



HM Treasury

Regulatory Framework for Approval of Financial Promotions: Consultation Response

June 2021

Regulatory Framework for Approval of Financial Promotions Consultation Response



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Chapter 1

Background

- 1.1 In July 2020 the Treasury launched a consultation on a Regulatory Framework for Approval of Financial Promotions.¹
- 1.2 Currently, section 21 of the Financial Services and Markets Act 2000 (FSMA) imposes a general restriction on the communication of financial promotions. Unauthorised persons may only communicate financial promotions if they are approved by an authorised firm (unless the promotion can otherwise be communicated pursuant to an applicable exemption in the Financial Promotion Order 2005).² An authorised person is a person that has received the approval of the Financial Conduct Authority (FCA), or the Prudential Regulatory Authority (PRA) to carry on a regulated activity (the terms authorised/unauthorised firms and authorised/unauthorised persons are used interchangeably in this document).
- 1.3 Authorised firms are able to approve the financial promotions of any unauthorised person. The rationale for this position is that, in order to be authorised, firms must meet the applicable 'Threshold Conditions' set out in FSMA, including conditions to ensure they are fit and proper persons to carry on business, and are subject to FCA rules. When approving a financial promotion authorised firms must ensure that the promotion complies with the relevant FCA rules.
- 1.4 However, as set out in the consultation, the government is concerned that the current regime is not sufficient as there is **no specific assessment authorised firms must undergo before they are able to approve financial promotions of unauthorised firms**. This gives rise to three potential risks:
- **Lack of relevant approver firm expertise:** Financial promotions cover a very wide range of financial products and services. This means an authorised firm could be approving promotions for a product outside of its area of expertise. Whilst this may not always pose a risk, there is the potential that an authorised firm could approve a promotion which is misleading, inaccurate or inappropriate for the intended recipients 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 notes that authorised firms should consider both the presentation and substance

¹ The consultation can be found here <https://www.gov.uk/government/consultations/regulatory-framework-for-approval-of-financial-promotions>.

² S.I. 2005/1529.

of a promotion before providing approval. However, the FCA has identified cases where authorised firms have not undertaken sufficient due diligence in relation to the product or service which is being promoted and, as a result, the promotions have not been compliant with FCA rules. 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 delivering 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.

- **Challenges in exercising appropriate regulatory oversight:** The FCA does not currently have a comprehensive and exhaustive view of those firms which are approving financial promotions for others, the nature of the financial promotions being approved and how they relate to 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.

1.5 In response to these risks, the consultation proposed that FSMA should be amended so that authorised firms are no longer able to approve the financial promotions of unauthorised persons, unless the authorised firm had passed through a new regulatory 'gateway' operated by the FCA. This change would lead to several improvements:

- **More effective prevention and intervention:** The FCA will be able to assess firms' suitability and competence before they are able to approve financial promotions of unauthorised persons. This will allow the FCA to prevent unsuitable firms from approving financial promotions.
- **Ensuring approver firms have relevant expertise:** Consent could be linked to products or services within the firm's area of expertise meaning that only firms with the relevant expertise are able to approve the promotion of a particular product.
- **More effective FCA oversight and supervision:** The FCA will have better oversight of which firms are carrying on approval activity, meaning it could take a more proactive supervisory approach, for example targeting its supervision where risks are highest.
- **Improved due diligence:** More effective oversight and supervision should, in practice, 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.

1.6 The government identified two policy options in its consultation to deliver the proposed gateway:

- **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. A universal requirement (the Financial Promotion Requirement) would be imposed on all new and existing authorised persons prohibiting them from approving the financial promotions of unauthorised persons.³ 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 authorisation would be able to apply as part of its application for authorisation to have the requirement not to approve financial promotions varied or cancelled.
- **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 4A⁴ permission from the FCA before they could 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.

