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Financial Services Authority

# Financial promotion and other communications

Including draft Handbook text for  
NEWCOB 4 and 5

October 2006





# Contents

1	Overview	3
2	Background and overall approach	6
3	NEWCOB Chapter 4: Communication to clients	12
4	NEWCOB Chapter 5: Financial promotion	17
5	FSA financial promotion strategy and implementation	32

**Annex 1:** Cost benefit analysis and compatibility statement

**Annex 2:** Details of the consultation process

**Annex 3:** List of questions

**Annex 4:** Draft Handbook text for NEWCOB 4 and 5

Annex 6 of the *Reforming COB Regulation CP* contains the full Draft Instrument for NEWCOB.

The Financial Services Authority invites comments on this Consultation Paper. Comments on the MiFID transposition elements of this consultation should reach us by 28 November 2006. Comments on other elements of this consultation should reach us by 23 February 2007.

Comments may be sent by electronic submission using the form on the FSA's website at ([www.fsa.gov.uk/pubs/cp/cp06\\_20\\_response.html](http://www.fsa.gov.uk/pubs/cp/cp06_20_response.html)).

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**It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.**

Copies of this Consultation Paper are available to download from our website – [www.fsa.gov.uk](http://www.fsa.gov.uk). Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

# 1 Overview

## Purpose

- 1.1 This Consultation Paper (CP) seeks views on our proposals to implement a more principles-based regime for financial promotions and other communications<sup>1</sup>. It also proposes rules and guidance to implement the conduct of business obligations in the Markets in Financial Instruments Directive (MiFID)<sup>2</sup> in relation to ‘all information’ and ‘marketing communications’<sup>3</sup>.
- 1.2 The proposed new rules will be located in a new conduct of business sourcebook, referred to in this CP as ‘NEWCOB’<sup>4</sup>. The relevant draft Handbook text is contained in Annex 4 of this publication. To see these chapters in context, please see Annex 6 of the *Reforming COB Regulation CP*, which contains the full Draft Instrument for NEWCOB.

## Overall approach

- 1.3 Following the Financial Promotion Review<sup>5</sup>, and in line with our commitment to more principles-based regulation, we are proposing a substantial reduction in the number of detailed financial promotion rules, and a much greater focus on principles and high-level standards. We expect this approach to provide real benefits for firms and consumers. It will allow firms more flexibility when marketing and scope for financial promotions to be tailored more closely to the needs of the consumers to whom they are directed.

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1 The Financial Promotion Review did not look at the financial promotion rules for general insurance or mortgages.

2 Article 19(2) of the European Parliament and Council Directive on markets in financial instruments (No. 2004/39/EC) and article 27 of the Implementing Directive 2004/39/EC.

3 In the *Reforming COB Regulation CP* we explain how we plan to implement most of the remaining conduct of business requirements of MiFID. Other CPs in the programme include the *Organisational Systems and Controls – common platform for firms CP* (CP06/9) and the *Implementing MiFID for Firms and Markets CP* (CP06/14).

4 The term ‘NEWCOB’ is used throughout this CP. However, when the new sourcebook is made, the abbreviation that will be used is likely to be ‘COBS’.

5 The Financial Promotion Review was announced in the Business Plan 2005/06.

## Summary of proposals in NEWCOB Chapter 4: Communications by firms

- 1.4 The proposals for NEWCOB 4 outline standards relevant to all firms when communicating with professional and retail clients. It replaces provisions in the Conduct of Business sourcebook (COB) which currently deal with this area in high-level terms<sup>6</sup>.
- 1.5 NEWCOB 4 will contain the key rule that all communications are ‘fair, clear and not misleading’<sup>7</sup>. It will also include some new provisions copied from MiFID that will apply for the first time to ‘all information’<sup>8</sup>. Where we consider these provisions to be relevant, we propose to apply them to both scope and non-scope business. However, we do not consider that all the provisions are relevant for all communications and some therefore will only apply to scope business.

## Summary of proposals in NEWCOB Chapter 5: Financial Promotion

- 1.6 The proposals for NEWCOB 5 expand on the fair, clear and not misleading high-level rule for financial promotions. They also contain revised, simplified and largely high-level requirements for the approval and communication of financial promotions aimed at retail clients. NEWCOB 5 replaces the existing financial promotion rules in COB 3 apart from certain requirements (relating to confirmation of compliance) that are now covered in the Systems and Controls Sourcebook (SYSC).
- 1.7 The importance of ‘fair, clear and not misleading’ financial promotions is central to our regime. If consumers get such information about financial products and services, they will be less vulnerable to buying or being sold unsuitable or poor value products or services. To date, the detailed financial promotion rules have not always resulted in these objectives being achieved as fully as possible.

## Next steps

- 1.8 We plan to meet the January 2007 deadline for the transposition of MiFID and therefore the consultation on MiFID provisions will close on 28 November 2006. In relation to MiFID scope provisions, we plan to publish feedback on responses to both this CP and the *Reforming COB Regulation CP* in a Policy Statement in January 2007, together with made rules. We have a four-month consultation period for non-scope proposals, ending on 23 February 2007, and plan to publish feedback in a Policy Statement in the second quarter of 2007. The new rules will take effect on 1 November 2007.
- 1.9 As a result of the proposals in this CP, and the associated proposals in the *Reforming COB Regulation CP*, we will need to make amendments to other FSA Handbook modules and guides. We will consult on these amendments in a CP proposed for the second quarter of 2007.

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6 COB 2.1.

7 We are consulting on the key rules (that is, the core high-level rules) in NEWCOB in the *Reforming COB Regulation CP*. See paragraph 2.20 and Annex 3 of that CP for more detail.

8 Implementing Directive article 27.

## Who should read this Consultation Paper?

### Firms

- 1.10 This CP is of interest to all firms that communicate with retail and professional clients; and all firms that either communicate or approve financial promotions<sup>9</sup>. The proposals outlined in this CP will mean that firms may need to review their communication strategies and, possibly, alter their approach to the communication and approval of financial promotions.
- 1.11 The review has considered the impact of the proposed rules on small firms, which we have discussed with relevant trade bodies and industry representatives. The *Reforming COB Regulation CP* provides further information for small firms on our move to more high-level rules, and details a programme of communications targeted particularly at them.

### Consumers

- 1.12 This CP will also be of interest to consumers. In light of our proposals, consumers may notice a change in some firms' communications and promotional material. They may also notice a change in the way direct-response advertising works, both in the way firms present information and also as a result of the introduction of the appropriateness test in the sales process (see Chapter 4 of this CP).

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<sup>9</sup> It should be noted that this review does not change the rules for general insurance or mortgages.

# 2 Background and overall approach

## Introduction

- 2.1 This chapter outlines our new approach to the rules that are relevant when firms communicate with clients, or communicate or approve financial promotions<sup>1</sup>.

## Background to the Financial Promotion Review, the review of COB and MiFID implementation

### *The review of the financial promotion regime and COB*

- 2.2 We are proposing new, higher-level rules as a result of our Financial Promotion Review, the review of COB and the need to implement MiFID. The new regime is a key component of other FSA initiatives, in particular the Better Regulation Agenda, and complements the Treating Customers Fairly work.
- 2.3 The main driver for the changes proposed in this CP has been the Financial Promotion Review, the aim of which was a more principles-based regulatory regime that is flexible to new market conditions while applying appropriate levels of consumer protection. This took account of feedback from stakeholders, our own research and other relevant FSA work streams.
- 2.4 The emphasis on more principles-based regulation, and the presentation of the new financial promotion rules, is consistent with the wider revision of COB, as detailed in the *Reforming COB Regulation CP*. The main drivers for the COB review were:
- our move towards more principles-based regulation and high-level rules that focus on outcomes rather than processes (unless necessary to implement European legislative requirements or to achieve a justified regulatory outcome); and
  - the identified scope for improvement in the structure and presentation of sourcebook content.

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<sup>1</sup> We do not deal with some requirements relevant to a firm's communications in this CP. The *Reforming COB Regulation CP* includes sections on: disclosure requirements, such as those implementing the Distance Marketing Directive (DMD) and the electronic-commerce Directive (ECD); the provisions that require a firm to provide certain information to clients about its business, services, fees and commission arrangements (including provision of the initial disclosure document); and requirements relating to packaged product disclosure, client agreements and the 'appropriateness test'.

- 2.5 More principles-based regulation is a key part of our Better Regulation Agenda and of our vision for the development of regulation. We believe that a more principles-based approach will help maintain the current constructive environment for business, while securing better outcomes for retail clients.
- 2.6 Principles have been a feature of regulation in the financial services industry since the early 1990s. In that time, we have used them to supervise and enforce. But our plan now is to enhance the emphasis placed on principles as opposed to detailed rules.
- 2.7 We believe a more principles-based approach is needed to replace the existing financial promotions regime as:
- detailed rules can divert from the purpose of a standard, and distract people’s attention away from new issues or risks;
  - product-specific rules are inflexible;
  - some issues are not appropriately addressed through prescriptive standards; and
  - an excess of detailed rules is a barrier to entry, and also to compliance, particularly for smaller firms.
- 2.8 In our view, a more principles-based approach better reflects the philosophy of UK regulation, and provides a better basis for doing cross-border business than detailed rules. Our approach will result in a financial promotions regime that focuses on senior management responsibility and allows firms to decide how best to interpret the standards for themselves.
- 2.9 We recognise that this approach presents challenges and opportunities, both for the FSA and for firms. We will need to be more flexible and outcome-focused in our approach to supervision and enforcement. Firms’ senior management will need to recognise that regulation is changing and that they will need to work constructively to apply the high-level rules. Firms will have a greater range of methods that they can use to demonstrate compliance with the high-level rules. This will create benefits for them in the form of increased freedom of action, so long as they meet the desired regulatory outcome.
- 2.10 In terms of the structure and presentation of the Handbook, our intention is to make it easier to navigate. This includes the removal of some of the complex defined terms which are currently used. We have also reviewed our use of guidance. Our aim is to eliminate unnecessary guidance, including repetitive text, superfluous cross-references and paraphrases of other legislation or material that rightly belongs outside the Handbook.

### *Implementation of MiFID and other European Directives*

- 2.11 In the *Reforming COB Regulation CP* we explain how the need to implement MiFID has influenced our proposals for NEWCOB text.
- 2.12 The presentation of the new rules in NEWCOB Chapters 4 and 5 is heavily influenced by our approach to implementing European directives. We will:

- use ‘intelligent copy-out’ for financial services directives – we will generally base our rules on copied-out directive text to avoid placing any unintended additional obligations on firms;
- propose measures that go beyond directive requirements only when these are justified in their own right, through the use of market failure and cost benefit analysis. MiFID is effectively a maximum-harmonising directive limiting our ability to add or retain additional rules for scope products and services, unless, in exceptional cases, we can objectively justify the need for them<sup>2</sup>. In implementing MiFID, we have not sought additional provisions relating to either financial promotions or general communications;
- rely as far as possible on the general UK implementing legislation and avoid making additional changes to the Handbook where directives are not specific to financial services (for example, the Unfair Commercial Practices Directive(UCPD)<sup>3</sup>); and
- label all Handbook material that is derived from European legislation.

### *Approach to scope and non-scope business*

- 2.13 An important consideration has been whether to propose applying MiFID requirements beyond MiFID-scope business. In this CP, we are proposing to extend some MiFID provisions to non-MiFID firms and non-scope business. We have made these judgements on a rule-by-rule basis.
- 2.14 In many instances, our preferred outcomes are similar to the MiFID high-level provisions. We are proposing to apply MiFID standards across the board where we have identified benefits to consumers and the industry in having a consistent regime across similar markets. But, where we have identified no reason for extending the requirements, we are simply proposing to apply MiFID requirements to MiFID-scope business.
- 2.15 We are obliged to ensure that non-EU firms are not treated more favourably than EU firms, so where MiFID standards are applied to scope business, our rules will also apply them to ‘equivalent business of a third country investment firm’.
- 2.16 In this CP, we distinguish between MiFID and non-MiFID firms and between scope and non-scope business.

### **The objectives of the financial promotion regime**

- 2.17 These changes are being consulted upon against a careful analysis of the underlying objectives of the regime.

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2 As per article 4 of the Implementing Directive.

3 See the *Reforming COB Regulation CP* for more detail.

### *Role of financial promotions*

- 2.18 Financial promotions are invitations to engage in investment activity, and play an influential role when consumers purchase financial products and services. A promotion is often one of the first stages in the buying process. Although the primary role of a financial promotion is to help sell a product or service, high-quality promotional material can also help to educate consumers and help them make better financial decisions<sup>4</sup>.

### *Information asymmetry*

- 2.19 Retail financial markets suffer from information asymmetry. Firms know more about the products they are offering than consumers. In this context, financial promotions can inform consumers about the characteristics or existence of products or services. Therefore, providing information within a financial promotion can help counteract the information asymmetry.

