



## INTEGER WEALTH GLOBAL

---

### Integer Wealth Global – Corporate Finance: Mainstream or Non-Mainstream

Date: 11 March 2021

---

#### Is it mainstream or non-mainstream corporate finance?

The question of how corporate finance activities fit into regulation under the Financial Services and Markets Act 2000 (FSMA) continues to raise queries. Questions arise about whether an activity is a regulated activity for which the firm needs a license from the Institute or authorisation from the Financial Services or Conducts Authority (FSA or FCA). Then, if a firm is authorised by the FSA, how corporate finance is dealt with under the FSA's Conduct of Business Sourcebook (COBS).

For this exercise we will refer to the regulator as the FSA.

This article concentrates on the questions raised by authorised firms but could also assist firms that are licensed by the Institute. It will also help firms that are not regulated for investment business activities by the FSA or the Institute to determine what corporate finance activities they can undertake.

A firm with FSA authorisation will be undertaking some activities that are not regulated in addition to regulated activities. In turn, the regulated activities will fall into two categories "mainstream" and "non-mainstream" business. Mainstream business attracts the full weight of COBS whereas non-mainstream is only subject to the COBS rules in respect of:

- Clear fair and not mis-leading communications
- Financial Promotions
- Terms of business and clients' agreements.

Firms may wish to differentiate between the two types of business for this reason. In addition, firms will need to consider which of their corporate finance advisers should become "approved persons" (in controlled function 23) under the FSA's regime.

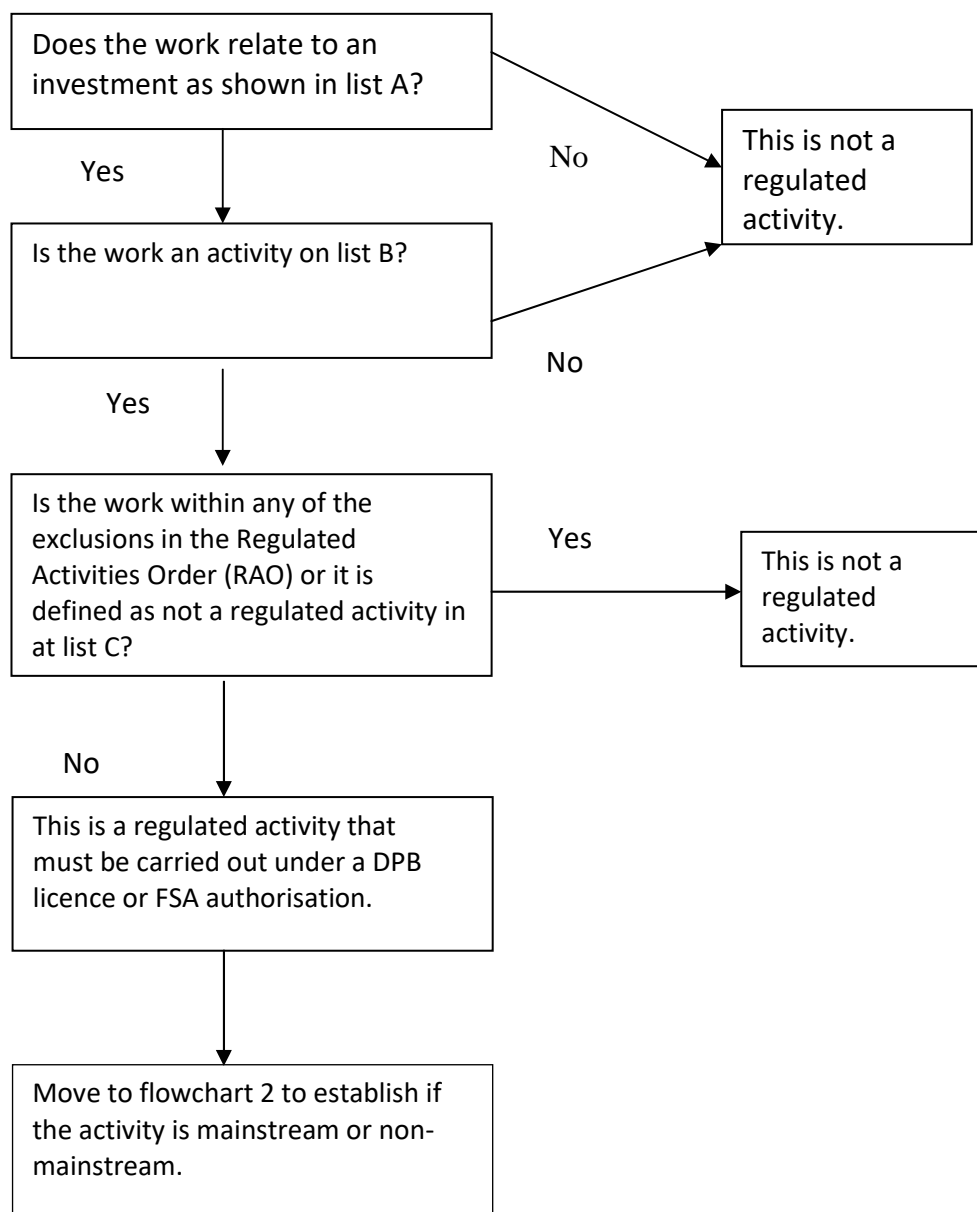
Under the rules, only those conducting mainstream business need to become approved persons and there may be economic reasons for a firm to ensure that the number of its approved persons are kept to a minimum as this will effect the fee paid.

