

Regulatory Framework for Approval of Financial Promotions Consultation

Regulatory Framework for Approval of Financial Promotions: Consultation



© Crown copyright 2020

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at: www.gov.uk/official-documents

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gov.uk

ISBN 978-1-913635-46-6

PU2981

Contents

Chapter 1	Introduction	2
Chapter 2	Consultation Structure and Ways to Respond	6
Chapter 3	Next steps	10
Chapter 4	Financial Promotions: How the Existing Regime operates	11
Chapter 5	Financial Promotions - Issues with the Existing Legislative Framework	14
Chapter 6	Proposals for Reform	17

Chapter 1

Introduction

- 1.1 A financial promotion is a communication that contains an invitation or inducement to engage in a financial product or service. Such communications can take a wide variety of forms, including advertisements placed through print, broadcast or online media; marketing brochures; direct mail; or use of social media (see Chapter 4 for an explanation of how financial promotions are defined in UK law). The form and content of these communications can have a significant influence over the financial decisions made by consumers. It is therefore important that promotions meet certain minimum standards so that consumers are able to make well-informed decisions appropriate to their financial circumstances.
- 1.2 The UK approach to the regulation of financial services recognises the importance of enabling financial services firms to promote their products and services, as well as the risks that can arise from misleading or inaccurate promotions. The communication of financial promotions is subject to regulatory safeguards which seek to ensure consumers are provided with clear and accurate information that enables them to make informed and appropriate decisions. The UK regime provides safeguards in two key ways:
- In general, a person cannot communicate a financial promotion unless that person is, or the content of the promotion is approved by, a firm which is authorised to carry on a regulated financial services activity (firms authorised to carry on a regulated activity are referred to as authorised persons in legislation – the terms authorised / unauthorised firms and authorised / unauthorised persons are used interchangeably in this document)
 - The Financial Conduct Authority (FCA) sets binding rules that authorised firms must comply with when communicating or approving financial promotions¹
- 1.3 The scope of the regulatory regime for financial promotions is broad. The regime applies to promotions relating both to regulated financial services activities (which can only be carried on by a firm which has received authorisation from the FCA or PRA) and certain activities that are unregulated (which can be carried on without the need for a firm to be

¹ EEA firms, that are authorised in their home member state and have exercised passport or Treaty rights to carry on regulated financial services activities in the UK, are currently treated as authorised persons in the UK. From 1 January 2021 this will cease to be the case, apart from EEA firms which have entered into the UK's Temporary Permissions Regime (TPR) pursuant to the The EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018. Firms in the TPR will be deemed to be UK authorised while they go through the process to be authorised by the FCA or PRA.

authorised). It is the use of financial promotions by unauthorised firms that is the focus of this consultation (the proposals set out in this consultation document would not affect the communication of financial promotions by authorised persons or the approval by authorised persons of their own promotions so that they can be communicated, or passed on, by unauthorised persons).

- 1.4 Where an unauthorised firm wishes to communicate a financial promotion, the promotion must be approved by an authorised firm (unless the promotion can otherwise be communicated pursuant to an applicable exemption in the Financial Promotion Order 2005²). The rationale for this requirement is that authorised firms are regulated by the FCA which has the power to make rules to ensure that financial promotions meet certain minimum standards. An authorised firm should also have the necessary expertise to check that a financial promotion meets those standards. The FCA, through its oversight of authorised firms, supervises the approval of financial promotions and may intervene if an authorised firm is not meeting its regulatory obligations.
- 1.5 Experience in recent years, however, suggests that the regime needs additional safeguards to ensure that approval by an authorised person is a genuinely effective means of ensuring that consumers are protected from deficient or potentially harmful financial promotions. The FCA has identified a number of cases of authorised firms failing to satisfy its requirements in approving the financial promotions of unauthorised persons. This includes cases in which the approving firm has failed to undertake adequate due diligence to ensure promotions it has approved meet FCA requirements and instances of firms approving financial promotions which relate to products which are beyond their sphere of expertise and which, as a result, fail to comply with FCA rules.
- 1.6 A number of consumer harms can result from financial promotions which are misleading, unclear or are not fair. With investment products for example, financial promotions may make unrealistic claims of high investment returns, or understate the risks involved, leading consumers to invest in products which are not suitable for them. While the risk from misleading promotions for investment products is a particular concern, this consultation and its proposals are relevant to the approval of the financial promotions of unauthorised persons across sectors. Misleading promotions may divert consumers away from more appropriate products across a range of financial services activity and this may have a negative impact on consumer confidence more generally. These harms are described in more detail in Chapter 5.
- 1.7 The government's view is that the simple requirement for an authorised firm to approve the financial promotion of an unauthorised firm does not operate as a strong enough safeguard to ensure such financial promotions are compliant with FCA rules. The key deficiency with this approach is that any authorised firm is able to approve any financial promotion of an unauthorised firm. There is no specific process through which a firm must be