### *Regulatory interventions in the buying/selling process*

- 2.20 Given the asymmetry of information in the retail market, however, financial promotions can sometimes be used to convince consumers to invest in products they would not choose if they had access to better information. This type of financial promotion can result in market failure and loss to consumers. For this reason, we consider regulatory intervention necessary.
- 2.21 Initially, the Financial Promotion Review looked at the market and how it has evolved since the current financial promotion regime was introduced in 2001. We also considered recent developments in the media and marketing tools available to firms, and identified the areas where we believe there is greatest potential for market failure.
- 2.22 We looked at the entire sales process, the provision of advice, and the information firms provided at point-of-sale and post-sale. We consider that, in deciding what information is required at the financial promotion stage, firms should assess the complexity of the product or service and the likelihood that further information will be provided later. Of course, where the selling process is shortened – in particular, in relation to transactions following direct sales marketing – then firms generally need to provide detailed information before the transaction is entered into.
- 2.23 We identified certain regulatory concerns already dealt with by existing high-level provisions, or by the high-level rules that will be in place following implementation of MiFID. We also identified provisions that, in the current market environment, are no longer appropriate or necessary to achieve our regulatory objectives.

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4 This conclusion emerges from the academic literature on the subject.

## Principles-based regulation and the Financial Ombudsman Service

- 2.24 In our discussions with firms, some have expressed anxiety that the Financial Ombudsman Service (FOS) may take a different approach to them and the FSA in interpreting the high-level rules.
- 2.25 It is important to note that, at present, only a small minority of FOS cases depend on the interpretation of individual conduct of business rules. Most cases turn on their individual facts or general legal principles, which apply to all businesses. This is not expected to change with the introduction of more high-level rules or greater reliance on the Principles for Businesses.
- 2.26 We are working closely with FOS on more principles-based regulation and have discussed our proposed changes with them. We do not consider that our proposals are likely to result in any significant change to the outcome of cases nor is it likely to create areas where FOS would need to develop a new approach in response to the removal of a rule.

## Client categorisation

- 2.27 As part of this review, we have considered the impact of the changes that MiFID and its implementation will bring about for our regulatory framework. Our preliminary views on client categorisation under MiFID were set out in a paper issued in August 2006<sup>5</sup>. In the *Reforming COB Regulation CP* we consider MiFID implementation and the client categorisation regime more fully and propose relevant Handbook text.
- 2.28 We are proposing to adopt the MiFID terminology (retail client, professional client and eligible counterparty) for financial promotions issued in conjunction with both scope and non-scope business. We believe this is consistent with our obligation to transpose MiFID and will also make the Handbook easier to follow.
- 2.29 Adopting both the definitions and terminology for the different categories of client under MiFID does give rise to a number of changes in relation to financial promotions. We do not, however, consider that these differences will impact in a manner which would be to the detriment of consumers. In general, the new client categorisation regime is likely to result in more ‘retail clients’<sup>6</sup> although certain classes of client who are ‘private customers’ under the existing COB regime will be categorised as professional or even eligible counterparties under MiFID.
- 2.30 Firms should also note the basis on which transitional provisions for the categorisation of clients under existing COB rules will operate (as set out in Chapter 3 of the *Implementing MiFID’s Client Categorisation requirements* paper and in the *Reforming COB Regulation CP*). Grandfathering under MiFID will, in most instances, allow firms to carry on scope business with existing retail and intermediate customers on the same basis without the need to review, ‘re-paper’ or notify these clients of the change to the client category<sup>7</sup>. It is likely that similar grandfathering

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5 *Implementing MiFID’s Client Categorisation requirements*, August 2006.

6 *Implementing MiFID’s Client Categorisation requirements*, paragraph 1.9.

7 *Implementing MiFID’s Client Categorisation requirements*, paragraph 3.5.

provisions will be made for non-scope business to allow existing client classifications to be carried over into the new terminology, with a minimum amount of re-categorisation required.

## **Legal position**

### *Restrictions on financial promotion*

- 2.31 Section 21 of the Financial Services and Markets Act 2000 (FSMA) prohibits an unauthorised person from communicating a financial promotion, unless the content of the promotion has either been approved by an authorised person or is exempt. The relevant exemptions are detailed in the Financial Promotion Order (FPO)<sup>8</sup>. An authorised person will not breach section 21 of FSMA when communicating a financial promotion, but must comply with the relevant financial promotion rules in our Handbook.
- 2.32 As announced in the 2005 Pre-Budget Report, the government plans to modernise the regulation of financial services further and this will include a review of the FPO and the section 21 restriction in FSMA. The aim is to reduce, where possible, the complexity and cost of marketing communications by financial firms. We expect the government to start work on this review in 2007, after MiFID has been implemented. We do not anticipate that this will result in the need for us to carry out a further review of the substantive financial promotion rules in our Handbook.

### **Rule-making powers**

- 2.33 Our power to make financial promotion rules does not extend to financial promotions that do or would benefit from an exemption in the FPO. MiFID does not have equivalent exemptions in all cases. To enable us to make rules that implement MiFID fully, the government will need to amend FSMA<sup>9</sup>.
- 2.34 Where MiFID does not apply, firms will be able to take advantage of FPO exemptions as they do now. But, for MiFID firms carrying on MiFID business and communicating in relation to a MiFID instrument, the FPO exemptions will not be available and the relevant financial promotion rules in NEWCOB will apply. We expect some MiFID firms will need to reconsider their business models. This will affect, for example, firms who rely on the one-off exemption, the exemptions relating to high net worth individuals or sophisticated investors, or the 'sale of a body corporate' exemption.

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8 The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529).

9 The Financial Services and Markets Act 2000 section 145.

# 3 NEWCOB Chapter 4: Communication to clients

## Introduction

- 3.1 In this chapter, we explain the standards that will apply to firms carrying out designated investment business when communicating information to retail or professional clients<sup>1</sup>.

### *Existing provisions*

- 3.2 At present, the requirement for communications to be clear, fair and not misleading is in a high-level rule<sup>2</sup>, which restates Principle 7<sup>3</sup>.

### *Drivers for change*

- 3.3 NEWCOB 4 replaces COB 2.1, expands on Principle 7 and implements MiFID requirements for information, including marketing communications, addressed by the firm to clients or potential clients, to be fair, clear and not misleading<sup>4</sup>. Other relevant requirements in MiFID contain conditions with which information must comply in order to be fair, clear and not misleading<sup>5</sup>.

### *Proposals*

- 3.4 In NEWCOB 4 we have ‘copied out’ MiFID text and provided guidance where appropriate. The basic requirement, as is the case now, is that all communications must be ‘fair, clear and not misleading’<sup>6</sup>.
- 3.5 With regard to non-promotional communications, some of the provisions in NEWCOB 4 will apply to scope and non-scope business and some will only apply to scope business.

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1 The term ‘all information’ is derived from MiFID article 19(2) and is explained further in paragraph 3.7.

2 COB 2.1.3R: When a firm communicates information to a customer, the firm must take reasonable steps to communicate in a way which is clear, fair and not misleading.

3 Principle 7: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

4 MiFID article 19(2).

5 Implementing Directive article 27.

6 We have changed the order of the words ‘clear’ and ‘fair’ in our text, in line with MiFID text.

## *Application and purpose*

- 3.6 The application provisions relevant to this chapter are located at the start of NEWCOB 4. Chapter 1 and Appendix 1 of NEWCOB will also contain application provisions relevant to the whole sourcebook (see the *Reforming COB Regulation CP* for further detail). Overall, our aim has been to re-order and simplify the application provisions, while still providing legal certainty.

### **Communicating with retail clients and professional clients: fair, clear and not misleading information**

- 3.7 The concept of ‘all information’ is wide, and can be considered to be any communication, including marketing communications, between a firm and its client or potential client. It will include such things as financial promotions, product disclosure documentation, communications between the firm and the client during face-to-face interviews (e.g. during sales advice), telephone conversations and any casual reference by a member of branch staff.
- 3.8 We will require all information addressed by firms to clients or potential clients to be fair, clear and not misleading. This requirement applies to information addressed to ‘retail clients’ and ‘professional clients’, but not to information addressed to eligible counterparties (ECPs) operating within the ECP regime – unless ECPs request otherwise.
- 3.9 Firms communicating with ‘market counterparties’ currently only need to ensure that the information is ‘not misleading’. Our proposed use of the MiFID-style client categorisation of ECP will affect the application of this principle for some firms.<sup>7</sup>
- 3.10 To implement MiFID fully, our proposed rules require firms to ensure that all information addressed by the firm to retail and professional clients is fair, clear and not misleading for scope business. For non-scope business we do not propose to carry forward the current ‘reasonable steps’ standard<sup>8</sup>, for the reasons set out in the attached CBA. We propose instead to apply the MiFID requirement to all firms.

### **Communicating with retail clients: conditions that information must comply with to be fair, clear and not misleading**

- 3.11 MiFID contains additional requirements expanding on the fair, clear and not misleading principle, for information addressed to, or likely to be received by, retail clients. We have identified no significant market failure calling for us to apply these rules to information addressed to professional clients or ECPs.
- 3.12 For retail clients, we do not consider it necessary for all of these requirements to apply in all cases and therefore some of the provisions will apply only within MiFID scope, as detailed below.

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<sup>7</sup> Some market counterparties may not qualify for classification as ECPs under MiFID and will be owed greater obligations under this, and other, rules as retail or professional clients.

<sup>8</sup> COB 2.1.3R: When a firm communicates information to a customer, the firm must take reasonable steps to communicate in a way which is clear, fair and not misleading.

*Identity, accuracy and balance, sufficiency and client understanding, prominence*

- 3.13 When consumers receive information from firms, they need to be clear about who they are dealing with and whether they can rely on the information. MiFID<sup>9</sup> requires the information to:
- include the name of the investment firm;
  - be accurate and in particular not emphasise any potential benefits of an investment service or financial instrument without also giving a fair and prominent indication of any relevant risks;
  - be sufficient and presented in a way that is likely to be understood by the average member of the group to whom it is directed, or by whom it is likely to be received; and
  - not disguise, diminish or obscure important items, statements or warnings.
- 3.14 We propose to apply these high-level rules to all firms, as they are inherent in the clear, fair and not misleading Principle and we expect all firms to be adhering to them already.
- 3.15 We are not proposing to give guidance in the Handbook on what is meant by particular terms used in MiFID. Instead, when ensuring their compliance with the requirements, we expect firms to apply ordinary meanings to these terms. For example, when considering what is sufficient information for ‘the average member of the group’ to whom information is directed, we do not expect firms to carry out an arithmetic approach for different segments of the market but to take a common sense approach.

*Comparative information*

- 3.16 Where firms compare their product or service to those of competitors, we feel it is important to regulate the way in which these comparisons are provided. At present, we have financial promotion rules restricting the way in which comparative information is supplied. These rules do not apply to non-promotional communications, which only have to be clear, fair and not misleading in the use of comparisons.
- 3.17 MiFID makes it clear that to be fair, clear and not misleading, all information containing comparisons (including non-promotional material) must be ‘meaningful and presented in a fair and balanced way’<sup>10</sup>. As this is a standard we expect all firms to meet at present (under the clear, fair and not misleading requirement), we are proposing to apply the meaningful, fair and balanced provision in all cases.
- 3.18 MiFID also requires firms to include particular detail on the ‘sources of information’ and ‘key facts and assumptions used to make the comparison’ in all communications<sup>11</sup>. We do not currently require this. Following cost benefit analysis, we have decided not to extend the scope of these provisions to non-scope business, because it would add new regulatory burden without addressing an observed market failure. These requirements will therefore only apply within MiFID scope.

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9 Implementing Directive article 27(2).

10 Implementing Directive article 27(3)(a).

11 Implementing Directive article 27(3)(b) and (c).

### *Past, simulated past and future performance*

- 3.19 We consider that performance information is not a reliable indicator of future returns and we are keen to reduce the emphasis placed on it in financial promotions. MiFID supports us in this aim, setting requirements for how past performance, simulated past performance and future performance (i.e. projections) must be disclosed<sup>12</sup>.
- 3.20 Under our current rules, firms need only ensure that non-promotional communications on this topic are clear, fair and not misleading. Although the MiFID requirements apply to all information supplied within MiFID scope, the Directive applies them in a way that is appropriate and proportionate, taking into account, for example, the means of communication and the information that the communication is intended to convey<sup>13</sup>. The detail may not be appropriate or proportionate in all instances for non-promotional communications. Examples include telephone discussions with a client who would like to know the one-day performance of a security (but would not need to be told the performance over the last five years) and annual performance reviews communicated to an individual client of an investment manager in which performance would be the most prominent feature of the communication. As the detail of the requirements on past, simulated post and future performance will always apply to financial promotions, we have located them in NEWCOB 5.
- 3.21 We are not applying MiFID-based rules on past, simulated past or future performance to non-promotional material outside of MiFID scope, because this would apply an additional regulatory burden where we have identified no market failure. Firms will only need to comply with the high-level fair, clear and not misleading rules for non-scope non-promotional communications<sup>14</sup>.

