

Harriett Baldwin MP  
Chair  
Treasury Select Committee  
Sub-Committee on Financial Services Regulations  
House of Commons  
SW1A 0AA

14 April 2023

Our ref: 230322C

Dear Harriett,

**Re: Introducing a gateway for firms who approve financial promotions**

Thank you for your letter of 21 March to our Chief Executive, Nikhil Rathi, in which you ask a number of questions regarding our consultation paper on 'Introducing a gateway for firms who approve financial promotions' (CP22/27). I am replying as the Executive Director responsible for this policy area.

The FCA and the Treasury continue to work together to strengthen the financial promotions regime for high-risk investments, including through the implementation of the new financial promotions gateway, which we welcome. However, we believe steps to strengthen the financial promotions regime will be undermined without significant reform to the Financial Promotions Order (FPO) exemptions relating to high net worth (HNW) and sophisticated investors, which we view as being the weakest part of the regime with limited evidence that such exemptions serve to support the sustainable financing of productive investment in the UK economy.

The exemptions enable unauthorised persons to communicate financial promotions to HNW and sophisticated investors without having to comply with any of our rules, including the most basic requirement that a promotion must be fair, clear, and not misleading. Our experience shows that they are a major enabler of firms mis-selling high-risk investments outside our remit. Their continued presence undermines our efforts to protect consumers, makes it difficult for us to effectively supervise financial promotions and results in significant consumer harm that the FCA is unable to mitigate.

There are different ways we regularly see the FPO exemptions being exploited by unscrupulous actors. Where firms deliberately misuse the exemptions, they may be superficially using the exemptions while marketing to ordinary consumers, or deliberately miscategorising consumers who do not meet the exemption criteria as HNW or sophisticated. We have seen consumers self-certify that they are a sophisticated or high-net worth investor without realising what they are signing or be persuaded using pressure sales tactics and misleading statements that they fall within the definition of the exemptions when in fact they do not. Even when the exemptions are used correctly, we have seen consumer harm from firms using them to issue promotions that would not comply with our rules if they were applicable. Where we have concerns about an investment offering, use of the exemptions limits our ability to act, and firms can readily market high risk products to consumers who may not be able to understand them.

Compared to exemptions in similar jurisdictions (USA, Australia, Canada, New Zealand), the UK's exemptions generally remove more regulatory protections, have weaker verification requirements and have significantly lower HNW thresholds (Annex 1) leaving us as an international outlier in this area of consumer protection. While there are many factors that underpin a jurisdiction's track record on business investment and SME financing, we have not seen evidence to suggest that the UK approach leads to a better or more sustainable outcome with respect to productive investment in the UK economy as compared to these international counterparts.

Our latest Financial Lives data also shows that just 1 in 5 adults holding high-risk investment products that fall under FCA marketing rules could recall being asked if they were a HNW or sophisticated investor the last time they invested; the vast majority either could not recall being asked or did not think they had been asked. Many consumers pass through the self-certification investor statements without appreciating their significance, rendering them a largely ineffective method of consumer protection.

I have set out responses to your specific questions below.

### **1. What assessment has the FCA made of the potential harm caused by these proposals increasing the number of unauthorised firms using high-net-worth individuals (HNWI) and sophisticated investor exemptions to the financial promotions regime?**

We have previously seen a trend of unauthorised firms increasingly using the exemptions to market investments when we have strengthened our financial promotion rules. For example, after our ban on the mass marketing of speculative illiquid securities, the number of websites we proactively monitor that had an authorised firm approve the financial promotion fell from 20% to ~0%<sup>1</sup>. This was as unauthorised firms migrated towards using the exemptions instead of obtaining approval for their promotion from an authorised firm. We are concerned that this trend may be repeated after the financial promotions gateway is implemented. It is reasonable to expect that some firms may decide that the exemptions, which take a promotion completely outside of the FCA's perimeter and rules, provide a more attractive pathway than the robust regulatory requirements of the new financial promotions gateway.

We expect that this could lead to harm from unscrupulous firms issuing promotions to retail consumers that would not be compliant with even our most basic rule that a promotion be fair, clear and not misleading. It may also lead to reduced choice for consumers if firms consider it more worthwhile to only promote within the scope of the FPO exemptions due to the cost of obtaining Section 21 (s21) approval. However, it is extremely difficult for the FCA to quantify the harm that may occur due to this potential migration towards the exemptions, as we have limited oversight over unauthorised firms issuing promotions outside of our perimeter, or over firms issuing s21 approvals until the new gateway has been implemented. Beyond the impact of the financial promotions gateway, the FCA supported the Treasury's ongoing work on legislative options with an evidence pack on the harm originating from the exemptions.