An activity, which is not a regulated activity, does not fall under the FSMA or COBS. To decide whether an activity is regulated at all, a firm will first discount such work as audit, which is not related to investments in any way. The firm will then consider whether the activity relates to an *investment*, as defined under the legislation (List A) and whether the activity itself is *regulated* (List B). The next step would be to decide whether any form of exclusion relating to corporate finance applied to the work (List C) and if not, the work is a regulated activity. This process is shown in flowchart 1.



## Flowchart 1

### Corporate Finance - is it a regulated activity?



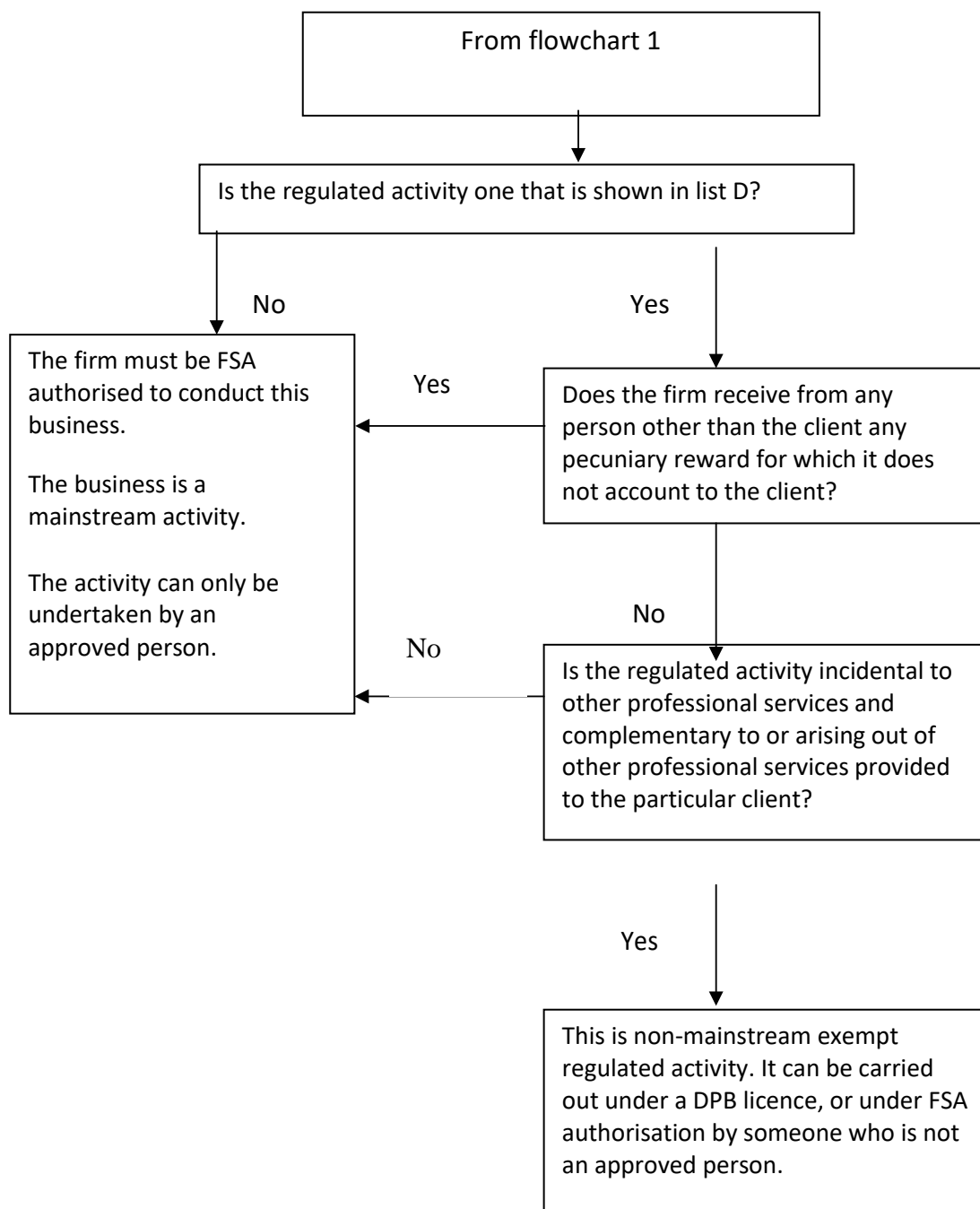
### What is non-mainstream business?