### *Taxation*

- 3.22 Where a communication refers to a particular tax treatment, MiFID prescribes the inclusion of extra wording that the tax treatment depends on the individual circumstances of each client and may change in the future<sup>15</sup>. We do not intend to extend this requirement to non-scope non-promotional communications, although in following the high-level requirement to be fair, clear and not misleading, it may be relevant for them to disclose this information in some situations.

### *References to Competent Authorities*

- 3.23 Consumers need to be clear that an organisation, such as the FSA, does not endorse or approve a particular firm's products or services. MiFID prevents firms from using the name of any competent authority in this manner<sup>16</sup>. Although the proposed rule goes beyond the current provision<sup>17</sup> by banning references even if approval is received in writing and imposes an additional restriction on firms, we consider it appropriate and expect the impact to be negligible. We are proposing to apply this restriction to all firms.<sup>18</sup>

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12 Implementing Directive article 27(4) to (6).

13 Implementing Directive recital 46.

14 Implementing Directive article 27(2).

15 Implementing Directive article 27(7).

16 Implementing Directive article 27(8).

17 COB 3.8.5E(1)(g).

18 We are consulting on an appropriate amendment to GEN in the *Reforming COB Regulation CP*.

## Implications for firms

- 3.24 From November 2007, senior managers will need to have taken steps to ensure that all information provided by firms complies with these standards. We anticipate that some firms will need to adjust their existing systems and controls, in particular the way they communicate about past, simulated and future performance.
- 3.25 Although we are proposing some additional requirements for non-scope business, we do not consider that these will result in significant changes for those firms. This is because we anticipate the standards we are proposing are already being adhered to by most firms.
- 3.26 Firms will have flexibility to apply the high-level provisions in the way best suited to their clients, products and services, while at the same time providing information that is fair, clear and not misleading.

## Implications for consumers

- 3.27 We expect that most consumers will be unaffected by the regulatory changes arising as a result of these proposals, as appropriate standards of protection will apply. However, some consumers may notice that firms provide more detailed information, particularly from MiFID firms communicating about a MiFID financial instrument.

## References

- The existing rules are at COB 2.1.
- The relevant sections of MiFID are at article 19(2) of MiFID (first sentence), and article 27 of the Implementing Directive.
- Draft rules implementing this proposal are at NEWCOB 4.

## One-Month Consultation Question

- 1MQ.1: For MiFID-scope business, do you agree with our interpretation and approach to the implementation of MiFID provisions for all information in NEWCOB 4?

## Four-Month Consultation Question

- 4MQ.1: Do you agree with our proposals relating to all information in NEWCOB 4 for non-MiFID scope business?
- 4MQ.2: At present firms must take **reasonable steps** to communicate in a way that is clear, fair and not misleading. Do you agree with our proposal that all firms should ensure that all information they address to customers in relation to relevant business **is** fair, clear and not misleading?

# 4 NEWCOB Chapter 5: Financial promotion

## Introduction

- 4.1 In this chapter, we explain the provisions we propose to apply in NEWCOB 5, to firms communicating or approving financial promotions. These rules will also implement relevant MIFID provisions<sup>1</sup>. In future, when considering requirements relevant to financial promotions, firms will also need to take account of associated chapters in NEWCOB and certain rules in SYSC<sup>2</sup>.

### *Existing provisions*

- 4.2 At present, COB 3 contains regulations for financial promotions. Many of these rules expand on the fundamental requirement for financial promotions to be clear, fair and not misleading; some of which are product-specific. COB 3 also contains guidance relating to the financial promotions regime under section 21 of FSMA and expands on Principle 6 and Principle 7<sup>3</sup>.

### *Drivers for change*

- 4.3 The main driver for the changes proposed in this CP has been the Financial Promotion Review. As discussed in detail in chapter 2 above, other drivers have been the review of COB initiated under our Better Regulation Action Plan and the shift to more principles-based regulation. We also had to ensure that our proposed financial promotion rules applied within MiFID scope, given the need for us to implement MiFID.

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1 MiFID article 19(2) 'Marketing communications shall be clearly identifiable as such', Implementing Directive article 27 (4) to (6) on past, simulated and future performance and Implementing Directive article 29 (7) and (8) regarding financial promotions containing an offer or invitation.

2 Including, among others, NEWCOB chapters 4, 6, 11, 13, 14 and 15 and SYSC chapters 3, 5, 6 and 9.

3 Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly.  
Principle 7: see chapter 3, footnote 3.

## **Application and purpose**

- 4.4 Overall, our aim has been to re-order and simplify the application provisions, while still providing legal certainty. Due to the level of detail, we propose to summarise the application provisions relevant to NEWCOB 5 at the outset and provide detail in an annex.
- 4.5 Chapter 1 and Appendix 1 of NEWCOB will also contain application provisions relevant to the whole sourcebook (see the *Reforming COB Regulation CP* for more detail).

## **Revision of the conduct of business rules**

- 4.6 In many cases, high-level rules remove the need for detailed and product-specific provisions. We therefore do not propose to carry forward provisions which simply expand on what is meant by ‘fair, clear and not misleading’, or duplicate other high-level provisions, either in the Handbook, or in separate legislation or regulations outside the Handbook<sup>4</sup>.
- 4.7 Generally, where we consider that an existing provision is not implicit in fair, clear and not misleading, it is retained in NEWCOB 5.

## **Conditions with which financial promotions must comply in order to be fair, clear and not misleading**

### *Form and content of financial promotions*

- 4.8 In NEWCOB 5 we propose to refer to the key rule that communications are fair, clear and not misleading (as detailed in NEWCOB 4), to make clear that it applies to financial promotions relating to all types of investment (including deposits) covered by NEWCOB.
- 4.9 We currently provide guidance that expands on what is meant by ‘clear, fair and not misleading’ and a ‘fair and adequate description’ in relation to specific financial promotions<sup>5</sup>. We are not proposing to carry forward most of this guidance as we plan to rely on high-level rules in the future.

### *Identity, accuracy and balance, sufficiency and client understanding, prominence*

- 4.10 A core requirement for a financial promotion is that a consumer can rely on the information provided. It is important that promotions make clear who is providing the information; that the information is accurate and sufficient for the needs of the promotion; that important facts are not masked; and, where benefits are discussed, that it provides balance by including details of relevant risks. This information must be presented in a way that is likely to be understood by the average member of the audience. MiFID meets our objectives in this area and, as discussed in Chapter 3 of

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4 For example, the existing text in COB 3 Annex 1G that duplicates material in the Financial Promotion Order on exemptions to the need to follow our rules will not be carried forward.

5 In COB 3 Annex 4, for example.

this CP, we will apply these MiFID standards in NEWCOB 4 to scope and non-scope communications (including financial promotions)<sup>6</sup>.

- 4.11 There are some differences to the current rules<sup>7</sup> but we do not consider these differences to be significant or to impose additional costs. Overall, we expect the future requirements to provide appropriate standards going forward.
- 4.12 We are introducing these high-level requirements at the same time as we remove existing product-specific rules. Acting under these high-level requirements firms will be required to provide consumers with relevant product details in financial promotions. We will no longer prescribe specific disclosures or actions and firms will need to decide for themselves what information is relevant. We consider that the high-level rules will provide appropriate consumer protections but we will continue to monitor firm behaviour and take action where appropriate (Chapter 5 of this CP gives more information).

### *Comparison or contrast*

- 4.13 Firms often try to distinguish their product or service by comparing it with other products, for example, or with competitors' offerings. We feel it is important to include rules regulating the way in which these comparisons are used.
- 4.14 There are requirements relevant to comparative information in the regulations implementing MCAD and the forthcoming regulations implementing UCPD.<sup>8</sup>
- 4.15 We are proposing to apply MiFID requirements on comparisons and contrasts to 'all information' produced by firms. Although located in NEWCOB 4, these provisions will also apply to financial promotions. The requirement for comparisons to be 'meaningful and presented in a fair and balanced way'<sup>9</sup> will apply for both scope and non-scope business (including financial promotions relating to deposits and certain pure protection contracts). The additional requirements (to include particular detail on the 'sources of information' and 'key facts and assumptions used to make the comparison') will only apply to scope business<sup>10</sup>.
- 4.16 We do not intend to apply any further requirements, or to retain any more details from our current rules<sup>11</sup>, in relation to financial promotions containing comparative information.

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6 Implementing Directive article 27(2).

7 For example, the current requirement in COB 3.8.2R that obliges firms to include a name and contact point is not the same as the MiFID rule on identity, which only requires the name of the firm.

8 Misleading and Comparative Advertising Directive (84/450/EEC), implemented through the Control of Misleading Advertisements Regulations 1988. Unfair Commercial Practices Directive (2005/29/EC) to be implemented.

9 Implementing Directive article 27(3)(a).

10 Implementing Directive article 27(3)(b) and (c).

11 COB 3.8.4R(2).

## Past, simulated and future performance

### *Past performance*

- 4.17 There are significant consumer protection issues around past performance disclosure in financial promotions. Past performance provides, at best, a very limited guide to future performance. When there is persistent out-performance it is most likely to occur in the short-term and so its value will typically not exceed the switching costs to which retail clients are usually exposed. Longer-term out-performance is rare and is difficult to identify in advance of the actual outcome<sup>12</sup>.
- 4.18 In essence, we are proposing rules that will require that:
- past performance disclosure must not be the most prominent feature of a communication;
  - a past performance risk warning must be included, that the figures refer to the past and that past performance is not a reliable indicator of future results; and
  - the information must cover at least the immediately preceding five years (or all years, if less) and be based on complete twelve-month periods. It is not possible to provide past performance data for funds with fewer than twelve months of performance.
- 4.19 The above rules are derived directly from MiFID<sup>13</sup>. We intend to apply them to all scope non-marketing communications and to all financial promotions of designated investments and structured deposits subject to our comments in 4.27. The rules, therefore, will provide consumers with protection against ‘cherry-picking’ of the best results and the use of past performance as the focal point in a promotion.
- 4.20 However, MiFID does not go as far as our current rules in two main areas, so our proposals entail some deregulation and the potential for consumer detriment.
- MiFID does not specify a standard presentation (either in terms of format or calculation), where COB currently requires information to be provided in a table using percentage format. Our research suggests that the current presentation has advantages for consumers and firms. However, it would be super-equivalent to retain it for MiFID-scope promotions.
  - The MiFID requirement for a past performance risk warning is not as specific as our current rules. This risk warning is important as it encourages consumers to question the relevance of past performance data but the increased flexibility over wording and prominence may reduce its effectiveness.
- 4.21 We considered proposing rules to prescribe past performance format as at present, but which would have been super-equivalent to MiFID. However, we concluded there was a significant possibility of international arbitrage if we had more detailed rules

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12 Previous FSA research and information on this issue includes: Consumer Research 21 *Standardisation of Past Performance*; CP132 *The presentation of past performance and bond fund yields in financial promotion*; CP170 *Informing Consumers: Product Disclosure at the Point of Sale*; CP183 *Standardising Past Performance*; Policy Statement *Standardising Past Performance: Feedback on CP183*.

13 Implementing Directive article 27(4).

than other EU states. We also consider that it should be possible to prevent most of the identified consumer detriment by applying the rules derived from MiFID, with guidance on this issue, without the need to propose super-equivalence. The cost benefit analysis in Annex 1 expands on this issue.

- 4.22 We also concluded that it is preferable to have consistent rules on past performance for promotions of scope and non-scope business. Retaining additional prescription for promotions of non-scope business would not be proportionate and may lead to arbitrage where new products are restructured within scope to avoid stricter rules (particularly where unit-linked life products share characteristics with scope products). We are therefore proposing to apply the same rules to scope and non-scope business.
- 4.23 Again, we will be monitoring how these new rules operate in practice.

#### *Simulated past performance*

- 4.24 In some situations where past performance data does not exist, it is possible for firms to simulate how an investment would have performed in the past. However, we propose to apply rules that will stop firms with actively managed investments (where the discretionary element would allow the firm to overstate performance) from providing simulated past performance. As with past performance, simulated past performance must comply with the requirements set out in paragraph 4.18 above.
- 4.25 As MiFID sets acceptable rules for the disclosure of simulated past performance, we also propose to apply these to promotions of non-scope business to have a consistent approach<sup>14</sup>.

#### *Future performance*

- 4.26 MiFID sets requirements for future performance that apply to all communications from firms to retail clients<sup>15</sup>. We will publish our proposals on the issue of illustrations in product disclosure for non-scope business in due course (see also the *Reforming COB Regulation CP* discussion on product disclosure).

#### *Appropriate and proportionate use of performance information*

- 4.27 The MiFID requirements for past, simulated and future performance will apply to scope business for ‘all information’, in a way that is appropriate and proportionate. We consider that these requirements are relevant to all financial promotions, but not always appropriate for all non-marketing communications (see chapter 3 of this CP). Consequently, the detailed rules are located in NEWCOB 5, with a cross-reference to them in NEWCOB 4, reminding firms that for non-marketing communications these detailed requirements may not be appropriate or proportionate in all instances<sup>16</sup>.

