Changes to the UK Financial Promotion Rules For High-Risk Investments – What Are They?

*Next week, the UK's financial regulator (the "**FCA**") will usher in the first wave of promised changes[1] to the current FCA rules governing financial promotion to retail consumers, effective immediately. The remaining rule changes will follow early next year (in February). We've broken down what those changes are, what they practically mean for the different groups which they affect, and what else we think is worth bearing in mind.*

Background

Following almost eighteen months of consultation and discussion with individual investors, industry experts, and product providers, the FCA confirmed in August the final set of changes which it intends to make to the current regime for those financial promotions which are targeted at the consumer investment market.

The regulator is concerned that, owing largely to a rapid rise in the use of digital marketing by product providers, platforms and fundraising companies combined with

[1] *"Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions", FCA Policy Statement PS22/10, August 2022 ("**PS22/10**")*

a period of historically low interest rates followed by now rising inflation, consumers are being led into higher risk investments which do not necessarily correlate to their individual appetite for risk. Risk warnings such as the ubiquitous 'capital at risk' have long lost their meaning and have simply become "wallpaper" for viewers of financial promotions, while investor journeys from first sight of an initial promotion (e.g., on social media or billboard advertising) through to the investor completing an application form to invest (known as a 'direct offer financial promotion') have in many cases become 'tick-box' exercises. The conclusion has been that existing rules consequently require strengthening to better protect consumers.

FCA guidance and rules only apply to FCA-authorised firms. They do not apply to unauthorised firms or individuals (i.e., any company or person which does not need to be regulated) and this is worth keeping in mind. FSMA[2] (and the statutory instruments made under it such as the Financial Promotion Order[3]) which *does* apply to everyone is not changing for the moment. However, it is expected to change very soon following separate consultations held by HM Treasury on the need to: in-scope cryptoasset promotions within the legislation[4] (somewhat urgent given recent events), update the current criteria for what constitutes a 'high-net worth individual' and 'sophisticated investor'[5] (as some of the metrics are widely considered to be outdated), and introduce a statutory gateway for authorised firms wishing to approve the promotions of others[6] (at the moment any authorised firm can approve a third-party promotion).

We will cover each of those upcoming statutory changes as and when they are properly announced (expected sometime next year) but for now let's distil the FCA's new rules.

The proposed changes – a whistlestop tour

There are several changes to the current FCA guidance and rules, which can broadly be broken down into three sub-sets:

(a) new categorisation of high-risk investments,

(b) enhanced risk warnings, a ban on incentives to invest, and greater friction imposed on the investor journey, and

2 The Financial Services and Markets Act 2000

3 The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

4 *"Cryptoasset promotions: Consultation response", HM Treasury, January 2022*

5 *"Financial promotion exemptions for high net worth individuals and sophisticated investors" a consultation, HM Treasury, December 2021*

6 *"Regulatory framework for approval of financial promotions: Consultation response", HM Treasury, June 2021*

(c) increased initial and ongoing responsibility for approvers of financial promotions.

Only the enhanced risk warnings will be mandatory from 1 December 2022, with all other changes effective (or required to be implemented as the case may be) by 1 February 2023. We've summarised the categorisation changes first however as its more intuitive to think of the other changes under the banner of the new terminology.

High-risk investment categorisation

Three overarching new categories are now going to sit above existing product types as part of a "rationalisation" of terminology by the FCA, with product types which have similar characteristics grouped below these three new categories such that they are treated the same way when it comes to applicable restrictions (from no restrictions through to heavy restrictions). The new terminology and recast groupings are as shown below:

*Categorisation of qualifying cryptoassets as proposed in CP22/2. Final categorisation is subject to parliamentary approval of the relevant statutory instrument and to our final rules for cryptoassets.

Shares in private companies (*non-readily realisable securities* ("**NRRS**") for FCA purposes) will be a form of *restricted mass market investment* ("**RMMI**") along with P2P agreements (and in due course, crypto) and any promotion to the general public

will continue to be restricted but on a more 'beefed up' basis (see below). This will affect crowdfunding platforms for example.

Units in a true collective investment scheme (such as a venture capital or private equity fund) which already constitute *non-mainstream pooled investments* ("**NMPI**"), and mini-bonds which fit the criteria for a *speculative illiquid security* will remain banned from promotion to the general public on account of them both now being categorised as *non-mass market investments* ("**NMMI**").

