

**The Financial Services and Markets Act 2000  
The Two Year Review**

**Response to the consultation document  
dated 27 February 2004 setting out  
proposed changes to secondary legislation  
Question 20**

**Suggested Amendments to  
the Financial Promotion Order  
the Regulated Activities Order  
the CIS Promotion Exemptions Order**

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**[Note:**

Overseas financial services firms which are not FISMA-authorised is perhaps the most important single category of non-authorised communicators which the Financial Promotion Order is designed to help (other than, perhaps, UK quoted companies). My suggested amendments to the existing exemptions are primarily put forward with overseas financial services firms in mind, especially as many of our clients belong to that category and have encountered difficulties in using them in practice.]

**A The Financial Services and Markets Act 2000 (Financial Promotion) Order  
2001 (as amended)**

**1 Article 8 (the meaning of “solicited”)**

1.1 The exemptions in the Financial Promotion Order from the section 21 FISMA restrictions on real time “financial promotion” communications by persons who are not FISMA-authorised are far wider when they are solicited than when they are

unsolicited. It would therefore be quite normal for the communication to be covered by an exemption for solicited communications but not by one for unsolicited communications. This is the case in particular in relation to communications by overseas financial services firms (which term when used in this memorandum includes any other communicators from outside the United Kingdom), especially as the important general exemption in article 30 for solicited real time communications by them has no equivalent exemption for unsolicited ones.

- 1.2 At present, for a financial promotion communication to be "solicited", it must be clear from all the circumstances when, or before, the personal visit, telephone call or other interactive dialogue in which it takes place is initiated (or (was) requested) by its proposed recipient that the relevant communication will be made during it (paragraphs (1) and (3)(b)). This means that it must be clear by then to a reasonable third party (even if not to either the communicator or the recipient).
- 1.3 Indeed, the communication would normally not be "solicited" even if it was requested by the proposed investor (the recipient of the relevant financial promotion communication) himself, if the communication took place during the interactive dialogue in which the request was made (paragraph (3)(b)). In this memorandum, "proposed investor" includes a recipient of a communication offering to buy or exchange his shares or other investments.
- 1.4 An interactive dialogue is seemingly a single entity and is not to be broken down into separate sections, the relevant one starting once the parties begin discussing investments or financial services, (see paragraph (1)). The scope of the proposed communication must therefore be referred to, expressly or impliedly, before even saying "Hello" (at the latest). Normally, therefore, there must have been an earlier communication about them.
- 1.5 The paragraph (3)(b) requirement (see 1.2 above) therefore imposes a very high standard for a financial promotion communication to be "solicited". In particular, a reasonable third party would have had to have been alerted to what the interactive dialogue would be about by when it is begun (or, if requested by the proposed

investor, was requested). It is irrelevant to this standard whether or not the proposed investor or the overseas financial services firm had been.

1.6 If, for example, the proposed investor telephones the overseas financial services firm without warning, it is likely that at first it would not be clear to anyone other than the proposed investor what the discussion would be about. Unless the proposed investor made it clear at the very beginning of the telephone call, a real time financial promotion communication by the firm in response during the subsequent discussion would therefore be "unsolicited". It may therefore fall outside any exemption (especially that in article 30).

1.7 It would also be quite likely that a proposed investor would request, during the course of an interactive dialogue which fell in paragraph (3)(b) in relation to certain investments or financial services, that the overseas financial services firm should also tell him about other investments or financial services which were not actually referred to by when the interactive dialogue was begun. As they had not been referred to before, the firm's response would again be "unsolicited".

1.8 Even though, in both these cases (see 1.6 and 1.7 above), the proposed investor himself decided to ask for the information, the financial promotion communication made by the firm in response during the same interactive dialogue will nonetheless not qualify as "solicited" (because the consequent communication to the proposed investor was not "contemplated" by when the interactive dialogue was begun).