### **2. What steps is the FCA taking to prevent the misuse of these exemptions to the financial promotions regime?**

The FCA takes enforcement action against firms or individuals that are not authorised or exempt under the Financial Services and Markets Act but who carry on regulated activities in breach of the legislation and/or who contravene restrictions on financial promotions. Every report we receive about unauthorised business is assessed individually alongside any other reports we may have received on that matter. Where we identify sufficient and credible evidence of a breach of our rules, the matter is escalated to enable more detailed enquiries to be carried out.

---

<sup>1</sup> 39 out of 202 websites reviewed April – December 2019 to 1 out of 400 websites reviewed August – November 2020

Additionally, we capture relevant intelligence, issue alerts on our website to warn consumers at the earliest opportunity about our concerns and make referrals to specialist teams, law enforcement agencies and other regulators where appropriate to facilitate wider action. Although not all of these relate to misuse of the exemptions, in 2022 we received 25,861 reports of potential unauthorised business and issued 1,882 consumer alerts as a result. This was a 33% increase in alerts from 2021.

As use of the exemptions takes promotions entirely outside our regulatory perimeter, we must predominantly rely on consumer reports or our proactive monitoring of websites to identify potential breaches. In many cases information about where the exemptions have been misused tends to emerge as part of the FCA's investigative work into the wider criminal behaviour of firms conducting regulated business without our authorisation.

Our ability to act on misuse of the exemptions is often limited to pointing out technical breaches to firms where they have not met all the conditions to properly benefit from the exemptions in the FPO. We issue alerts about these technical breaches on the FCA website so that consumers can find out that a site is issuing promotions without the necessary approval. Where a firm takes remedial action and corrects their website, we can often do no more since once the information about the exemptions is correctly applied what lies beyond the warning is outside of our regulatory reach.

Consumers also often self-certify that they are a sophisticated or high-net worth investor without realising what they are signing, or they are persuaded to miscategorise themselves by firms. In this way, while the paperwork may demonstrate technical compliance with the requirements of the exemptions, the exemptions are used to create an appearance of legitimacy and to make it more difficult for bad actors to be prosecuted, as they rely on the fact that the consumers self-certified that they were within scope of the exemptions, putting them outside any regulatory protection. This makes it inherently difficult for us to address, and in such circumstances significant consumer harm occurs.

### **3. Are there any legislative changes the FCA believes should be made regarding exemptions to the financial promotions regime?**

We have argued for some time now that the way to fully address the widespread harms and illegal activity we have seen is to remove the exemptions in legislation. We recognise that high-risk investments have a place in a well-functioning consumer investment market. Removing the exemptions would still allow access to these high-risk investments for suitable investors, but the person communicating the promotion would need to comply with financial promotion rules. A consumer's wealth does not always correlate with their ability to withstand a loss of regulatory protection - our Financial Lives Survey found that 52% of HNW investors self-assessed as having moderate to low confidence in managing their money, and 68% of HNW investors said they had a moderate to low knowledge of financial matters.

We appreciate the Treasury Committee's previous support for reform in this area and its recommendations in this regard in June 2021.<sup>2</sup>

The Treasury's December 2021 consultation on reforming the FPO exemptions set out the Government's intention to maintain the exemptions in legislation. Should the exemptions not be removed, significant reforms to the exemptions could substantially limit the consumer harm we have identified.

---

<sup>2</sup> See paragraphs 179-180.

[https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14909.htm#\\_idTextAnchor067](https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14909.htm#_idTextAnchor067)

"The Financial Promotion Order would benefit from reform due to the increasing risks associated with the exemptions that allow customers to self-certify as high net worth or sophisticated.

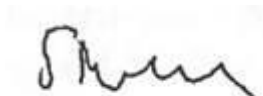
"The Treasury should—as a matter of priority—re-evaluate the Financial Promotion Order exemptions to determine their appropriateness and consider what changes need to be made to protect consumers."

We have previously suggested reforms such as changing the product scope of the exemptions to remove investments subject to an FCA mass-marketing ban, thereby requiring firms marketing these products to comply with FCA rules. This could address our concern about promotions of higher risk investments using the exemptions, while protecting the ability of SMEs to raise working capital. We note that this proposal has not been taken forward. Additional reform suggestions in line with the Treasury's consultation include:

- Removing self-certification by placing a greater degree of responsibility on firms to ensure individuals meet the criteria to be deemed HNW or sophisticated. This would make it easier for us to act against firms that have inappropriately categorised ordinary consumers as falling within the exemptions, and not strengthening the verification requirements renders other criteria, such as the net asset thresholds, far less meaningful. Weak verification requirements also leave the UK as an outlier amongst comparable jurisdictions. We are not aware of any other jurisdiction that allows firms to use exemptions purely based on investors' self-certification.
- Increasing the thresholds for the HNW investor exemption to a point where investors are better able to withstand losses from unregulated, high-risk investment products. We suggest an appropriate threshold would be the top 1% of earners and asset holders. As per ONS data from 2020 and using the same net asset calculation as in the existing legislation, this gives an income threshold of £175k and a total asset threshold of £1.25m. These thresholds would be in line with the intent of the original legislative drafting, account for developments such as pensions freedoms that have made it easier for consumers to meet the conditions of the exemptions, and better mitigate concerns that less knowledgeable consumers could be targeted via the exemptions.

