

# **THE FINANCIAL SERVICES AND MARKETS ACT 2000 (PROMOTION OF COLLECTIVE INVESTMENT SCHEMES) (EXEMPTIONS) ORDER 2001**

## ***REGULATORY IMPACT ASSESSMENT***

1. This Regulatory Impact Assessment is of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes)(Exemptions) Order 2001 (the “CIS Order”). The Order is made under section 238 of the Financial Services and Markets Act.

### **Purpose and intended effect**

2. The Financial Services and Markets Act 2000 (the Act) will, when brought into force, replace the regulatory arrangements currently contained in the Financial Services Act 1986, the Banking Act 1987, the Insurance Companies Act 1982, the Building Societies Act 1986 and the Friendly Societies Act 1992. It creates a single statutory regulator for the UK financial services industry, with a single set of functions and powers. This will benefit both businesses and consumers.
3. The CIS Order sets out, alongside the Financial Services and Markets Act 2000 (Financial Promotion) Order (the Financial Promotion Order), the legal framework for the promotion of collective investment schemes, for example, unit trusts. Section 238 of the Act prohibits the promotion of collective investment schemes by authorised persons except where the schemes are authorised or recognised. The CIS Order specifies the circumstances in which this prohibition does not apply.
4. As controlled investments, units or shares in collective investment schemes are subject to the financial promotion restriction in section 21, so unauthorised persons cannot generally promote any such schemes unless they can benefit from any of the exemption in the

Financial Promotion Order. These promotions relate to the promotion of all schemes: authorised, recognised or unauthorised.

5. The aim is that the same exemptions as apply in relation to unauthorised persons through the Financial Promotion Order also apply to authorised persons. This Order largely follows the provisions of the Financial Promotion Order. As such, the costs and benefits set out in the Regulatory Impact Assessment (RIA) for that Order apply equally to the CIS Order. A copy of the RIA for the Financial Promotion Order is attached to this note as an Annex.
6. There are, however, some differences between the two Orders. The majority of these differences are necessary because the CIS Order applies to authorised persons whereas the Financial Promotions Order applies to unauthorised persons. The purpose of this RIA is to identify these differences and any additional costs or benefits associated with them. It should be read in conjunction with the attached RIA for the Financial Promotion Order.

### **Changes compared with Financial Promotion Order**

#### *General*

7. The number of exemptions included in the CIS Order is less than the number in the Financial Promotions Order. The application of the CIS Order to authorised persons in respect of unregulated schemes means that a number of the exemptions included in the Financial Promotion Order would simply not be appropriate for the CIS Order. For example, the exemption relating to communications from customers and potential customers is not appropriate because the prohibition in the Act (which applies to authorised persons) relates to selling units or managing a scheme as opposed to simply participating in a scheme. And it is the latter which would be caught by an exemption relating to communications from potential customers.

### *Territorial Scope*

8. The CIS Order provides exemption for communications to overseas recipients. For unsolicited real time communications, this exemption applies only where the communication is made from outside the United Kingdom (UK) and it relates to an overseas scheme (an unregulated scheme which is operated and managed outside the UK). The equivalent exemption in the Financial Promotion Order relates to communications from outside the UK which are made for the purpose of business carried on outside the UK and which is not carried on in the UK.
9. The difference reflects the fact that the CIS Order applies to authorised persons and by definition an authorised person will carry on business in the UK. Replicating the exemption exactly would effectively discriminate against a particular group of authorised persons. The difference in drafting therefore ensures that authorised and unauthorised persons are treated in a broadly similar way.
10. In addition, as the CIS Order relates only to authorised persons, there is no requirement for the concept of an overseas communicator. This is because the concept relates to a person who carries on overseas investment activities but who does not carry on the activity from a permanent place of business in the UK. A concept that cannot apply to authorised persons who, by definition, will have a place of business in the UK.
11. This allows a more liberal exemption to be applied for overseas communications, that is communications made from outside the United Kingdom relating to units in an overseas scheme. (This exemption is drawn more narrowly for unsolicited real time communications.) In general, this more liberal approach is possible because of regulatory regime applying collective investment schemes generally and the application of the Order to authorised persons. The approach recognises that different circumstances apply and

the effect should be that the cost to business will be reduced. As with the Financial Promotion Order, this should assist the UK regulatory regime in adapting to the growth and importance of new technology, including the internet.