Units in an S/EIS fund, which you might think should also fall within the NMPI bracket and so be banned from mass promotion, can however continue to benefit from a specific statutory exemption[7] from being classed as a NMPI, and consequently remain *non-readily realisable securities* and thus a form of RMMI (the same as promotions of S/EIS shares). Confusing? It is! Accordingly, EIS funds which are structured in the right way can continue to be promoted to ordinary retail investors so long as their promotion is compliant with the new rules specific to risk warnings and the investor journey (see below).

Venture capital trusts (being premium-listed investment funds) will be exempt for now from the additional restrictions applicable to RMMI and NMMI on account of falling within the first (unrestricted) category of *readily realisable securities* – even though VCT shares are somewhat illiquid in nature given the unavailability of upfront tax relief on any secondary purchases. However, the FCA has suggested that it will review this position in "*the second phase of our work intended for next year*", which raises the spectre of VCTs perhaps being part of the high-risk investment world in the future (although likely on the relaxed end).

Enhanced risk warnings

Effective from the end of next week, any existing or newly published promotion which relates to either a RMMI or a NMMI must prominently display a risk warning in the following prescribed format:

> Don't invest unless you're prepared to lose all the money you invest. This is a high-risk investment and you are unlikely to be protected if something goes wrong. Take 2mins to learn more.

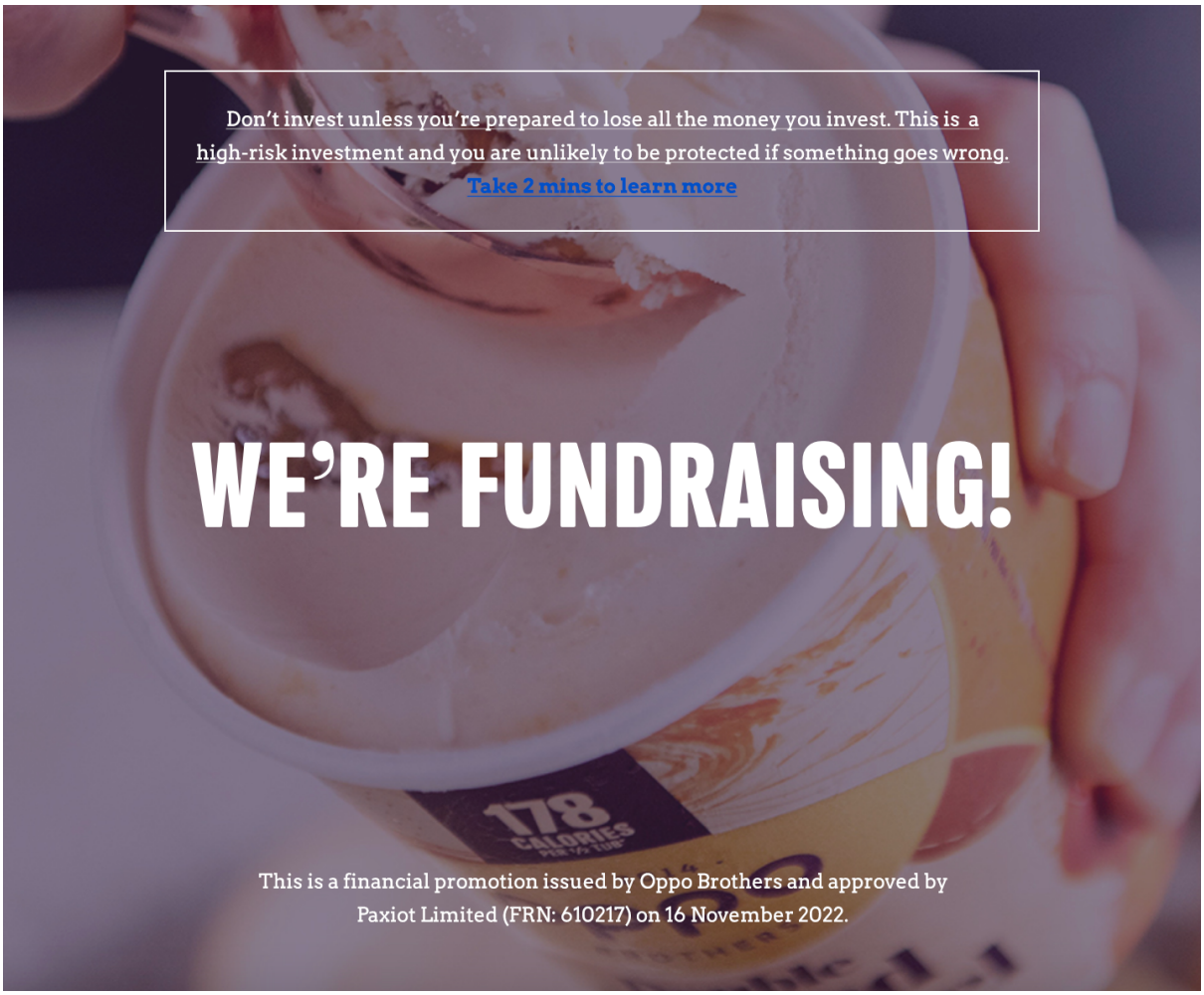
For character-limited platforms (such as Twitter), a truncated form of the above may be used ("*Don't invest unless you're prepared to lose all the money you invest*"). Alternate versions of the standardised risk warning are allowable for P2P agreements,

