Public Accounts Committee

Oral evidence: Privatisation of Royal Mail, HC 1221-i

Monday 28 April 2014

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Members present: Margaret Hodge (Chair); Mr Richard Bacon, Stephen Barclay, Guto Bebb, Jackie Doyle-Price, Meg Hillier, Mr Stewart Jackson, Anne McGuire, Austin Mitchell, Nick Smith, Ian Swales, Justin Tomlinson

Amyas Morse, Comptroller and Auditor General, National Audit Office, Gabrielle Cohen, Assistant Auditor General, National Audit Office, Matthew Rees, Director, National Audit Office, and Marius Gallaher, Alternate Treasury Officer of Accounts, were in attendance.

Martin Wheatley, Chief Executive, Financial Conduct Authority, and William Amos, Director, Wholesale Banking and Investment Management, Financial Conduct Authority*:* gave evidence.

Q1 Chair: Welcome. Thank you for coming at such short notice. I should declare an interest before we start. The financial advisers for my late husband's pension pot bought a few shares in Royal Mail during their early privatisation.

May I start with you, Martin? The share price exploded. It went up 38% on that very first day. Given what is a pretty unbelievable jump, according to the NAO Report on similar IPOs, what action are you taking? What inquiries have you instituted, if any?

Martin Wheatley: Two points. When you say a pretty incredible jump, most IPOs are priced to see some jump on the first day. Around the world, that is a familiar model in which you see an increase. Perhaps this was a bigger increase than most, but, typically, they are priced to go.

In terms of inquiries, we do not routinely inquire into anything that happens in the market, unless we suspect there is a particular possibility of misconduct. We have read the NAO Report. We have seen some of the observations made. There is nothing that suggests to us that our resources should be used on an inquiry, absent any further information coming out.

Q2 Chair: If you look at figure 19 of the NAO Report, in relation to other IPOs, this one looks substantially much bigger, and of course there is a public interest point here in that we the taxpayer lost on day one £750 million, so I think there is a pretty substantial public interest for you to assure us, and through us the public, as to the appropriateness of the regulatory regime in which this deal was launched on to the exchange.

Martin Wheatley: Again, there are two separate points. You and the NAO have looked at the potential cost to the Exchequer, and that is entirely right; that is where that inquiry belongs. Our job is to look at whether there has been regulatory failure. Nothing that I have seen so far suggests there was a regulatory failure.

Q3 Chair: So tell me, if a 38% jump on day one does not give you any indication of regulatory failure, what would?

Martin Wheatley: "What would" would be if the jump was explained by information that was available to only some people in the market, or if people were operating with the benefit of information that was not publicly and fully disclosed. There are lots of things that would, but an IPO that goes on the back of a prospectus and a marketing campaign to a premium does not of itself generate for us a suspicion of regulatory failure.

Q4 Chair: We are seeing most of the players on Wednesday, but what stands out to me is the issue of potential conflict between the banks themselves and the players that have both a banking arm and an investment management arm. Given that a large proportion of the shares were given to priority investors, are you satisfied in your current regime that the protections against a conflict of interest were adequate and worked properly in this instance? I have to tell you, looking at it, that is the major regulatory issue that you should be addressing.

Martin Wheatley: Okay. Again, the model of most complex financial services is that they will have conflicts, and they will have potential conflicts between different parts of the group. We have very clear rules about the management of those conflicts—about keeping information separate and not allowing inappropriate information to transfer across. That is something that we supervise, but in this instance there is nothing that I am aware of that suggests those conflicts were not appropriately managed.

Q5 Chair: Have you looked? Do you know who were the priority investors on day one?

Martin Wheatley: No. As I said, we have not looked into this.

Q6 Chair: Why not? If you want to assure yourself and assure the public—and certainly assure, through us, the public—that those potential conflicts of interest were properly managed, it would be sensible to know who, actually, were the beneficiaries of that allocation on day one, in terms of shares, and whether or not proper systems preventing conflicts of interest were indeed prevailing.

Martin Wheatley: Well, I think the seller and its advisers will know who the allocation was to. We have had no issues raised with us about either that there was inappropriate management of conflicts in the process.

Q7 Mr Bacon: Well, you wouldn't, would you, because they are sitting very pretty. The question to which most people would like an answer is, for example, did one of the advisory businesses such as Lazards give a large number of shares to its group asset management business, which were then sold—and, if so, how many? Was it disproportionate? Did they favour their friends, in a crude caricature? That is a question to which most people would like an answer, but you do not even sound curious about it.

Martin Wheatley: Well, if I can come back to your first point. You said we would not have issues raised because they are sitting pretty, but we would because they have an obligation to report to us anything which is suspicious, so both the adviser and the asset manager, if they felt there was something untoward in the process, have a positive obligation.

Q8 Chair: Hang on a minute, Mr Wheatley. You have an obligation to monitor.

Martin Wheatley: No, we don't. We have an obligation to review, where we think there has been market misconduct.

Q9 Chair: Yes, but how do you? If you think there has been market misconduct, are you simply waiting for them to report to you before you assess whether there has been market misconduct? How do you know?

Jackie Doyle-Price: I think, in fairness, there is enough intelligence in the marketplace that if there was anything smelly it would have reached your ears.

Martin Wheatley: Yes, and we would know, from either reports from the market from potential whistleblowers, from our own surveillance work when we look at the market. I understand there is a point that is being looked at here, which is about whether proper value was achieved, but that is quite different from whether there was a regulatory failure, and nothing has come to our attention which suggests a regulatory failure.

Q10 Chair: I am sorry; I am completely bemused by this. I think for you to make that judgment you would know who benefited from that initial allocation of shares on the day of the launch, and therefore who made a great big killing on day one when it went up 38%. You would need to know that, and you would need to know their relationship with the banks. It is what Richard Bacon alluded to. It think it is not so much Lazards; I think it is actually the syndicate of banks that were involved in actually identifying and finding investors who wanted to take those shares.

