14: Corporate finance

Note: This sectoral guidance is incomplete on its own. It must be read in conjunction with the main guidance set out in Part I of the Guidance.

This sectoral guidance considers specific issues over and above the more general guidance set out in Part I, Chapters 4, 5 and 7, which firms engaged in corporate finance activity may want to take into account when considering applying a risk-based approach to that sector. Firms may also find the following sectors useful:

- **Sector 13: *Private Equity*, which covers the private financing of companies.**
- **Sector 18: *Wholesale Markets*, which covers the trading of securities in a primary or secondary market.**

Overview of the sector

14.1. "Corporate finance" is activity relating to:

(i) The *issue of securities.* These activities might be conducted with an issuer in respect to itself, or with a holder or owner of securities. Examples include: arranging an initial public offering (IPO), a sale of new shares, or a rights issue for a company, as well as making arrangements with owners of securities concerning the repurchase, exchange or redemption of those securities;

(ii) The *financing, structuring and management of a body corporate, partnership or other organisation*. Examples include: advice about the restructuring of a business and its management, and advising on, or facilitating, financing operations including securitisations;

(iii) C*hanges in the ownership of a business.* Examples include: advising on mergers and takeovers, or working with a company to find a strategic investor;

(iv) B*usiness carried on by a firm for its own account* where that business arises in the course of activities covered by (i), (ii) or (iii) above, including cases where the firm itself becomes a strategic investor in an enterprise.

What are the money laundering risks in corporate finance?

14.2. As with any financial service activity, corporate finance business can be used to launder money.

14.3. The money laundering activity through corporate finance will not usually involve the placement stage of money laundering, as the transaction will involve funds or assets already within the financial system. However, corporate finance could be involved in the layering or integration stages of money laundering. It could also involve the concealment, use and possession of criminal property and arrangements to do so, or terrorist funding.

14.4. The money laundering risks associated with corporate finance relate to the transfer of assets between parties, in exchange for cash or other assets. The assets can take the form of securities or other corporate instruments.

How to assess the elements of risk in this sector

14.5. In order to forestall financial crime, including money laundering and terrorist financing, it is important to obtain background knowledge about all the participants in a corporate finance transaction, and not just those who are customers, who must be subject to customer due diligence. This background gathering exercise should include measures to understand the ownership and control structure of the customer as well as looking at the beneficial ownership and any possible involvement of politically exposed persons and establishing the purpose and intended nature of the business relationship and whether this is consistent with the transaction being undertaken.

14.6. In its assessment of the financial crime risk of a particular corporate finance transaction, a firm should use - where possible and appropriate - the information it has obtained as a result of the intensive due diligence it normally undertakes in any corporate finance transaction. This may include, but not be limited to, firms assessing the probity of directors, shareholders, and any others with significant involvement in the customer's business and the corporate finance transaction.

14.7. The money laundering risks associated with corporate finance activity can be mitigated if a firm understands or obtains assurances from appropriate third parties as to the source and nature of the funds or assets involved in the transaction.

14.8. In addition, a firm should assess whether the financial performance of an enterprise is in line with the nature and scale of its business, and whether the corporate finance services it seeks appear legitimate in the context of those activities. The outcome of this assessment should be consistent with the purpose and intended nature of the business relationship.

Who is the customer for AML purposes?

Issuer of securities

14.9. Where a firm is facilitating the issue or offer of securities by an entity, that entity is the firm's customer.

Purchaser of securities

14.10. Whether purchasers of the *securities* issued are customers for AML purposes will depend upon the relationship the firm has with them, and in particular whether or not a firm has behaved in a way that would lead the purchaser to believe that he is a customer. Therefore:

- A direct approach by a firm to a potential purchaser will create a customer relationship for the firm.
- Purchasers of *securities* in new issues arranged by a firm will not be customers of the firm so long as their decision to purchase is based on offering documentation alone, or on advice they receive from another firm (which will have a customer relationship for AML purposes with the purchaser).

14.11. To protect its own reputation and that of the issuer, a firm that is acting as arranger in the issue of securities may wish to ensure that appropriate investor identification measures are adopted in the offering and that the entity administering the subscription arrangements understands the legal and regulatory AML requirements and confirms to the firm that it will undertake appropriate customer due diligence on its customers participating in the purchase of securities.

Owners of securities

14.12. Where a firm advises the owners of *securities*, in respect of the repurchase, exchange or redemption by an issuer of those *securities*, the owners will be customers of the firm for AML purposes.

14.13. However, other than in exceptional cases, a firm may be precluded by other regulatory requirements from acting for both the issuer and the owners of the investments concerned. In the circumstances where a firm does act for the owners of the *securities*, the issuer will not generally be a customer of the firm for AML purposes.

Financing, structuring and management of a body corporate, partnership or other organisation

14.14. The entity with which a firm is doing investment business, whether by way of advice provided to the entity, or through engaging in transactions on its behalf, will be a customer of the firm for AML purposes.