² S.I. 2005/1529.

assessed as suitable and competent before it is able to approve the financial promotions of unauthorised firms.

- 1.8 In order to strengthen the FCA's ability to ensure the approval of financial promotions operates effectively, the government proposes to establish a regulatory 'gateway', which a firm must pass through before it is able to approve the financial promotions of unauthorised firms. Any firm wishing to approve the financial promotions of unauthorised firms would first need to obtain the consent of the FCA.

Related government and FCA initiatives

- 1.9 In November 2019, the FCA made rules under its temporary product intervention (TPI) powers which banned the promotion of high-risk speculative illiquid securities (such as mini-bonds) to most retail consumers (excluding sophisticated and high net worth retail investors) with effect from 1 January 2020. The ban applies to more complex and opaque securities issues where the funds raised by the issuer are used to lend to a third party, buy or acquire investments, or buy or fund the construction of property. The FCA consulted on permanent measures on 18 June 2020.
- 1.10 The context for the FCA's intervention was the failure of the firm London Capital and Finance (LCF) in January 2019. LCF was an authorised firm that issued mini-bonds worth more than £230m to over 11,000 investors. Prior to the firm's failure, the FCA had intervened to ban misleading promotions issued by LCF. The Treasury subsequently directed the FCA to launch an independent investigation into the circumstances surrounding the collapse of LCF and the FCA's supervision of the firm. This investigation, led by Dame Elizabeth Gloster, is due to report by September 2020.
- 1.11 Alongside the independent investigation, the Treasury also announced a review to consider the wider regulatory arrangements currently in place for the issuance of non-transferable debt securities, such as some 'mini-bonds', including the financial promotions regime which governs the marketing of those products. Although LCF was an authorised firm, the case has prompted HMT to consider further measures to strengthen consumer protection across the financial promotions regime, including the proposals concerning unauthorised firms' promotions in this consultation. These proposals are not limited to the market for non-transferable securities.
- 1.12 The government continues to keep the legislative framework underpinning the regulation of financial promotions more broadly under review. This includes arrangements for financial promotions communicated by authorised firms, as well as the effectiveness of the exemptions that currently form part of the regime.
- 1.13 This consultation is concerned with the risks which arise from misleading, inaccurate or inappropriate financial promotions and whether the current regulatory regime is effective in ensuring that promotions communicated by unauthorised firms comply with regulatory safeguards. It is not directly concerned with addressing the harms created by underlying financial products which are unlawful or 'scams'. A scam is a false financial services offering created by criminals to incite consumers into investing in a fake

product or service. This can also include fraudsters cloning a legitimate company to trick consumers into a false sense of security. As consumers increasingly seek investment opportunity online, they are also increasingly exposed to potential scams. The government is working with the FCA to determine the best approach to tackling this fraudulent financial services activity online.

Chapter 2

Consultation Structure and Ways to Respond

- 2.1 The consultation has six Chapters.
- 2.2 This consultation will run from 20 July. In order to respond to the consultation, please send a response document to FinProms@hmtreasury.gov.uk. You should respond by 12 pm 25 October.

Processing Personal Data

- 2.3 This notice sets out how HM Treasury will use your personal data for the purposes of a consultations campaign and explains your rights under the General Data Protection Regulation (GDPR) and the Data Protection Act 2018 (DPA).

Your Data (Data Subject Categories)

- 2.4 The personal information relates to you as either a member of the public, parliamentarians, and representatives of organisations or companies.