Martin Wheatley: The book-building model, which has been adopted in London for many, many years and has been very successful, always relies upon finding a set of investors who are prepared to give an indication at an early stage as to their likely appetite within a particular price range. That is as normal. That is how the market operates. For most issuers there is a trade-off between maximising price and the certainty of selling all the shares. People take different decisions about where they want that trade-off point to be. Simply the fact that a share offer has gone to a higher premium than previous offers does not itself raise alarm bells for us. There would have to be other considerations.

Q11 Chair: So what would raise alarm bells?

Martin Wheatley: As I explained to you earlier: if there was information in the market—if people were operating on non-public information—that would be something that we would look into.

Q12 Chair: And how would you know that?

Martin Wheatley: We would know that through our monitoring of the market and potentially through sources of intelligence that comes from the market.

Q13 Chair: So explain to me how you can know that without knowing who those priority investors were, and their relationship with the banks—the syndicate of banks.

Martin Wheatley: We do not routinely investigate every IPO on the market.

Q14 Chair: I understand that; I know you do not think this, but I think that if you look at figure 19 this is a pretty extraordinary bounce in the share price in day one and of course beyond that: £750 million—it is a lot of money.

Martin Wheatley: Yes. It is the top end of what you would normally expect.

Q15 Chair: Very much at the top end. About three times the amount of any other. On figure 19 the other big ones were Foxtons, which went up 16%, HellermannTyton, which went up 17%, and Crest Nicholson, which went up 16%. This went up 38%.

William Amos: It might be useful if I gave some context on how we manage conflicts of interest that exist between what are groups which have numbers of different business functions. So for example we insist on clear walls between the flows of information.

Chair: You are going to have to speak up—the acoustics in this room are terrible.

William Amos: Okay. We have clear rules around the flows of information between different parts of the business. So, for example, the part of the business which is advising on a deal to the issuer, and then the actual asset management area, which may be making a decision—

Chair: I understand the rules. The issue here is whether those rules were adhered to. It seems to me that the only way in which you can assess that is by having a bit of knowledge about who had the allocation in the first instance and their relationship with the banks that were responsible as part of the syndicate.

Q16Stephen Barclay: Could we just clarify what the rules are and how the FCA enforces them? Mr Amos was talking about information flows, but there will be other rules as well and it would be helpful to understand those.

William Amos: In addition, there are clear rules that firms have to act in the interest of the client. In this case, the adviser has to act in the interest of the client and is not allowed to act in the interest of its own profit position or that of another part of the business. We have those rules over who they are acting for and also over the flows of information.

Q17 Chair: I do not understand how you assess that. You seem to have said that you have this knowledge of the market, which I am unclear how you obtain, and somehow that satisfied you that, in this issue, those rules were properly adhered to.

Martin Wheatley: Our approach is that we do three things. We have a supervisory approach where we go out to firms, kick the tyres and look at how they go about their business. We typically do not do that on an individual instance. That would be a rolling programme where each of these banks would have been subject to some level of scrutiny from us over a time period and, if we find that they are falling short against those rules, then we would take action.

Quite separately to that, we would launch an investigation if a trigger came through to us that said that there is sufficient doubt—or misconduct, in this particular case—and that we should open an investigation. The bar for that has to be reasonably high. Otherwise, we would do nothing but investigations into the market. And, in this instance, simply the share price movement or the fact that there are a number of advisers who have asset management arms as part of their business does not in itself pass the threshold level for launching an investigation. That investigation would have to be, as I said, into suggested misconduct.

Q18 Chair: Okay. Explain to me again, because I am being a bit thick: what is the threshold level?

Martin Wheatley: It is not a precise number. It is based on our judgment.

Q19 Chair: Explain that a bit more to me.

Martin Wheatley: That would be explained by unusual share price movements aligned with information that suggests to us that there had been a breach of some of our rules.

Q20 Chair: And what is unusual share price movement if not 38%, as compared what all the other IPOs? What level would it have to have been? Fifty per cent?

Martin Wheatley: It depends on the circumstances, but it would have to be unexplained share price movement. Because most IPOs go to a significant premium, the premium in itself does not count as an unexplained share price movement.

Q21 Austin Mitchell: The Office of Fair Trading did a market study in 2011 and identified the potential for conflict of interest in circumstances like the provision of equity of the writing services and the sales distribution service. A problem is identified there. I take it that there was no further investigation and you did not do anything about that.

Martin Wheatley: Well, they identified that there was the potential, but decided that the evidence was not sufficient to make a competition referral. At that point—

Q22 Austin Mitchell: There are problems, it said, but you did not look at them.

Martin Wheatley: I think they are saying that there are potential conflicts within the existing system, but they did not believe that that merited a competition referral. They make some suggestions as to how the market might evolve and it has evolved somewhat since then.

Q23 Austin Mitchell: Okay. Let's look at this problem in another way. Of the seven investment banks in the syndicate, the NAO says that at least five were allocated shares on behalf of their asset management arms for distribution to their clients. Can an adviser truly be independent if they are interested in advising and asset management and selling the shares that they are advising on? Can they be independent?

Martin Wheatley: Yes.

Q24 Austin Mitchell: They can—how?

Martin Wheatley: By managing the conflict and ensuring that that conflict does not in any way affect the advice that they give to their client.

Q25 Austin Mitchell: So people in the same bank do not talk to each other in the canteen. Do they have a Chinese wall down the middle of the room? How does it work?

Martin Wheatley: That is exactly how it works. They are required not to pass on information.

Q26 Austin Mitchell: And you investigate that and ensure that there is no liaison or comparison or coercion or any other form of management between the two arms of the bank. You are satisfied that one arm can be independent?

Martin Wheatley: I am satisfied that one arm can be independent. Are they always and are there breaches? No. There are occasional breaches and when there are we act against them.

Q27 Chair: Are you absolutely satisfied in this instance that there were no breaches? Are you completely and utterly satisfied in this instance that there were no breaches?