14.15. The activity undertaken by a firm may entail the firm dealing in some way with other entities/parties on behalf of the customer entity, for example, through the sale of part of its customer's business to another entity or party. In these circumstances, the other entity or party whom the firm deals with on behalf of the customer will not also become the firm's customer as a result of the firm's contact with them during the sale. (For *Securitisations transactions* see paragraphs 14.30 – 14.36.)

Changes in the ownership of a business

14.16. The entity with which a firm is mandated to undertake investment business, whether by way of advice or through engaging in transactions, will be the customer of the firm for AML purposes.

14.17. Other entities or parties affected by changes in ownership, for example a takeover or merger target, will not become the firm's customers, unless a firm provides advice or other investment business services to that entity or party. Similarly, an approach by a firm to a potential investor on behalf of a customer does not require the firm to treat the potential investor as its customer for AML purposes, unless the firm provides advice or other investment business services to that investor.

Business carried on by a firm for its own account

14.18. Where a firm makes a principal investment in an entity, that entity will not be a customer of the firm. A principal investment in this context means an investment utilising the firm's capital and one that would not involve the firm entering into a business relationship within the meaning of the ML Regulations. If, as well as making a principal investment in an entity, a firm enters into a business relationship with that entity, for example, by providing investment services or financing to the entity, the firm must apply the measures referred to in Part I, Chapter 5 as appropriate. When a firm has determined that the investment is not subject to the requirements of the ML Regulations, it may nevertheless wish to consider, in a risk-sensitive way, whether there are any money laundering implications in the investment it is making and may decide to apply appropriate due diligence measures.

Involvement of other regulated firms

14.19. A regulated firm (X) may be involved in a corporate finance transaction in which another regulated firm (Y) from an equivalent jurisdiction, is also involved. The relationship between X and Y may take a number of different forms:

(a) X may be providing investment services to Y, for example, by facilitating an IPO for Y. In this case Y is the customer of X. X is not the customer of Y.
(b) X and Y may both be providing investment services to a customer Z, for example by underwriting a private placement of shares for Z. In this case, Z is the customer of X and of Y. There is no customer relationship between X and Y.
(c) X may be acting for an offeror (Z) in a takeover, and Y may be acting for the offeree (ZZ). Z is the customer of X and ZZ is the customer of Y. There is no customer relationship between X and Y.

14.20. A firm should establish at the outset whether it has a customer relationship with another regulated firm and, if so, should follow the guidance in Part I, Chapter 5 in verifying the identity of that firm.

Customer due diligence

14.21. Corporate finance activity may be undertaken with a wide range of customers, but is predominantly carried on with listed and unlisted companies or their owners. The guidance contained in Part I, Chapter 5 indicates the customer due diligence procedures that should be followed in these cases. However, the following is intended to amplify aspects of the Part I, Chapter 5 procedures, with particular reference to the business practices and money laundering risks inherent in a corporate finance relationship.

Background information

14.22. It is necessary to look more closely than the procedures set out in Part I, Chapter 5 for acceptance of the customer. It is important to check the history of the customer and to carry out reputational checks about its business and representatives and shareholders.

Timing

14.23. In corporate finance transactions, when a mandate is issued or an engagement letter is signed is the point at which the firm enters into a formal relationship with the customer. However, it is common for a firm to begin discussions with a customer before a mandate or engagement letter has been signed.

14.24. A firm should determine when it is appropriate to undertake customer due diligence on a prospective customer and where applicable any beneficial owners, but this must be before the establishment of a business relationship. In all cases, however, the firm must ensure that it has completed appropriate customer due diligence prior to entering into a legally binding agreement with the customer to undertake the corporate finance activity.

14.25. Where, having completed customer due diligence, a mandate or engagement letter is not entered into until some time after the commencement of the relationship, a firm is not required to obtain another form of evidence confirming the customer's agreement to the relationship with the firm prior to the signing of the mandate, provided it is satisfied that those individuals with whom it is dealing have authority to represent the customer.

14.26. Whilst not an AML requirement, if the relationship is conducted, either initially or subsequently, with non-board members, the firm should satisfy itself at an early stage that the board has approved the relationship by seeking formal notification of the non-board members' authority to act on behalf of the company they represent.

Other evidence for customer due diligence

14.27. Where there is less transparency over the ownership of the customer, for example, where ownership or control is vested in other entities such as trusts or special purpose vehicles (SPV's), or less of an industry profile or less independent means of verification of the customer, a firm should consider how this affects the ML/TF risk presented. It will, in certain circumstances, be appropriate to conduct additional due diligence, over and above the firm's standard evidence. Firms have an obligation to verify the identity of all beneficial owners (see Part I, Chapter 5). It should also know and understand any associations the customer may have with other jurisdictions. It may also consider whether it should verify the identity of other owners or controllers. A firm may, subject to application of its risk-based approach, use other forms of evidence to confirm these matters. Consideration should be given as to whether or not the lack of transparency appears to be for reasonable business purposes. Firms will need to assess overall risk in deciding whether the "alternative" evidence, which is not documentary evidence as specified in Part I, Chapter 5, is sufficient to demonstrate ownership and the structure as represented by the customer.