### *Introductions*

12. In the CIS Order, the exemption from the scheme promotion restriction for introductions carries an additional condition in comparison with that in the Financial Promotions Order. This additional condition is that the person making the introduction does not carry on business in relation to unregulated schemes. This is necessary in order to ensure that an introduction may be made only where the authorised person is not involved in the business for which he or she is making the introduction. Again, the difference reflects that the exemption applies to authorised persons and should have only a negligible effect on costs and benefits.

### **Costs and Benefits**

13. Detailed estimates of costs and benefits are given in the RIA for the Financial Promotions Order. It is estimated that around 1,000 firms could be authorised to be involved in the marketing of unregulated collective investment schemes. Potentially all these firms could benefit from one or more of the exemptions provided for in the CIS Order.
14. It is not possible to quantify the cost of the effect on authorised persons of not implanting the exemptions in the CIS Order. If the exemptions were not implemented, the result would be that authorised persons would be at a competitive disadvantage compared to unauthorised persons, who benefit from the exemptions in the Financial Promotion Order. In practical terms, it would mean that authorised persons could not promote units in unregulated schemes at all.

**Summary and recommendation**

15. The effect of the exemptions in this Order is broadly to reproduce, where appropriate, equivalent exemptions in the Financial Promotion Order.

*I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.*

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Melanie Johnson MP

Economic Secretary to the Treasury

HM Treasury

5 March 2001

## **ANNEX**

### **THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) ORDER 2000**

#### ***REGULATORY IMPACT ASSESSMENT***

1. This Regulatory Impact Assessment is of the Financial Promotion Order (FPO) made under Section 21 of the Financial Services and Markets Act 2000.

#### **Purpose and intended effect**

2. The Financial Services and Markets Act 2000 (the Act) will, when brought into force, replace the regulatory arrangements currently contained in the Financial Services Act 1986, the Banking Act 1987, the Insurance Companies Act 1982, the Building Societies Act 1986 and the Friendly Societies Act 1992. It creates a single statutory regulator for the UK financial services industry, with a single set of functions and powers. This will benefit both businesses and consumers.
3. Those financial services whose promotions will be regulated include insurance, banking (deposit taking), mortgages and investments. Examples of investments which are commonly promoted by unauthorised persons under the investment advertisement regime contained in Section 57 of the Financial Services Act 1986 include public offers of securities (other than those involving a prospectus or listing particulars), private offers of securities and newspaper advertisements.
4. Section 21 and the FPO will replace the investment advertisement regime of the Financial Services Act 1986 and its associated legislation, as well as provisions in other legislation on advertisements for insurance and banking services. As with the Financial Services and

Markets Act, it will replace multiple legislative frameworks with a single restriction, a single definition of financial services, and a single set of exemptions, although the promotion of collective investment schemes is governed by a different section of the Act and separate secondary legislation.

5. Section 21 contains a restriction on financial promotions by unauthorised persons where:
  - the promotion is made in the course of business;
  - the communication amounts to an invitation or inducement to engage in investment activity.
  - the communication does not fall within an exemption.
6. In many areas there will be no significant change in the impact of the financial promotion regime as a result of the FPO compared with previous legislation, nor therefore in the direct costs and benefits to businesses, although there will be an indirect benefit from the convenience of having a single restriction and set of exemptions. This assessment focuses on the areas of change.

