

Optimising the Regulatory Approach to Approving Financial Promotions



Mark Bishop, 14 October, 2020

Context

- Connaught and LCF External Reviews expected to be published next month
- Both likely to criticise supervision/enforcement regime for approval of promotions
- Connaught: promotions approved by Capita Financial Managers, Blue Gate Capital (own account - Fund's Operators)
- LCF: promotions approved by Sentient Capital (third party), LCF (own account) and Surge (contested; unauthorised firm)
- FCA is positioning reviews as 'lessons learned for [the FCA]'
- Consultations underway this year could be attempts to implement changes that suit the regulator before we've seen the Reviews (as with complaints scheme)
- We therefore have to respond to the underlying problems, not just the proposals - and do so blind, without seeing the Reviews

FCA/Treasury proposed solution

- Authorised firms will no longer be able to approve promotions for unauthorised ones unless they first obtain FCA consent to conduct this category of activity
 - Two options for revising the law to make this possible
 - Technically, a Treasury consultation, because change to the law is mooted
-

Why this proposal is inadequate

- Can we be confident the FCA will filter out authorised firms tempted to conduct this business negligently or dishonestly?
 - Proposal does not address problems of authorised firms approving own misleading promotions or promotions being approved by unauthorised firms
 - Deterrence and redress problems ignored entirely
-

Understanding the problem

Misleading promotions

1. Authorised firms approve misleading promotions for their own products
2. ... or on behalf of third parties
3. Unauthorised firms approve promotions for own products ('boiler rooms')
4. Some unauthorised promotions actually or apparently originate outside the UK (mostly EEA)

Lack of deterrence

- Part 7, Financial Services Act 2012 (misleading statements and impressions - max. 7yrs custodial sentence)
- Section 21, Financial Services and Markets Act 2000 (unapproved promotions, max. 6mths custodial sentence)
- Enforcement powers - removal of permissions, fines

Lack of redress

- FCA reluctance to use s382 restitution powers
- Difficulty of proving chain of causation in civil court, esp. when authorised firm approves promotion for unauthorised party
- Limit to professional indemnity insurance (authorised), dissipation of assets (unauthorised)
- FSCS policies

Alternative approach

Authorised firms approving own misleading promotions

- UK needs equivalent to US Securities Act 1933
- All promotions, with supporting accounts etc, to be deposited with FCA/successor
- If misleading, firm and senior managers must face criminal and civil consequences
- FSCS rules should extend to misleading promotions irrespective of product type
- Requires duty of care - of firms to customers and of regulator to public

Authorised firms approving misleading promotions for third parties

- See above
- Consequences of approving misleading promotions would be identical
- Huge disincentive to approve third-party's promotions where there's minimal control over what actually happens

Unauthorised firms ('boiler rooms') approving own promotions

- Penalty needs to be very much more severe than six months' maximum prison time
- US-style 'wire fraud' legislation needed (phone, email, online/social media)
- Perhaps also enhanced investigatory powers (use of covert recording, w/blower incentives)
- 'Black hole' between FCA and police must be filled in (FCA should be responsible)

Misleading promotions apparently/actually from outside UK (EEA)

- Online Harms Act could create duty of care/liability for carrier - if we're quick
- Reverse or amend Financial Promotions Order 2005
- Allow non-UK promotions where there's MoU, FSCS or local cover, extradition treaty

Benefits of these proposals

- Address all misconduct involving misleading financial promotions and not just one type (authorised firms approving promotions for unauthorised ones)
- Deal also with issues of deterrence and remedies
- Avoid problems created by ‘regulatory perimeter’ (excuse for regulatory inaction)
- Media neutral: recognises seriousness of threat from online scammers
- Leverage Brexit to evolve UK financial services regulation from unfit-for-purpose European model (BaFin: Wirecard, Dolphin Trust) to superior US one
- In tune with wider Anglosphere trend toward more rigorous consumer protections (cf Australian Royal Commission)

Questions?