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14 Implementing Directive article 27(5).

15 Implementing Directive article 27(6).

16 Implementing Directive recital 46.

### *Marketing communications to be identifiable as such*

- 4.28 MiFID requires that ‘marketing communications shall be clearly identifiable as such’<sup>17</sup>. This is a new provision within our rules, although firms should be doing this to comply with the fair, clear and not misleading requirement and there are also similar requirements that apply more widely to advertising<sup>18</sup>. As it is relevant to all firms when they communicate marketing materials, we are proposing that the provision implementing this requirement applies to all firms.

### *Co-branding*

- 4.29 At present we have a provision in the financial promotion rules that specifically bans financial promotions that give a misleading impression of the identity of a product’s producer<sup>19</sup>. The high-level rules (including the requirement to disclose the firm’s name and provide accurate and sufficient information) mean that a detailed rule on co-branding is no longer necessary.
- 4.30 However, we are proposing guidance on the standards we expect of firms when they communicate or approve financial promotions about another firm’s products.

### *Financial promotions containing advice*

- 4.31 If a financial promotion contains advice, then the revised ‘suitability’ rules proposed in NEWCOB 10 will also be relevant. If the promotion refers to a packaged product, NEWCOB 7 may also be relevant. For further information about identifying client needs and advising please see the *Reforming COB Regulation CP*.

## **Packaged product disclosure requirements**

- 4.32 From our research on levels of financial capability in the United Kingdom, we have concluded that people are generally poor at choosing products<sup>21</sup>. Consumers are potentially more vulnerable in the direct sales marketing context than in face-to-face sales as they are largely unable to ask questions to clarify meaning and must rely mainly on the paperwork. There are also fewer consumer protections (such as the suitability test and suitability letter) in the direct sales marketing context<sup>22</sup>.

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17 MiFID article 19(2) (second sentence).

18 The British Code of Advertising, Sales Promotion and Direct Marketing clause 22.1.

19 COB 3.8.19R(2).

20 The Finance Act 2004 introduced a new tax regime for pensions with effect from 6 April 2006.

21 Consumer Research 47 *Levels of Financial Capability in the UK: Results of a Baseline Survey* which covered all products, not just investments.

22 Our current general policy approach to non-advised business initiated by the client (i.e. not in response to a financial promotion) is that there are fewer grounds for requiring the additional protections expected in other channels. Currently, for schemes sold at the initiation of the client and at a distance, we require that the client is given a Key Features Document (KFD) or Simplified Prospectus (SP). This is beyond what is required by the DMD. For similar schemes not sold at a distance, we do not require that a disclosure document be provided to the consumer. We intend to align our requirements for this type of business and remove the requirement for distance business to include a KFD/SP. Instead, firms will need to provide the information required by the DMD, along with any information they may be required to provide under MiFID. Where non-advised business is initiated by the firm (i.e. in response to a financial promotion) different disclosure requirements apply. As at present, firms will not need to provide the KFD or SP so long as they provide the information contained in those documents.

- 4.33 To address the asymmetry of information between firms and consumers, the *Reforming COB Regulation CP* proposes to carry forward rules specifying the content and format of product disclosure documents for packaged products.

### **New approach to direct offer financial promotions**

- 4.34 Our current approach assumes that the direct offer financial promotion is the final contact between the firm and the client before a transaction. A direct offer financial promotion is one that, in summary, contains an offer or invitation to enter into an agreement in relation to a financial instrument or a service, and specifies a means of response or includes a form by which a response may be made. We therefore require that direct offer financial promotions must contain sufficient information to enable a consumer to take an investment decision on an informed basis. However, where the promotion is not the last communication from the firm and the information could be supplied later in the process, this current prescription is inflexible and may lead to difficulties in interpretation.
- 4.35 As a result of the Financial Promotion Review and the need to implement MiFID, we are revising the rules for these promotions. In the future, disclosure requirements<sup>23</sup> will not be triggered by whether or not a promotion is a direct offer. Instead, for non-advised sales, disclosure may be supplied at any stage in the sales process (including within the promotion), so long as it is provided in good time before a transaction resulting from the promotion<sup>24</sup>. As at present, the proposed new requirements still aim to provide appropriate consumer protection and to address the information asymmetry between firms and clients.
- 4.36 One of the consequences of the increased flexibility over timing of disclosure material and the move away from product-specific rules, is that it is no longer necessary for direct offer financial promotions to be such a focus of our rules. They are now only one step in the process culminating in a sale. We are therefore proposing to remove the ‘direct offer financial promotion’ defined term.
- 4.37 The combined effect of the high-level rules for financial promotions (to act in the best interests of the client; to be fair, clear and not misleading; to provide sufficient information and not to disguise, diminish or obscure important items) will mean that information is likely to be sent close to the time of the financial promotion that includes an offer or invitation and specifies the manner of response.

### **Appropriateness test**

- 4.38 Detail on the provisions relevant to the ‘appropriateness test’ in NEWCOB 11 can be found in the *Reforming COB Regulation CP*. However, the appropriateness test is relevant to our proposal for the marketing of derivatives and warrants, so we summarise the effect of the appropriateness test below.

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23 Implementing Directive articles 30 to 33, which cover, in summary: the firm and its services for retail clients and potential retail clients, the financial instruments offered, details concerning safeguarding of client financial instruments or client funds, and information about costs and associated charges.

24 Implementing Directive article 29(8) and recital 48.

- 4.39 The appropriateness test is a new requirement in MiFID. The closest current requirement is the pre-marketing ‘may be suitable’ assessment relating only to direct offer financial promotions of derivatives and warrants.<sup>25</sup>
- 4.40 In brief, the appropriateness test obliges a firm to seek information from a retail client to enable it to determine whether the client has the necessary knowledge and experience to understand the risks involved in the transaction or service. If the firm considers that the client does not have that knowledge or experience (or is unable to determine either way) then the firm must warn the client. We would expect firms to apply the test on a sliding scale, with a higher standard of test for more complicated products and for more vulnerable consumers.
- 4.41 The appropriateness test must be conducted before the transaction is completed or the service entered into. Firms do not have to make the assessment before they send out a promotion, as is currently required with the ‘may be suitable’ assessment.
- 4.42 The appropriateness test applies to all scope ‘complex’ products sold by MiFID firms to retail clients. This captures most, but not all, derivatives and warrants. Sports and political spread bets, for example, are not within MiFID scope, and non-MiFID scope firms marketing any derivative or warrant are not automatically required by MiFID to apply the appropriateness test. We have observed a market failure for these products, which at present is mitigated by the pre-marketing ‘may be suitable’ assessment. Rather than have different standards for scope and non-scope situations, we propose to replace the current ‘may be suitable’ assessment with the appropriateness test for all retail transactions in derivatives and warrants that result from a specified type of financial promotion<sup>26</sup>.
- 4.43 In practice, we envisage that firms will find it difficult to identify when a client is responding to a financial promotion and where they are acting on their own initiative and this may impact on the way they structure their business models. We are consulting in the *Reforming COB Regulation CP* on whether to extend the appropriateness test to all non-advised retail transactions of derivatives and warrants.
- 4.44 Where we propose to apply the test to non-scope retail transactions of derivatives and warrants, transitional provisions will allow firms until mid-2008 to comply with the appropriateness test requirements. Until then, firms may continue to comply with the existing ‘may be suitable’ assessment unless they wish to move to the new standard.
- 4.45 MiFID firms will also need to consider whether a communication for a MiFID ‘non-complex’ product is ‘personalised’, since such communications may trigger the need for the appropriateness test (see further the *Reforming COB Regulation CP*).

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25 COB 3.9.5R(2).

26 Such financial promotions are, in summary, those that contain an offer or invitation to enter into an agreement in relation to a financial instrument or a service, specify a means of response and otherwise comply with the requirements of Implementing Directive article 29(8).

## Distance marketing and electronic-commerce

- 4.46 The proposed structure for NEWCOB incorporates the DMD and Electronic Commerce Directive (ECD) provisions in a new Distance communications chapter, NEWCOB Chapter 6, which we discuss in more detail in the *Reforming COB Regulation CP*.
- 4.47 In summary, the DMD impacts on firms' distance communications with consumers and the ECD sets out the legal framework governing all cross-border electronic-commerce services. In particular, a firm communicating a financial promotion that it expects will lead to a distance contract needs to make specified pre-contractual disclosures. As part of the revision of COB, the current DMD and ECD-derived disclosure requirements<sup>27</sup> have been recast as rules within NEWCOB 6.
- 4.48 When communicating with consumers at a distance, firms will need to ensure they comply with the disclosure requirements detailed elsewhere in NEWCOB<sup>28</sup>.

## Further deregulation

- 4.49 There are a number of areas where we have considered it appropriate to deregulate. In some of these cases we consider that high-level provisions will provide appropriate standards. In others, the existing rules are no longer objectively justified and there are other cases where deregulation may be necessary to avoid being super-equivalent to MiFID.

### *The move to more principles-based regulation*

- 4.50 As part of the move to the new regime, we will be introducing high-level requirements and removing many product-specific rules, which currently mandate the inclusion of specified information in promotions<sup>29</sup>. In some cases, the current prescription may lead to the inclusion of irrelevant detail. Instead of requiring this information, the new rules will be more flexible. They will place responsibility on firms to decide for themselves what information or actions are relevant to their consumers and for their products or services. Below are some examples of areas where this is the case.

### *Collective investment schemes: charges*

- 4.51 We do not propose to retain the current requirement for direct sales promotions for Collective Investment Schemes to disclose whether charges are taken from capital or income, and the likely long-term effect of those charges on capital or income<sup>30</sup>. High-level provisions that apply to all firms will require firms to disclose arrangements for payment of charges<sup>31</sup> and should result in firms making it clear to consumers what charges are deducted. We consider the new high-level rules should provide adequate consumer protection.

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27 COB 3.9.6R and COB 3.9.7AR.

28 For example, the disclosure provisions in NEWCOB 2, 6 and 7.

29 Many of the rules relating to direct offer financial promotions in COB 3.9, for example, are product-specific and require firms to include specified information such as particular risk warnings, tax disclosures and information about products.

30 COB 3.9.23R.

31 Implementing Directive article 33.

### *Enterprise investment schemes: projections and disclosure*

- 4.52 We do not propose to retain the current explicit ban on projections<sup>32</sup> in financial promotions for Enterprise Investment Scheme (EIS) shares<sup>33</sup>. Other provisions should provide appropriate consumer protection. To retain the ban would also be super-equivalent to MiFID<sup>34</sup>.
- 4.53 Also, we do not propose to retain the disclosure requirements relating to an EIS<sup>35</sup>. We do not impose such requirements on comparable high-risk products, and no additional consumer detriment has been identified. So, we are proposing to rely on high-level disclosure requirements. Other requirements, such as the appropriateness and suitability tests, will provide a measure of consumer protection by addressing the information asymmetry arising when dealing with products that may be regarded as 'complex' under MiFID.

### *Broker funds: direct offer financial promotions*

- 4.54 We are proposing to remove the current ban on the direct sales promotion of broker funds<sup>36</sup>. There are now other products on the market with similar characteristics where we have not restricted the promotion (such as multi-manager funds, open architecture fund platforms, self-select ISAs and SIPPs, which invest in a range of underlying investments, and can include charging structures that are difficult to understand). We believe that high-level rules are sufficient and capable of dealing with broker funds and other products and do not want to retain product-specific rules that are not flexible to changes in the market.
- 4.55 In the absence of this ban, we recognise the importance of firms taking care when communicating promotions for products with charging structures and other characteristics that are difficult for consumers to understand. We are therefore proposing to provide guidance to indicate that we expect firms to consider the needs of the intended recipients and their understanding of the product being promoted. Additionally, for those firms within MiFID scope we would not have been able to retain these rules.

### *Qualified investor schemes*

- 4.56 We do not propose to carry forward the provisions for qualified investor schemes (QISs)<sup>37</sup>. This is in line with the move to high-level rules, the review of COB and the move away from product-specific rules, as well as the need to remove super-equivalent marketing restrictions on MiFID-scope products.

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32 COB 3.8.18R.

33 The Enterprise Investment Scheme is a government-originated scheme designed to encourage investment in small unquoted companies carrying on qualifying trades in the UK by granting tax relief to investors.

34 Implementing Directive article 27(6) prevents firms from presenting information on future performance unless the information is based on reasonable assumptions supported by objective data.

35 COB 3 Annexes 2 and 3.

36 COB 3.9.5R(1).

37 COB 3.11.6R to COB 3.11.7G: A QIS is, essentially, an authorised mixed-asset fund developed for the non-retail market. QISs have more relaxed rules governing their operation and investment powers than retail schemes. They are scope products and our current rules restricting promotions are super-equivalent to MiFID.

- 4.57 The rules that govern the operation of QISs in the new Collective Investment Schemes Sourcebook (COLL) will continue to include a requirement for a QIS operator to act as a gatekeeper and take reasonable care to ensure that only eligible investors invest in the fund<sup>38</sup>. At present, we plan to publish a CP in 2007 covering necessary consequential amendments. We anticipate that this CP will relocate the material relating to eligible investors in a new COLL annex<sup>39</sup>.