Martin Wheatley: I think you have turned the statement round. What I have said is that there is insufficient evidence for us to suggest that there is a breach. That is completely separate from the way you have characterised it.

Chair: Okay. That is a different answer. As there is huge public uncertainty about whether or not there was a breach in this instance, don't you think—

Jackie Doyle-Price: Is there really?

Chair: Yes. I think there is.

Jackie Doyle-Price: Is there really? I have seen no evidence of that.

Q28 Chair: That might be your view. My view is that there is. In those instances, don't you think it behoves you to satisfy the public interest, or those of us who feel that public interest, that there was no breach in this particular case?

Martin Wheatley: I have read the NAO Report. I think it is an excellent Report and I have read it carefully. There are some suggestions about a number of things. I don't think there is a suggestion in the Report that there has been a breach.

Chair: Well, I am not sure about that.

Q29 Mrs McGuire: Given that one of the aims of the 60% sale of Royal Mail was to create a stable shareholder base, and given that you are not concerned about the dramatic increase in the prices on those first few days, should you have been concerned that seven of the priority shareholders sold all their allocated shares between October and November 2013, and that another four had reduced their stake by over half? Would that not have raised just a bit of concern, given the objectives of the initial sale of the Royal Mail shares? Seven of them get out within a matter of a few weeks with a dramatically increased share price, but the aim was to create the stability of finance for the Royal Mail.

Martin Wheatley: The aim of the asset managers who were allocated the shares is to act in the best interests of their clients, so whatever intentions were created by the seller, an asset manager has a fiduciary responsibility to its clients. Clearly a number of them judged that it was good value at that point to sell. Actually, I do not have a concern that they sold—the job of an asset manager is to try to buy at a reasonably low price and sell when you believe that the stock is overpriced.

Q30 Mrs McGuire: But the asset manager's job—or the syndicate's job—is to try to create a shareholder base that would give some stability to the Royal Mail, and yet within a matter of weeks, a significant number of those shareholders sold on their shares. Would that not have rung just a little alarm bell somewhere?

Martin Wheatley: No.

Q31 Mrs McGuire: No, right, okay.

Martin Wheatley: To be honest, a liquid market is usually a good thing. It is usually judged to be a good thing.

Q32 Mrs McGuire: I am not objecting to the liquid market, to the flexibility, to the right of organisations. I am starting at the point where the aim of putting together the priority shareholders—the priority investors—was to give some sort of stability, yet that stability was rocked in many respects within a matter of weeks, because seven of the shareholders, the investors, sold all their shares.

Martin Wheatley: Well, again, they were the objectives of the sale. That may be what a selling entity—the Government in this case—wants to achieve, but a healthy secondary market has to allow buyers and sellers to interact.

Mrs McGuire: You are missing the point but never mind.

Q33 Austin Mitchell: The expectation on the part of BIS that there would be a stable shareholding if there were priority shareholders was totally wrong. They had no right to make that expectation.

Martin Wheatley: It is perfectly reasonable to have that as an expectation. It is difficult to tie asset mangers to a pre-ordained course of action when those asset managers have fiduciary responsibilities to their clients.

Q34 Austin Mitchell: As a general question, I am just reading Lewis's *Flash Boys*. The expectation with shareholding used to be that shares would be held for a long period and that would give companies stability. He says there is turnover in micro-seconds. What is the situation in London?

Martin Wheatley: High-frequency trading is different from the US. There is still quite a large amount; it is not as predominant as it is in the US, but you still get people holding shares for very short periods—as you say, counted in fractions of a second.

Q35 Chair: What has surprised me about what you are saying—I have taken this all from the NAO Report—is that there were various points at which the syndicate that also had asset management arms in their business took a view on the price. Their advisers, if I can get the—

Matthew Rees: On page 30.

Chair: Yes. If you look there, their advisers prepared equity valuations. All this happened very close to the sale. If you look at that bit about the syndicate equity research analyst valuations on 12 September—those ones around there—they are way above. The analysts working to the asset management part of the businesses were valuing the shares way above that. That was point No. 1.

You look at the demand on figure 14, and you can see that, at the end, we got—what was it?—400%. It all happens very close towards the date when they were launching the share. The demand absolutely escalated. You look at how they were able to refinance the debt and the very favourable interest rates that they got, so there are all sorts of indications all the way through, of which I have picked three—I probably haven't picked the lot—that demonstrate to you that there is an under-valuation in the prospectus on the share price. Yet, this syndicate of banks, when asked by the Department in the few days before, "Shouldn't the price go up?"—I think it suggested by 20p or something; a tiny bit—said, "Don't go up, because it would upset the momentum." That was, in effect, what they said.

I find it really, really hard that you, as the regulator, seeing what—I don't agree with you—was a massive increase in the share price on day one, and then beyond that, don't think that there are questions to be answered. I am not saying that it was wrong, but there are questions to be answered. You, as the regulator, should investigate whether there was a proper separation between the advice arm of these banks and the asset management interest that they had. There is too much in there that suggests to me that you should be asking questions and therefore instituting an inquiry.

Martin Wheatley: Again, as I have said, because these structures always invariably have banks that will have asset management arms as part of the business, we know—and the banks know—that they have to be independent and able to give independent advice. There is nothing that we have heard that suggests that they didn't.

Q36 Chair: So all those things I mentioned to you were not enough.

Martin Wheatley: No, they are not.

Q37 Chair: I am left astounded with this. I don't know in what circumstances you would do something. What would be a price increase in the share on day one that would ring alarm bells with you? What would it be? You have said to me that it is a judgment. If 38% is too little for you, what is enough?

Martin Wheatley: It would not be about a price increase.

Q38 Chair: You said to me earlier that it is a question of the price increase; there was a second factor, but one was the price increase. You said that that was a factor you had regard to.

Martin Wheatley: But not in and of itself—

Q39 Chair: No, but what would the price increase need to be?

