AUTORITÉ
DES MARCHÉS FINANCIERS

AMF

AMF public consultation on corporate finance

1. GOALS AND PRACTICAL ARRANGEMENTS FOR THIS CONSULTATION

1.1. Goals

For the past several years, the Autorité des marchés financiers (hereinafter "the AMF") has been engaging with all stakeholders involved in financing the economy and listening closely to small and medium-sized enterprises, as well as mid-tier enterprises. In this context, the AMF is taking an interest in firms that provide companies, their executives or their shareholders with advise and support in connection with the planned sale or transfer of a business, external growth transactions or new equity financing.

This type of service, commonly known as 'merger and acquisition advisory' or more generally as 'corporate finance', is provided by (i) regulated professionals – investment banks, financial investment advisers and crowdfunding advisers, (ii) legal and accounting professionals (lawyers, notaries and accountants), who are also regulated, and (iii) unregulated professionals[1].

Since such a service is not free of risk to those who use it, and given not only the financial issues at stake, but also the economic and social issues surrounding such transactions[2], whether they be conducted routinely or on a one-off basis, the AMF is considering both whether such firms should be regulated and, if so, how they might best be regulated.

While the AMF does not, for the time being, intend to create a new regulated profession encompassing all such firms, consideration needs to be given to whether there is room for something between the lack of regulated status and a more optional type of regulation that would guarantee the professionalism, ethics and expertise of those wishing to avail themselves of it.

1.2. Who is this consultation aimed at?

This consultation is aimed at:

- organisations representing businesses
- public, parapublic and private organisations involved in selling or transferring businesses and/or in corporate finance
- institutions authorised by the AMF or the ACPR and/or registered with ORIAS
- legal and accounting professionals
- other corporate consultants
- industry groups
- investors and their representatives

1.3. Procedure and deadline for responses

This consultation will end on **Tuesday, 28th February 2017**. Participants are asked to submit their responses and comments to the following address: **directiondelacommunication@amf-france.org.**

[1] Expressly referred to in the third paragraph of Article L.321-2 of the Monetary and Financial Code, "Advisory services provided to firms in relation to capital structure, industrial strategy and related subjects, as well as advisory services relating to mergers and acquisitions" are not an investment service requiring authorisation but an 'ancillary service', for which French legislation – like European legislation – lays down no specific rules.

[2] For example, some owners of small and medium-sized enterprises sell their business, which likely represents the bulk of their personal wealth, to help fund their retirement.

2. OVERVIEW OF THE CONSULTATION

Further to repeated requests from some firms concerning the AMF's understanding of 'corporate finance' activities undertaken by some financial investment advisers (FIAs), an iterative working process was initiated with relevant associations of FIAs and their members working in these professions and subsequently extended to other firms.

Overview of firms: Corporate finance is mainly undertaken by firms with a variety of statuses:

- entities with FIA status: however, such firms note that FIA status is not appropriate to their business
- within banking groups, through entities licensed as investment services providers (ISPs) or unlicensed subsidiaries
- by firms with no status or particular authorisation

However, corporate finance is also undertaken, on an ancillary basis, by legal and accounting professionals: accountants, lawyers and notaries. These professionals, acting within the confines of their respective statuses, are also bound, in respect of such activity, by their own ethical rules. As such, this consultation and any resulting next steps will not have any consequences as to the rules applicable to these professionals.

Lastly, where the provision of an advisory service is likely to result in a transaction in non-tradable shares of companies (shares of limited liability companies, single-person limited liability companies, partnerships and limited partnerships) whose corporate assets include real estate or goodwill, the provision of that service is covered by the 'Hoguet Act' and those who provide it must, where applicable, hold a 'T' licence. In that situation also, this consultation and any resulting next steps are without prejudice to these specific regulations.

Goal of work undertaken and of this consultation: The work has aimed to better understand the activity undertaken and the nature of the service provided (2.1) and to determine a regulatory outline (2.2). Its conclusion has prompted the AMF to consider whether it should intervene in the regulation of this activity and/or these firms. Such is the purpose of this consultation.

2.1. Description of corporate finance

Through interviews with various firms, the AMF was able to observe that corporate finance (or advisory services on the sale or acquisition of businesses and capital raising) provided by the firms in question, as presented by those firms to the AMF, is a service intended to help companies sell or acquire businesses or secure new equity finance, rather than simply entering into an agreement of underwriting sale or placing of financial instruments.

While the duration of the service, the number of stakeholders and the intensity of the dialogue between them largely depend on the size of the planned transaction, it transpired that, across all the professionals interviewed, the service provided generally included a number of phases.

When necessary (e.g. meeting a new client), the adviser carries out initial checks to help prepare the 'pitch' and its presentation to the client. The aim of this initial 'marketing' action is to convince the potential client to sign a 'mandate' with the adviser. This mandate is a contract governed by ordinary law – though devoid of any power of representation – the purpose of which is generally to 'provide advice and assistance' in implementing the project or transaction under consideration (with the transaction or project described in the contract in general terms).

In more concrete terms, the adviser's role begins with seeking out and identifying possible counterparties – i.e. potential buyers where a company is being sold, potential equity investors in the case of capital raising and target companies in the case of an acquisition. At the same time, the adviser carries out the necessary analysis and, where applicable, completes an assessment of the client so as to draw up

the required documents for the attention of counterparties, which represent part of the service provided (the 'teaser' and information memorandum or 'info memo').

With the client's consent, the adviser contacts the identified counterparties and sends them the teaser and the information memorandum. In some cases, a confidentiality agreement will need to be signed before specific information can be shared with interested counterparties.

Following this initial contact, the adviser is responsible for analysing and comparing indicative offers or letters of interest formally addressed to the adviser's client by interested counterparties. These counterparties may themselves be assisted by their own advisers.

This analysis and comparison undertaken by the adviser is based on a variety of elements. For example, while price is a critical factor, other criteria are also taken into account, such as the search for industrial synergies, access to a new market, the impact of the offer on taxation and the labour force, and the quality of counterparties and their governance. The strengths and weaknesses of each offer are thus presented to the client, who decides what action should be taken in respect of each offer. During its interviews, the AMF asked firms whether, at this stage, they felt they were providing their client with a 'personalised recommendation' concerning one or more transactions in 'a specific financial instrument', within the meaning of the fifth point of Article D.321-1 of the Monetary and Financial Code and Article 314-43 of the AMF General Regulation.

Almost all the professionals interviewed replied in the negative, for a number of reasons:

- At this offer analysis stage, it is not a question of a transaction in a specific financial instrument but rather of a project whose contractual form remains to be determined; the financial instrument is far from being defined, and even the price is subject to negotiation.
- While firms acknowledge that, informally, their clients expect them to give a clear opinion as to the 'best offer', none of them give a firm commitment on this point, nor any written indication that they recommend one transaction over another. Firstly, certain factors fall outside the scope of their role; and secondly, they consider that giving a commitment on this point would represent an unreasonable liability. At best, offers are formally 'graded' based on their strengths and weaknesses (e.g. by assigning them star ratings), and it is up to the client to make a choice; finally, whatever the client's choice, the adviser continues to fulfil its role.

A second phase then begins with a smaller number of counterparties. Subject to signing a confidentiality agreement, the counterparty or counterparties selected by the client are given access to more detailed information: accounting records, customer files, contracts, litigation, patents, etc. This information is intended to help the counterparty or counterparties refine their offers. To this end, they are sometimes also provided with draft agreements to be completed and, where applicable, negotiated (such as a share purchase agreement, shareholders' agreement, management package, seller's warranty, etc.).

During this phase, the corporate finance adviser seeks to answer any questions raised by the interested counterparty or counterparties or, where applicable, by their advisers.

Once they have completed their work, the counterparties put forward their binding offers. Here again, the adviser's role consists of receiving, analysing and presenting these offers to the client, once again in the form of a table comparing the strengths and weaknesses of each. The criteria used to compare and classify offers are as varied as those previously used to compare letters of interest, in addition to which there are also proposals concerning draft agreements (conditions of the shareholders' agreement, governance, seller's warranty, conditions precedent, etc.).

The professionals interviewed stressed that the client remains the ultimate decision-maker as regards whether to continue negotiations with the counterparty or counterparties of its choice.

During the final phase, the client has selected one or two (and possibly as many as four) potential counterparties, and negotiations revolve around the contractual terms of the deal. Depending on the size of the deal and the issues at stake, these final negotiations may also involve other professionals: legal

and tax advisers, lawyers and potentially a banking adviser (a licensed professional) to arrange financing for the deal. The corporate finance adviser supports the client by ensuring that discussions with these professionals proceed smoothly, until contracts are signed. For smaller deals, where clients have little in the way of resources, the corporate finance adviser remains the only professional supporting the client.

The adviser's service formally concludes once all conditions precedent in the signed contract have been met: the completion of the transaction thus marks the end of the adviser's involvement, and the latter can legitimately claim its success fee.

Lastly, according to the professionals interviewed, corporate finance service ends where financial advice on proceeds from the sale of one of the client's assets begins. Such advice is provided by other wealth management professionals, and most corporate finance advisers see it as falling outside their area of expertise.

2.2. Regulatory framework applicable to corporate finance

Consideration of the regulations governing corporate finance, as described above, lead to the conclusion that while, in certain specific circumstances, such activity runs the risk of being reclassified as a **service of placing of financial instruments without a firm commitment basis**[3] or an **investment advice service**[4] – both investment services which cannot, in theory, be legally provided without authorisation – it appears to more closely resemble an ancillary service, as referred to in the third point of Article L.321-2 of the Monetary and Financial Code and in the third point of section B of Annex I of MIFID, which may be freely exercised, without any special authorisation, and is defined as follows:

> "3. Advice to undertakings on capital structure, industrial strategy and related matters, as well as advise and services relating to mergers and acquisitions".

Given the criminal risk that might be incurred (as a result of an unauthorised firm carrying on a regulated activity), the professionals interviewed were not all in the same position. Some of the investment banks that provide this service have the necessary authorisations (including in particular authorisation to provide the service of placing and financial instruments). Others found that FIA status at least offered some protection against the risk of the service being reclassified as investment advice.

While the boundaries between these different classifications could usefully be clarified by domestic and European authorities, the assertion that such an activity could, when exercised as such, fall solely within the scope of the ancillary services referred to under point 3 above raises questions as to the appropriateness of establishing rules governing this service.

In this respect, two options are available.

1. Confirm that ancillary service no. 3 is freely exercised and not subject to any particular status

To the extent that ancillary service no. 3 is a freely exercised service, not subject to authorisation under MiFID, it could absolutely be decided not to establish any specific rules governing it.

[3] Defined in the seventh point of Article D.321-1 of the Monetary and Financial Code as "seeking […] buyers on behalf of an issuer or seller of financial instruments without guaranteeing an investment or acquisition".

[4] Defined in the fifth point of Article D.321-1 of the Monetary and Financial Code and Article 314-43 of the AMF General Regulation as "providing personalised recommendations to a third party […] concerning one or more transactions in financial instruments", "a recommendation [being considered] personalised when it is addressed to a person by virtue of that person's capacity as an investor or potential investor […]; presented as tailored to that person, or based on an examination of that person's specific circumstances, and […] recommend[ing] the completion of a transaction [such as] (1) the purchase, sale, […] of a specific financial instrument […]".

Such an approach would have the effect of removing all corporate finance advisers operating under FIA status from the 'regulated' arena, since they do not provide investment advice – i.e. around 375 entities, with total 2015 sales of EUR 429 million[5].

The services provided by such firms would thus be entirely governed by ordinary law[6] and would fall within the jurisdiction of the commercial courts (in the event of disputes), while being subject to the forces of competition between firms.

2. Adjust FIA status to include corporate finance

Some corporate finance advisory firms would like their activities to be regulated, since this is considered a sign of ethical conduct and professionalism. This is true of most such firms currently operating under FIA status.

Through such regulation, corporate finance advisory firms with, or choosing to adopt, FIA status could, in respect of this specific activity, be subject to:

- conditions governing access to the profession (requirements concerning expertise, particularly in corporate valuation, as well as fitness and properness);
- an obligation to have in place professional indemnity insurance;
- an obligation to have in place resources and procedures appropriate to the performance of their role (contractual documents governing the service, KYC checks, traceability of the service, etc.);
- an obligation to act ethically and professionally ("act in the client's best interests"), which entails:

    - an obligation to provide information that is clear, accurate and not misleading, including about risks (particularly for transactions requiring the use of debt – LBOs), whether to clients or counterparties;
    - transparency concerning all fees paid to business introducers;
    - identification, prevention and handling of conflicts of interest with a view to acting solely in the client's interest;
    - assurance of the confidentiality and return of all client information obtained;
    - an obligation to manage inside information;
    - an obligation to provide counterparties with equal information.

Adjusting FIA status to potentially cover corporate finance would require legislative changes insofar as the provision of the ancillary service of corporate finance by FIAs is not specifically covered at present.

For the time being, such regulation of corporate finance firms in France would be optional only (since it would only apply to firms that already have, or opt for, FIA status), designed in the manner of a 'quality label'. Firms who opted for this status and fell short of their obligations could have the label withdrawn or be subject to other penalties, imposed by their professional association or the AMF.

[5] According to data reported by firms in their annual information submissions in respect of the 2015 financial year.

[6] Ordinary contractual law, and in particular the obligation to act fairly and in good faith laid down in Articles 1104 and 1194 of the Civil Code, provides sufficient control over the relationship with the client.

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Interested parties are asked to respond to the following questions.

Consultation questionnaire to be completed and returned

Depending on your capacity, are you satisfied with the quality of corporate finance services provided by professionals?

Please specify the capacity in which you are responding.

Concerning the regulatory framework applicable to corporate finance, what do you think of the following proposals?

Proposal 1:
Corporate finance requires no additional regulation relative to the existing situation.
Under this proposal, corporate finance would be subject to ordinary law and all disputes would fall within the jurisdiction of commercial courts.

Your opinion:

Proposal 2:
Consideration could be given to developing optional regulations for corporate finance consultants, governed by industry bodies and the AMF.
Professionals opting for such regulation would have to meet criteria based on professional expertise (particularly as regards corporate valuation) and fitness and properness, and undertake to comply with conduct of business and organisational rules to ensure that they perform this service with due expertise, care and diligence in the best interests of their clients. All breaches would be subject to penalties imposed by the relevant professional association or the AMF.

Your opinion:

Finally, would you like to share any particular expectation or need in relation to firms that provide corporate finance?