### **The internet and electronic media**

- 4.58 Much of the existing guidance on using the internet and other electronic media to communicate financial promotions duplicates material covered in PERG, the FPO and NEWCOB 6 and so is unnecessary<sup>40</sup>. We do not propose to carry this forward in NEWCOB, other than the guidance on record keeping for continuously updated market information<sup>41</sup>, which we intend to retain in NEWCOB 5.

### **Confirmation of compliance and approval of financial promotions**

- 4.59 High-level rules will require firms to implement systems and controls to meet their regulatory requirements<sup>42</sup>. Rather than retain detailed confirmation of compliance rules, we are proposing to include guidance reminding firms that under SYSC, they are required to have systems and controls or policies and procedures to ensure compliance with the financial promotion rules.
- 4.60 Although the relevant provisions will no longer be housed in the financial promotion chapter, we will still expect firms to have systems and controls in place to confirm compliance with the financial promotion rules.

#### *Confirmation of compliance on behalf of authorised firms*

- 4.61 A MiFID firm cannot rely on another firm to have carried out the confirmation exercise on its behalf. However, our rules will allow non-MiFID firms to continue, as at present, to rely on a confirmation of compliance process carried out by another authorised firm.

#### *Approval for unauthorised firms*

- 4.62 We are also proposing requirements that apply when a firm approves a financial promotion for an unauthorised person, in order to satisfy the requirements of section 21 of FSMA.

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38 COLL 8.1.3R.

39 Currently this is contained in COB 3 Annex 5.

40 COB 3.14.

41 COB 3.14.5G(6).

42 Currently, SYSC requires a firm to: take reasonable care to establish and maintain such systems and controls a) as are appropriate to its business; and b) for compliance with applicable requirements and standards under the regulatory system; and have an adequately resourced and competently staffed compliance function. These provisions in SYSC will be revised as per the *Organisational Systems and Controls: Common Platform for Firms CP* (CP06/9).

## Record keeping

- 4.63 We have concluded that the existing rules which require firms to retain adequate records of financial promotions should largely be retained. To help firms, we are also proposing to give guidance in NEWCOB 5 on the record keeping requirements.
- 4.64 There is also value in retaining the existing guidance on telemarketing scripts<sup>43</sup> as a rule to make clear that they are financial promotions and must be kept as records. We are also retaining the existing guidance that makes it clear that firms can record financial promotions containing continuously updated market information without recording the updated information itself<sup>44</sup>.
- 4.65 Regarding the retention periods, we are proposing to retain our existing rules as they currently apply to non-scope business<sup>45</sup>. Where MiFID applies, the MIFID provisions on retaining records will apply<sup>46</sup>. This means that records will need to be kept for three, five or six years, or indefinitely depending on the nature of the firm and the nature of the business to which the financial promotion relates.

## Unchanged provisions

### *Cold calls*

- 4.66 We intend to retain restrictions on cold calls<sup>47</sup>, but are proposing a higher-level approach setting out issues firms might like to consider in deciding on a reasonable process for cold calling. For example, we do not propose to prescribe the exact hours during which a call can be made.

### *Approval of financial promotions and additional requirements for overseas or unauthorised persons*

- 4.67 The provisions relating to communication and approval of financial promotions for an overseas person or an unauthorised person will be carried forward in NEWCOB 5<sup>48</sup>. We will recast some of the guidance at a slightly higher level, but leave the effect of the replacement NEWCOB provisions unaltered. These rules are outside the scope of MiFID and are derived from primary legislation and the FPO. We are therefore unable to make changes in this area.

## Unregulated collective investment schemes

- 4.67 At present, it is our intention to retain the substance of the existing provisions relating to the promotion of unregulated collective investment schemes (UCISs)<sup>49</sup>. However, we will be consulting on this issue at a later stage.

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43 COB 3.8.25G.

44 COB 3.14.5G(6).

45 COB 3.7.1R.

46 MiFID article 13(6) and Implementing Directive article 51 as implemented in SYSC.

47 We are proposing to retain existing provisions (COB 3.10.3R) to impose restrictions on the promotion of unsolicited real time financial promotions (redefined in NEWCOB as 'cold calls'), where no FPO exemption applies.

48 COB 3.12 and COB 3.13.

49 COB 3.11.1G to COB 3.11.5G.

## Industry codes

- 4.69 At present in COB 3, we have guidance suggesting that firms may find it helpful to take account of the British Bankers' Association/ Building Society Association Code of Conduct for the Advertising of Interest Bearing Accounts and the ABI Life Insurance (Non-Investment Business) Selling Code of Practice<sup>50</sup>. We continue to believe that codes are a useful tool, especially in a more principles-based regime. A Discussion Paper is to be published shortly, which details how the Industry Guidance providers can attain recognition from the FSA that their guidance is fit for purpose. In line with that paper we are only proposing to carry forward the reference to the Banking Code.

## Public offer advertisements

- 4.70 An advertisement about an offer or admission to trading of transferable securities may currently be covered by both the financial promotion rules and by the advertising rules in the Prospectus Rules sourcebook (PR)<sup>51</sup>. Our proposal is that the requirements in NEWCOB for the content of such an advertisement under the financial promotions regime will mirror the requirements for their content under the PR rules. In addition, the financial promotions rules in NEWCOB 4 and 5 that implement MiFID provisions will apply where the advertisement is issued by a MiFID firm providing a MiFID service.
- 4.71 This means that where PR or NEWCOB rules apply to such an advertisement that is issued in the course of non-MiFID scope business, the information in the promotions must not be inaccurate or misleading<sup>52</sup>. The existing clear, fair and not misleading standard will no longer apply to such business. We feel that this provides appropriate standards, particularly as we understand that most of these promotions are not directed at retail customers<sup>53</sup>.

## The regulation of investment trust companies

- 4.72 In the November 2005 government response to *The Regulation of Investment Trust Companies* consultation document<sup>54</sup>, the government invited us to consider whether financial promotions relating to shares in an investment trust company must warn that recourse to the Financial Ombudsman Scheme (FOS) and the Financial Services Compensation Scheme (FSCS) is not available to direct investors. We have decided not to propose such a requirement. As explained in this CP, we are moving towards more principles-based regulation and removing product-specific rules where we

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50 COB 3.8.6G(1) and (3).

51 PR 3.3.

52 PR 3.3 sets out other requirements that a promotion must comply with before it is issued.

53 It is also relevant that other EU initiatives set relevant standards which protect retail investors receiving these advertisements, such as those provisions implementing the Unfair Commercial Practices Directive and the Misleading & Comparative Advertising Directive.

54 HM Treasury, *The Regulation of Investment Trust Companies* consultation document, November 2004.

consider high-level rules are adequate. In line with this approach, it will be a firm's responsibility to decide whether to refer to FOS and the FSCS in a financial promotion for investment trusts.

### **Authorised professional firms**

- 4.73 Financial promotions communicated by MiFID-scope authorised professional firms will need to comply with the relevant requirements in MiFID. For promotions for non-MiFID activities, we are consulting now on carrying forward the current approach, but we intend to consult further on the conduct of business rules relevant to authorised professional firms in a CP planned for the first quarter of 2007.

### **Implications for firms**

- 4.74 From November 2007, as a result of the proposals in this chapter, all firms may need to revise their approach to the communication and approval of financial promotions. In particular, we expect that firms that use direct sales marketing may wish to consider revising their business models.

### **Implications for consumers**

- 4.75 We expect most consumers to be unaffected by the regulatory changes arising as a result of these proposals, as appropriate standards of protection will apply. Some consumers will notice more detailed information is provided in some financial promotions, and less in others. In addition, some consumers will become aware of a need to provide 'appropriateness test' information before a firm is prepared to conclude certain non-advised sales.

### *References*

- The existing rules are at COB 3.
- The relevant sections of MiFID are at article 19(2) of MiFID and article 27 of the Implementing Directive.
- Draft Rules implementing the proposals in this chapter are at NEWCOB 5.

### **One-Month Consultation Question**

- 1MQ.2: For MiFID-scope business, do you agree with the way in which we propose to implement MiFID provisions relating to scope financial promotions in NEWCOB 5?

## **Four-Month Consultation Question**

- 4MQ.3: Do you agree with the way in which we have applied financial promotion provisions to non-MiFID scope business in NEWCOB 5?
- 4MQ.4: Do you agree with our new approach to direct offer financial promotions?

# 5 FSA financial promotion strategy and implementation

## **Introduction**

- 5.1 In August 2006, we published a paper that provided an update on our recent work on financial promotions and an outline of our future plans<sup>1</sup>. The proposals in this CP are consistent with the more principles-based approach to regulation outlined in that paper.
- 5.2 The standard of financial promotions continues to be a priority in achieving our aim of securing the appropriate degree of consumer protection through an efficient and effective retail market in financial services.

## **Intelligence collection**

- 5.3 We acquire intelligence in the course of proactive work; visiting firms and reviewing thousands of financial promotions across a range of media. This will continue to be a mainstay of our approach. However, we also find the Financial Promotions Hotline to be a useful source of intelligence as to promotions that constitute a risk to consumers. Firms, interested parties and consumers can report financial promotions which they consider to be unfair, unclear or misleading, either by phone on 08457 300 168, or by using our online reporting form at [www.fsa.gov.uk/consumer/advertising/mn\\_spot.html](http://www.fsa.gov.uk/consumer/advertising/mn_spot.html).

## **Communications with firms, industry bodies and consumers**

- 5.4 A more principles-based regime increases the need for us to provide firms with information so they can satisfy their requirements. We plan to use our website and other publications to set out our views and to highlight issues arising from our thematic work.
- 5.5 When we asked trade associations, firms and advisers what communications they wanted from us about financial promotions it was clear that a range of communications was desired. We have been asked to give examples of good and bad practice, case studies, bulletins, dedicated web pages, and provide training.

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1 Financial Promotions: Progress update and future direction.

- 5.6 In response, we have provided the following:
- dedicated industry and consumer focused web pages;
  - regular consumer and topic-specific bulletins;
  - presentations at conferences and events;
  - bespoke training for firms and other bodies;
  - ‘Dear CEO’ letters highlighting areas of concern;
  - targeted letters to individual firms;
  - press releases on financial promotion issues; and
  - details of the outcome of our thematic work.
- 5.7 We aim to continue to communicate with firms on this basis to help them understand the outcomes we are seeking and to improve standards.

## **Supervision**

- 5.8 In carrying out our financial promotion supervisory work, we will continue to take a risk-based and proportionate approach to selecting the areas to which we allocate resources. We assess the potential risk to consumers of any financial promotion that we consider fails to be fair, clear and not misleading. In doing this, we take into account various considerations, including: the type of product, the distribution channel, the intended recipients, the overall seriousness of the issue, and any actual or potential consumer detriment. Then, as necessary, we may apply different supervisory tools, such as directly approaching the firm, carrying out a firm visit, or carrying out thematic work looking at the wider market.
- 5.9 We will continue to conduct thematic work to identify areas where there are wider market issues or where there is a potential reduction in standards. We will pay particular attention to those areas where we are removing product-specific rules. We will also continue to communicate the outcomes of this thematic work, instances of good and bad practice and our expectations for firms, through our website, press releases, via our industry and consumer bulletins and by alerting relevant trade bodies.
- 5.10 In relation to our case-based work, we will continue to conduct an initial assessment of promotions. If we decide that a promotion is deficient, we will engage with the firm, explaining why we consider it fails to meet the high-level requirements set out in this CP. We will explain our preliminary view of the promotion, indicating areas of concern, and will ask the firm to explain why it believed the promotion was fair, clear and not misleading and what process it went through in issuing that particular promotion, which may include looking at any relevant research or other information used.
- 5.11 We recognise the need for timely action both to prevent consumer detriment and to avoid other firms from being unfairly disadvantaged. This will often involve intervening with firms and asking them to amend or withdraw misleading promotions.

- 5.12 We will continue to use firm visits to gain a better understanding of the business strategy and senior management's view on how financial promotions fit into that strategy. These visits will also continue to help us understand how the firm is structured and resourced in the financial promotions area; the links between product development, marketing and compliance functions; and the firm's systems and controls in the creation, approval and monitoring of financial promotions.

### **Enforcement**

- 5.13 A referral to our Enforcement Division is reserved for more serious cases. This includes cases such as failure to disclose significant risks or drawbacks; failure to describe adequately the commitment required of the consumer; the issuing of unclear, unfair or misleading financial promotions; or failure to establish and maintain effective systems and controls for ensuring appropriate standards. We are prepared to take enforcement action on the basis of high-level rules and principles when appropriate.

### **Transitional provisions and waivers**

- 5.14 Please refer to Chapter 26 of the *Reforming COB Regulation CP* on the impact of NEWCOB on transitional provisions and waivers.
- 5.15 The only transitional provision we propose for the new financial promotion and other communications rules relates to the current 'may be suitable' assessment for direct offer financial promotions of derivatives and warrants to retail clients (see paragraph 4.44 above).