1.7 As stated in the consultation, the government’s view was 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, without fundamentally altering the overall regulatory architecture of the financial promotion regime. Option 2 on the other hand represented a significant departure from the current regime by making the approval of financial promotions a regulated activity. This approach would have meant firms carry on a regulated activity when approving the financial promotions of others but not when communicating their own promotions. This would therefore have created a more significant divergence of regulatory treatment between firms communicating and approving promotions.

1.8 The consultation invited responses from industry on three questions:

- 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?

³ The Financial Promotion Requirement, and ‘a requirement not to approve financial promotions’ are used interchangeably in this document.

⁴ 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).

- What are the risks and benefits of each of the two policy options put forward? Would there be any unintended consequences resulting from implementation?
- If the government was to proceed with one of the two policy options, which would be your preference and why?

Chapter 2

Overview of response to consultation

Response Breakdown

2.1 There were a total of 26 responses to the consultation, representing more than 22,000 organisations and individuals. This is due to a small number of responses from key industry trade bodies representing numerous organisations. All returns have been analysed and given full consideration in preparing this response. Table 2.A sets out the breakdown of responses by respondent type.

Table 2.A: Respondents to Consultation

Respondent Type	
Consumer representative	9
Firm	9
Individual	2
Trade association	5
University	1

Source: *Response to consultation*

2.2 The government sought views on:

- Support for the proposal of a regulatory gateway
- The benefits and risks of each of the proposed options
- Which of the two options was preferable.

2.3 A considerable majority of respondents supported the introduction of a regulatory gateway. There was also a slight preference amongst respondents for option 1 as the method for implementation. Further details of the responses are summarised below.

Support for a regulatory gateway

2.4 A considerable majority of respondents supported the gateway. The main justification for supporting the gateway was that the requirements on approver firms are currently too low and more action is needed to encourage due diligence. A regulatory gateway which would lead to a specific

assessment of firms' suitability to approve financial promotions, and improved supervision was seen to achieve this.

- 2.5 This was reflected in responses to the question on the risks and benefits of the gateway. A number of respondents agreed with the potential benefits stated in the consultation: more effective prevention and intervention against unsuitable firms approving financial promotions, ensuring approver firms have relevant expertise, more effective FCA oversight and supervision, and improved due diligence. Other respondents highlighted further perceived benefits in particular that this would likely reduce the harm consumers faced.
- 2.6 Respondents that did not support the introduction of the proposed gateway had a variety of reasons for doing so. The main reasons are set out below:
- **Disorderly Transition** – Several respondents were concerned that without a transition mechanism for the implementation of a gateway there was a high risk of disruption to the financial promotions market.
 - **Additional administrative burden** – Several respondents agreed with the risk the government noted in the consultation that a new gateway would constitute an additional administrative burden on authorised firms which are currently approving the promotions of unauthorised persons.
 - **Excessive reduction in number of approver firms leading to a disruption in the market** – Concerns were raised that a gateway would reduce the number of firms able to approve financial promotions. This could increase the cost of approvals, lead to potential conflicts of interest between approvers and unauthorised firms (where approver firms offer competing products), or remove the possibility of approval all together. This could have a particularly detrimental impact on emerging unregulated sectors which are nevertheless captured by the financial promotion regime and rely on authorised firms operating in other sectors to approve their promotions.
 - **Ineffective solution** – Respondents raised concerns that the proposal would be ineffective due to pre-existing issues such as the adequacy of supervision of authorised firms, and the fact that proposals would only impact the promotions of unauthorised firms. As previously noted under the government's proposals authorised firms will continue to be able to make their own financial promotions.
 - **Implementation risks** – Respondents raised concerns that poor implementation could make the proposal ineffective. Concerns in this area focussed on risks arising from a lack of a transition period, and the importance of ensuring there were robust consequences for breaches of any rules.
- 2.7 The government has taken on board these concerns and addresses these in Chapter 3 of this document. The government is grateful for comments and feedback on the functioning of the financial promotion regime and will incorporate it into its wider policy making process.

