book of demand is built for the seller before agreeing on a price (based on demand).
Block trades	Where holders of substantial equity stakes wish to monetise their position this may be undertaken via block trades through the secondary sale of large blocks of existing shares. Block trades may be carried out on the basis of a bought deal (whereby the investment bank buys the shares from the seller prior to commencing its marketing efforts). A block trade may also be undertaken on the basis of a back-stopped deal where the investment bank does not take the shares onto its own books prior to marketing (but does guarantee the selling shareholder a minimum price).
Equity linked transactions	The issue of fixed income (generally debt) securities that investors may surrender to the issuer in exchange for equity securities at an established price or ratio.

22. Equity placements may be either public or private. Private placement occurs where a company makes an offering of shares to a small number of chosen investors and is the opposite of a public issuance where shares are able to be acquired on the open market.

Debt Capital Markets

23. Bonds are debt instruments created by the borrower for the purpose of raising financing and capital. As a fixed income security, they pay a specified amount of interest on a regular basis. Bonds typically have fixed rate coupons but may also be floating. A bond may also be rated or unrated and will generally have a maturity profile of between 2 years and perpetuity, with a sweet spot depending upon the market of issuance.

24. Subject to the requirements of the issuer, bonds have differing periods of maturity. Bonds may be described as a short-dated with up to five years maturity; medium-dated, with maturities of between five and 15 years; and long-dated, with maturities of over 15 years. Bonds may be public in that they are mostly sold to institutional investors (such as asset managers, pension and insurance companies and hedge funds) through a public offering (i.e. a public bond). They may also be sold privately to a single or select group of investors (i.e. a private placement).

25. There are many different forms of bonds. The most common is a vanilla bond which is characterised by regular (either semi-annual or annual) fixed coupons and a specified redemption date. Other forms of bonds are variations of this whereby a floating or variable interest rate applies. Some pay coupons every three months

while others do not pay a fixed coupon but one which varies depending upon the level of the short term interest rates or otherwise have an interest rate linked to the rate of inflation.

26. The type of bond will also vary given the type of issuer. The main relevant types of bonds are summarised in Figure 4.

Figure 4: Types of bonds

Type of bond	Description
Corporate bonds	A bond issued by a corporate typically for the purpose of financing its on-going activities. They generally offer a higher rate of return than government bonds, given the greater risk of default. They are usually sufficiently tradable that they are listed on the London Stock Exchange or other exchanges in Europe, Asia or the United States, although the majority of trading occurs over the counter (OTC).
Investment grade bond	A bond issued by an institution which has a credit rating of BBB- (according to Standard and Poor ratings) or Baa3 (on the basis of Moody's ratings) or above. The rating indicates whether the corporate or local authority/municipal bond has a relatively low risk of default. A bond rated below either BBB- or Baa3 will be categorised as non-investment grade.
High yield bond	A bond that pays a high rate of interest in relation to its market value and is generally rated below investment grade.
Convertible bonds	An interest-bearing bond convertible into a fixed number of shares at the conversion price. The bond can be converted into a predetermined amount of the company's equity at certain times during its life, usually at the discretion of the bond holder.
Asset-backed securities/mortgage-backed securities/ covered bonds	An ABS is a bond backed by a pool of assets such as loans and credit cards which provide regular payments. An MBS is the same as an ABS with the exception that it is backed by a pool of mortgages. Covered bonds are similar in that they are bonds which are backed by a pool of assets such as mortgages or loans.
Government /sovereign bonds	A bond issued by a national government. They may be either denominated in the local currency or denominated in a foreign currency. Gilts are issued by the UK government.

Type of bond	Description
Local authority / municipal bonds	A bond issued by governments at a sub-national level such as county, city or State. These pay a fixed rate of interest and are repayable on specific future dates.
Foreign Bonds	A bond that has been issued by a foreign entity in the currency of the country in which it is sold. For example, Yankee bonds, Samurai bonds and bulldog bonds.
Euro-medium notes / domestic MTN programmes	An MTN programme extending over several years can be established with one suite of legal documents. Numerous notes of various structures and currencies may then be issued under the programme. Typically these notes are short-term, i.e. with maturities of one to three years.

Ratings advisory services

27. Issuers require a credit rating in order to issue a bond. This is because institutional investors that buy bonds and investment banks that trade in them need to be able to readily assess the issuer's credit risk. Ratings advisory is also relevant in hybrid capital issuance, leveraged buy outs, M&A and restructuring transactions. Ratings advisory services generally encompass providing strategic advice in respect of a first time rating and assisting the issuer in selecting a ratings advisory agency. The advisory service also includes preparing all the necessary documentation and guiding the issuer through meetings with the agency and any subsequent follow-up requirements. It may also include evaluating and managing the impact of a potential event on an existing rating.

M&A

28. M&A activities comprise identifying, formulating and executing customised transactions including, but not limited to, sales, acquisitions, mergers, restructuring and corporate recapitalisation. The bank or adviser will seek to earn fees from deals as well as participation in any securities transactions that may result from M&A activity such as new debt or equity issuance.

29. These activities involve identifying opportunities for a company and advising them on the potential for M&A or the sale of a business, including on a cross-border basis. Sell-side transactions involve identifying a buyer for a client and a buy-side transaction involves identifying an acquisition for a client. Banks also offer corporate advisory services to companies seeking to engage in M&A activity or are themselves that target of a potential acquisition. These services include advice on capital and legal restructuring or securitisation of the firm's assets. It may also include defence advice. It is also common for a number of services to be offered or recommended alongside M&A advisory, including acquisition finance as well as deal contingent hedging and other derivative products.

Ancillary services: Derivatives

30. Derivatives are instruments that are derived from shares, bonds, currencies, commodities and market indices. There are three types of derivatives - swaps, options and forward / futures contracts:

- **Swaps** are the most common and simplest form of derivative and are generally in the form of interest rates or currency. Interest rate swaps arise where one party arranges with its counter party to exchange interest rate payments, thereby reducing or eliminating exposure to interest rate fluctuations. Currency swaps enable a corporate to raise funds in one currency and then swap the proceeds into another currency.
- **Options** give a party the right but not the obligation to buy or sell, usually a financial instrument, commodity or other underlying asset, at a given price on or before a specified date.
- **Forward contracts** are a contract to take delivery of something at a fixed date in the future for an agreed price. Forward contracts are traded over the counter (OTC). A futures contract is an agreement between two parties to undertake a transaction at an agreed price and quantity on a specified future date. Futures contracts are traded on-exchange.

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