Legal basis of processing

- 2.5 Information may include your name, address, email address, job title, and employer of the correspondent, as well as your opinions. It is possible that you will volunteer additional identifying information about themselves or third parties.

Special Categories data

- 2.6 The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in HM Treasury. For the purpose of this consultation the task is consulting on departmental policies or proposals or obtaining opinion data in order to develop good effective government policies.

Legal basis for processing special category data

- 2.7 Where special category data is volunteered by you (the data subject), the legal basis relied upon for processing it is: the processing is necessary for reasons of substantial public interest for the exercise of a function of the Crown, a Minister of the Crown, or a government department.
- 2.8 This function is consulting on departmental policies or proposals, or obtaining opinion data, to develop good effective policies.

Purpose

- 2.9 The personal information is processed for the purpose of obtaining the opinions of members of the public and representatives of organisations and companies, about departmental policies, proposals, or generally to obtain public opinion data on an issue of public interest.

Who we share your responses with

- 2.10 Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004 (EIR).
- 2.11 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.
- 2.12 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.
- 2.13 Where someone submits special category personal data or personal data about third parties, we will endeavour to delete that data before publication takes place.
- 2.14 Where information about respondents is not published, it may be shared with officials within other public bodies involved in this consultation process to assist us in developing the policies to which it relates. Examples of these public bodies appear at: <https://www.gov.uk/government/organisations>.
- 2.15 As the personal information is stored on our IT infrastructure, it will be accessible to our IT contractor, NTT. NTT will only process this data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we will hold your data (Retention)

- 2.16 Personal information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958.
- 2.17 Personal information in responses that is not published will be retained for three calendar years after the consultation has concluded.

Your Rights

- 2.18 You have the right to:
- request information about how your personal data are processed and to request a copy of that personal data

- request that any inaccuracies in your personal data are rectified without delay
- request that your personal data are erased if there is no longer a justification for them to be processed
- in certain circumstances (for example, where accuracy is contested), to request that the processing of your personal data is restricted
- to object to the processing of your personal data where it is processed for direct marketing purposes
- to data portability, which allows your data to be copied or transferred from one IT environment to another

How to submit a Data Subject Access Request (DSAR)

2.19 To request access to personal data that HM Treasury holds about you, contact:

HM Treasury Data Protection Unit
G11 Orange
1 Horse Guards Road
London
SW1A 2HQ
dsar@hmtreasury.gov.uk

Complaints

2.20 If you have any concerns about the use of your personal data, please contact us via this mailbox: privacy@hmtreasury.gov.uk.

If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner, the UK's independent regulator for data protection. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

- 2.21 The data controller for any personal data collected as part of this consultation is HM Treasury, the contact details for which are:

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

London

020 7270 5000

public.enquiries@hmtreasury.gov.uk

Contact Details

- 2.22 The contact details for HM Treasury's Data Protection Officer (DPO) are:

The Data Protection Officer

Corporate Governance and Risk Assurance Team

Area 2/15

1 Horse Guards Road

London

SW1A 2HQ

London

privacy@hmtreasury.gov.uk

Chapter 3

Next steps

- 3.1 The government will analyse responses to this consultation, and respond in due course, setting out next steps on what its analysis revealed and setting out which policy options it intends to take forward.

Chapter 4

Financial Promotions: How the Existing Regime operates

The Financial Promotion restriction

- 4.1 Financial promotions play an important role in the financial decisions made by individuals. Consumers are influenced by both the substance and presentation of promotions, which can have a significant impact on whether they decide to engage with a particular financial service provider or take out a particular financial product. The financial promotions regulatory regime – which consists of legislative restrictions set by government, as well as more specific FCA rules for firms – seeks to ensure consumers are provided with clear and accurate information that enables them to take decisions which are appropriate for their individual circumstances.
- 4.2 The scope of the financial promotions regulatory regime is broad. It applies to promotions communicated by firms authorised to carry on regulated financial services activities, and to promotions of certain unregulated investment activities communicated by unauthorised firms. The Financial Services and Markets Act 2000 (FSMA), which sits at the centre of the UK legislative framework for financial services, sets out how the financial promotions regime applies to both regulated and unregulated activities.
- 4.3 Section 19 of FSMA sets out the ‘general prohibition’. This provides that no person may carry on a regulated financial services activity in the UK unless they are authorised or exempt. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) specifies the financial services activities which are subject to regulation. In order to undertake a regulated activity, a firm must generally be authorised by the FCA or, in the case of banks, credit unions and certain insurers and investment firms, by the Prudential Regulation Authority (PRA). Authorised firms are referred to as authorised persons in FSMA.
- 4.4 Section 21 of FSMA contains the financial promotion restriction. This restriction is broad in scope and provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity or claims management activity. This includes invitations or inducements to engage in certain activities which are not regulated for the purposes of the general prohibition. For example, a person may not necessarily carry on a regulated activity requiring authorisation in issuing bonds but the marketing of the bonds is likely to be subject to the financial promotion restriction. The financial promotion restriction does not apply if:
- the communication is made by an authorised person