1.9 Accordingly, the mere "real time" response by the overseas financial services firm in the same telephone call or other interactive dialogue as the (earlier) request for information about investments or financial services was made by the proposed investor (without any prompting) may in itself constitute a criminal offence. This could lead to an unlimited fine and may require the firm to compensate the investor for any loss.

1.10 A response by the overseas financial services firm will only be "solicited" (and so, for example, qualify for the article 30 exemption) if the firm does not respond in the same telephone call or other interactive dialogue in which the request was made but

provides the information only in a later telephone call or other real time communication (or, indeed, in a later non-real time communication).

- 1.11 The overseas financial services firm will therefore need to tell the proposed investor that, for example, it will telephone him back with a response in a few minutes (so that the response will seemingly be "solicited" within both paragraph (1)(b) and paragraph (3)(b)). This seems an unnecessary (and unexpected) step to require.
- 1.12 Indeed, it is arguable that the later call was not itself expressly requested by the proposed investor, as required by paragraph (1)(b), unless his agreement to an offer by the overseas financial services firm to telephone him back qualifies as an "express request" by him for the firm to do so, or at least equivalent to it, (see 1.23 below). It may therefore be necessary for the firm to ask, instead, that the proposed investor should telephone the firm back in a few moments.
- 1.13 When we explain this to our clients, they normally cannot believe our analysis of the provisions (especially where they are overseas financial services firms). The continuation of this position surely cannot qualify as either necessary investor protection or, indeed, "light touch" regulation.
- 1.14 The prohibition on cold calling, technically "unsolicited real time communications", (and indeed on other financial promotion communications) is intended to protect the proposed investor. If it is the proposed investor who asks for information about the particular investments or financial services before the overseas financial services firm first mentions them that should therefore surely be acceptable.
- 1.15 Indeed, it should be acceptable even if neither the financial services firm nor, indeed, a reasonable third party would have contemplated at the beginning of the interactive dialogue that the firm would make a communication to the proposed investor about them, at least if the firm did not make any other financial promotion communication to him.
- 1.16 Accordingly, in paragraph (3)(b), line 1, please would the Treasury **delete** "from all the circumstance[s]" and **substitute** "to the proposed recipient".

- 1.17 It should also be sufficient that the proposed investor himself asked for the information or, perhaps (see 1.23 below), agreed that the overseas financial services firm should provide it, even if he did so during a visit, call or other interactive dialogue initiated by the firm but not requested by the proposed investor (so that paragraph (1) would not apply). Indeed, 1.12 above shows why this expansion of the exemption is, in fact, probably necessary.
- 1.18 Please would the Treasury therefore **expand** the **definition of “solicited”** (in paragraph (1)) to include all communications requested by the recipient even though it was not clear (as is presently required by paragraph (3)(b)) when or before the personal visit, telephone call or other interactive dialogue in which they were made was initiated or requested by the proposed investor (or, indeed, even if it was not initiated or requested by him) that they would in fact be made during it.
- 1.19 In other words, the definition should also cover a requested communication (as in section 56 of the Financial Services Act) rather than only one made in such an initiated or requested personal visit, telephone call or other interactive dialogue.
- 1.20 Accordingly, please would the Treasury **insert** a new paragraph (1A) as follows:
- “(1A) A real time communication is also solicited if it is made in response to an express request by [(or with express permission from)] the recipient of the communication.”
- and, in paragraph (2), **after** “paragraph (1)” **insert** “or paragraph (1A)”.
- 1.21 In my view, a mere offer by a financial services firm to talk about particular investments it is marketing, or the financial services it can provide, is normally not in itself a financial promotion “inducement” within section 21, at least if the firm does not say that it may be of interest to the proposed investor (or similar).
- 1.22 In this regard, section 21 is in my view not as wide as sections 56 and 57 of the Financial Services Act, which it replaced. Accordingly, there is usually no need to consider whether the offer to discuss investments or financial services was solicited

or unsolicited. If, however, I am wrong in my view, the **definition of “solicited”** should surely be **expanded** to cover these offers.