Preferred Option

- 2.8 There was a slight preference amongst respondents for option 1. Respondents were more likely to view option 1 as less onerous and more proportionate than option 2, as option 2 would more fundamentally alter the treatment of financial promotions within the regulatory framework. Respondents also raised other benefits of option 1, including that it provided a simpler process to follow, and would not make the approvals process excessively burdensome. However, a number of respondents raised questions about how the process would work. More detail in response to this question is provided in Chapter 3 of this response.

Implementation Questions

- 2.9 A number of questions were raised by respondents about how the proposals in the consultation would be implemented. Some of the main questions are listed below:

- **Procedural questions** – There should be further clarity on the application process, the scope of permissions firms would receive, and the possible enforcement actions that could be taken in response to any breach of the restrictions. The government sets out more detail on this in paragraph 3.3 to 3.5 of this response.
- **Position of appointed representatives and intermediaries** – There should be further clarity regarding how appointed representatives will be treated, and whether there will be any exemption for authorised firms approving the financial promotions of appointed representatives. The government sets out the structure of a proposed exemption relating to appointed representatives in paragraph 3.23 of the response.
- **Complaints mechanism** – There should be further clarity on what mechanism is available for consumers to complain about non-compliant financial promotions. Information relating to this question is set out in paragraph 3.19 of this document.

- 2.10 Respondents also made some suggestions concerning additions or modifications to proposals in the consultation:

- **Transition period required** – There should be an interim permission regime, or transition period for authorised firms. The government has taken this comment on board, and further detail on a transitional period is set out in paragraph 3.7 to 3.12 of this document.
- **Grandfathering for specific sectors** – Sectors for whom approving financial promotions of unauthorised firms is a core part of their business model should be automatically given permission to approve financial promotions through a grandfathering process. The government considered this issue carefully and has provided more detail on its position in paragraph 3.24 of this document.

- **Permissions should be limited to areas where firms have a Part 4A permission** – Permission to approve financial promotions should be limited to regulated activities authorised firms have permission to undertake. The government has set out more detail on the scope of permissions to approve financial promotions in paragraph 3.5 of this document.
- **Remove the intra-group exemption** – The restriction should be extended to apply to the activities of firms approving promotions of unauthorised firms within their own group. The government's response to this suggestion is set out in paragraph 3.22 of this document.

Broader comments on the financial promotion regime

- 2.11 A number of respondents also provided comments about the financial promotion regime that covered issues outside of the scope of this consultation.
- 2.12 The government appreciates the feedback it received and will incorporate these comments into its policy making process.