- the content of the communication is approved by an authorised person
- or the financial promotion otherwise meets the conditions of an exemption within the Financial Services and Markets Act 2000 (Financial Promotion) Order (FPO) 2005¹

4.5 The effect of the financial promotion restriction is that an unauthorised person must have its financial promotions approved by an authorised person before they are communicated (unless an exemption applies). Communicating a financial promotion in breach of section 21 is a criminal offence on the part of the unauthorised person under section 25 of FSMA.

4.6 The FCA's Handbook contains rules on financial promotions which authorised persons must comply with when communicating or approving financial promotions. FCA rules include the basic requirement that financial promotions must be "fair, clear and not misleading."² In addition, promotions may need to comply with FCA product-specific rules, depending on the type of product or service being marketed. Authorised firms, whether communicating their own financial promotions or approving the promotions of unauthorised firms, are obliged to ensure that promotions are compliant with these rules.

4.7 The role of authorised firms in ensuring that financial promotions are compliant with FCA rules is crucial in protecting consumers from potentially harmful promotions. In order to be granted authorisation, a firm must satisfy the Threshold Conditions set out in FSMA relating, amongst other things, to the adequacy of its resources and suitability to undertake regulated activity. Authorised firms should therefore be well placed to check that their own financial promotions, or the promotions they approve for unauthorised firms, meet the requirements set out in relevant FCA rules. These firms will also be subject to supervision, so the FCA is able to check that authorised firms are communicating or approving financial promotions appropriately. The FCA has enforcement powers which can be used to address any breach of its rules by an authorised firm, so the FCA will be able to intervene if it discovers that non-compliant financial promotions are being communicated or approved. These interventions include informally asking the firm to amend or withdraw non-compliant promotions, imposing voluntary requirements and banning financial promotions³.

4.8 It is the role of authorised firms in approving the financial promotions of unauthorised persons that is the focus of this consultation. The FCA has published guidance⁴ for firms that approve the financial promotions of unauthorised persons explaining some practical implications of existing FCA requirements in its Handbook. The guidance explains, amongst other things,

¹ S.I. 2005/1529. The FPO 2005 includes a number of exemptions from the financial promotion restriction. These enable unauthorised persons to communicate financial promotions in certain circumstances, including to defined groups or individual investors, without requiring approval. Financial promotions which are communicated within the scope of the exemptions are not subject to FCA rules.

² For example, see COBS 4.2 on rules applying to financial promotions relating to investment business.

³ See the FCA's powers of direction under section 137S of FSMA.

⁴ <https://www.fca.org.uk/firms/financial-promotions-and-adverts/approving-financial-promotions>

that to be in a position to confirm that an unauthorised person's financial promotion is clear, fair and not misleading, the authorised person should consider both the presentation (for example, whether risk warnings for consumers are given sufficient prominence) and substance (for example, whether claims of investment return can be substantiated) of the promotion. Authorised firms usually charge a fee to unauthorised persons for approving financial promotions.

- 4.9 As any authorised person is able to approve the financial promotions of unauthorised persons, the FCA's oversight of such approvals is, by necessity, generally reactive. It would not be practicable for firms to notify the FCA every time they approved a financial promotion or for the FCA to check all approved promotions before they were communicated. Supervision focuses instead on investigating potential breaches of the financial promotion rules. The FCA is made aware of potential breaches through online reporting forms submitted by consumers and firms, or by calls to the FCA Contact Centre. The FCA may also be alerted to potential breaches through information gathered in the course of its general supervisory activity.
- 4.10 If the FCA finds that an approved financial promotion breaches its rules, the FCA will usually engage with the authorised firm that approved the promotion to request that the promotion is changed or withdrawn. If the FCA is not satisfied with the response of the authorised firm, it has a broad power under section 137S of FSMA to direct the firm to address the breach, which may include directing the firm to withdraw its approval of the promotion. The FCA can also open an investigation which can lead to enforcement action (such as a financial penalty) if serious misconduct is discovered.