1.23 Similarly, if the firm offers to talk about investments or financial services, a positive response by the proposed investor allowing it to do so seems to render the later financial promotion communications about them, and indeed the consequent discussion in which they were made, "solicited" within the new paragraph (1A) (see 1.20 above and paragraph (3)(a)(ii), which merely adds an extra condition to be fulfilled before a provision in a “standard form” customer agreement saying that financial promotion communications will be made qualifies them as “solicited”). Indeed, in paragraph (3)(a)(ii) it is surely better to **delete** "will" at the end of line 1 and **substitute** "can".

1.24 Accordingly, if this is acceptable as a matter of policy, it would be helpful to **provide for this** expressly in a new paragraph (3)(bA), if my suggested paragraph (1A), which contains wording (see 1.20 above) to cover this suggested extension (“or with express permission from”), is not incorporated.

1.25 Finally, one drafting point, if I may. **Please could the Treasury recite** the three concepts of a “telephone call”, a “personal visit” and an “interactive dialogue” **in the same order** in all the different places in article 8 where they occur. This would make the provisions of article 8 read much more easily.

## **2 Articles 12(5) and 12(6) (including UK persons in the “overseas recipients” exemption)**

2.1 Article 12 is in substance aimed at allowing financial promotion communications to be made to or directed only at persons outside the United Kingdom. However, the “directed at” exemption helpfully applies even if the communication is also directed at persons in the United Kingdom provided that they are investment professionals or high net worth persons (and who therefore are presumably both within domestic exemptions, but see 2.8 below). This is made clear in paragraph (5) and paragraph (6)(a), but the position is unfortunately confused by the requirement in paragraph (6)(b).

- 2.2 Paragraph (6) requires the making of specified indications that the communication is directed only at persons within the exemption and must not be acted upon by persons outside it. Paragraph (6)(a) therefore provides that there must be an indication that the communication is directed only at persons outside the United Kingdom or at persons who have professional experience or are high net worth persons. It is accordingly clear that the communication can also be directed at persons in the United Kingdom if (but only if) they have professional experience or are high net worth persons.
- 2.3 This express inclusion of these persons in the United Kingdom is similarly spelled out in paragraph (5), although paragraph 5(a) actually refers to “investment professionals” (see 2.8 below).
- 2.4 However, paragraph (6)(b) provides that, in addition, there must also be an indication that the communication must not be acted upon either by persons in the United Kingdom or (in addition) by persons who do not have professional experience or are not high net worth persons. **This is where the problem arises.** The way that this is written, it can mean only that the persons who are excluded because they do not have professional experience and are not high net worth persons are persons who are outside the United Kingdom. This is because their exclusion is additional to the exclusion of persons in the United Kingdom.
- 2.5 As a result, instead of widening the class of permitted recipients (as in paragraphs (5) and (6)(a)) to include persons in the United Kingdom if they have professional experience or are high net worth persons, the required indication in paragraph 6(b) is that persons outside the United Kingdom are suddenly excluded as permitted recipients (strictly, cannot act upon the communication) if those non-UK recipients do not have professional experience or are not high net worth persons. In other words, the translation from the positive statement in paragraph (6)(a) to the negative requirement in paragraph (6)(b) has just gone wrong.

