

Financial Promotion: A Reference Guide to the Prohibition and Useful Exemptions

The General Prohibition

No person must, in the course of business, communicate an invitation to engage in investment activity, unless the contents of the communication have been approved by an authorised person or the communication is otherwise exempt. The restriction is defined widely to cover pretty much any activity in respect of investments - guidance on how to interpret the prohibition and phrases used in the main exemptions is set out in the Glossary.

The general prohibition is set out in section 21 of the Financial Services and Markets Act 2000 (**FSMA**), but the details of exemptions from this restriction are contained in secondary legislation – mainly The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (**FPO**). There are over 65 exemptions: this guide focuses on the main useful categories.

Any person in breach of the general prohibition is committing a criminal offence and may be liable to a fine, up to two years' imprisonment or both.

Agreements entered into as a result of an unlawful financial promotion are potentially unenforceable and the person engaging in investment activity may be entitled to recover any money paid under the agreement and compensation for any loss. In addition, a communication of misleading or inaccurate financial promotion could result in a claim for misrepresentation, criminal liability under insider dealing legislation and/or civil liability under the market abuse regime.

Scope

Essentially, the financial promotion regime applies to all communications made to recipients in the UK and to all communications originating outside the UK if they are capable of having an effect in the UK. However, in certain cases EU legislation may affect how this general rule is applied. For example, communications made to investors in the UK about potential business under MiFID from a company based outside the UK will be regulated by that company's home Member State and the UK financial promotion regime will not apply.

Indeed, it is entirely possible that a number of EU directives could apply to one particular financial promotion; in such circumstances, the person making the communication would be well

advised to consider carefully how such communication might be regulated.

Application of the Exemptions

The financial promotion regime applies to both written and oral communications, but a distinction is made in many exemptions between real time and non-real time communications, and solicited and non-solicited real time communications (see Glossary).

The general rule is that a greater number of exemptions apply to non-real time communications or solicited real time communications on the basis that recipients are felt to need greater protection in circumstances where they are being asked to react immediately or in "cold-calling" situations (which, except in very limited cases, cannot even be approved by authorised persons).

Exemptions can be combined in respect of different recipients, except where the relevant exemption specifically prevents this. A disclaimer to the effect that the communication is only being sent to a certain class of recipient falling into one of the exemptions (and a statement that anyone not falling into exemption should return the document) may go some way to show compliance with the FPO provided that the communication is "directed at" the group rather than "made to" a particular person (see the Glossary for the distinction).

In fact, for certain exemptions to apply, specific disclaimers **must** be added to the document.

One-off Communications

There is an exemption for "one-off" non-real time communications or solicited real time communications which are made to (rather than directed at) recipients. The communication will fall into the exemption provided it is tailored and individual in nature (counter-intuitively, it does not necessarily have to be an isolated event) and should not form part of an overall organised marketing campaign.

Examples include responses given to reader enquiries, questions raised in a website forum or individual one-to-one conversations.

In addition, a further exemption applies to "one-off" unsolicited real time communications. The same test as above applies, but in addition the communicator must reasonably believe that the

recipient understands the risks involved and expects to receive the communication. This stretches the meaning of “unsolicited” somewhat and begs the questions of how the communicator can sensibly believe that the recipient expects to receive the communication whilst at the same time it remains unsolicited.

Certified High Net Worth Individuals and Self-Certified Sophisticated Investors

Non-real time or solicited real time communications are exempt if made to an individual whom the communicator reasonably believes to be a certified high net worth individual or a self-certified sophisticated investor.

However, this only applies if:

- the individual has signed an appropriate statement (see below) within the period of 12 months **prior to** receiving the communication;
- the communication contains appropriate risk warnings (or such warnings are given orally at the beginning of the communication); and
- the communication is accompanied by statements that it is exempt on the grounds that it is made to certified high net worth individuals or self-certified sophisticated investors, that set out the relevant qualifications and that anyone in doubt about the investment should consult an authorised person.

In addition, the communication must only relate to investments in unlisted companies.

Amongst other things, the appropriate statement for high net worth individuals must include acknowledgements that:

- the individual understands that by signing the statement he may lose significant rights;
- he is a high net worth individual because he has had for the preceding financial year either an annual income of at least £100,000, or net assets to the value of at least £250,000 (except primary residence, life assurance policies and pension); and
- he accepts that he can lose his property and other assets from making investment decisions based on financial promotions.

Similarly, the statement given by a self-certified sophisticated investor must include acknowledgements to the effect that:

- the individual understands that by signing the statement he may lose significant rights;

- he is a self-certified sophisticated investor because: (i) he is a member of a network or syndicate of business angels and has been for six months before the date of the statement; (ii) he has made more than one investment in an unlisted company in the two years before the date of the statement; (iii) he is working or has worked in the two years before the date of the statement in a professional capacity in the private equity sector or in the provision or finance for small and medium enterprises; or (iv) he is currently or has been in the two years before the date of the statement, a director of a company with an annual turnover of at least £1 million; and
- he accepts that he can lose his property and other assets from making investment decisions based on financial promotions.

In order for the exemption to apply, the communicator must comply with the strict provisions of the FPO as to the nature of the risk warning. On written documents, such warning must be given at the beginning of the document in front of any other written or pictorial matter, be in a font size consistent with the rest of the text, be indelible, legible, printed in black bold type, surrounded by a black border and not be hidden or obscured by any other information.

In terms of the reasonable belief required by the communicator, it would appear from HM Treasury guidance that confirmation (including an oral confirmation) from a potential investor that he has a high net worth or self-certified sophisticated investor statement would probably be sufficient.

Mere Conduits

This exemption applies to passive communications providers such as postal services or telecommunication companies. A real time communication (whether solicited or unsolicited) is exempt if the communicator makes it in the course of his activity, the principal purpose of which is receiving and transmitting materials provided to him by others. It will only apply if the content of the communication is wholly devised by a third party and the communicator does not modify or control the content in any way.

Members and Creditors of Certain Bodies Corporate

Non-real time and solicited real time communications made by a company to people it reasonably believes to be its creditors or shareholder are exempt. This is a very useful

exemption – without it communications by a company to its shareholders would otherwise fall foul of the financial promotion prohibition.

Participation in Employee Share Schemes

There is an exemption for communications relating to existing or proposed bona fide share schemes for the benefit of employees or former employees (and their families) where the communicator is the employer (or a group company of the employer). This applies to both unsolicited or solicited real time and non-real time communications but only in respect (essentially) of shares, bonds, warrants and options.

Sale of a Body Corporate

Unsolicited or solicited real time or non-real time communications by or on behalf of a corporate body, partnership or individual (or group of connected individuals) are exempt if the communication relates to a transaction to buy or sell shares which:

- following the transaction would give the buyer 50% or more of the voting rights; and

- each of the buyer and seller is a corporate body, partnership, individual or group of connected individuals.

FSA guidance suggests that even if it does not meet the above criteria, the exemption could still apply if it relates to a transaction entered into for the purposes of a share acquisition or disposal and day-to-day control of the company is transferred. The FSA acknowledges that this could equate to the sale of a minority holding if “the remaining shareholders represent a large number of small shareholders who it is reasonable to suppose will not regularly act in concert”.

HM Treasury has recognised that, if read literally, the exemption could apply to public takeovers (which is clearly not the intention). Despite some criticism from commentators, there does not appear to be any clear intention to amend this exemption, although this may be one of the points covered by the proposed 2008-09 review.