Chapter 3

Proposed Government Approach

Outcome of consultation

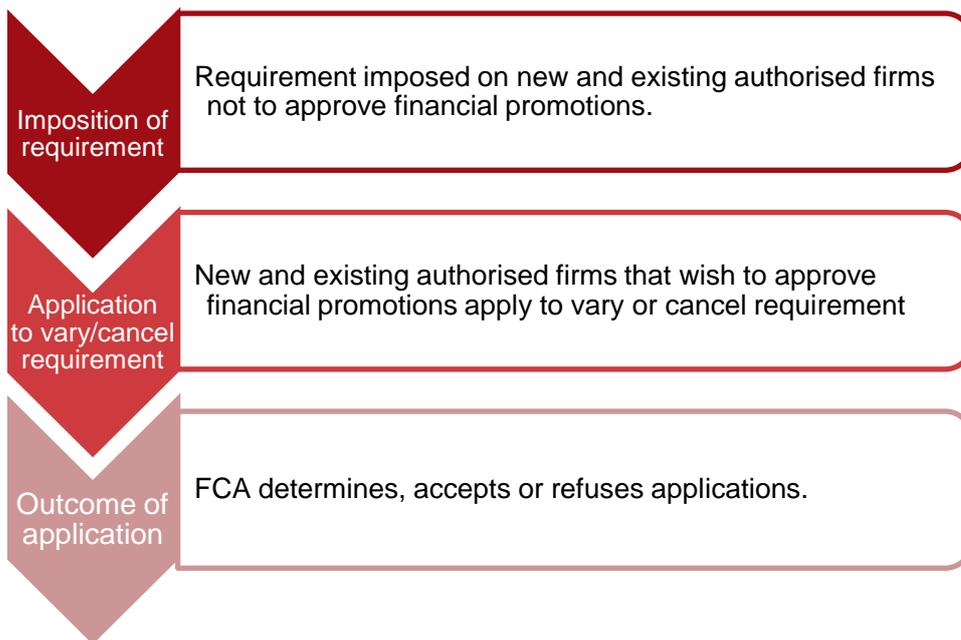
- 3.1 The government agrees with the majority view that **a gateway should be introduced for the approval of financial promotions of unauthorised persons**, and that this should be implemented through option 1 (detailed in paragraph 1.5 of this document). Under this gateway the ability of an authorised firm to assess a financial promotion will be specifically assessed against the FCA's objectives. The government considers this approach will achieve the desired objective of strengthening the FCA's supervision of firms approving the promotions of unauthorised persons whilst maintaining the existing distinction between regulated activities and financial promotions as set out in FSMA. This chapter details how this gateway will work in practice, including the application process for new and existing firms, the proposed transition period, and the legislative changes required.
- 3.2 The government believes that the proposals set out in this chapter address the concerns raised by those respondents that did not support a gateway (set out in more detail in paragraph 2.6). The government has worked to ensure that the structure of the proposed gateway is proportionate and addresses concerns about the additional administrative burden on firms. The government has also developed proposals to implement a transitional period allowing an orderly transition between the two regimes. The chapter also sets out how the gateway will be enforced and will help to improve supervision of the approval of financial promotions.

Structure of the proposed gateway

- 3.3 All new and existing authorised firms will be prohibited from approving the financial promotions of unauthorised persons. This will be implemented through the imposition of a requirement on their permission – the Financial Promotion Requirement.
- 3.4 Both new and existing authorised firms that wish to approve financial promotions will have to apply to the FCA to have the prohibition removed either entirely (allowing them to approve all types of financial promotions), or partially (allowing them to approve certain types of financial promotions). Firms will do this using what is known as a variation of requirement (VREQ) application to the FCA. The FCA will determine, and accept or refuse, such an application under powers in Part 4A FSMA. The FCA will be able to refuse an application if this is deemed necessary in order to advance its operational objectives.

- 3.5 Permissions to approve financial promotions could be limited to a specific type or types of products or services dependent on the firm’s expertise. The proposed gateway is not intended to require the FCA to grant permission on a promotion by promotion basis. This approach should reduce the additional administrative burden on firms addressing some of the concerns raised by industry in paragraph 2.6. We also believe this proportionate approach will reduce the risk of an excessive reduction in approver firms.

Chart 3.A: Process for firms



Source: HMT

Subsequent applications to vary requirement

- 3.6 Firms will be able to apply to the FCA at any point for their requirements to be varied further (either to increase the scope of their permission to approve financial promotions, or to reduce it). These applications will be made as VREQ applications and the FCA will determine and make or refuse those applications under section 55L(5) FSMA.

Transitional period

- 3.7 The proposals set out in this consultation are important as they will strengthen the financial promotions regime, providing the benefits set out in paragraph 1.5. However, the government is also aware that this will be a significant change for firms that approve financial promotions, and that some firms may no longer wish to continue this activity as a result. Therefore, the government is committed to implementing a transitional period for this change. It will also allow time for the FCA to determine applications for firms that do wish to carry on under the new regime.
- 3.8 The transitional period will have three distinct phases as set out in Chart 1.C. First, before the transitional period commences, there will be an application

window, in which firms that wish to continue to approve financial promotions in the new regime will apply to do so. All existing firms can continue to approve financial promotions during this window.