- 2.6 As a result, the indication that has to be made, in order to be able to direct communications also at qualified UK recipients, is different from the substantive result required, which is itself actually permitted by paragraph (5)(a) and (b). Indeed, according to the indication there are in fact no “qualified UK recipients”.
- 2.7 Accordingly, in paragraph (6)(b), lines 2 and 3, please **delete** "or by persons who do not" and **substitute** "unless they" and **delete** " who are not" and **substitute** " are".
- 2.8 It would seem that the expression “persons having/who have professional experience in matters relating to investments” as used in paragraphs (6)(a) and (6)(b) is supposed to mean persons who are “investment professionals” (see paragraph (5)(a)). However, compliance officers often think that they are a wider class, exactly because the defined term is not being used. The problem with this analysis is that a wider class is normally not covered by any domestic exemption. It would also not be appropriate to have different categories of permitted “professional” UK recipients in paragraph (5)(a) and in paragraphs (6)(a) and (6)(b) respectively.
- 2.9 Accordingly, please would the Treasury **delete** references to “professional experience in matters relating to investments” (in both paragraph (6)(a) and paragraph (6)(b), as amended as described in 2.7 above) and **substitute** references to “investment professionals” (as in paragraph (5)(a)).
- 2.10 In addition, it seems to be provided by paragraphs (5)(a) and (5)(b) (and, arguably, by paragraphs (6)(a) and (6)(b), because of their final words "(as the case may be)") that there must be one communication directed at investors outside the United Kingdom and investment professionals in the United Kingdom and another one directed at investors outside the United Kingdom and high net worth persons in the United Kingdom, respectively.
- 2.11 These separate communications would usually be contrary to what is desired commercially. It would, for example, require two separate but very similar newspaper advertisements at the same time; this would be expensive and may look

silly. Surely it is better to allow communicators to combine both the two (extra) categories of recipients in the United Kingdom in the same communication.

2.12 Accordingly, paragraph (5) should be **amended** to allow the communication to be directed at both investment professionals and high net worth persons, or either of them, in the United Kingdom. Similarly, the expression “(as the case may be)” in paragraphs (6)(a) and (6)(b) should be **deleted**.

2.13 In addition, I think that the condition in paragraph (4)(c) should also be copied into paragraph (6) and amended there to allow publicising the communication to “permitted recipients” in the United Kingdom. Otherwise, the overseas financial services firm could not tell them about the financial promotion communication in other materials.

2.14 Accordingly, please would the Treasury **insert** a new paragraph 6(c) as follows:

“(c) the condition in paragraph (4)(c) is to be construed as requiring that the communication is not referred to in, or directly accessible from, any other communication which is made to a person or directed at persons in the United Kingdom (other than an investment professional or a high net worth person) by or on behalf of the same person.”

### **3 Article 30(2) (definition of “overseas communicator”)**

3.1 Article 30 provides an exemption for solicited real time communications. It applies only to qualifying communications made from outside the United Kingdom by “overseas communicators” (as defined in paragraph (2)) which carry on outside the United Kingdom a relevant investment activity, namely one falling within paragraphs 3 to 7 of schedule 1 to the Financial Promotion Order, (paragraph (1)).

3.2 The exemption therefore does not apply unless the overseas financial services firm qualifies as an overseas communicator. This requirement applies also to the three following exemptions.

3.3 Apart from having to carry on relevant investment activities outside the United Kingdom, the overseas financial services firm only qualifies as an overseas

communicator (within paragraph (2)) if it “does not carry on any such activity” from a UK branch. If the firm did carry on a relevant investment activity from a UK branch without being FISMA-authorised, it would have had to carry on the activity only within the exclusions set out in the Regulated Activities Order (so that they fall only within the wider class of “controlled activities”).

3.4 In other words, the relevant investment activity would have to be a controlled activity within paragraphs 3 to 7 but not a regulated activity. Otherwise, the overseas financial services firm would have needed to be FISMA-authorised. If it was, section 21(2) provides that the restrictions in section 21(1), from which the Financial Promotion Order provides exemptions, would not have applied anyway.

3.5 The problem with the expression “[which] does not carry on any such activity” (see 3.3 above) is that there are two different possible interpretations of the expression with very different results:

- (a) that the communicator does not carry on any relevant investment activity from a branch in the United Kingdom; or
- (b) that the communicator does not carry on from a branch in the United Kingdom any relevant investment activity it (also) carries on outside the United Kingdom.

3.6 I hope that the Treasury intend the expression “[which] does not carry on any such activity” to have the meaning set out in (b) in 3.5 above rather than that set out in (a). This is not only more helpful but also conforms with the exclusionary wording in article 12(2)(b), which helps retain the exemption in relation to overseas recipients in the case of unsolicited real time communications. It should be made clear that it is this definition which applies.