# Cost benefit analysis (CBA) and compatibility statement

## Introduction

- 1.1 We are required under the Financial Services and Markets Act 2000 (FSMA) to publish ‘an estimate of the costs together with an analysis of the benefits that would arise if the proposed rules are made’. Under section 155(8) of FSMA, an analysis is not required if the resulting increase in costs is of minimal significance. We consider that the proposed changes set out in this CP warrant a CBA since the cost of their implementation is expected to be more than minimal.
- 1.2 This section sets out our analysis in relation to our proposals for the new financial promotion and other communications regime. The analysis compares the situation that will arise once our proposed requirements are in place with the situation had they not been introduced. It is accompanied by a compatibility statement, which sets out how our proposals contribute to our objectives and how we have had regard to the principles of good regulation.
- 1.3 In our Better Regulation Action Plan published in December 2005, we committed to implement EU directives in a way that adds national measures to directive provisions only when justified and consistent with directive provisions. The Better Regulation Action Plan also notes that where we exercise discretion (for example by adding rules that go beyond the requirements of a directive) we will only do so ‘when there is a market failure and where regulatory intervention is likely to be cost-effective’. The HMT/FSA MiFID Joint Implementation Plan published on 5 May 2006 reaffirms this approach and describes the FSA’s approach to implementing MIFID in greater detail<sup>1</sup>. In the rules we are proposing, none of the changes are super-equivalent to MiFID.
- 1.4 This annex includes analysis of the:
  - direct costs to the FSA;
  - compliance costs to implement MiFID minimum requirements;
  - compliance costs of discretionary policy proposals;

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1 Joint Implementation Plan for MiFID, HM Treasury and FSA, May 2006.

- indirect costs; and
- benefits.

1.5 We invite responses as to whether our assumptions are correct.

## **Population**

1.6 Firms currently subject to the COB Sourcebook will be affected by the new regime. This will include firms operating in markets involving: deposit taking; life, pensions and investment advisory business; management of retail and pension funds; brokerage services; life packaged product providers; non-life packaged product providers and non-packaged product providers.

## **Methodology**

1.7 In July 2006, we commissioned LEK Consulting to review our proposals and to indicate the likely impact on industry. This has helped inform our policy development. In addition, we have used the following sources of information:

- informal discussion with industry, specialist bodies and the Financial Services Consumer Panel;
- an informal pre-consultation survey of firms;
- a workshop attended by industry and consumer representatives; and
- other data already available to us.

1.8 In determining our approach to regulation, we have considered the use of financial promotions by both firms and consumers. From a supply side perspective, advertising is often a necessary cost incurred by firms to increase demand and the willingness of consumers to pay for their products. Where advertising increases one firm's sales compared to others in the market, this will lead to competition to provide more advertising, and so to higher marketing costs. Financial services is an advertising-intensive industry (in 2005, the industry spent £1.5 billion on marketing<sup>2</sup>).

1.9 We have also considered the different purposes promotions can serve.

- Persuasive advertising aims to convince consumers to invest. Primarily this focuses on brand loyalty and, as such, tends to lead to less price-sensitive consumers. Advertising may deter market entry for new providers, as consumers become reluctant to try new products of unknown quality. Firms may also enjoy higher profits as the price inelasticity may lead to higher charges. Persuasive advertising to create brand loyalty works with credence type goods or experience goods (including many financial services), where the product outcome may only be experienced after a long time (and, therefore, consumers are less able to adjust their choices through experience). In this case, advertising in the absence of

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2 Source: Nielsen Media Research (NMR).

regulation can be focussed on misleading messages, such as past performance being an accurate predictor of future returns.

- Informative advertising aims to increase demand by communicating information about product features or the existence of products. From this perspective, advertising can help to reduce the asymmetry of information, leading to more price-sensitive consumers and reducing the ability of firms to maintain higher charges. Advertising may therefore provide a positive benefit to consumers and help new competitors (which are more likely to compete on charges and product features as they do not have a well-known brand) to enter the market.

- 1.10 In our discussions with LEK Consulting we agreed that, in order to analyse the market impacts of the proposed regulatory changes, financial promotional activity should be grouped into two main areas.
- Advertising of long-term investment products tends to focus on branding and performance as the features of packaged products are often difficult for consumers to understand. Some providers do try to advertise based on charges and product features but, in general, promotions try to build consumer trust in the provider.
  - Financial advice is mainly based on inter-personal relationships between advisers and clients. The adviser usually receives the majority of the fee or commission income from advice. This limits the potential for the firm to advertise or promote advice services. In some instances, there are moves toward a more firm-based business model (and away from the focus on the relationship between the adviser and client). Part of this process involves financial promotion to increase brand value.
- 1.11 Where the promotional focus is on branding, our proposed regulation aims to moderate the adverse effects of information asymmetry and to facilitate competition, while still allowing firms to provide compelling promotional material.
- 1.12 By removing much of the detail and prescription from the sourcebook, the high-level rules should help firms that promote based on product features.
- 1.13 The proposed changes in this CP move toward more principles-based regulation and implement MiFID. Compliance costs within these two approaches cannot be estimated in isolation from other Handbook changes, as they will form part of the overall costs. Attributing meaningful costs to specific rules or principles has not been feasible and therefore we have not provided estimated figures for the compliance costs of these changes.
- 1.14 The need for additional training, for example, will arise in a number of business areas following the introduction of NEWCOB. It is probable that training will be aggregated, rather than focused on particular areas. We therefore do not include an estimate of the incremental costs involved for training relating to the new financial promotion and other communications rules. Please refer to the *Reforming COB Regulation CP CBA* for an estimate of the total cost of increased training requirements. Similarly, analysis of the impact of the new client categorisation rules

and MiFID-scope record keeping requirements is included in the *Reforming COB Regulation CP*.

- 1.15 We are publishing a separate report into the expected costs and benefits of the introduction of MiFID. This will analyse the issue as a whole, rather than cover specific areas of rules in isolation.

### **Direct Costs for the FSA**

- 1.16 We are already supervising promotions with a greater focus on principles and objectives (such as whether promotions are fair, clear and not misleading), rather than relying on compliance with detailed rules. Where we contact firms concerning potential breaches of the rules, we do so primarily in relation to high-level rules and the principles. The introduction of the new financial promotion and other communications rules should not therefore represent a sudden shift in our behaviour or systems, although it will place greater reliance on our use of these methods.
- 1.17 To contribute towards a consistent approach and consistency in the system, it is likely that there will be a need for monitoring on a different basis, increasingly looking at promotions thematically rather than promotion-by-promotion. We are already beginning to do this and the transition to the new regime should be smooth. Approaching promotions thematically will help to ensure that similar standards are maintained across all promotions.
- 1.18 We will continue to work with trade bodies to help them understand the new regime and assist them in providing supplementary information to member firms.
- 1.19 We will also continue to communicate directly with firms to provide information to help them meet the requirements. We will use our website and publications to communicate more generally, including with consumers, on the standard of promotions and highlight concerns arising from our thematic work.
- 1.20 Often, judgement calls will be needed where there is ambiguity under the high-level rules. It is important for us to take a fair and consistent approach in these cases, proportionate to the risk involved. There will be limited training costs to help our staff become more experienced and confident in making the correct, outcome-focused judgements.

### **Compliance costs to implement MiFID minimum requirements**

- 1.21 We have identified the changes to the regime that will lead to an increase in compliance costs of more than minimal significance.

#### *Greater reliance on high-level rules and principles*

- 1.22 Some firms have suggested to us that the move to a higher-level regime would redirect resources from meeting detailed requirements toward new processes required to show compliance with the higher-level rules, therefore not necessarily leading to an increase in compliance costs. However, the majority of firms have stated that one-

off and ongoing costs are likely to increase with the introduction of the new system, though as noted above were unable to quantify the magnitude.

- 1.23 Implementing the rules in this CP may, for example, lead to one-off costs for training and internal or external compliance and legal consultancy, leading to the generation of new compliance manuals. Ongoing costs may include the increased collection of evidence and research (where appropriate) to justify interpretations of the rules and increased monitoring costs to confirm compliance with the high-level rules. Initial uncertainty about how the high-level rules work in practice may mean that these costs are higher at first, but reduce over time. A number of firms suggested that this is likely to be the case.
- 1.24 Where possible, however, LEK Consulting suggested (and firms have subsequently confirmed) that initially many will act cautiously, preferring to retain current marketing practice since this will often be consistent with the new high-level rules. As we are largely simplifying the rules rather than imposing additional regulatory requirements on firms, we are not enforcing any specific change in practice. Firms will be able to decide for themselves how best to adjust their processes. They may do so in a cost-effective manner to make best use of the additional flexibility for their needs. Firms will make such changes as part of the general review following the introduction of the NEWCOB sourcebook and it will prove difficult to isolate costs for this one specific area. As such, firms have found it difficult to provide estimates of the compliance costs involved.

#### *Detailed MiFID rules that apply to all scope communications*

- 1.25 MiFID imposes detailed rules on the use of past performance, simulated past performance and future performance in all scope communications (including non-promotional communications). We would expect firms to apply these rules where relevant and this may lead to some additional compliance costs.
- 1.26 Past performance disclosure within MiFID-scope structured deposit and non-packaged product communications, for example, will be subject to higher requirements than they face at present. They will now be subject to all past performance provisions, where at present the rules impose a less onerous burden for these products.
- 1.27 We expect the additional rules to lead to one-off training costs for MiFID firms.
- 1.28 Ongoing compliance with these detailed rules should become part of the compliance procedure and may not add significantly to costs.
- 1.29 Additionally, these detailed requirements apply in a way that is appropriate and proportionate. In many cases, firms will be able to avoid adding details to non-promotional communications and to continue with current practice where the extra detail is inappropriate and disproportionate. They will still have to ensure the detail is irrelevant before making this decision.

### *MiFID rules on the use of comparison data in communications*

- 1.30 Where firms compare their products and services to other investments and their competitors' offerings, MiFID requires them to include particular details that are not required at present (the source of the comparison information and key facts and assumptions used to make the comparison). There will therefore be an additional regulatory requirement on MiFID firms, as they will need to disclose more information if they choose to make comparisons.
- 1.31 The information should already be available to the firm as part of the background research for the communication, but inclusion of the additional material may lead to additional one-off and ongoing costs. However, firms have been unable to quantify the magnitude of these costs

### *Application of rules to FPO exempt firms*

- 1.32 MiFID covers some promotions that are currently exempt under the FPO. Similar non-scope promotions will still benefit from the FPO exemptions. Where communications are now subject to our regime, firms will need to consider applying the rules to these promotions. In some cases, this may lead to additional compliance costs. The change may affect some life, pensions and investment advice firms in particular.

### *Incremental compliance costs of minimal significance*

- 1.33 The remainder of the changes are expected to give rise to compliance costs of no more than minimal significance. For the following proposals, this is due to the following reasons:
- **Past performance:** Firms should largely be able to retain current practices without breaching the MiFID requirements. Where MiFID does impose additional disclosure requirements (on the source of information, for example), firms should already have this information available as part of the research underlying the promotion. They should be able to incorporate the additional data without adding significantly to costs.
  - **Simulated past performance:** The rules in MiFID largely reaffirm the current guidance in COB and follow from the fair, clear and not misleading high-level rule. They should lead to minimal additional compliance costs.
  - **The changed rules relating to direct offer financial promotions:** The new rules relating to the disclosure of information when communicating a direct sales promotion in MiFID should add no incremental compliance costs as firms will be able to retain current practices.
  - **Loss of the 'reasonable steps' standard for the 'fair, clear and not misleading' requirement:** Although MiFID appears to apply a higher standard, which could lead to higher compliance costs for firms. According to LEK Consulting, the change will make little difference in practice as firms act as if the requirement were already absolute. The change should not therefore lead to higher incremental costs or changes in firm behaviour. As such, we also intend to apply

the MiFID standard to non-scope business. This approach is consistent with Principle 7, which does not include the ‘reasonable steps’ standard.

- Marketing communications to be clearly identifiable as such: We do not expect this to generate incremental compliance costs, as there should be no change in practice. The British Code of Advertising, Sales Promotion and Direct Marketing (the BCAP Code) has similar rules already in place for all promotions.

### **Compliance costs of non-scope policy proposals**

- 1.34 We have identified the following discretionary policies as giving rise to incremental compliance costs of more than minimal significance.

#### *Greater reliance on high-level rules and principles*

- 1.35 As with the move toward high-level rules within MiFID scope, we are simplifying the rules rather than imposing additional regulatory requirements. We are not forcing firms to make specific changes to their processes. Firms will have the flexibility to apply the high-level standards for themselves and in a manner consistent with their business model. The types of cost firms are expecting to incur are the same as those analysed in paragraph 1.23. It will prove difficult to isolate costs for this one specific area, as firms will make changes as part of the general review following the introduction of the NEWCOB sourcebook. Firms have therefore found it difficult at this stage to say how they will adapt their systems and we have been unable to obtain reliable estimates of compliance costs.