The FSA Professional Firms Sourcebook provides a full definition of non-mainstream regulated activities. In principle, they are regulated activities that could be conducted under a DPB license and where the firm does not receive from a person other than the client, any pecuniary reward (e.g. commission) for which the firm does not account to the client. The activity must also be one incidental to the provision of other professional services and complementary to or arising out of other professional services provided to that client.



Flowchart 2 will assist firms in deciding whether a regulated activity is mainstream or non-mainstream.

## Flowchart 2 Mainstream or non-mainstream business?





List A (regulated investments) and list B (regulated investments) are essentially the article headings in the FSMA 2000 (Regulated Activities) order 2001 - SI 2001/544 (RAO) that relate to corporate finance. The RAO should be referred to for a fuller explanation of each and, if needed, for details of other investments and activities.

## List A

### Regulated investments

| RAO Article |  |
|-------------|--|
| 76          | Shares   |
| 77          | Instruments creating or acknowledging indebtedness (e.g. debentures) |
| 78          | Government and public securities                                     |
| 79          | Instruments giving entitlement to investments (e.g. warrants)        |
| 80          | Certificates representing certain securities                         |
| 83          | Options  |
| 84          | Futures  |
| 85          | Contracts for differences  |
| 89          | Rights to or interests in investments                                |

The RAO does not distinguish between investments listed on a public market and any other investment.

## List B

### Regulated activities

| RAO Article |  |
|-------------|--|
| 14          | Dealing in investments as principal        |
| 21          | Dealing in investments as agent            |
| 25          | Arranging deals in investments             |
| 37          | Managing investments                       |
| 40          | Safeguarding and administering investments |
| 45          | Sending dematerialised instructions        |
| 53          | Advising on investments                    |
| 64          | Agreeing to carry on a specified activity  |

Professional services that are not regulated activities due to exclusions in the Regulated Activities Order (RAO) or because of the definitions of regulated activities in the RAO