14.28. Firms should maintain file notes setting out the basis on which they are able to confirm the structure and the identity of the customer, and individuals concerned, without obtaining the documentary evidence set out in Part I, Chapter 5. Such notes should take account of:

- Social and business connections
- Meetings at which others are present who can be relied upon to know the individuals in question
- The reliance which is being placed on banks, auditors and legal advisers

Subsequent activity for a customer

14.29. Some corporate finance activity involves a single transaction rather than an ongoing relationship with the customer. Where the activity is limited to a particular transaction or activity, and the customer subsequently engages the firm for other activity, the firm should ensure that the information and customer due diligence it holds are up to date and accurate at the time the subsequent activity is undertaken.

Securitisation transactions

14.30. Securitisation is the process of creating new financial instruments by pooling and combining existing financial assets, which are then marketed to investors. A firm may be involved in these transactions in one of three main ways in the context of corporate finance business:

(i) as advisor and facilitator in relation to a customer securitising assets such as future receivables. The firm will be responsible for advising the customer about the transaction and for setting up the special purpose vehicle (SPV), which will issue the asset-backed instruments. The firm may also be a counterparty to the SPV in any transactions subsequently undertaken by the SPV;

(ii) as the owner of assets which it wants to securitise;

(iii) as counterparty to an SPV established by another firm for its own customer or for itself - that is, solely as a counterparty in a transaction originated by an unconnected party.

14.31. As a general rule, the firm should be more concerned with the identity of those who provide the assets for the SPV, as this is the key money laundering risk. So long as the firm demonstrates the link between the customer and the SPV, the SPV is not subject to the full requirements of

Part I, Chapter 5. However, the firm should obtain the basic identity information and hold evidence of the SPV's existence.

14.32. Whether a purchaser of the instruments issued by the SPV will be treated as customers will depend upon the relationship the firm has with them. Purchasers of instruments issued by the SPV arranged by a firm will not be customers of the firm so long as their decision to purchase is based on offering documentation alone, or on advice they receive from another firm, who will have a customer relationship with them. However, as part of a firm's risk-based approach, and for reputational reasons, it may also feel it appropriate to undertake due diligence on those who are purchasers of the instruments issued by the SPV.

14.33. In addition to verifying the identity of the customer in line with normal practice for the type of customer concerned, the firm should satisfy itself that the securitisation has a legitimate economic purpose. Where existing internal documents cannot be used for this purpose, file notes should be made to record the background to the transaction.

14.34. The firm needs to follow standard identity procedures as set out in Part I, paragraphs 5.3.68 to 5.3.278 with regard to the other customers of the firm to which it sells the new instruments issued by the SPV it has established.

14.35. If the firm is dealing with a regulated agent acting on behalf of the SPV, it should follow normal procedures for dealing with regulated firms.

14.36. If the firm is dealing with an unregulated agent of the SPV, both the agent and the SPV should be identified in accordance with the guidance in Part I, paragraph 5.3.70. Background information, obtainable in many cases from rating agencies, should be used to record the purpose of the transaction and to assess the money laundering risk.

Monitoring

14.37. The money laundering risks for firms operating within the corporate finance sector can be mitigated by the implementation of appropriate, documented, monitoring procedures. General guidance on monitoring is set out in Part I, section 5.7.

14.38. Monitoring of corporate finance activity will generally, due to the relationship-based, rather than transaction-based (in the wholesale markets sense), nature of corporate finance, be undertaken by the staff engaged in the activity, rather than through the use of electronic systems.

14.39. The essence of monitoring corporate finance activity involves understanding the rationale for the customer undertaking the transaction or activity, and staff using their knowledge of the customer, and what would be normal in the given set of circumstances, to be able to spot the unusual or potentially suspicious.

14.40. The firm will need to have a means of assessing that its risk mitigation procedures and controls are working effectively. In particular the firm will need to consider:

- Reviewing ways in which different services may be used for ML/TF purposes, and how these ways may change, supported by typologies/law enforcement feedback, etc;
- Adequacy of staff training and awareness;
- Capturing appropriate management information;
- Upward reporting and accountability; and
- Effectiveness of liaison with regulatory and law enforcement agencies.

The responses to these matters need to be documented in order to demonstrate how it monitors and improves the effectiveness of its systems and procedures.

14.41 The firm will have ongoing relationships with many of its customers where it must ensure that the documents, data or information held are kept up to date. Where, as is likely in some cases with corporate finance activities, the customers may not have an ongoing relationship with the firm, it is important that the firm's procedures to deal with new business from these customers is clearly understood and practised by the relevant staff. It is a key element of any system that up to date customer information is available as it is on the basis of this information that the unusual is spotted, questions asked and judgements made about whether something is suspicious.

Staff awareness, training and alertness

14.42 The firm must train staff on how corporate finance transactions may be used for ML/TF and in the firm's procedures for managing this risk. This training should be directed specifically at those staff directly involved in corporate finance transactions and should be tailored around the specific risks that this type of business represents. Whilst there is no single solution when determining how to deliver training, training of relationship management staff via workshops may well prove to be more successful than on-line learning or videos/CDs.