These issues have been the subject of debate for a number of years, and we now very much hope that urgent progress can be made in addressing them.

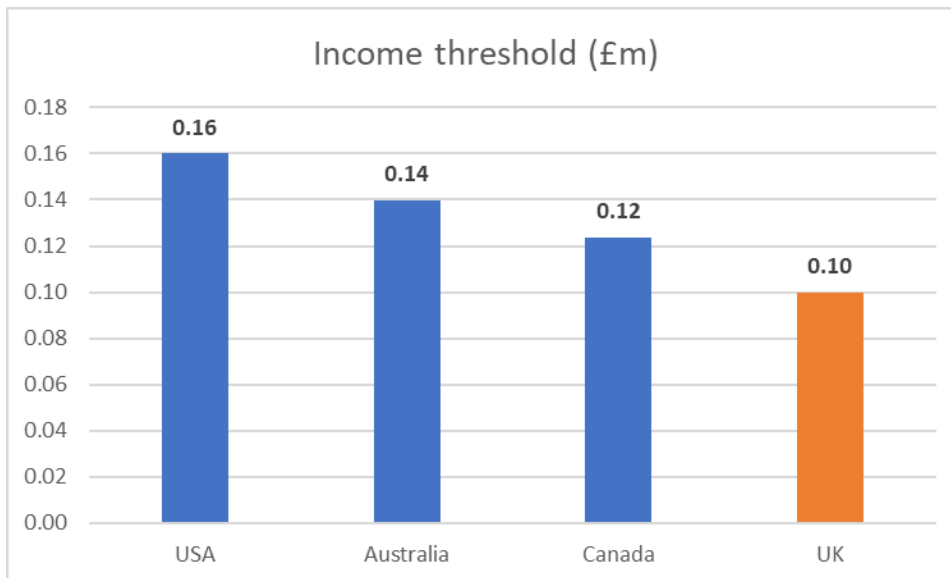
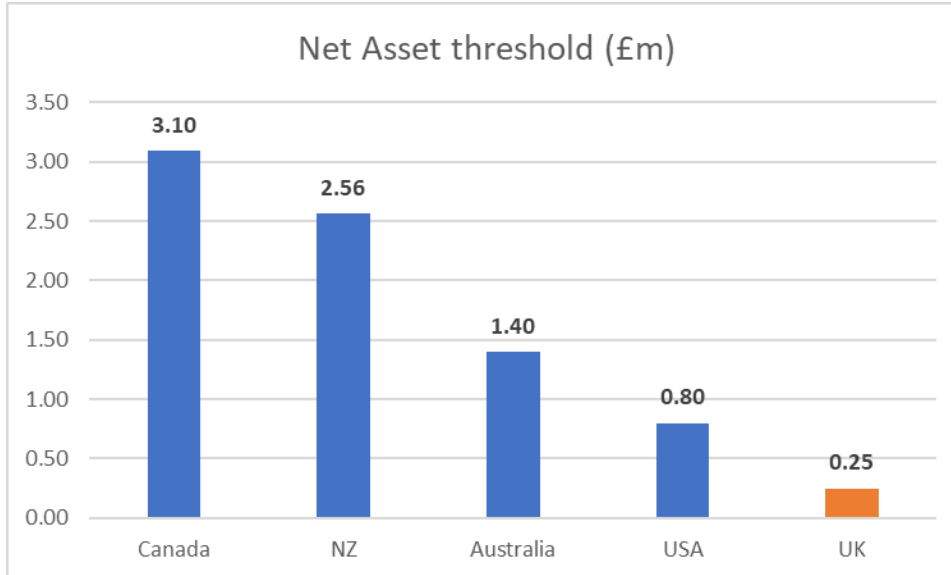
Yours sincerely



**Sarah Pritchard**  
**Executive Director of Markets**  
**Supervision, Policy and Competition**

## Annex 1

### International comparison of HNW investor Net Asset and Income thresholds



Thresholds converted from local currencies to GBP using 2022 average exchange rates from HMRC