#### *Incremental compliance costs of minimal significance*

- 1.36 Other discretionary policy proposals are expected to lead to compliance costs of no more than minimal significance:
- Changed rules on comparison data in communications: We propose implementing one of the MiFID provisions for comparative data in communications (‘the comparison must be meaningful and presented in a fair and balanced way’) so that it applies to all scope and non-scope communications. This provision clarifies the ‘fair, clear and not misleading’ requirement. We do not anticipate that it will result in any additional burden on firms. The new rule reaffirms current provisions, but is redrafted at a high level.
- 1.37 We do not expect any incremental compliance costs to arise from applying the following MiFID requirements to non-scope business for the same reasons given above regarding these changes within MiFID scope:
- MiFID past performance and simulated past performance requirements;
  - The changed rules relating to direct offer financial promotions;
  - Loss of the ‘reasonable steps’ standard for the ‘fair, clear and not misleading’ requirement; and
  - Marketing communications to be clearly identifiable as such.

## **Indirect costs**

- 1.38 This section provides an analysis of those proposals we have identified as potentially giving rise to indirect costs of more than minimal significance.

### *Past performance*

- 1.39 Firms may begin to use past performance data more aggressively in promotions to exploit the additional flexibility granted under MiFID. This is an area where firms can gain an advantage over competitors and make their promotions more compelling to consumers. As such, LEK Consulting has suggested it is likely to be one of the first areas where firms take advantage of the greater flexibility in NEWCOB to adjust their practice.
- 1.40 There is some risk of consumer detriment from three sources:
- certain presentations encourage unrealistic expectations of future performance;
  - the loss of prescribed calculations for the data will lead to non-standardised information and make comparisons more difficult; and
  - the less explicit requirements for past performance risk warnings may diminish their importance.
- 1.41 Guidance proposed for NEWCOB 5 will confirm that presenting past performance data in a similar format to the one currently outlined in COB satisfies the new higher-level rules. This is likely to mitigate the identified potential for consumer detriment by leading firms to be more cautious in their portrayal of past performance data and, as noted in Chapter 4, we will review how this operates in practice.
- 1.42 We propose to extend MiFID past performance disclosure standards to non-scope promotions, replacing the current standards. The impacts are therefore expected to be the same for scope and non-scope promotions.

### *Removal of the ban on the direct offer financial promotion of broker funds*

- 1.43 At present, generally, only advised sales of broker funds are possible, so allowing their sale through direct sales promotions is deregulatory and there is increased potential for consumer detriment. However, as noted in Chapter 4, there are now other products on the market with similar characteristics where we have not restricted promotion. We believe that high-level rules in the new regime will provide adequate consumer protections.
- 1.44 Removing the ban may stimulate the market and reverse the observed decline in sales, as broker fund advisers would be able to promote broker funds by financial promotion where the suitability assessment would prevent them from advising clients to invest. Where this leads to an increase in unsuitable broker fund purchases, consumer detriment could occur.
- 1.45 NEWCOB will contain emphasis on the need for firms to disclose clearly the nature and risks of opaque and high-charged products. In addition, promotions should be

presented in a way that is likely to be understood by the average member of the group to whom it is directed. Adequate disclosure should help to mitigate potential detriment by helping consumers to take investment decisions on an informed basis. As is always the case, this mitigation only works if consumers read, understand and act in response to this information.

- 1.46 We could not retain this ban for MiFID-scope broker funds. To avoid arbitrage, we also plan to remove the rule for non-scope direct offer financial promotions of broker funds. The impacts are therefore expected to be the same for scope and non-scope business.

### *Greater reliance on high-level rules and principles*

- 1.47 Our discussions with industry representatives and LEK Consulting suggest that many firms are likely to be cautious initially, preferring to retain some of the certainty from the current Handbook and continue with current practice as far as possible. We do not anticipate radical change immediately with the introduction of NEWCOB, although some firms may decide to take early advantage of the new rules where they believe they can gain a competitive advantage. In time, we do expect firms to take advantage of the greater flexibility.
- 1.48 LEK Consulting also suggested that there will be initial uncertainty and potentially increased compliance costs as a result of the new regime. This may lead to firms reducing their use of advertising in the short-term or focusing on brand-based promotions. This may reduce competition or innovation in promotions in the short-term.
- 1.49 The high-level rules focus on outcomes. We will no longer insist that firms provide specific information in a certain format. Firms will have both responsibility for and discretion over what information they provide to consumers. In some cases, the move to high-level rules will be deregulatory. Examples include the removal of specific risk warnings, prescribed methods of disclosing collective investment scheme charges, prescribed methods of conducting real time communications, prescribed disclosures of taxation and the prohibition on the use of projections in promotions for EISs.
- 1.50 While there may be some risk of detriment attached to removing detailed rules and guidance, much of the current Handbook covers obvious information, which firms would disclose or choose to disclose in a more meaningful way, regardless of whether there was a specific rule in the Handbook. In addition, in order to satisfy the high-level provisions, firms will need to disclose sufficient information that does not disguise, diminish or obscure important items, statements or warnings and that does not emphasise potential benefits without also giving a fair and prominent indication of any relevant risks. This should provide an appropriate level of consumer protection.
- 1.51 In general, the MiFID high-level requirements will be extended to cover non-scope communications and the impacts will be the same in and out of MiFID scope.

### *The changed rules relating to direct offer financial promotions*

- 1.52 At present, COB requires direct offer financial promotions to contain sufficient information to enable a consumer to make an informed assessment of the investment. The new approach will allow greater flexibility as information may be supplied at a different time to the promotion<sup>3</sup>.
- 1.53 In some areas, this brings the rules in line with current practice and avoids interpretational difficulties. The key requirement is for the consumer to be supplied with sufficient information to make investment decisions on an informed basis in good time before the transaction.
- 1.54 In other areas, however, the new approach gives firms greater scope to vary the timing of information in the sales process. A financial promotion may be mailed to targeted recipients, for example, and the full information pack only sent to the consumer after they signal an interest in proceeding with a transaction. At present, the initial mailing should contain the data, but under the new rules, it will only need to be supplied in good time before the transaction.
- 1.55 There may be some consumer detriment where the information is provided significantly early or late in the process, limiting its impact on consumers. However, to satisfy the high-level requirements (to act in the best interests of the client and not diminish the importance of relevant items, statements or warnings, for example), the timing of disclosure may not be significantly different and there is an absolute requirement for consumers to receive it before they enter into the transaction. These factors help mitigate the potential detriment. Additionally, in practice, we do not believe that firms will often take advantage of the flexibility. LEK Consulting has suggested that firms will prefer to incorporate all compliance information in the initial contact with the client (i.e. in the financial promotion), to avoid erecting a further barrier between the client and the sale.
- 1.56 We propose to extend MiFID rules in this area to cover non-scope promotions. The impacts will be the same for scope and non-scope promotions.

### *Detailed MiFID rules that apply to all scope communications*

- 1.57 Where MiFID imposes detailed rules requiring firms to provide certain information in all scope communications, then including unnecessary detail within non-marketing communications may be to the detriment of both firms and consumers. It may lead to excessive detail and over-complication and reduce consumer understanding of the firm's message. Clearly, this is not the intention and the rules apply in a manner that is appropriate and proportionate so that communications remain fair, clear and not misleading.

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<sup>3</sup> Currently for schemes sold at a distance and at the initiation of the client (rather than in response to a communication from a firm), we require that a private customer is given a KFD or SP. In NEWCOB, we propose that firms will need to provide the information required by the DMD along with any additional information they are required to provide under MiFID. We do not expect this to cause significant consumer detriment since the consumers purchasing products via this channel tend to be more sophisticated. Therefore, we do not consider that additional protections (such as the Q&A format used in KFDs) are required for this segment of consumers.

### *The impact of MiFID rules on comparison data in communications*

- 1.58 As we have observed no market failure requiring us to extend all MiFID rules on comparisons to non-scope communications, different standards will apply for scope and non-scope business.
- 1.59 Adding information on the source of the comparison information and key facts and assumptions used to make the comparison to the communication may take up extra space within communications and reduce the viability of certain media for such disclosure.

### **Benefits**

- 1.60 The following proposals are expected to give rise to material incremental benefits.

#### *Greater reliance on high-level rules and principles*

- 1.61 The increased flexibility granted by high-level rules should be to the benefit of both firms and consumers. The new regime will allow a more flexible approach to marketing, allowing promotions tailored more closely to the needs of the group to whom the promotion is directed.
- 1.62 The outcome we aim to achieve is that the regulatory regime should be flexible to allow for the differing risk profiles of various products and services, allow product and technology innovation and changes in demand among consumers. Firms should be able to offer their products and services in a way that allows them to create demand while at the same time providing information that is fair, clear and not misleading.
- 1.63 By removing the need to take a tick-box approach to the development of promotions the new rules should help to reduce regulatory failure, where the financial promotion regime has in itself contributed to the market failure by making it more difficult for consumers to understand promotions.
- 1.64 We expect the high-level rules and reduction in detailed prescription should support firms in a move towards informative advertising from persuasive advertising, and encourage competition based on relevant product features. This will be beneficial to consumers, by informing them of the existence of products and services and of their features.
- 1.65 In general, the MiFID high-level requirements will be extended to cover non-scope communications and the benefits will be the same in and out of MiFID scope.

#### *Past performance disclosure*

- 1.66 The MiFID-derived provisions continue to cover the most important issues relating to past performance disclosure. In essence, the rules provide protection against the cherry-picking of strong returns and the use of past performance as the focal point in a promotion. A prominent past performance risk warning must also be included. The general high-level provisions that apply to all information will support the detailed past performance rules and help to limit consumer detriment. However, the MiFID past performance requirements are not expected to generate any incremental benefits relative to our current rules.

- 1.67 Extending the MiFID standards to non-scope promotions will avoid regulatory arbitrage, particularly where unit-linked life products share characteristics with Collective Investment Schemes and could be re-engineered to be within MiFID scope. If we were to retain super-equivalent requirements, firms operating under the UK financial promotion rules would, to some degree, be put at a competitive disadvantage compared to firms selling into the UK from the EU. The move to MiFID standards will avoid this.

#### *Removal of the ban on the direct offer financial promotion of broker funds*

- 1.68 To the extent that the ban has been deterring some consumers from purchasing a suitable product, removing it will generate benefits, although this may be limited to a small population.
- 1.69 There is limited potential for arbitrage where lifting the ban for MiFID scope direct sales promotions only may have led to an increase in their market share compared to non-scope broker funds. This would have undermined the consumer protection offered by retaining the rule for non-scope broker funds. As most IFAs are expected to be non-scope and broker funds are only a small market, we do not believe that this arbitrage would be a significant outcome.

#### *Benefits of minimal significance*

- 1.70 We have also identified some MiFID requirements that have compliance costs implications but will generate marginal benefits.
- Detailed MiFID rules that apply to all scope communications: Where this additional information is relevant to the communication, it may aid consumer understanding. However, we have identified no market failure requiring detailed rules for non-promotional communications beyond the high-level fair, clear and not misleading requirement, and we foresee only limited benefit.
  - Changed rules on comparison data: MiFID-scope communications will include some additional details regarding the source of the comparison information and key facts and assumptions used to make the comparison. This additional information may be of some benefit to consumers in helping to judge the relevance of the data. As we have observed no market failure justifying the need to prescribe the inclusion of this data, we expect the benefit to be minimal.
  - The changed rules relating to direct offer financial promotions: The new approach provides greater flexibility to firms and changes the focus onto the provision of sufficient information before a transaction is completed. This approach meets our requirements for product disclosure in non-advised transactions and avoids complexities as to what is and what is not a direct sales promotion. The benefits arising from this change are expected to be minimal.

## **Compatibility Statement**

- 1.71 This section explains our reasons for concluding that the proposals set out in this CP are compatible with our general duties under section 2 of FSMA and our regulatory objectives set out in sections 3 to 6.

### **Compatibility with our statutory objectives**

- 1.72 The proposals set out in this CP are primarily designed to help us meet our objective of securing the appropriate degree of consumer protection. They are also particularly relevant to our public awareness objective. Our discretion has been restricted with regard to the implementation of MiFID, the provisions of which are mandatory and have been developed in an EU-wide context.

#### *Consumer protection*

- 1.73 The new rules for financial promotions and other communications are focussed on outcomes rather than detailed prescription. In setting these outcomes, we intend senior management to take responsibility for the provision of appropriate and proportionate information to consumers. In order to satisfy the high-level provisions, firms will need to disclose relevant information and this should provide an appropriate level of consumer protection. Detailed rules are only to be retained or added where we have identified a significant market failure that the high-level rules cannot address adequately. An example of this relates to the use of past performance data in promotions. Past performance provides, at best, a very limited guide to future performance. We do not consider that high-level rules on their own would be sufficient to guard against market failure here, and propose to retain some detailed rules.