3.7 Accordingly, please would the Treasury **amend** the definition of “overseas communicator” in paragraph (2), by **deleting** “such activity” in line 2 and **substituting** “of those activities”.

3.8 Indeed, it would be helpful if the business excluded in the definition of “overseas communicator” is only the particular business in the course of or for the purposes of which the solicited communication is made. As a result, the exemption would apply if the communication is made in or for a relevant investment activity which it does not carry on in the United Kingdom. Importantly, it would do so even if the communicator does indeed carry on from a branch in the United Kingdom one or more of the other relevant investment activities it carries on outside the United Kingdom.

3.9 Accordingly, if this is acceptable (which as a matter of “mischief” it surely should be), please would the Treasury also **amend** the definition of “overseas communicator” in paragraph (2) so as to **restrict** it as referred to in 3.8 above. Perhaps appropriate language would be something like:

“...but who does not carry on from a permanent place of business maintained by him in the United Kingdom the relevant investment activity in the course [of] or for the purposes of which the communication was made.”.

#### **4 Further amendments**

4.1 If the Treasury kindly accept all or any of the amendments I ask for in Part B below, those amendments should also be made please to the corresponding provisions of the Financial Promotion Order.

4.2 I have referred to the amendments in Part B as being made to the Regulated Activities Order only because it is the definitions in that Order which are used for the purposes of other legislation (see, for example, the Prospectus Regulations as defined in B.1.3 below).

4.3 As indicated in 4.1 above, I could otherwise have referred instead to the Financial Promotion Order. I hope that the Treasury will therefore still regard the amendments in Part B as coming within the terms of question 20.

**5 The draft consolidated Financial Promotion Order**

5.1 In the draft new consolidated Financial Promotion Order contained in Volume 2 (Draft legislation) the numbers of the divisions referred to as Parts as set out in the draft Order are specified in Arabic numerals (Part 1, 2, 3 etc).

5.2 However, they should conform with the heading as used in the Contents pages and, more importantly, as referred to throughout the Order (for example, in article 12).

5.3 Accordingly, please renumber the divisions in Roman numerals (for example, Part I, II, III etc), as in the existing version of the Order.

5.4 In schedule 1, paragraph 17, line 1, please **delete** "16" and **substitute** "18".

**B The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended)**

**1 Article 76 (shares in a non-UK unincorporated body)**

1.1 Article 76(1)(b), and its equivalent in the Financial Promotion Order (paragraph 14(1)(b) of schedule 1), list as "Shares" shares in the share capital of non-UK unincorporated bodies. In principle, an unincorporated body does not have a share capital. It would therefore seem that what is intended to be covered by "share capital" is capital which is not loan capital and "shares" is treated as including "interests". This would mean that, typically, interests in non-UK limited partnerships are covered by the definition of "Shares".

1.2 Accordingly, non-UK limited partnerships are covered by article 76 whether they are incorporated (as in Delaware) or are unincorporated (as in Bermuda or the Cayman Islands). However, if they are unincorporated, they may also constitute collective investment schemes within article 81 and its if equivalent in the Financial Promotion Order (paragraph 19 of schedule 1). This would mean that dealings in (or offers of) non-UK limited partnership interests would be regulated by the Regulated Activities Order (or the Financial Promotion Order, which is based on it) under two separate headings, which may be confusing and normally is not required.