|    | <b><u>Services</u></b>   | <b><u>Examples/comments</u></b>   |
|----|--|---|
| 1. | Generic advice – i.e. general discussion with a client about different types of investments, but not discussions on the merits of a specific investment. (RAO article 53 refers to advice about a <u>particular</u> investment.)   |   |
| 2. | Introducing a client to a permitted third party*.<br><br>(RAO article 33)  | Firm introduces a client, who wants advice about the merits of buying a specific investment, to a permitted third party*. Firms should remember that such introductions should only be made to entities able to give independent advice, and no comments can be made on the advice given by the permitted third party*.   |
| 3. | Advice, arranging a deal or dealing as agent regarding the sale or purchase of a body corporate but only if: <ul style="list-style-type: none"><li>• the object of the transaction may be regarded as the acquisition of day to day control over the affairs of the body corporate; or</li><li>• the shares (together with ones already held) are 50% or more of the voting rights and the transaction is between two parties each of whom is a body corporate, a partnership, a single individual or a group of connected individuals, as defined in the RAO.</li></ul><br>(RAO article 70) | Firm advises a family owned company on a sale to a venture capitalist or to a company whose shares are publicly traded. This exemption applies even if the advice is about the balance of consideration between cash and publicly traded securities.<br><br>The exclusion also works in many situations relating to management buyouts. Further information on the use of the exclusion is contained in the article on “corporate finance scenarios” in this edition of the IB Gazette. |



|    | Services   | Examples/comments  |
|----|--|--|
| 4. | <p>A firm can arrange a deal in investments, deal as agent in investments, safeguard and administer investments or give advice, provided:</p> <ul style="list-style-type: none"> <li>• the firm is <u>not</u> separately remunerated for this work,</li> <li>• the service may <u>reasonably</u> be regarded as a <u>necessary</u> part of other professional services, and</li> <li>• the business or profession does not otherwise consist of regulated activities.</li> </ul> <p>(RAO article 67, this exemption is known as the professional firms exemption.)</p>   | <p>Firms should be careful of using this exemption as it may have to justify why it regards the transaction, which in all other respects is investment business, as reasonably being a necessary part of another professional service.</p> <p>For example, in advising the board of a client company, advice may involve discussions on expansion with, as an option a trade investment in another company. This may meet the exclusion.</p> |
| 5. | <p>Making arrangements for a client to buy, sell, subscribe for or underwrite an investment with or through a permitted third party, provided:</p> <ul style="list-style-type: none"> <li>• the transaction is on the advice of a permitted third party* or</li> <li>• the client has not requested advice on the merits of the investment from the firm, or if requested, the firm has refused and suggested that the client seek advice from a permitted third party*.</li> </ul> <p>In both cases the firm must account to the client for any commission etc which arises out of the transaction. (RAO article 29.)</p> | <p>This exclusion would allow a firm to arrange a contract with a permitted third party* if no advice was given. However, it does not allow a firm to <u>arrange</u> for a private company share purchase or sale, as the arrangement must be made with a permitted third party*. Most corporate finance activities would not meet this exclusion unless the transaction was arranged through, for example, a stockbroker.</p>               |
| 6. | <p>Buying, selling, subscribing for or underwriting an investment as agent for a client with or through a permitted third party* provided:</p> <ul style="list-style-type: none"> <li>• the transaction is on the advice of a permitted third party* or</li> <li>• the client has not requested advice on the merits of the investment from the firm, or if he did, the firm has refused and suggested that the client seek advice from a permitted third party*.</li> </ul> <p>In both cases the firm must account to the client for any commission etc which arises out of the transaction. (RAO article 22.)</p>        | <p>Similar comments to those above apply.</p>  |



There are other exclusions in the Regulated Activities Order 2001 (RAO) that do not constitute investment business. In addition, because of the wording of the specific definitions of what are regulated activities, some activities are not regulated. These include:

- a. Receiving documents about an investment solely for passing to the owner or as the owner directs.
  - b. Providing information about the value of any assets safeguarded.
  - c. A company issuing its own shares is not engaging in a regulated activity, but advice to a potential shareholder to subscribe for the shares is.
  - d. Advising a company on the issue of shares as the company is not an “investor” under RAO 53, although arranging for the issue of shares which extends beyond administration is a regulated activity.
  - e. Generally transactions within a group of companies are not investment business.
  - f. Arranging for the transfer of shares for no financial consideration (for example between husband and wife).
  - g. Valuing investments where no advice is given on whether to sell or buy.  
Advice on securing an overdraft.
- \* A permitted third party includes a person authorised by the Financial Services Authority to carry out regulated activities under the Act or an appointed representative of an FSA authorised firm acting in the course of a business it is exempt for.