Martin Wheatley: I can't tell you what it would be, because it would depend on a set of circumstances. The circumstances in this case were that the advisers, I believe, did have discussions with BIS about whether a re-pricing was necessary. Their advice was that there was uncertainty hanging on the US debt ceiling and on industrial action. I understand that, based on those factors, they said that there would be considerable uncertainty in trying to re-price the deal at that late stage. That is an entirely appropriate conversation to have had. Clearly, BIS, along with their advisers, took the view that they did not want to re-price at that stage.

Q40 Chair: I understand that that was what happened; what I can't get is what would ring the alarm bells with you, the regulator. You are sitting there almost giving me the BIS story. What would ring the alarm bells with you?

William Amos: We would be concerned if no such discussion had taken place.

Chair: Yes, but you do not know, because you are not asking the questions.

Amyas Morse: Does the fact that you know those conversations have taken place mean that you actually have had some informal discussions about this?

William Amos: No, this is from the NAO Report.

Amyas Morse: From our Report?

William Amos: Yes.

Amyas Morse: May I take us on a little bit—if you don't mind, Chair—to asking about how all these elements have interacted? In other words, do you find yourself with a book-building exercise and then you find yourself with a group of preferred priority investors? All that, I think it is fair to say, probably has a result, which is that you do not have an even distribution of shares into the market, but quite a concentrated distribution. Would that be fair? If so, do you think that that has an effect on how well the market actually functions in this case, from the point of view of both other investors and your own interest in the market as a whole, rather than simply looking at it from the Government's point of view? How do you feel about how that process worked out?

Martin Wheatley: That book-building process has been the model for London for 20-odd years. London is very successful as an equity-raising centre. Companies like that, because it provides certainty about issuing shares—

Amyas Morse: Getting the issue—

Martin Wheatley: No one wants to be left with an overhang—that is the death knell for any company coming to market. There is a trade-off, therefore, that you leave something on the table if you are trying to get that away. That is the model that has evolved; it appears to have served London very well and been very successful.

Amyas Morse: Did that work unfortunately alongside having a group of priority investors? It was not just a book-building process; it was a book-building process and a decision to have a preferred category of investors who, it appears, behaved just like any other investors—I am not finding fault, I am just stating as it turned out, but they had no different characteristics from any other group of investors, it seems.

Martin Wheatley: Which comes back to the question—they appear to have operated as with anyone who would have bought in at the IPO with no advanced discussion with them. It means that there is less stock available for anyone else who wishes to buy in at that point, so you have a less wide market at that point, but that is a choice that the company makes—or, in this case, BIS selling—it is not a regulatory point.

Matthew Rees: May I just follow up on the excess demand? There were £33 billion-worth of orders for about £2 billion-worth of shares, so does that tell you anything about how accurate or reliable the process is at revealing true demand?

Martin Wheatley: Well, as you will know, the orders were somewhat inflated by people feeling that they would get scaled down anyway, so it is quite hard to make an exact correlation. Whatever the figure, there clearly was excess demand, and in an excess demand situation, you have the ability to say, "Do I want to re-price to take advantage of that?" As Will has said, I think that they had that discussion. They did take that consideration into account and the conclusion that they reached was that they did not want to take the additional risk that that would create.

Q41 Chair: But again, to emphasise that point, there was that excess. Repeat those figures again.

Matthew Rees: It was £33 billion of institutional demand for about £2 billion of shares.

Chair: Doesn't that ring alarm bells with you?

Martin Wheatley: Many, many issues are heavily oversubscribed.

Q42 Chair: And the other thing is that it seems to me that you made your judgments on the back of the NAO Report—did you?

Martin Wheatley: As I have said, we read the Report and there is nothing that we have seen—

Q43 Chair: But that is your only knowledge really—the Report and, presumably, stuff in the press. You did not do anything beyond that.

Martin Wheatley: We have not instigated any investigation, as I said at the start. We have not gone out and looked specifically for data on this.

Q44 Stephen Barclay: When have you previously enforced for a failure to maximise price?

Martin Wheatley: I would not say to maximise price—I do not think that we have ever enforced for that. We have enforced against breaches of confidentiality and we have taken action against underwriting standards, but never against whether a price was achieved or not.

Q45 Stephen Barclay: I accept that it is a trade-off between certainty of sales and the price, but under treating customers fairly, either for the market at large or for those investing, you have never seen a breach on the grounds of failure to maximise price.

Martin Wheatley: No.

William Amos: No.

Q46 Stephen Barclay: So when you said earlier, "When there are breaches, we act," that is always on issues separate to price.

Martin Wheatley: Yes. We do not act as an economic regulator; we act against our rules—against conduct—and it would be on failure to manage conflicts of interest.

Q47 Stephen Barclay: And there was no point at which, given that the OFT said there was a risk of conflicts in its 2011 report, you yourselves saw that in action?

Martin Wheatley: No, we have, absolutely, acted where there have been conflicts that have not been properly managed. As part of our programme this year, we will be doing work looking at how banks manage conflicts of interest.

Q48 Stephen Barclay: What was the last fine you issued for failure to manage those conflicts?

Martin Wheatley: I will have to come back to the Committee. I cannot remember exactly, but we can write to you on the specifics.

Q49 Stephen Barclay: Do you have a ballpark figure?

Martin Wheatley: No.

Q50 Stephen Barclay: Was it significantly less than the profits made by the bank?

Martin Wheatley: Again, because I do not have the figures before me, I cannot give you—

Q51 Chair: You must know that.

Martin Wheatley: No.

Chair: You don't know?

Q52 Stephen Barclay: If you don't know, Mr Wheatley, it is very difficult to know that you have got the incentives in the right place, isn't it?

Martin Wheatley: Our incentives are set by statute: to provide the appropriate level of protection to ensure competition in the market and to ensure market integrity.