[7] Article 2, FSMA 2000, (Promotion of Collective Investment Schemes) (Exemptions) Order 2001

or where protection via the Financial Services Compensation Scheme may indeed be available.

The "Take 2mins to learn more" text should be hyperlinked text which (when clicked by the viewer) either triggers a centralised pop-up box or leads to a separate webpage, in each case containing a 'Risk Summary'. The 'Risk Summary' is a longer set of risk warnings, also in a prescribed format[8], save for instances when some of the wording may not be relevant or right for the investment in question (in which case firms will be allowed to tailor the risk summary to their offering).

Finally the existing rules on the 'prominence' of risk warnings have been bolstered, with both warnings and risk summaries expected to be prominent, contained in their own border and, where the promotion is displayed on a website or mobile device, statically fixed at the top of the screen above all content save for any banner which links to other pages on the site (and remaining fixed even when the viewer scrolls up/down the page).



[8] See PS22/10 for a copy of the prescribed wording.

Ban on incentives to invest

The FCA was concerned that the use of incentives and inducements by product providers, platforms, and fundraising companies to attract increased consumer interest in their investment opportunities was creating "*powerful social and emotional pressures*" on consumers and (in respect of 'refer-a-friend' inducements) often causing consumers to *take undue comfort from a friend or family member's referral*. Incentives such as 'refer-a-friend' or new joiner bonuses (e.g., free gifts or investment discounts) are to therefore be banned under the new rules, which in effect means authorised firms are not allowed to approve financial promotions for any high-risk investment which contain an investment incentive.

'Shareholder benefits' for example discounted products or services produced or provided by the product provider or fundraising company will however be exempted from the ban. The FCA gives the example of a brewing company which raises funds through crowdfunding being permitted to offer discounts to investors on the beer which it produces (as a 'real economy' good). How this exemption plays out in practice, particularly through the conduit of the crowdfunding platforms (where shareholder benefits are regularly promoted) will be interesting to monitor.

Where do early bird discounts and loyalty discounts offered to an IFA (the benefit of which may then be passed on to the advised investors) fall? The position for now is less black and white, and we would recommend any product provider for whom this may be relevant for to seek advice as to their own arrangements as for now the rules are not clear on a 'one-size-fits-all' basis in this respect.

Investor journey (RMMIs only)

If you have ever previously bought shares through a crowdfunding platform or invested in a S/EIS fund by completing an application form attached to the information memorandum then you have more than likely been on the receiving end of what is known as a *direct offer financial promotion* (a "**DOFP**"). A special category of financial promotion for which additional restrictions already apply. The most debated of the new restrictions to be implemented are those which will now join the current additional restrictions applying to DOFPs.

A DOFP is a type of financial promotion which is made accessible to an ordinary retail investor (i.e., not just HNWI or sophisticated retail investors), which relates to an NRRS (such as unlisted shares) and contains an offer to enter into a controlled agreement by including an application form by which the response can be made. Essentially anything that promotes an investment and contains a mechanism which enables the consumer to place their money in that investment is likely to constitute a DOFP.

Unless an investor has already been vetted as suitable for the investment in question (e.g., by their appointed IFA), then he or she may only view the DOFP once a certification stage has been completed (with the investor certifying either as a HNWI, sophisticated or 'restricted' investor (being someone who can declare that they are investing less than 10% of their net assets annually in NRRS)), and then successfully completing an appropriateness assessment (usually a 'quiz' format checking basic investment aptitude).

Those are the existing hurdles.