### **Changes compared with current legislation**

7. First, the financial promotion restriction applies only to promotions made in the course of business, so for example promotions between neighbours would not be caught, whereas the investment advertisement regime (although not the unsolicited calls regime under Section 56 of the Financial Services Act) applies to all advertisements without restriction.
8. The second main change is that the restriction applies to communications across all media

and does not distinguish between “advertisements” or “calls”. This media-neutral approach is designed to accommodate new methods of communication, particularly electronic media.

9. Third, there will be changes resulting from the definition of controlled activities to which the financial promotion restriction will apply. In particular, the scope of regulation will be increased to include aspects of Lloyd's insurance not hitherto subject to FSA regulation, deposit-taking by credit unions, mortgage products and pre-paid funeral plans.
10. Fourth, additional exemptions from the restriction are permitted compared with existing legislation:-
  - for “one-off” communications by which is meant tailored promotions to one person, for example a solicitor drawing a client’s attention to a rights issue in the area of the client’s business;
  - for financial promotions not directed at the UK;
  - for passive communications providers (or “mere conduits”), for example an internet service provider who communicates a promotion but has no control over its content;
  - for generic promotions;
  - for promotions to high net worth or sophisticated individuals.
  - for journalists.
11. On the other hand, the financial promotion restriction will apply for certain types of solicited calls where it did not previously.

## **Risk**

12. The trading of financial services is characterised by a frequent asymmetry of information between seller and buyer which, if misused, can result in the mis-selling of financial products (personal pensions is a recent example), which can have serious and long term adverse consequences for consumers. This risk argues for regulating the promotion as well as the carrying out of financial services to a greater extent than non-financial products. Regulation does not eliminate the risk of mis-selling or other unsuitable promotion of financial services. But it does enable a framework for financial promotion to be created which takes account of consumers' needs, including where necessary means of redress.

### **Benefits**

13. Benefits will accrue from the modernisation and consolidation of the legislative regime for the promotion of financial services. The FPO sets out in one place, rather than throughout a number of different pieces of legislation, the regime for the promotion of financial services. The FPO's media-neutral approach provides clarity for all promoters of financial services, including those using electronic media. As secondary legislation the FPO is easier to update to take account of technological and legislative developments. Any change which extended the restriction on financial promotion would require a debate and vote in both Houses of Parliament.
14. Promoters of financial services will benefit from the additional exemptions, in particular through not having to bear the cost of seeking approval of a promotion by an FSA-authorized person. It is not expected that the exemptions will be at the expense of the protection of consumers.
15. The exemptions for promotions not directed at the UK and for mere conduits, which has

been amended in light of responses to previous consultation, should assist the UK regulatory regime in adapting to the growth and importance of new technology, including the internet.

11. The exemption for generic promotions will provide a consistency with the scope of regulated activities under the Act where generic advice also falls outside the scope of regulated activities. Generic investment advertisements are not exempted under the Financial Services Act 1986.
12. Journalists will benefit from an exemption, provided neither the journalist nor editor derive benefit from the product being promoted or, if benefit is derived, that this is disclosed.
13. The exemption for “one-off” promotions will benefit those whose promotions are to individuals, such as from a solicitor to a client.

### **Costs**

14. The direct cost to businesses of the financial promotion regime is the cost of securing approval by an authorised person of a financial promotion. The impact on particular businesses will therefore depend on how often they issue such promotions.
15. It is not expected that the cost of obtaining approval of a financial promotion will differ significantly from that of obtaining approval of an investment advertisement under the Financial Services Act 1986.
16. That cost is estimated as being in the region of one and a half hours of time by an external lawyer per page of investment advertisement to be approved. At a rate of £120 an hour

(although many firms charge higher rates), a 20 page financial promotion may therefore cost in the region of £4,000 for approval. The exact amount will, of course, depend on the charge out rate, the size of the advertisement and the nature of the material being approved - whether its contents are largely factual or made of more general statements which are more difficult to verify.