Chapter 5

Financial Promotions - Issues with the Existing Legislative Framework

- 5.1 The legislative framework explained in Chapter 4 allows any authorised person to approve any financial promotion of an unauthorised person. The government's view is that financial promotions communicated by unauthorised persons should continue (subject to the operation of the exemptions in the FPO) to be subject to a requirement for approval by authorised persons so that FCA rules can be applied to such promotions. But, following detailed discussions with the FCA, the government believes the safeguard of requiring an authorised person to approve a financial promotion of an unauthorised person is not operating effectively, for the reasons set out below.
- 5.2 **Lack of a specific suitability assessment for authorised firms approving financial promotions:** As any authorised firm is able to approve the financial promotions of unauthorised persons, the FCA does not generally have the opportunity to specifically assess the suitability of authorised firms before they start approving promotions. This gives rise to three key risks:
- **Lack of relevant approver firm expertise:** Financial promotions are used in connection with a very wide range of financial products and services. In the absence of the opportunity to specifically assess the suitability of authorised firms before they start approving promotions, the FCA does not have a mechanism to assess whether a firm has sufficient expertise in the product area covered by the financial promotions it is approving before it starts doing so. This gives rise to a risk that an authorised firm approves promotions which are misleading, inaccurate or inappropriate for the intended investors because the approving firm does not have sufficient understanding of the product or service that is the subject of the promotion.
 - **Lack of approver firm due diligence:** The FCA's guidance on approving financial promotions of unauthorised persons notes that authorised firms should consider both the presentation (e.g. whether risk warnings are given sufficient prominence) and substance (e.g. whether claims of investment return can be substantiated) of a promotion before providing approval. However, the FCA has identified cases where authorised firms have approved financial promotions which do not comply with its rules because the approving firm has not undertaken sufficient due diligence in relation to the product or service which is being promoted in order to be able to properly assess the promotion prior to approval. For example, the FCA has identified cases where firms have approved the financial promotions of unauthorised

issuers of securities without properly assessing whether such issuers were reasonably capable of achieving the rates of investment return to which their promotions referred. It has also found instances of approving firms accepting at face value the information provided to them by unauthorised persons without forming their own views as to the compliance of promotions with FCA rules. Creating a new gateway would ensure that the FCA is able to determine that a firm's systems, governance and overall approach to the assessment of financial promotions are robust before any firm is able to begin approving financial promotions.

- **Challenges in exercising appropriate regulatory oversight:** There are challenges for the FCA in exercising appropriate oversight of those firms which are approving the financial promotions of unauthorised persons. This is because the FCA does not currently have a comprehensive and exhaustive view of those firms which are engaged in such activity, the nature of the financial promotions being approved and how they relate to the authorised firms' areas of expertise. While the FCA may obtain information about firms which are undertaking approvals on an ad hoc basis through the course of its supervisory activities, the FCA does not hold a definitive and up-to-date list of which authorised firms are undertaking this activity at any moment in time.

5.3 The FCA has both a broad general power (under section 137A of FSMA) and a specific power (under section 137R of FSMA) to make rules applying to authorised persons in relation to financial promotions communicated by them, or their approval of the promotions communicated by unauthorised persons. It is therefore possible, without legislative change, for the FCA to introduce rules requiring authorised persons to notify the FCA of their intention to approve the financial promotions of unauthorised persons, or requiring authorised firms to maintain appropriate expertise for the approval of such promotions.