- 3.9 Second, once the transitional period has begun existing firms that have applied to the FCA to be able to approve financial promotions by the end of the application window will be able to continue approving financial promotions during the transitional period until such time as their application is decided. Firms that have not made such an application will not be able to approve financial promotions during the transitional period. Applications by existing authorised firms to approve financial promotions under the new regime will be assessed during the transitional period.
- 3.10 Lastly, at the end of the transitional period, the new regime will commence and only those firms that have successfully applied to have the Financial Promotion Requirement cancelled or varied will be able to approve financial promotions.
- 3.11 This transitional period is designed to mitigate any disruption to the market for approving financial promotions that could result from the sudden introduction of a gateway. Several respondents highlighted the importance a transitional period (these comments are set out in paragraph 2.6 and 2.10). A transitional period should also address some of industry's concerns about implementation risks raised in paragraph 2.6.
- 3.12 Unauthorised persons will remain able to communicate any financial promotion that was approved prior to the implementation of this gateway provided the promotion remains unchanged and continues to comply with FCA rules.

Chart 3.B: Transitional period



Source: HMT

FCA Register

- 3.13 Under section 347 of FSMA the FCA is required to maintain a Register of every authorised person. The register must include such information as the FCA considers appropriate. The FCA will consider, what implications the new

regime has for the information which it includes on the Financial Services Register.

Proposed changes to legislation

- 3.14 Section 55L of FSMA sets out that the FCA may impose requirements both on persons applying for Part 4A permission as well as on authorised firms. The existing regime anticipates requirements being applied by the FCA individually, on a firm-by-firm basis. Therefore, changes to legislation will have to be made to enable the imposition of a blanket requirement on all firms (both existing and newly authorised) prohibiting the approval of financial promotions of unauthorised persons. As this requirement will at first be imposed equally on all firms, the usual procedures that the FCA is required to follow when imposing requirements on applicants and firms will be disapplied.
- 3.15 In order to implement the preferred option, the government will amend section 21(2)(b) of FSMA to remove the general ability to communicate financial promotions which have been approved by authorised firms. This will have the effect that unauthorised persons are only able to communicate their own financial promotions if these have been approved by an authorised firm which has had the requirement on it not to approve financial promotions varied or cancelled.
- 3.16 The government will also make changes to FSMA to allow firms undergoing an authorisation application to apply to have the Financial Promotion Requirement varied or cancelled as part of the application process. The FCA would also be empowered to determine such requests to vary or cancel the Financial Promotion Requirement as part of the authorisation process. This is to ensure that applicants can have certainty about their ability to approve financial promotions for unauthorised persons from the point of authorisation. The government will ensure that these changes will provide applicants for authorisation with the usual procedural safeguards where the FCA refuses an application to approve the financial promotions of unauthorised persons.

Supervision and enforcement of gateway

- 3.17 Any authorised firm that approves a financial promotion in breach of the Financial Promotion Requirement will be breaching a requirement on their Part 4A permission. The FCA would be able to take enforcement action against such a breach using its powers under Part XIV of FSMA such as publishing a statement of censure, imposing a financial penalty, and suspending permission to carry on regulated activities.
- 3.18 The proposed amendments to section 21 of FSMA will mean that an unauthorised person communicating a financial promotion which had not been approved by an authorised firm or was approved in breach of a requirement would be committing a criminal offence. Further, if section 21

has been breached then any agreement entered into as a result of the unlawful promotion may be unenforceable.

- 3.19 This gateway will ensure that the FCA has a record of which authorised firms are approving financial promotions. This will make it easier for the FCA to proactively supervise this activity. Consumers should continue to alert the FCA if they encounter a promotion they feel is unfair, unclear or misleading. The government believes that the clear penalties for firms that breach the gateway, and the record the FCA will have of which authorised firms are approving financial promotions addresses concerns from respondents (set out in paragraph 2.6) about the effectiveness of the solution and risks to implementation.
- 3.20 As set out in the original consultation, consumers who invest in a product issued by an unauthorised person on the basis of a financial promotion communicated by that person would not be covered by the Financial Services Compensation Scheme (FSCS). 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 default 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 protected regulated activities carried on by participant firms (i.e. authorised firms and appointed representatives) or their successors which are in default.