17. The cost to businesses will be reduced for those which are able to take advantage of the additional exemptions in the FPO (not directed at the UK, mere conduits and so on).
18. On the other hand, those which undertake certain types of solicited calls i.e. those which the recipient of the promotion has requested (and who cannot take advantage of the exemption for one-off solicited real time calls), may in future be unable to make such calls, or require them to be approved, depending on FSA rules, by an authorised person. Bringing these activities within the scope of the financial promotion restriction is needed to strike the appropriate balance with the need to protect consumers.
19. A further cost for firms arises from the extension in the scope of controlled activities, which define the boundaries of the financial promotion regime, to mortgage products, aspects of Lloyd's insurance, pre-paid funeral plans and credit unions. After consultation with those affected the Government decided to bring these activities within the scope of regulation. The additional costs will arise from the relevant Financial Services Authority (FSA) rules rather than from this Order, except in the case of firms carrying on those activities who will not require FSA authorisation. There are separate requirements specified in the Act for consultation on, and cost benefit analysis of, rules made by the FSA.

### **Securing compliance**

20. The FSA will be primarily responsible for securing compliance of all firms, whether authorised or unauthorised, with the financial promotion regime. Failure by unauthorised firms to comply with the restriction will be a criminal offence. Contracts made as a result of unauthorised promotions will be unenforceable against the purchaser. This is also the case with the investment advertisement regime under Section 57 of the Financial Services Act 1986. The FSA will have primary responsibility for monitoring and evaluating the impact of the FPO.

### **Impact on small businesses**

21. The exemptions for financial promotions to high net worth individuals and sophisticated investors should be of considerable assistance for smaller companies in finding the capital, from “business angels” and similar sources, which they need. It has been estimated that the costs of approval of investment advertisements may, in some circumstances, be as much as two thirds of the costs of legal and financial advice associated with offers of securities in small companies.
22. The impact of the Financial Promotion Order on smaller companies has been discussed with four companies from the Small Business Panel of the FSA. Among the comments they made were, first, that the reputation of the UK as a fair place to do business was a factor in favour of restrictions on outward promotions. The Government agrees, but has decided, in light of many other consultation responses, to remove the restriction on outward promotions, while continuing to advocate within the EU and elsewhere a “home state” basis for regulation of cross border promotions. Second, that there were a number of persons who might be eligible to certify high net worth and sophisticated individuals as such, and that we should consult further on this, which we have done and have extended the ability to certify high net worth to a person’s employer. Third, they did not want an exemption for journalists. The Panel's comments focussed on what they perceived as the

inaccuracy and irresponsibility of much financial journalism in respect of particular classes of investment such as endowment mortgages. Nonetheless we have included an exemption for journalists; wider questions about the quality of financial journalism are relatively unaffected by an exemption for journalists from the financial promotion restriction in respect of specific products.

### **Impact on competition**

23. The FPO broadly replicates the existing regulatory regime. None of the extensions to it appears likely to have an appreciable effect in reducing the scope for competition in the financial services sector. On the other hand, there should be competition benefits for the economy generally from the deregulation of promotions to high net worth and sophisticated investors, typical characteristics of “business angels”, as the cost of encouraging investment in small companies should fall significantly.

### **Summary and recommendation**

24. The cost of seeking approval of a financial promotion is not expected to change significantly under the FPO compared with the existing legislation. The impact on business of the FPO therefore depends on whether under the new framework unauthorised persons will need their promotions to be approved more or less often compared with current legislation.
25. The biggest contributors to a reduction in the numbers requiring approval of promotions will be we believe the new exemptions for promotions to high net worth and sophisticated individuals, and for generic promotions. But all unauthorised persons, even if they have to obtain approval, will benefit from having a single restriction on financial promotions, with all the exemptions to that restriction being in one place, and expressed

in terms which do not discriminate between different media. While it is possible to quantify the cost of a promotion it is difficult to quantify meaningfully the numbers likely to be affected by each of these measures. We expect however that the numbers benefiting from the changes will exceed the numbers whose costs are increased.