5.4 However, the government believes such an approach would not effectively address the deficiencies of the current regime. This is because such an approach would not provide for a regime whereby the FCA could specifically assess the suitability and competence of firms before those firms began approving the financial promotions of unauthorised persons. Rather, a rules-based approach would mean that regulation of this activity would remain largely reactive. The key risk of unsuitable firms approving promotions would therefore remain, with the FCA having to react once a firm had approved promotions which did not comply with FCA rules, rather than being able to prevent an unsuitable firm from approving promotions in the first place. A change to legislation would provide a clear statutory basis for FCA consent to be obtained before firms were able to approve the financial promotions of unauthorised persons; and would ensure that financial promotions of unauthorised persons could only be lawfully communicated (subject to FPO exemptions) if approved by a firm that the FCA had assessed as suitable and competent to provide such approval.

- 5.5 The government believes the issues explained above mean that the regulatory regime is not sufficiently mitigating the risks that may arise from financial promotions communicated by unauthorised firms. Financial promotions that do not meet the FCA's standards can result in significant harm to consumers, including:
- **Investor Losses:** Financial promotions may be misleading because they might understate the risks involved, or overstate levels of investor protection. A misleading financial promotion could cause investors to make poor investment decisions and lose money unexpectedly (sometimes their full investment if the unauthorised firm becomes insolvent). Further, where investors deal with unauthorised firms, they are, in most cases, not able to complain to the Financial Ombudsman Service or, in the event of the unauthorised firm becoming insolvent, seek compensation through the FSCS. This provides further rationale for strengthening the approvals process.
 - **Re-direction of investment away from appropriate products:** Consumers should have the freedom to invest in products that meet their personal appetite for risk and reward. Misleading promotions - such as those offering unrealistic rates of return – can potentially divert consumers away from more appropriate investments offered by both unauthorised and authorised firms.
 - **Loss of Consumer Confidence:** If a consumer makes a lower than expected return on investment or loses money unexpectedly due to a misleading promotion, this can lead to a loss of trust in any financial promotion. Financial promotions are an important tool for firms to advertise financial products to potential investors, and this loss of confidence can reduce the willingness of consumers to engage with the market altogether.
- 5.6 Recent trends in the retail investment sector have highlighted the importance of financial promotions being fair, clear and not misleading. The FCA has observed a growth in investment products which are issued by unauthorised persons, such as mini-bonds, the financial promotions for which are therefore often approved by authorised persons. The increased prevalence of online marketing channels has meant that misleading financial promotions can quickly reach a mass audience. The current low interest rate environment has drawn large numbers of retail investors towards higher risk products in a 'search for yield'. These factors may exacerbate the risk to consumers under the existing legislative framework and they reinforce the importance of unauthorised firms' financial promotions being thoroughly checked by authorised firms to ensure they are compliant with FCA rules.

Chapter 6

Proposals for Reform

A new regulatory 'gateway'

- 6.1 As explained in Chapter 4, section 21 of FSMA imposes a general restriction on the communication of financial promotions. By virtue of section 21(2)(b), unauthorised persons may communicate financial promotions if they are approved by an authorised firm. Once a firm is authorised, that firm is able to approve the financial promotions of unauthorised persons without any restriction. Legislation does not provide a specific regime for the FCA to assess the suitability of an authorised firm before it begins approving financial promotions.
- 6.2 In order to address the risks with this approach, the government proposes to amend FSMA so that the general ability of authorised firms to approve financial promotions of unauthorised firms is removed. Unauthorised persons will only be able to communicate financial promotions which have been approved by a firm which has obtained consent from the FCA to provide such approval. Firms wishing to approve financial promotions to be communicated by unauthorised firms will first have to obtain the consent of the FCA. This will enable the FCA to operate a specific 'gateway' that a firm is required to pass through before it can approve the financial promotions of unauthorised persons. It is important to be clear that the government does not intend this new gateway to apply for firms approving the financial promotions of an unauthorised person within the same group, or to the approval of authorised firms' own promotions for communication by unauthorised persons.
- 6.3 By establishing such a gateway, it would no longer be possible for any authorised firm to approve the financial promotions of unauthorised persons. A firm would first need to obtain specific consent from the FCA before it was able to provide such approvals. This change would lead to several improvements in the regulatory regime for financial promotions communicated by unauthorised persons:
- **More effective FCA oversight and supervision:** Currently, the FCA does not have comprehensive information on those firms which are approving the financial promotions of unauthorised persons, the nature of the promotions involved and how suitable firms are to approve those promotions. If firms were only able to approve financial promotions for unauthorised persons with FCA consent, the FCA would have a much clearer picture of firms and their approval activity. With this information, the FCA would be able to target its supervisory