Exemptions

- 3.21 The government set out in its original consultation that it does not intend the new gateway to apply to 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.
- 3.22 The decision to exempt firms approving the financial promotions of an unauthorised person within the same group recognises the realities of intra group business and the way in which those businesses are interconnected. The decision to exempt the approval of authorised firms’ own promotions for communication by unauthorised persons reflects the fact that authorised firms should have the relevant expertise to approve promotions for their own products. This responds to concerns set out in paragraph 2.6 and paragraph 2.10 on the intra-group exemption.
- 3.23 The consultation did not address how appointed representatives should be treated. Following feedback from the consultation the government has considered the position of appointed representatives. The government proposes to exempt from the gateway principals approving financial promotions for their appointed representatives in relation to regulated activities, for which the principal has agreed to accept responsibility.¹ This reflects the fact that there are also requirements on a principal to have

¹ For instance, SUP 12.4.2 R

sufficient expertise and experience to oversee the regulated activities for which the firm has accepted responsibility. This exemption would mirror the scope of the exemption set out in Article 16 (2) of the Financial Promotion Order. Separately, the FCA issued a call for input in September 2020 in the Consumer Investment market where they were seeking views on how the appointed representatives regime is working in practice in the investment sector, and the Government will continue to work with the FCA on developing a better understanding of the effectiveness of the current appointed representatives regime and any future reforms.

- 3.24 The government has also considered, and decided against, grandfathering-in permissions for sectors that approve financial promotions as part of their core business model and which may have provided information on that activity to the FCA as part of previous authorisation applications. This follows suggestions outlined in paragraph 2.10. The proposed gateway creates a specific assessment of the act of approving financial promotions against the FCA's objectives that has not been expressly required as part of the authorisation of any firm. Therefore, it will be beneficial for all existing firms to pass through the gateway. Including a transitional period for the proposed gateway should mitigate any disruption for firms that are approving financial promotions at this point in time and wish to continue doing so following the introduction of the gateway.

Analysis of benefits

- 3.25 The government believes option 1 will successfully achieve the objectives set out in the original consultation. As a result of the gateway the FCA will be able to specifically assess the suitability of authorised firms to approve financial promotions before they are able to undertake such activity. The FCA will therefore have a more comprehensive view of which firms are approving financial promotions, which will enable more effective supervision of such activity.
- 3.26 Implementing the gateway in the proposed way (through the imposition of requirements) preserves the current distinction within FSMA between regulated activities, and financial promotions. The government considers that this better reflects the nature of financial promotion approval as an activity an authorised person is able to do, but which falls short of a regulated activity.
- 3.27 Preserving this distinction brings with it certain additional benefits:
- It ensures consistency of treatment across promotions *made* by authorised firms and *approved* by authorised firms
 - It reduces potential confusion about regulatory protections associated with financial promotions
 - It reduces the potential disruption to the market of approver firms by providing a less onerous approval process for this activity.

Chapter 4

Next Steps

- 4.1 There are two steps that the government and the FCA will take to put in place the regulatory framework for this gateway:
- legislation: the government intends to bring forward legislation when parliamentary time allows
 - FCA rules: the FCA will consult on its proposals for implementing the gateway in due course. The FCA will announce its final rules once it has fully considered the responses to its consultation.

Annex A

List of respondents

A.1 There were also 2 responses on behalf of individuals (one of which on behalf of four individuals), and one response from a university professor,

- Association of British Insurers
- Association of Financial Mutuals
- Association of Investment Companies
- The Association of Mortgage Intermediaries
- AXA UK
- The City of London Law Society Regulatory Law Committee
- CryptoUK
- Enterprise Investment Scheme Association Regulatory Committee
- Financial Services Consumer Panel
- Nationwide
- NatWest Group plc
- Nyman Libson Paul LLP
- Personal Investment Management & Finance Advice Association (PIMFA)
- Prosper Capital LLP
- Starmark Investment Management Limited
- Transparency Taskforce
- Triodos Bank
- UK Crowdfunding Association
- UK Shareholders Association
- Which
- XReg Consulting

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