Q53 Stephen Barclay: Isn't one of the lessons from the recent financial crash, particularly around guaranteed bonuses, that people's individual benefit was far greater than their losses when things went wrong? That was the culture. The FSA and now the FCO have given numerous speeches. That is the culture it wanted to change, but if you do not know whether you have ever issued a fine greater than the gain from a breach of conflict, it is difficult to see why a firm would necessarily manage those conflicts effectively.

Martin Wheatley: Our approach to penalties—I just do not have the specifics in mind at the moment, although I am happy to write to the Committee—is that, typically, our penalties would be in excess of the gain made or the loss avoided.

Q54 Chair: You must know vaguely when you last issued a breach. You must know that. I cannot believe you do not.

Martin Wheatley: We issue breaches every week. The last breach we issued was this morning. We issue breaches every single week. You are asking very specifically about breaches in terms of prices and an IPO. I don't know, but our latest—

Q55 Stephen Barclay: Mr Amos, you were head of enforcement in your previous role. Can you tell us?

William Amos: I can give you an idea. On insider dealing, for example—

Q56 Stephen Barclay: I am not asking about that. It is a different issue, isn't it?

William Amos: Well, it is still around a conflict of interest.

Q57 Stephen Barclay: I am not suggesting that the people involved in this have made a profit from buying shares; I am suggesting that they are getting a profit from their bonus in due course on what would have been a very successful deal for the group. It is a different issue.

William Amos: I think your point, then, is around incentives and how they incentivise.

Q58 Stephen Barclay: Yes, but one is a criminal offence and one is a regulatory breach. That is the distinction, as I am sure you are aware.

William Amos: And in terms of regulatory actions, we have taken actions—not necessarily wholesale ones, but where individuals have been incentivised in a certain way.

Q59 Stephen Barclay: Sorry, we are talking about the wholesale market. You are director of the wholesale market, so can we focus on the subject in hand? What was the fine?

William Amos: Again, I do not have that information.

Q60Chair: Why not? I cannot believe you are running this and you cannot remember that. The problem is when people write to us. We want this in the public domain, but it is a way of not getting things into the public domain. Perhaps the people sitting behind you—your advisers—can remind you while we carry on asking you questions, and we will come back to that question at the end. Somebody must know. I cannot believe you don't know.

Martin Wheatley: Sorry, it is just that I don't have it in my head at the moment. We will write to you.

Q61Chair: No, I'd rather it were in the public domain by you giving an answer today. It just irritates me when people say they will write to us. I suggest that somebody behind you gets the information and gives it to us before the end of the session so that it is in the public domain.

Q62 Stephen Barclay: Unlike the Chair, I accept that when you take enforcement action, it needs to be evidence-based, so you gather intelligence by various routes. I fully understand that. What I am interested in is what evidence there is of you actually probing those conflicts of interest and, where you discover breaches of conflict of interest along the lines alluded to by the OFT, whether the penalty is greater than the benefits. That is where I am not clear on the evidence.

Martin Wheatley: Well, as I have said, I apologise that I do not have the information here. There will be cases that we can give you. Unfortunately, we may not be able to give them to you verbally now.

Chair: Well, I am hoping the people behind you are discovering them as we speak.

Q63 Stephen Barclay: You guarantee that there will be cases?

Martin Wheatley: I am pretty sure that there will be, relating not to price in the way that you have discussed, but to management of conflicts of interests and incentives.

Chair: I think we will ask the question again at the very end.

Q64 Austin Mitchell: I think Nelson would have made a good chairman of the Financial Conduct Authority, the way things are proceeding. The discredit and the damage caused by this—there has been a good deal of public opprobrium for what has happened—falls on you as the Financial Conduct Authority. Let me put it as the Report puts it. Paragraph 3.29 says that the Department "decided to focus on 21 'priority investors' who it considered fulfilled the allocation criteria of long-term supportive investors." You say that they could not have done that in the first place. Paragraph 3.30 goes on to state that "the priority investors provided firm, but non-binding, expressions of demand at various price levels." As a result, the bottom of the price range was set at 260p. Paragraph 16 of the summary states: "Sixteen of the 17 priority investors bought shares, and were allocated larger proportions of their orders than other investors reflecting the Department's expectation"—you have told us that the Department should not have had this expectation because it was wrong—"that they would form part of a stable long-term and supportive shareholder base, but almost half of the shares allocated to them had been sold within a few weeks". I put the question this way because I would like your opinion, rather than the defensive treatment that you have given us up to now: does that look to you like a good, ethical and well-functioning market?

Martin Wheatley: There are two components to this. I am not sure what "firm, but non-binding" means. If you want a contractual lock-up, you sign a contract for a specified period that locks people into those shares. It sounds like that did not happen, so I am not sure what a firm, long-term commitment meant. The asset managers acted in the way that other shareholders would act, which was that, having bought something, they decided that the price was right for them to sell. Clearly, whatever firm commitment they gave, they did not feel that that commitment overrode their fiduciary commitment to their shareholders.

Q65 Austin Mitchell: So it was an ethically conducted, well-functioning market, was it?

Martin Wheatley: I have not heard anything that says it wasn't.

Q66 Austin Mitchell: But you are the Financial Conduct Authority. You must know whether markets are ethical and functioning well.

Martin Wheatley: Overall, but you are asking about a specific transaction rather than whether markets function well. One of our objectives is to make markets function well. In this instance, as I have said, I have heard nothing that says to me that the market's integrity was undermined or that there was misconduct in the transaction.

Q67 Chair: But you have chosen not to investigate.

Martin Wheatley: We have chosen not to investigate on the basis—

Q68 Chair: So you are not sitting there today to tell us categorically that the market functioned according to the rules. You cannot say that.

Martin Wheatley: No, we cannot say that because we have not done the investigation, but for us to do an investigation, we would have to believe that something went wrong in this case.

Chair: It is chicken and egg.