The new gateway/onboarding process will involve first a (minimum) 24-hour cooling-off period between first interaction with a prospective investor (e.g. via a standard financial promotion) and the prospective investor being permitted to agree to continue the investment journey, followed by a *personalised* risk warning, then followed by the same certification stage (but with certificates updated to reflect the new RMMI terminology), and finally an appropriateness assessment which has been taken up a notch in terms of difficulty (no binary questions, no guidance allowed, second-time test takers to be presented with new questions, further cooling off periods after failed tests etc.).

Firms approving DOFPs will also be required to keep a record of the metrics related to investor certification and the appropriateness assessment as part of new monitoring obligations (see below).

It's fair to say that market feedback to these particular changes were overall net negative (particularly as to the imposition of the cooling-off period which comes with not insignificant considerations as to web design, the allocation of responsibility between IFAs (where used) and product providers etc.), but the FCA has stood firm.

We would recommend that product providers who use DOFPs as a means of selling investments to retail consumers to already be actively looking at how to implement these changes across their existing marketing and sales flows so as to avoid any interruption of service come February next year (when a full implementation is required).

Increased responsibility for approvers of financial promotions

Finally, there are several new responsibilities imposed on those firms who approve the financial promotions of others. These measures have been designed to: assist consumers to identify the approver when viewing an approved promotion (i.e., approver accountability), prevent a 'once and done' approval approach taken by

some approvers, and to ensure that each approving firm has sufficient competence and expertise in the nature of the relevant investment product or service being promoted by their client.

As regards accountability, where character space is not limited any approved promotion should now display the full name of the approving firm, their FCA number and the date stamp on which approval was given. For character limited media, "*Approver FRN xxxxx*" is permitted (i.e., just the FCA number of the approving firm) so long as the text hyperlinks to a pop-up box or webpage which does contain the firm's full name and date of approval.

As to ongoing monitoring, the FCA will now require approving firms to take reasonable steps to consider whether there have been any changes which may affect whether a live promotion approved by them remains a clear, fair and not misleading promotion, as well as check the ongoing commercial viability of the proposition described in the promotion. Approvers will now be required to obtain attestations of 'no material change' in respect of their clients' approved promotions every three months and withdraw an approval where necessary as soon as reasonably practicable.

Competence and expertise to approve each promotion should be undertaken on a 'self-assessment' basis by firms, although it is clear that the sum of these responsibility measures imposed by the FCA are a prelude to the statutory gateway to be imposed for approvers of financial promotions by HM Treasury in the near future. Firms that can demonstrate several months of good systems and processes in their approval and monitoring of promotions are no doubt more likely to be permitted by the FCA to continue approving third-party promotions when the time comes for firms to apply to be able to continue doing so[9].

Again, some of the market feedback was unsupportive of some of these new responsibility measures, largely on account of the cost and time burden that will inevitably be involved. The FCA have responded that they consider that the benefits derived from these measures outweigh the costs, and that firms might consider passing on some (or all) of these additional costs to the clients for whom they approve promotions.

In summary

The breadth of the incoming changes is certainly far-reaching, with those who routinely use DOFPs as part of their investment flow (crowdfunding platforms, intermediaries, and fund managers) perhaps most affected from a process implementation standpoint, while authorised firms wishing to continue approving the

[9] *"Regulatory framework for approval of financial promotions: Consultation response", HM Treasury, June 2021*

promotions of others have plenty to consider as regards their internal approval arrangements being fit for purpose by next February.

The FCA has stated that compliance with the new set of financial promotion rules should be considered the minimum standard expected of those who operate within the consumer investment market and that firms should also be live to the incoming Consumer Duty (effective from July of next year and summarised here), a principles-based duty to be placed on firms which will require firms to focus on achieving good outcomes for their consumer base and in doing so be mindful of their investment needs.

For those that operate outside of the FCA rules (e.g., angel syndicates communicating opportunities to HNWIs and sophisticated investors in reliance of the relevant statutory exemptions) the future legislative changes to the definitions of 'HNWI' and 'sophisticated' will likely be of more relevance to the operation of their business. Finally, it's worth also mentioning that any fundraising company which decides to raise capital from retail consumers by taking advantage of an FCA-prospectus approach will continue to circumvent the (now much tougher) DOFP rules so long as all other supplementary promotions direct viewers to read the prospectus.

If you would like to discuss any aspect of the incoming changes as they relate to your business, please feel free to reach out to either Ollie Blears or Frank Daly. This note does not constitute legal advice and should not be relied upon on that basis.

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