## List D

The regulated activities in column one can be performed by a licensed firm in respect of the investments shown in the second column. The third column contains some specific examples and further commentary.

| (1) ACTIVITIES   | (2) INVESTMENTS  | (3) ILLUSTRATIONS/COMMENTS   |
|--|--|--|
| The activities below are contained in the Regulated Activities Order (RAO) and the appropriate article number is given | What constitutes an investment is contained in the RAO.                                  | This column provides further explanation of what a licensed firm can do in respect of the activities and investments in the previous columns. These activities can only be undertaken in accordance with the requirements of Parts 3 and 4 of the Handbook.  |
| 1. Dealing* in investments as agent for a client (RAO article 21).   | Securities, which include shares, debentures and units in collective investment schemes. | Participating in investment planning in co-operation with permitted third parties.   |
| 2. Making arrangements for a person to deal* (RAO article 25).   | As above.  | <ul style="list-style-type: none"> <li>• A licensed firm can, on the instruction of a client, arrange the buying, selling, subscribing for or underwriting of an investment (a licensed firm can advise on the transaction as outlined in the following section on advice but an unlicensed firm cannot).</li> <li>• Advice to a client leads to the arranging for the disposal of a client's investment (to provide funds for other purposes).</li> <li>• Arranging the transfer of shares for valuable consideration, for example, husband to wife and around the family.</li> <li>• Making the arrangements for a company to issue shares.</li> <li>• Arranging an equity for debt exchange for a company with financial problems to increase stability.</li> </ul> |





| (1) ACTIVITIES  | (2) INVESTMENTS | (3) ILLUSTRATIONS/COMMENTS  |
|---|-----------------|---|
| 3. Managing investments (RAO article 37, but see schedule 1). | As above.       | Licensed firms cannot, if managing investments, exercise discretion in connection with buying or subscribing for a security or contractually based investment unless: <ul style="list-style-type: none"><li>• All routine or day to day decisions are taken by a permitted third party* with permission to manage investments or</li><li>• The decision to buy or subscribe is taken in accordance with the advice of a permitted third party* who is permitted to give advice in relation to that activity.</li></ul> Thus licensed firms can make decisions; <ul style="list-style-type: none"><li>• to sell or not to sell existing shares;</li><li>• concerning strategy such as the mix of different types of investments.</li></ul> |
| 4. Safeguarding and administration (RAO article 40).          | As above.       | Licensed firms can look after share certificates or other documents of title, arrange for the collection of dividends, act as the addressee to receive documents relating to the investment etc.  |
| 5. Sending dematerialised instructions (RAO article 45).      | As above        | For example, sending instructions through the Crest system.   |



| (1) ACTIVITIES   | (2) INVESTMENTS | (3) ILLUSTRATIONS/COMMENTS  |
|--|-----------------|---|
| <p>6. Advising (RAO article 53. Note, there is a prohibition in schedule 1 of part 3 of the DPB Handbook (paragraphs 3 and 4) concerning recommending individuals to buy or subscribe for certain types of investments).</p> | <p>As above</p> | <ul style="list-style-type: none"> <li>• Explaining and evaluating investment advice and offering alternatives (unless the prohibition in schedule 1, paragraph 3 or 4 applies, see column 1).</li> <li>• Explaining the advice received from a permitted third party*.</li> <li>• Identifying unsuitable advice.</li> <li>• Endorsing an authorised person's advice.</li> <li>• Advising on disposals (unless the prohibition in schedule 1, paragraph 4 applies, see column 1).</li> <li>• Advising clients about the commercial utility of futures, options and contracts for differences, e.g. to support commercial bank borrowings or as commercial hedging mechanisms.</li> <li>• In the course of tax advice or planning, the specification of realisable investments that have unrealised capital gains which may give an opportunity for an equivalent to 'bed and breakfast type' transactions.</li> </ul> |
| <p>7. Agreeing (RAO article 64).</p>   |                 | <ul style="list-style-type: none"> <li>• A licensed firm can agree to carry on any of the activities noted in the activities column.</li> </ul>   |

\* A permitted third party includes a person authorised by the Financial Services Authority to carry out regulated activities under the Act or an appointed representative of an FSA authorised firm acting in the course of a business he is exempt for

\*\* 'Dealing' and 'deal' in this context mean buying, selling, subscribing for or underwriting a particular investment.