Q69 Mr Bacon: Correct me if I am misstating this, but essentially you are saying that it would be perfectly possible for the rules to have been followed and for the market to have functioned well in a situation where there was a very significant premium, as there was on this occasion. Actually, you said that it is normal to have very significant premiums, although of the 16 IPOs referred to in figure 19, four went down on the first day, two had a zero change, five had a significant premium, four had a small premium and one, the Royal Mail one, had a huge premium. What you are saying is that it is perfectly possible for the rules to have been followed completely and for you to have no concerns as a regulator because, for example, the client had taken an extremely cautious, risk-averse approach to the pricing of the IPO in order to make absolutely certain that the issue was successful which, in and of itself, would not necessarily raise regulatory concerns. Is that a fair statement of your position?

Martin Wheatley: Yes, it is. Absolutely.

Q70 Mr Bacon: May I ask one other question? What is the rationale for giving large blocks of shares to selected priority investors? Why do that?

Martin Wheatley: The rationale would be to have more certainty about your issue and the aftermarket. That would be why.

Q71 Mr Bacon: Let me divide that in two. More certainty about the issue is to say that you will get a large block of shares away because you have allocated as a priority buyer an institutional investor that you know will buy a large block. Is that what you are saying?

Martin Wheatley: Yes.

Q72 Mr Bacon: When you speak of the aftermarket, you are talking about what happens after the issue has taken place and there is trading on the secondary market. Clarify for me what you mean about the aftermarket. Do you mean that they will be stable holders or that they will definitely be sellers so that there is lots of liquidity? What are you speaking of when you say "the aftermarket"?

Martin Wheatley: I think the question was whether there would be—

Q73 Mr Bacon: My question was: what is the rationale for having large blocks given to priority investors? You said that it is, one, to ensure that you get it away and, two, the aftermarket. There is certainty about the fact that you get it away. That is what you said. I am asking about the second part of your answer—the aftermarket. What do you mean by the aftermarket? Is it that you know that they will sell and you will have lots of liquidity, or is it that you know that they will hold, or what?

Martin Wheatley: I believe, from what I have read, that BIS believed that there would be stability of shareholding after the initial issue. From the information that we have seen, that clearly was not the case.

Q74 Mr Bacon: Hang on. In other words, when you say that BIS believed that there would be stability, you mean that the giving of a large number of shares to a small number of priority investors would ensure, or increase the chances of, stability in the market because there would be people who would hold rather than sell. Is that what you are saying?

Martin Wheatley: I believe that that was the intention, or one of the intentions.

Q75 Mr Bacon: So that failed, anyway.

Martin Wheatley: Again, I am only going on the report that I have seen.

Q76 Mrs McGuire: I just want to reflect on what you have just said over the past few minutes, compared with what you said earlier when I asked a question. Did it not ring at least some alarm bells that with this approach, which I think a couple of minutes ago you said should have given certainty in terms of the stability of the investors, that did not happen? I am struggling with that fact. It is like swimming through treacle here this afternoon, frankly. I am not quite sure what it takes to ring the alarm bells, because you have not given us any real indication about how the regulations work in terms of your alarm bells being jangled. We have been talking about this for the best part of 40 minutes and I do not think, unless I have misinterpreted some of the questions, that some of my colleagues understand either. What rings your alarm bells if you do not know what you do not know because you do not want to know it?

Martin Wheatley: Can I answer your question about stability? It may well have been disappointing for the issuer to have found that those shares were subsequently sold very quickly. That is not a regulatory issue. There was no misconduct and no suggestion of breach. People have fiduciary responsibilities to their clients.

Q77 Mrs McGuire: But would it not have alerted you at least to think that there might be some issue to do with regulation, which would have exercised just a little tiny bit of your curiosity?

Martin Wheatley: Our curiosity is always exercised by what we see in the market. We have to put our resources on the areas where we think there has been a potential for misconduct in the market. There is nothing in this instance that suggests that that has been the case.

Q78 Chair: Just try once more to explain to us what rings your alarm bells, because we do not get it. I do not get it either. I am with Anne on this. I just want to understand: if this doesn’t, what does?

Martin Wheatley: Unexplained share price movements.

Q79 Chair: And what does that mean?

Martin Wheatley: It means share price movements for which there is no evident information in the market.

Q80 Mr Bacon: Do you mean, for example, if there were a *Daily Telegraph* journalist who had access to information that no one else had access to and used it in the market?

Martin Wheatley: Well, if it was unpublished, price-sensitive information, then yes.

Q81 Chair: I have to say to you that this is an IPO, and the issue that we are drawing to your attention is the regulatory issue about the Chinese walls between the bank and the asset manager—the advice bit and the asset management. In that particular instance, a rise of 38% on day one does not in any way ring a bell or make you ask the question, “Did they adhere to the rules?” We all understand the rules, but did they adhere to them? Does it not make you ask that question?

Martin Wheatley: No, it doesn’t. The fact that there are potential conflicts is a feature of every IPO. The fact that an IPO would go to a premium is usually what people aim for. It is the client who makes a decision about how they want to price—

Chair: But it is the extent of the premium here. That is why this figure is so important.

Q82 Mr Bacon: You said that they might have been disappointed, so one might have described it as a pricing failure, but what you are saying is that there is a difference between a pricing failure—or, to use a less tendentious word, a pricing inadequacy, or whatever one might want to call it—on the one hand, and what you would call a regulatory failure on the other. They are not the same thing.

Martin Wheatley: That’s right. They are not.

Q83 Mr Bacon: Okay. This is obviously a sale of Government-owned assets, but if this were a private sector company that had advice and ended up pricing the issue at a certain level, and it turns out that it could probably have priced it higher and still got it away quite comfortably, the people who are left looking disappointed are the owners of the private sector company that, shall we say, floated or had an offering, who got less money than they could have done. Those are the people who are adversely affected, but that in itself is not a regulatory matter; it is a matter of how well or poorly the advisory business that was helping with the flotation advised its client and the decision that was reached on the price.