effort more effectively, for example focusing on the approval of financial promotions associated with riskier products. The FCA would have satisfied itself that relevant firms were suitable to be engaged in approval activity such that incidents of non-compliant promotions being issued should be reduced. This would enable supervisory resource to be more focussed on those potential breaches which do emerge and which have the potential to cause harm. If the FCA had a clear view of the population of approving firms, this would also give it the ability to carry out more proactive work across the portfolio of firms to ensure that standards are kept to a high level.

- **More effective prevention and intervention:** Requiring firms to have FCA consent before they can approve financial promotions would enable the FCA to assess firms' suitability and competence before they were able to approve the financial promotions of unauthorised persons. This would allow the FCA to prevent unsuitable firms from approving financial promotions, as well as allowing the FCA to withdraw consent for an approver firm, in appropriate circumstances.
- **Ensuring approver firms have relevant expertise:** Consent could be linked to products or services within the firm's area of expertise. This would ensure that only firms with the relevant expertise are able to approve the promotion of a particular product type, rather than any authorised firm, which is the case under the current regime. The government will consider what legislative measures may be necessary to provide the FCA with flexibility when giving its consent.
- **Improved Due Diligence:** Ensuring that only firms which are suitable to do so can approve financial promotions of unauthorised persons should lead to an improvement in the quality of financial promotions, as there will be greater assurance that those firms will apply a more rigorous approach to ensuring that FCA rules are complied with. In practice, this should mean that authorised approvers conduct more in-depth due diligence to ensure that the substance and presentation of a promotion meets regulatory standards, before providing approval.

6.4 The government is aware that a new gateway would constitute an additional administrative burden on authorised firms which are currently approving the promotions of unauthorised persons. However, the government's view is that the benefits for consumers and firms explained above would outweigh any costs related to additional burden for industry. Working with the FCA, the government will consider what legislative measures are necessary to facilitate a smooth transition to the new regime. We are interested to hear the views of all stakeholder groups on the proposed gateway, but particularly from those authorised firms currently approving the financial promotions of unauthorised persons; retail consumers; and unauthorised persons which communicate financial promotions.

Policy Options to Deliver the Gateway

6.5 The government has identified two policy options to deliver the proposed gateway and would welcome the views of stakeholders on both options. The government is looking to implement only one of the following options:

- **Option 1 – Restrict approval of the financial promotions of unauthorised firms through the imposition of requirements by the FCA:** This would involve amending section 21(2)(b) of FSMA to remove the general ability to communicate financial promotions which have been approved by authorised firms. Section 21(2)(b) would be amended so that unauthorised persons were only able to communicate their own financial promotions if these had been approved by a firm which had obtained consent from the FCA to provide such approval. The FCA would be empowered to impose a universal requirement on all existing authorised persons preventing them from approving the financial promotions of unauthorised persons. An existing authorised person wishing to undertake approval of financial promotions would then need to apply to the FCA to have this requirement varied or cancelled. A firm applying for a new permission to carry on a regulated activity would be able to request that such permission includes FCA consent to approve the financial promotions of unauthorised firms.
- **Option 2 – Specify the approval of financial promotions communicated by unauthorised persons as a 'regulated activity' under FSMA:** This would involve amending the Regulated Activities Order to make the approval of financial promotions of unauthorised persons a regulated activity, with firms requiring a Part 4A¹ permission from the FCA before they can undertake the activity. Section 21(2)(b) would also have to be amended to provide that only financial promotions of unauthorised persons approved by a firm with the relevant Part 4A permission could be lawfully communicated.