- 1.3 In addition, offers of interests in a non-UK unincorporated limited partnership may also be regulated by the Public Offers of Securities Regulations 1995 (the "Prospectus Regulations"). These apply to public offers of "shares" as defined in article 76 (regulation 2(1A)); regulation 2(1A) was incorporated by the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 (the "Amendments Order").
- 1.4 In my view, "shares" in the Prospectus Regulations covers the investments listed in the Regulated Activities Order under the heading "Shares". It therefore includes interests in non-UK unincorporated limited partnerships or other unincorporated bodies.
- 1.5 This is unexpected and seems to result in the double regulation of public offers of these "shares", for which there appears to be no special reason. Conversely, however, article 76(3)(a) of the Regulated Activities Order (and paragraph 14(3)(a) of schedule 1 to the Financial Promotion Order) excludes shares in open-ended investment companies from the heading "Shares". Accordingly, they are covered only by article 81 (or paragraph 19) as collective investment schemes.
- 1.6 This avoids their being listed in the Regulated Activities Order (and in the Financial Promotion Order) under two separate headings. More importantly, it accordingly also avoids regulation under the Prospectus Regulations, where double regulation would not have been so unexpected, as those companies are at least bodies corporate.
- 1.7 However, it may be the case that "shares" in the Prospectus Regulations instead refers only to the shares covered by the Regulated Activities Order (and therefore does not cover interests in non-UK unincorporated bodies at all).
- 1.8 In other words, on the analysis in B.1.7 above, "shares" is not treated as referring to the heading in the Regulated Activities Order. However, in my view it should be. The possible analysis in B.1.7 above seems to ignore the requirement that "shares" is to be interpreted as provided in the Regulated Activities Order (see B.1.3 above).

- 1.9 The express inclusion in regulation 3(2)(a) of building society deferred shares even though they are already listed in article 76 casts doubt on my analysis in B.1.4 above. However, as the deferred shares are clearly “shares”, it would also not be necessary to include them expressly even if regulation 3(2)(a) referred instead only to shares covered by the Regulated Activities Order (see B.1.7 above).
- 1.10 Accordingly, to avoid this confusion, please would the Treasury kindly **amend** article 76(3)(a) of the Regulated Activities Order by **inserting** after “company” the words “or any other collective investment scheme falling within article 81”.
- 1.11 In addition, please would the Treasury **amend** regulation 3(2)(a) **to refer instead to** “shares or stock” and **delete** the seemingly unnecessary reference to deferred shares of a building society. Please would the Treasury also **insert** at the end of paragraph (3) “or shares or stock in the share capital of unincorporated bodies”; I think that referring to these bodies as “non-UK” might imply that UK unincorporated bodies are covered.
- 1.12 Please would the Treasury also **amend** the heading to article 76 itself to read “Shares or stock”; this substitute heading then conforms exactly with regulation 3(2)(a) and should also be used as the heading to paragraph 14 of schedule 1 to the Financial Promotion Order.
- 1.13 The amendment in B.1.10 above would also avoid double regulation in the case of offers of interests in non-UK unincorporated limited partnerships and other non-UK unincorporated bodies qualifying as collective investment schemes. This is because interests in them would no longer be regarded as “shares” for the purposes of article 76 or, consequently, of the Prospectus Regulations.
- 1.14 Accordingly, offers of interests in unincorporated collective investment schemes would clearly fall outside the Prospectus Regulations in the same way as offers of interests in collective investment schemes which are bodies corporate (and would be regulated only by the Financial Promotion Order). This confirms the reduction in the original scope of the Prospectus Regulations and is very welcome.

## **2 Article 77 (meaning of “debt securities”)**

- 2.1 The definition of “debt securities” (technically, instruments creating or acknowledging indebtedness) in the Regulated Activities Order is also used for the purposes of regulation 3(2)(b) of the Prospectus Regulations. Like the definition of “shares”, it was incorporated in the new regulation 2(1A) by the Amendments Order (see B.1.3 above). In addition, the whole of regulation 3 was also inserted by it.
- 2.2 The definition is arguably not restricted to the investments listed in the Regulated Activities Order under the heading “Instruments creating or acknowledging indebtedness”. Instead, it seemingly means the debt securities covered by the Regulated Activities Order. For example, there is no heading in the Regulated Activities Order exactly corresponding to regulation 3(2)(c) or regulation 3(2)(d) of the Prospectus Regulations.
- 2.3 Accordingly, regulation 3(2)(b) seems under this analysis to cover not only the investments listed in article 77 in the Regulated Activities Order but also those listed in article 78. Article 78 relates to government and public securities which are carved out from article 77, into which they would otherwise have fallen, (article 77(1)). They should not however be covered by the Prospectus Regulations.
- 2.4 Offers of instruments relating to government or public securities are expressly excluded from the Prospectus Regulations (regulation 3(5)). Their exclusion could have been needed because the investments referred to in regulations 3(2)(c) and 3(2)(d) covered them. However their exclusion was also necessary because the investments listed under the headings “Instruments giving entitlements to investments” and “Certificates representing certain securities” also included instruments and certificates relating to government or public securities.
- 2.5 I cannot find any provision similar to regulation 3(5) excluding government or public securities themselves. It is likely that this is because regulation 3(2) is intended to refer instead only to the investments listed under the heading “Instruments creating or acknowledging indebtedness” (and therefore does not include the investments