Martin Wheatley: Yes, and the decision that was reached between the client and the advisers.

Q84 Mr Bacon: So the people who we should be cross with if it turns out to be, as it were, a disappointment and an under-pricing are not the regulators—not you—but the people who fixed the price in a very small “c” conservative way.

Martin Wheatley: Yes.

Q85 Mr Bacon: The fixing of the price in a very conservative way left the owners of the business with less money than they could have had. That would be a fair analogy compared with the one I gave from the private sector. Is that right?

Martin Wheatley: I want to be careful about what I am answering.

Q86 Mr Bacon: I just gave an example from the private sector. I am just saying that, while this happens to be a public sector company rather than a private sector company, surely the same applies.

Martin Wheatley: I am only pausing because you started a sentence talking about the people who you should be cross with, and I do not think it is my job to tell you who to be cross with. It is my job to tell you that, if you want to look at where the failure was, the failure was in the pricing decision, not in the regulation.

Q87 Chair: But the pricing decision was taken on the advice of advisers who at the same time ran asset management arms. That is the key, key point, which you are not addressing. Of course, the Government in the end take the decision, and we will look at that on Wednesday. It is quite clear from this that the Government took the decision on the advice of the banks who have asset management arms. As an ordinary punter, you have not given me satisfaction that you have done the regulatory job of ensuring that that was done properly.

Amyas Morse: This is along those lines, but perhaps slightly different. Clearly, the principal, which in this case is the selling Department, is responsible for whatever decisions are made. There is no argument about that. They rely on advice, and one might say that some principals might be less experienced and rely on advice rather more than others. I imagine that that has some bearing on the importance of the disinterestedness of the advice. Absent any evidence that the advice was not disinterested—I am not saying that there is any evidence of that—if the advice given by the advisers was shown to be disinterested, the responsibility for the substantial shortfall in the realised value, despite the fact that they have retained these very eminent advisers, primarily reverts back either to the principals, or if they feel unhappy about how their advisers have functioned, they should take it up as a matter of dispute with them. Is that about right?

William Amos: Yes.

Amyas Morse: So if you are not happy with how your adviser has performed, it is not so much a matter for the regulator, unless there is an evident lack of disinterest, but it might be a matter for the principal to take action against the adviser.

William Amos: We would not take action because a decision that was subsequently shown to be wrong came about or because the judgment was wrong in that case. That would not be a regulatory breach.

Chair: It would be interesting if it was an inquiry.

Q88 Justin Tomlinson: I want to get some clarity here, because I think I understand this. You have a defined role, and your role is on insider information or something that is unexplained. The fact that the share price went up 38% can be explained by the fact that the shares were oversubscribed by 24 times. That would not set your alarm bells off, because it is obvious that if there is such pent-up demand, there will be a huge amount of buying on that first day. Is that why your alarm bells have not gone off?

Martin Wheatley: Well, yes. It is that and the absence of any other suggestion that there was misconduct.

Q89 Chair: But I have got to say, Justin, that the point is that they knew some days before, if you look at the relevant graph in the NAO Report, that there was over-demand. They advised the Department at that time not to put up the price beyond this marginal 20p. Is that right?

Matthew Rees: The advice on the 20-pence increase was provided between 3 and 4 October, but the evidence that there was sufficient demand was available a week earlier on 26 and 27 September.

Chair: But that did not ring an alarm bell. I just wonder what does.

Jackie Doyle-Price: That's not for the regulator though, Margaret.

Stephen Barclay: That was the Department's wrong decision—

Q90 Mr Jackson: I am trying to understand the statements you have made, Mr Wheatley, in the last hour or so. Are you saying that essentially, the price that was identified is not, of itself, a regulatory issue, and that as far as you are concerned, this was as close an approximation to perfect competition and perfect knowledge as you can have in a modern market, and therefore, in the absence of any prima facie evidence of inappropriate or criminal activity, that you had no locus to intervene or specifically make a value judgment as to the efficacy of the IPO disposal?

Martin Wheatley: I think that is what I am saying. You confused me a little bit in saying, "Is this close to perfect competition?"

Q91 Mr Jackson: Well, do you think it is? Perfect competition is when everyone has the knowledge. Everyone has the detail—the data—in the market, so there is no special interest intervening in order to get a pecuniary advantage to themselves. Are you satisfied that that was the case obtaining in this particular instance?

Martin Wheatley: At the point of IPO, I am satisfied that everybody had the document, which talked about the business, and was therefore able to make a judgment. Clearly, it was not quite perfect competition in that you had a selected set of investors who were taken over the wall early and were given an allocation early. So it was not perfect competition in that sense, but at the point of IPO, all the information was public.

Q92 Mr Jackson: And can I perhaps invite you to speculate as to why, hypothetically, if the price was not appropriate—to put it that way—that would have happened? Would that be a failing in methodology or a misreading of the market? Why would that have happened, in your experience of other sales?

Martin Wheatley: Again, when you say the price was not appropriate, there are always two objectives in any IPO. One of them is selling all of the stock and the second is getting a reasonable price for that stock, and you trade those two things off. There have been attempts to run auctions in the past that absolutely maximise the price and have left people with unsold stock. Nobody wants to be in that position, so the common parlance is that there is a bit left there for investors who expect to get something. I entirely accept that 38% is at the high end of the range, but it is not so high-end that you would say, "Well, actually, that completely failed." It sold the stock within this Government, which I believe was one of the objectives.

Q93 Justin Tomlinson: Could it be that the market has got it wrong as well? For example, I remember when Railtrack was privatised, the share price went through the roof, and everybody was saying, "Oh, I wish I had bought those. The Government have flogged it off too cheap." Fast forward a few years and it is not worth a penny. Could it be that the market has got it wrong on this one and, in 12 months' time, we might be looking back—Amazon has cancelled its contract and is doing same-day delivery itself—all thinking, "Cor blimey! We ripped everybody off selling Royal Mail shares."?

Martin Wheatley: It is impossible for me to say. People make a judgment on the trends in freight mail, parcel mail, the competition in the market, pricing capability—

Q94 Mr Bacon: Do you mean you are not going to give us free share tips, Mr Wheatley?

Martin Wheatley: I certainly will not, no.

Q95 Stephen Barclay: Just going back to conflicts of interest, do you accept that there is a conflict of interest between the big clients of banks like Goldman's and UBS, with whom they have ongoing regular relationships, compared with their one-off relationship with the Department for Business, Innovation and Skills?

Martin Wheatley: No, they have the same fiduciary responsibility in each case, so I would not think that that is a conflict. No, they have exactly the same responsibility.

Q96 Stephen Barclay: Have banks like Goldman's and UBS been repeatedly fined for breaches of conflicts of interest in terms of their clients?

Martin Wheatley: There are a number of fines.

William Amos: There is. I am not sure about UBS, but Goldman's was subjected to regulatory action in the US.

Q97 Stephen Barclay: It is not just in the US though, is it?

William Amos: I can't remember if there was corresponding UK action as well—as to where the locus of it was—but it was on the conflict matter.

Q98 Stephen Barclay: And there was just one bank. You are the former head of enforcement. I seem to remember quite a few cases.

William Amos: Yes. I was responsible for retail enforcement, rather than wholesale enforcement.

Q99 Stephen Barclay: So you simply do not know if they were fined more than once, though.

William Amos: Goldman's, no.

Q100 Stephen Barclay: You don't know. I would have thought that would be the sort of thing you would know in terms of setting their risk profile. Just to be clear then, you do not think that their ongoing relationship with their big clients is a cause for concern in terms of your risk register.

Martin Wheatley: No. They have a responsibility to their client, whoever that is. When they take on a client, that is the contract that they enter into.

Q101 Stephen Barclay: Right, and in terms of culture, that is not something you have been looking at.

Martin Wheatley: Again, if I understand, the question is that if they repeatedly go for a particular client, are they somehow going to give that client—they are clearly giving a better service if there is an ongoing relationship, but is that to the detriment of a smaller client that they take on? No. If they take on a client, they owe a responsibility to that client.

Q102 Stephen Barclay: And there have not been examples of exactly that risk materialising recently.

Martin Wheatley: I don't believe so.

Q103 Chair: Do you want to ask your initial question as well, Stephen? It was about breaches. I think that you now have an answer.

Stephen Barclay: They were going to come back to me on that, in terms of funds.

Chair: No, I think they are going to answer it now.

Stephen Barclay: To be fair, I do not think that Mr Wheatley has had a chance to get that information.

Chair: He has had it from behind; I saw a note being passed.

William Amos: I have something, but I don't have—I can give you one example of where we imposed a fine of more than £8[i] million against an asset manager.

Q104 Chair: Sorry, I missed that, Mr Amos. Could you say that again?

William Amos: We issued a fine against an asset manager of more than £8[i] million around conflicts of interest.

Q105 Stephen Barclay: Yes, but that was not on an IPO, was it?

William Amos: No, I don't think so.

Q106 Stephen Barclay: There have been other fines—you have fined another bank £22 million. That is on your website, but it was not for an IPO, was it?

William Amos: No.

Q107 Stephen Barclay: Okay. I was asking about IPOs, as you know.

William Amos: For IPOs, I am not aware that we have taken enforcement action.

Q108 Stephen Barclay: It is just a bit worrying if you give me an example that I have already seen and that is about a different subject.

William Amos: I misunderstood the question.

Q109 Mr Bacon: I think we are wrapping up any second, but can I just check something very quickly? Your enforcement actions, declarations of breaches and enforcement actions on your fines are all publicly available, are they not?

Martin Wheatley: Yes.

Q110 Mr Bacon: Secondly, paragraph 3.8 of the Report says that in 2011 the OFT "found a number of features of the equity underwriting market which provided reasonable ground for suspecting that competition for equity underwriting services is prevented, restricted or distorted in the United Kingdom," but that it chose to "exercise its discretion" not to "make a market investigation reference to the Competition Commission." Forgive my ignorance, but does the book-building exercise approach essentially mean that you avoid underwriting the cost of underwriters completely? Is it right that no underwriters were taking a fee for underwriting?

Martin Wheatley: You minimise the risk to the banks. There is a very short window when they take on risk—

Q111 Mr Bacon: But in this transaction, are people acting as underwriters and being paid for that?

Martin Wheatley: There is a very small window in which I believe they are.

Q112 Mr Bacon: Who?

Martin Wheatley: I think the consortium of banks.

Q113 Mr Bacon: Some of the syndicate, basically.

Martin Wheatley: Yes.

Q114 Mr Bacon: Is that right, Mr Rees?

Martin Wheatley: I think that the underwriting risk is literally down to non-payment of an order. It is a very tiny underwriting risk.

Q115 Chair: I think that Matthew knows more about it.

Matthew Rees: On the IPO, the underwriters are not taking risk, other than the difference between—there is a three-day settlement period from placing to paying for shares. The work that the OFT was talking about was for rights issues, which is for companies that are already listed and seeking to raise new money. In that case, the banks will provide a sort of insurance against the placement of shares.

Q116 Mr Bacon: I was just thinking of the BP flotation in 1987, which happened to coincide with the stock market crash. Goldman Sachs took 2% of the value of the issue in order to underwrite it and were then rather annoyed to find that they were stuck with a lot of the stock. That is the analogy that I am making. Was underwriting going on in that sense in this transaction?

Matthew Rees: In that previous example that you are talking about, underwriting risk was taken by the banks, and for Royal Mail, it was not.

Q117 Mr Bacon: Right, so there was no underwriting going on in that sense.

Matthew Rees: Not in Royal Mail.

Chair: Okay. Thank you very much indeed.

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[i] Note from witness: Although this is what William Amos did say, it was later corrected. It should actually read "of more than £3 million".