6.6 The proposal would not affect the way authorised firms communicate their own financial promotions, approve their own promotions for communication by unauthorised persons, or approve the promotions of unauthorised persons within the same corporate group. To implement either option, amendment of section 21(2)(b) of FSMA would be necessary. Under either option, the government would also need to make amendments elsewhere in FSMA to reflect the changes to section 21(2)(b) and the narrowing down of the circumstances in which an unauthorised person can communicate a financial promotion which has been approved by an authorised firm. For example, it is currently a defence in section 25(2)(a) FSMA for a person accused of breaching the financial promotion restriction to demonstrate that he believed on reasonable grounds that the content of the communication was approved for the purposes of section 21 FSMA by an authorised person. Section 25(2)(a) FSMA would need to be amended to

¹ See section 55A ('Part 4A Permission to carry on regulated activities') of the Financial Services and Markets Act 2000 ('Application for permission' to carry on one, or more, regulated activities)

reflect the change to section 21(2)(b) of FSMA that not all authorised persons are able to approve financial promotions.

- 6.7 Under either option, consumers who invest in a product issued by an unauthorised person on the basis of a financial promotion communicated by that person would continue not to be covered by the Financial Services Compensation Scheme (FSCS) purely as a result of the failure of the issuer. As the scheme covers claims “in connection with” protected regulated activities only and is funded by levies on authorised firms, compensation is not available to cover investor loss purely by virtue of the failure of an unauthorised person carrying on an unregulated activity. The general position remains that the FSCS exists to provide compensation in respect of claims made in connection with regulated activities carried on by authorised firms or their appointed representatives.

Analysis of Policy Options

- 6.8 Both policy options would involve amending section 21(2)(b) of FSMA to narrow down the general ability of any authorised firm to approve the financial promotions of unauthorised firms. Only those authorised firms with specific consent from the FCA would be able to undertake financial promotion approvals. Authorised firms would need to apply to the FCA on an individual basis to obtain consent.
- 6.9 Under policy option 1, the FCA would be given the power to impose requirements to prevent all existing authorised persons from approving the financial promotions of unauthorised persons. Any existing authorised person or any applicant for a new permission to carry on a regulated activity would then need to request that the FCA amend its permission so that the general requirement is lifted, enabling the authorised firm to approve the financial promotions of unauthorised persons. The FCA would assess the fitness and competence of each firm when determining an application. Consent to approve the financial promotions of unauthorised persons could be linked to products or services within the firm’s area of expertise (in the form of a modified requirement on the firm’s permission).
- 6.10 The government would consider whether legislative change, in addition to the amendments required to section 21(2)(b) of FSMA, would be needed to ensure the FCA has the power needed to impose a general requirement and to vary that requirement as described here. This policy option preserves the role that authorised firms play in overseeing the financial promotions of unauthorised persons. But it strengthens the ability of the FCA to ensure the safeguard of requiring an authorised person to approve a financial promotion of an unauthorised person operates effectively.
- 6.11 Under policy option 2, the approval of an unauthorised person’s financial promotions would become a new regulated activity. This would establish a regulatory gateway and improve the ability of the FCA to ensure that authorised firms are meeting their regulatory obligations when approving the financial promotions of unauthorised persons, in the ways described for option 1 above.

- 6.12 But option 2 represents more significant change. It would fundamentally alter the regulatory treatment of financial promotions by making approval of promotions a regulated activity in its own right. As such, it is arguably a disproportionate way to address the government's concerns and it could have unintended consequences for the regulation of financial promotions in general. The government is not seeking to change the role of authorised firms in overseeing the financial promotions of unauthorised firms, but to address the concern that this safeguard is not operating as effectively as intended. The government's intention is to strengthen the ability of the FCA to make sure authorised persons approve promotions of unauthorised persons in accordance with FCA rules.
- 6.13 On balance, the government believes that option 1 would achieve the intended outcome of strengthening the FCA's ability to ensure that authorised firms comply with FCA rules when approving the financial promotions of unauthorised persons, but without fundamentally altering the overall regulatory architecture of the financial promotion regime.
- 6.14 The government would be grateful for the views of stakeholders on the following consultation questions. The government is looking for views from members of the public or industry, but would particularly welcome responses from authorised firms currently approving the financial promotions of unauthorised persons; retail consumers; and unauthorised persons which communicate financial promotions.

Consultation Questions: Proposals for Reform

- 1 Do you agree that a gateway should be established enabling the FCA to assess the suitability of a firm before it is permitted to approve the financial promotions of unauthorised persons?
- 2 What are the risks and benefits of each of the two policy options put forward? Would there be any unintended consequences resulting from implementation?
- 3 If the government was to proceed with one of the two policy options, which would be your preference and why?

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk