**Financial promotion**

This element outlines the regulation of financial promotion and marketing surrounding a primary or secondary issue.

**Introduction**

As we have seen, the prospectuses must be specifically approved by the FCA before publication. A large number of other documents and/or statements made in connection with any primary or secondary issue are also subject to regulatory rules.

**Legislation**

**Section 21 FSMA**

Section 21 FSMA contains a general prohibition on all types of financial promotion and marketing of investment activity (e.g. adverts, cold-calling, web sites and general advertising). This regime aims to regulate all forms of communication and includes comprehensive control over the use of internet communications in this context.

Section 21(1)

*‘A person (“A”) must not, in the course of business, communicate an invitation or inducement (a) to engage in investment activity or (b) engage in claims management activity.’*

Section 21(2)

‘…subsection (1) does not apply if:

a)A is an authorised person; or

b) the content of the communication is approved for the purposes of this section by an authorised person

(2A)The content of a communication may be approved for the purposes of this section by an authorised person only if the giving of the approval—

(a) is permitted under section 55NA (which enables approval to be given with FCA permission), or

(b) falls within an exemption conferred by regulations under section 55NB.

Section 21 (2A) introduced a “gateway” (effectively, an additional level of FCA authorisation) through which an authorised person must pass in order to be able to approve financial promotions.

Section 21(1) will also not apply if the promotion falls under any of the exemptions set out in the FSMA 2000 (Financial Promotion) Order 2005 (the “FPO”) pursuant to s. 21(5) FSMA.

Examples of these exemptions are considered later in this element.

**Scope**

The s. 21 prohibition applies (generally) both to:

Communications originating inside the UK including those made only to persons outside the UK (this will include global offerings); and

Communications originating outside the UK that are capable of having an effect in the UK - this will include internet communications from outside the UK but which are transmitted into the UK.

**Interpretation of key terms**

**Key words:**

‘**A person … in the course of business**’ is widely construed and simply requires a 'commercial interest' (eg a company making communications to its employees in relation to its share schemes).

‘**Communication**' includes 'causing’ a communication to be made (e.g. a person pays someone else to make a communication) so authors, publishers and distributors will need to comply with this provision as they are classed as 'communicators'. All forms of communication are included (e.g. telephone calls, correspondence, meetings, presentations, websites, advertising, TV or radio broadcasts).

**‘Invitation’ and ‘inducement’:** not specifically defined but carry their ordinary dictionary meanings. The FCA considers that an objective test should be applied to whether a communication is an invitation or inducement: in all of the circumstances, would a reasonable observer: a) consider that the communicator intended to persuade or incite; and b) regard the communication as seeking to persuade or incite, the recipient to engage in investment activity.

**‘Invitation**' is a communication which directly invites someone to take steps which will result in them engaging in investment activity and includes an invitation to treat. For example, a communication inviting someone to enter into an investment agreement (i.e. to buy shares) would be an invitation for the purposes of s 21 FSMA. Therefore, a prospectus with an application form would constitute an 'invitation'.

**‘Inducement**' is not clearly defined, although the FCA guidance goes some way to clarifying what that term covers. The FCA considers that, in interpreting whether a communication is an invitation or an inducement, account should be taken of the context in which the communication is made and what a reasonable person would consider to be its purpose. Therefore, viewed objectively, the communication must contain an element of 'persuasion or incitement' intended to lead, ultimately, to an agreement to engage in investment activity in order for it to be an 'invitation or inducement’.

In practice, an invitation is generally straightforward to identify; an inducement can be more tricky. Further guidance is provided by the FCA’s PERG sourcebook (see later in this element).

**FCA Guidance**

The FCA has published guidance on s 21 FSMA found in chapter 8 of the Perimeter Guidance manual (‘PERG’) (part of the FCA Handbook). The PERG sets out the scope of the restriction on financial promotion, the main exemptions provided and the circumstances in which persons involved in making or helping others to make financial promotions may themselves be conducting regulated activities which may require authorisation or exemption.

The guidance is of persuasive effect only and does not bind the courts but it is likely a court would have regard to it in deciding whether s 21 FSMA had been breached.

To ensure full and comprehensive advice is given, solicitors should always consult the PERG and any updates on the FCA website.

**Exemptions**

There are over 60 exemptions from the restriction contained in s 21 FSMA. These are set out in the FPO.

When drafting certain of the exemptions, the FCA has drawn a distinction between the following forms of communication:

**Real time communications** – e.g. personal visits, telephone conversations and other interactive dialogue.

**Non-real time communications** – e.g. letters, e-mails, websites, TV broadcasts.

**Solicited real time** - where a personal visit, telephone conversation or other interactive dialogue is initiated by, or in response to, an express request from the person receiving the communication.

**Unsolicited real time** - a real time communication which is not solicited. This is considered to be the most highly pressurised form of communication for the recipient.

Key exemptions for the purposes of equity finance are addressed in the following pages.

**Key exemptions -** **Communications made to persons sufficiently expert to understand the risks involved**

All forms of communication to persons who are sufficiently expert to understand the risks involved ie professional or business investors, those who are in the business of disseminating information and high net worth entities are exempt. These exemptions assume that certain recipients are sufficiently expert to understand the risks involved with investments and therefore do not need additional statutory protection.

For example, professional or business investors will be included in this category (Article 19), the financial press (Article 47) and high net worth companies (Article 49). The FCA believes this type of person does not need additional statutory protection.

**Key exemptions –** **Communication with members and creditors of certain bodies corporate**

Non-real time and solicited real time communications made by (or on behalf of) a company to its members or creditors (or the members or creditors of one of its group companies) may be exempt provided the communication relates only to certain types of investments (including shares) issued or to be issued by the company or the group company (Article 43).

**Key exemptions -** **Certified High Net-Worth Individuals**

Non-real time or solicited real time communication to certified high net worth individuals may be exempt provided certain detailed conditions are satisfied (Article 48). This exemption aims to cover communications between new companies and rich individuals wishing to invest in new enterprises.

**Key exemptions -** **Sophisticated Investors**

All forms of communication to certified sophisticated investors - ie persons who have been certified by an FCA authorised person as being sufficiently knowledgeable to understand the risks of accepting an unapproved communication associated with a particular investment - are exempt, provided the conditions in the Article are complied with (Article 50).

**Key exemptions –** **Sale of a body corporate**

The general rule under Article 62 is that all forms of communication relating to a transaction to acquire or dispose of a controlling interest in the shares of a company (i.e. more than 50% of the voting rights) or to acquire or dispose of shares which, when aggregated with existing shareholdings, take total shareholdings to a level which amounts to a controlling interest are exempt.

If the transaction does not satisfy the above, it will still benefit from this exemption if it is a communication relating to a transaction which is one to acquire or dispose of shares in a company and the object of the transaction may reasonably be regarded as being the acquisition of day-to-day control of the company.

This Article is probably applicable to public takeovers, although note that there is an element of doubt and not all law firms recommend reliance on Article 62 in this context.

The exemption could be useful to the board of a company which wishes to communicate with its own shareholders e.g. in a takeover situation, the board wants to issue a circular to shareholders regarding an offer.

**Key exemptions – Promotions included in Listing Particulars etc.**

Non-real time communications included in an approved prospectus or supplementary prospectus or any other document required or permitted to be published by the PRRs under Part VI of FSMA are exempt (Article 70).

**Penalties**

• Breach of s 21 FSMA is a criminal offence punishable by a maximum of 2 years' imprisonment (six months on summary conviction) or an unlimited fine or both (s 25(1) FSMA).

• Under s 400 FSMA if the “controlling individuals” of any company that has committed an offence have consented or connived in commission of that offence, or the offence is attributable to their neglect, then they can be liable to prosecution themselves.

• An agreement entered into as a result of the communication which contravenes the financial promotion regime may also be unenforceable and the innocent party may be entitled to recover money paid or property transferred under the agreement with compensation for loss (s 30(2) FSMA). Alternatively, s 30(4) FSMA gives the court the discretion to allow agreements concluded as a result of an unlawful communication to be enforced or money or property paid or transferred under the agreement to be retained if this would be just and equitable under the circumstances of the case.

• The remedies for misleading or inaccurate statements we have previously considered (eg s 90 and Part 7 of FS Act) may also apply to the relevant promotion.

**Defences**

It is a defence under s. 25(2) FSMA for a person to show that he/she:

• believes, on reasonable grounds, that the content of the communication was prepared, or approved for the purposes of s.21, by an authorised person; or

• took all reasonable precautions and exercised all due diligence to avoid committing the offence.

**Financial promotion summary**

• The prospectuses must be specifically approved by the FCA before publication. A large number of other documents and/or statements made in connection with any primary or secondary issue are also subject to regulatory rules.

• Section 21 FSMA contains a general prohibition on all types of financial promotion and marketing of investment activity.

• There are many exemptions to this prohibition. These include:

• communication to persons who are sufficiently expert to understand the risks involved;

• communications to members regarding shares issued or to be issued;

• certain communications to certified high net worth individuals;

• communications to sophisticated investors;

• communications relating to a transaction to acquire or dispose of a controlling interest in the shares of a company.

• Contravention of s 21 is a criminal offence punishable by a maximum of 2 years’ imprisonment and/or an unlimited fine.