listed under the heading “Government and public securities”). However, the fact that regulation 3(2)(c) and (d) do not match the headings in the Regulated Activities Order casts doubt on this; indeed, it also casts doubt on my analysis in B.1.4 above.

- 2.6 To correct the position (if “debt securities” is intended to cover all the debt securities referred to in the Regulated Activities Order), regulation 3(4) of the Prospectus Regulations should be **amended by inserting** a new paragraph (c) to the effect that investments of the kind specified in paragraph (2)(b) also do not include government or public securities.
- 2.7 Alternatively, to correct the position (if, as I think, “debt securities” is intended to mean the investments covered by the heading “Instruments creating or acknowledging indebtedness” in the Regulated Activities Order”), it is surely better to use for the purposes of regulation 3(2) of the Prospectus Regulations the exact headings used in the Regulated Activities Order; I have in fact already requested this in B.1.12 above in relation to “shares”.
- 2.8 This would avoid any doubt as to what is covered and leave no room for the argument that government or public securities are covered.
- 2.9 Accordingly, please would the Treasury **amend** regulation 3(2)(c) and (d) **to refer instead** to “instruments giving entitlements to investments” and “certificates representing certain securities” respectively. However, the express inclusion in regulation 3(2)(c) of warrants and other instruments “to acquire” (rather than merely “to subscribe” as in paragraph 79 of the Regulated Activities Order) should be retained (unless my suggestion in 2.11 below is adopted).
- 2.10 As the definitions were originally incorporated by a FISMA statutory instrument, surely they can now be amended by one.
- 2.11 Perhaps it would be appropriate to **amend** paragraph 79 to cover rights to “acquire” investments as well (see B.2.9 above). Their non-inclusion is somewhat anomalous.

### 3 **Article 84 (dealings in the cash market treated as futures contracts)**

- 3.1 Article 84(1) provides that futures are rights under contracts for the sale of property under which delivery is to be made at a future date at an agreed price. Although paragraph (2) provides that contracts are normally excluded if they are not made for investment purposes, paragraph (3) provides that a contract is to be regarded as made for investment purposes if it is "made or traded" on a recognised investment exchange.
- 3.2 By referring to contracts "made" on an RIE, paragraph (3) in effect confirms that the definition covers contracts for the sale of shares, gilts or other "cash" instruments on the London Stock Exchange or any other recognised investment exchange. The exemption for where delivery is to be made within seven days, as normally required by the London Stock Exchange, (paragraph (4)) does not apply, as the contracts are made on an investment exchange.
- 3.3 The wording of article 84(1), and indeed the whole of article 84, is, of course, copied (with minor variations) from the Financial Services Act but that does not mean that it cannot be improved. The Financial Services Act's definition was in the Act itself (paragraph 8 of schedule 1) and accordingly could only be corrected by amending primary legislation; we therefore had to live with it. However, as the definition is now in the Regulated Activities Order, article 84 can be amended by secondary legislation; this, indeed, was the reason put forward by the Treasury for moving the list of "regulated activities" from the Act in the first place.
- 3.4 Although the necessary wording may be difficult (as share or gilt futures, and futures on other "cash" instruments, should remain in article 84), I would urge the Treasury to **correct the wording** now, so as to ensure that "cash market" contracts for the sale of shares or gilts, or other "cash" instruments, themselves are outside article 84, unless those contracts are themselves traded (or can be closed out) on a recognised futures exchange.
- 3.5 Otherwise, given that we are now in a new regime, it will continue to be an important problem for FISMA-authorized firms whose permitted business is limited

to shares or debt securities, or other cash instruments, and does not cover futures. In addition, the FSA's restrictions on direct offers of derivatives (COB 3.9.5R) will (wrongly) apply.

3.6 It would be helpful to amend paragraph (3) so as to **restrict** the first part of the definition of "contracts for investment purposes" to contracts which are "traded" on a recognised investment exchange (or, perhaps, can be closed out on one) and **to exclude** references to contracts "made" on a recognised investment exchange. However, even if it is, it would normally be necessary to regard contracts in the cash market as made for investment purposes, quite apart from paragraph (3).

3.7 Perhaps, paragraph (4) should be allowed to apply to contracts made on a recognised investment exchange (so that most of those contracts are treated as made for commercial purposes).

3.8 Accordingly, please would the Treasury **amend** paragraph (3) by deleting in line 1 "A contract" and substituting therefor "Subject to paragraph (4), a contract" and **amend** paragraph (4) by **deleting** in line 1 the words "not falling within paragraph (3)".

3.9 Alternatively, it would seem best to **provide an express exclusion**.

#### **4 Treatment of limited liability partnerships**

4.1 The Regulated Activities Order seems not to refer specifically to limited liability partnerships when it defines "investments". It is clear that a limited liability partnership can constitute a collective investment scheme even though it is a body corporate (the Financial Services and Markets Act (Collective Investment Schemes) Order 2001, paragraph 21 of the schedule). However, if it does, interests in it are seemingly to be treated not only as "units" in a collective investment scheme but also (exactly because it is a body corporate) as "shares": Regulated Activities Order, article 76(1)(c).

4.2 This gives rise to the same problems as those relating to non-UK limited partnerships (see B.1 above), albeit in reverse. Accordingly, it is important to avoid interests in limited liability partnerships being captured under two different headings

in the Regulated Activities Order (and the Financial Promotion Order) and public offers of them being subject to double regulation.

4.3 It seems to me that the wording I have suggested in B.1.10 above (excluding interests in collective investment schemes from the heading “Shares [or stock]”) would have the effect of also avoiding double regulation in the case of public offers of interests in limited liability partnerships and I would hope that the Treasury are happy that it should do so.

4.4 Conversely, a limited liability partnership which does not constitute a collective investment scheme would be treated as covered by the heading “Shares [or stock]” and as being subject to the Prospectus Regulations in the same way as other bodies corporate.

**C The Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001**

**1 Application of corresponding amendments in Parts A and B**

1.1 All of the amendments set out in Parts A and B which are accepted by the Treasury should please also be made to the corresponding provisions in the CIS Promotion Exemptions Order where relevant.

1.2 The main reason why the amendments I have suggested in relation to the Financial Promotion Order should also be made to the CIS Promotion Exemptions Order is that the former also apply to the marketing of investment funds. It would be inappropriate to allow overseas financial services firms which are not FISMA-authorized to market investment funds to the relevant permitted investors directly without any need for approval but yet prohibit FISMA-authorized firms from marketing them in the same (amended) circumstances.

1.3 This indeed was, I seem to remember, the rationale put forward by the Treasury for copying into the CIS Promotion Exemptions Order the exemptions now provided by the Financial Promotion Order in the first place.

1.4 In addition, it was surely for this reason (and not just for "consistency") that the Treasury's recent proposals (in the consultation document on High Net Worth and Sophisticated Investors issued in January 2004) to amend the marketing exemptions in the Financial Promotion Order were also put forward in relation to the CIS Promotion Exemptions Order.

Charles Abrams

1 June 2004