#### *Public awareness*

- 1.74 The removal of detailed, product-specific requirements and the move to higher-level rules should assist firms in creating informative advertising, which is proportionate to client needs and the nature of the product. The provision of appropriate information to consumers should help to tackle the information asymmetry that exists in the market. To the extent that this happens, consumers should benefit from marketing that promotes awareness of the benefits and risks associated with different kinds of investment.

#### *Market Confidence*

- 1.75 The new financial promotion and other communications regime is to be simpler, shorter and easier for firms and other stakeholders to use. The mainly high-level and less prescriptive nature is consistent with our general policy of more principles-based regulation. We still focus on the need for communications to be fair, clear and not misleading, helping to retain confidence in the accuracy of information supplied by firms.

### *Reducing financial crime*

- 1.76 The proposals in this CP have no material impact on the objective of reducing financial crime.

### **Principles of good regulation**

- 1.77 Section 2(3) of FSMA requires that, in carrying out our general functions, we have regard to the specific matters set out below.

#### *a. The need to use our resources in the most efficient and economic way*

- 1.78 We announced in the 2005/6 Business Plan that we would carry out a review of the financial promotions regime, with the aim of moving toward a more principles-based regulation. MiFID also includes provisions that apply to communications from firms to consumers and we have decided to publish this CP in parallel with the *Reforming COB Regulation CP*, which implements other aspects of MiFID.

- 1.79 The proposals in this CP will help to protect consumers without significant resource implications for us. We do not expect to need additional resources to monitor and enforce these standards.

#### *b. The responsibilities of those who manage the affairs of authorised persons*

- 1.80 Firms will need to take greater responsibility for compliance with the more high-level rules. We aim to focus responsibility for compliant financial promotions on senior management. As firms are in the best position to determine the needs of their consumers and the nature of their products, this is an efficient method to ensure that consumers are provided with appropriate information.

#### *c. The principle that a burden or restriction which is imposed on a person, or on the carrying out of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction*

- 1.81 We have undertaken a cost benefit analysis to help shape our proposals and inform this consultation. We also seek to avoid ‘gold-plating’ European Directives, and intend to add or retain additional material only where the benefits clearly outweigh the costs.

- 1.82 We have concluded that our proposals are proportionate to the anticipated benefits. We invite responses as to whether our assumptions are correct.

#### *d. The desirability of facilitating innovation in connection with regulated activities*

- 1.83 Our experience in supervising financial promotions under the current detailed rules suggests that the level of prescription has led, in some cases, to a tick-box approach to compliance. Re-focussing regulation on higher-level rules should provide firms with greater flexibility to innovate and allow our Handbook to be more dynamic to market changes.

*e. The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom*

1.84 The Financial Promotion Review has incorporated MiFID provisions relating to financial promotion and other communications by firms to clients. In general, we do not propose to add additional requirements to those required in the Directive. This should help firms to compete at an EU level.

*f. The need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions*

1.85 Our CBA indicates that, overall, the proposed changes should not have material adverse effects on competition. Some adverse effects are identified, for example, as a result of the MiFID past performance requirements, though we welcome comment on whether our assumptions are correct.

*g. The desirability of facilitating competition between those who are subject to any form of regulation by the FSA*

1.86 The streamlining of the rules relating to financial promotion and other communications should provide firms with greater flexibility on how to comply with the regime, helping to facilitate competition.

**Acting in a way which we consider most appropriate for the purpose of meeting our statutory objectives**

1.87 The current financial promotion regime has grown incrementally in response to events and problems that the industry and regulators have encountered. The level of detail prescribed has not always resulted in our desired outcomes being met. In some cases, it has led to a tick-box approach and formulaic promotions rather than leading firms to follow the spirit of the rules. We have therefore taken a step back from the existing detail to reconsider the role we want financial promotion and other communications to play.

1.88 The new, more principles-based regime is more flexible to changing market conditions. The proposed regime will also give effect to the MiFID requirements on financial promotion and other communications from firms to consumers. It refocuses firms on the overarching principles. The foundation will remain the general requirement for communications to be fair, clear and not misleading. Overall, we consider the proposed new financial promotion regime is the most appropriate way to achieve our statutory objectives.



# Timetable and consultation process

## Introduction

- 2.1 In our Joint Implementation Plan for MiFID, published with the Treasury in May 2006, we explained our approach to consulting on implementing the conduct of business aspects of MiFID. As explained in the *Reforming COB Regulation CP* we had a number of choices, and chose to consult fully in October 2006, rather than in parts. We did this to ensure we could consult on the final text of MiFID and present as full a picture of NEWCOB as possible in one combined consultation.

## A 'split' consultation

- 2.2 As we need to transpose the conduct of business elements of MiFID by 31 January 2007, some parts of NEWCOB 4 and 5 that implement MiFID in respect of MiFID firms and activities need to be made into rules on a shorter timescale than we would normally propose. We are therefore giving respondents one month, until 28 November 2006, to comment on how we propose transposing the MiFID requirements. Respondents have four months, until 23 February 2007, to comment on the proposals relating to non-MiFID areas.
- 2.3 The proposed text for NEWCOB 4 and 5 is contained in Annex 4 of this CP. Annex 6 of the *Reforming COB Regulation CP* contains the full Draft Instrument for NEWCOB. Where provisions are derived from MiFID, their origin is noted.
- 2.4 Although the one-month consultation period is shorter than we would have liked, we believe it is practicable given that our general approach to MiFID transposition is to utilise 'intelligent copy-out'. This approach transposes EU requirements using as much of the original text as possible, sticking closely to the minimum requirements.
- 2.5 Using copy-out limits the extent to which we can exercise discretion or judgement, but we welcome views on issues such as:
- the extent to which we reproduce MiFID text word-for-word;
  - how we ensure that MiFID terminology and concepts fit with Handbook concepts and definitions; and

- how far we reproduce MiFID recitals, either as rules or as guidance, in the Handbook.
- 2.6 Following the one-month consultation, a combined Policy Statement (PS) responding to this CP and the *Reforming COB Regulation CP* will be published with a formal MiFID transposition instrument at the end of January 2007. The new rules will come into force on 1 November 2007.
  - 2.7 We expect the MiFID transposition instrument we make in January 2007 to be a definitive statement of the future conduct of business rules as they apply to MiFID-scope business. The instrument should give industry a reasonably firm basis for planning purposes.
  - 2.8 The four-month consultation on the remaining proposals in NEWCOB 5 will continue until 23 February 2007. We plan to make the consolidated final NEWCOB 4 and 5 rules in the second quarter of 2007, to come into force on 1 November 2007. The final text for NEWCOB will incorporate and replace the MiFID transposition instrument made in January.
  - 2.9 Our intention is that NEWCOB will come into force on 1 November 2007 subject to certain transitional arrangements that will be in place for a limited time.
  - 2.10 Further detail on the consultation process for reforming COB regulation and the transitional provisions is provided in the *Reforming COB Regulation CP*.

# List of questions

## One-Month Consultation Question

- 1MQ.1: For MiFID-scope business, do you agree with our interpretation and approach to the implementation of MiFID provisions for all information in NEWCOB 4?
- 1MQ.2: For MiFID-scope business, do you agree with the way in which we propose to implement MiFID provisions relating to scope financial promotions in NEWCOB 5?

## Four-Month Consultation Question

- 4MQ.1: Do you agree with our proposals relating to all information in NEWCOB 4 for non-MiFID scope business?
- 4MQ.2: At present firms must take **reasonable steps** to communicate in a way that is clear, fair and not misleading. Do you agree with our proposal that all firms should ensure that all information they address to customers in relation to relevant business **is** fair, clear and not misleading?
- 4MQ.3: Do you agree with the way in which we have applied financial promotion provisions to non-MiFID scope business in NEWCOB 5?
- 4MQ.4: Do you agree with our new approach to direct offer financial promotions?

## General Question

- 4MQ.5: Do you have any other comments on issues raised by this CP?



# Draft Handbook text for NEWCOB 4 and 5

- 4            Communication to clients
- 4.1        Application
- 4.1.1      R        This chapter generally applies in relation to:
- (1)        communicating information to a *client* in the course of, or in connection with, *designated investment business*;
  - (2)        *communicating* or *approving* a *financial promotion*;
  - (3)        *communicating* a marketing communication in relation to *MiFID business* or the *equivalent business of a third country investment firm*.
- 4.1.2      G        The application of this chapter in relation to *communicating* or *approving* a *financial promotion* is subject to detailed exceptions set out in *COBS 5.1* and *COBS 5 Annex 1*.
- 4.1.3      R        The *rules* in this chapter apply in a way that is appropriate and proportionate, taking into account, for example, the means of communication, and the information that the communication is intended to convey to the *clients*.
- [Note: recital 46 to the *MiFID implementing Directive*]
- 4.1.4      R        *COBS 4* does not apply to the provision by a *firm* to a *client* of a copy of a prospectus that has been drawn up and published in accordance with the *Prospectus Directive* if the *firm* is not responsible under that directive for the information given in the prospectus.
- [Note: recital 52 to the *MiFID implementing Directive*]
- 4.1.5      G        *COBS 5* contains *rules* on past, simulated past and future performance that apply, where appropriate and proportionate, in relation to information that is not a *financial promotion*.
- Fair, clear and not misleading communications
- 4.2.1      R        A *firm* must ensure that all information addressed by it to a *client* in relation to a *relevant business*, is fair, clear and not misleading. (The "*fair, clear and not misleading rule*").
- [Note: article 19(2) of *MiFID*]
- 4.2.2      G        The purpose of the *fair clear and not misleading rule* is to impose a requirement that adds detail to the *client's best interests rule*.
- 4.2.3      G        The *fair, clear and not misleading rule* applies in a way that is appropriate and proportionate in all the circumstances. A communication addressed to a *professional client* may not need to include the same information, or be presented in the same way, as a communication addressed to a *retail client*.

[Note: recital 31 to the *MiFID implementing Directive*]

- 4.2.4 G Section 397 of the *Act* creates a criminal offence relating to certain misleading statements and practices.

#### Compensation information

- 4.2.5 R A *firm* must ensure that any reference in advertising to an investor compensation scheme established under the *ICD* is limited to a factual reference to the scheme.

[Note: article 10(3) of the *Investors Compensation Directive*]

- 4.2.6 G The Credit Institutions (Protection of Deposits) Regulations 1995 may also apply in relation to a communication with a *client*.

### 4.3 Communications to retail clients

#### General rule

- 4.3.1 R This section applies in relation to all information addressed to, or disseminated in such a way that it is likely to be received by, a *retail client*.

- 4.3.2 R A *firm* must ensure that information:

- (1) includes the name of the *firm*;
- (2) is accurate and in particular does not emphasise any potential benefits of *relevant business* or a *relevant investment* without also giving a fair and prominent indication of any relevant risks;
- (3) is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received; and
- (4) does not disguise, diminish or obscure important items, statements or warnings.

[Note: article 27(2) of the *MiFID implementing Directive*]

- 4.3.3 G This section will be relevant to a *firm's* decision whether and how to communicate about a particular *relevant investment* or *relevant business* to a particular target audience.

- 4.3.4 G A *firm* must not omit any matters the omission of which leads the information to be insufficient, unclear, unfair or misleading.

- 4.3.5 G For the purposes of this section, the name of the *firm* may be a trading name or shortened version of the legal name of the *firm* if that is reasonably sufficient to enable the *client* to identify the *firm* (including where this is done by identifying the *group*) responsible for the communication.

#### Comparative information

- 4.3.6 R A *firm* must ensure that, if information compares *relevant business*, *relevant investments*, or *persons* who carry on *relevant business*;

- (1) the comparison is meaningful and presented in a fair and balanced way; and
  - (2) (in relation to a *financial promotion*, *MiFID business* or the *equivalent business of a third country investment firm*);
    - (a) the sources of the information used for the comparison are specified; and
    - (b) the key facts and assumptions used to make the comparison are included.
  - (3) In this *rule*, *relevant business* includes *ancillary services* in relation to *MiFID business* or the *equivalent business of a third country investment firm*.
- [Note: article 27(3) of the *MiFID implementing Directive*]

#### Referring to tax

4.3.7 R A *firm* must ensure that:

- (1) any information in relation to *MiFID business* or the *equivalent business of a third country firm*; or
- (2) otherwise, any *financial promotion*;

that refers to a particular tax treatment prominently states that the tax treatment depends on the individual circumstances of each *client* and may be subject to change in future.

[Note article 27(7) of the *MiFID implementing Directive*]

#### Applying the rules in this section

4.3.8 G A *firm* should take into account all of the relevant factors in deciding the medium of the communication, and in designing the form and content of the information. The form and content of information, including the description of the product or *relevant business* to which it relates and any description of risks and the *client's* commitment, should reflect the nature of the product or *relevant business* and the likely information needs of the average recipient.

## 5 Financial promotion

### 5.1 Application

5.1.1. R *COBS 5 Annex 1R* governs the application of this chapter and of the *financial promotion rules* in *COBS 4* and also deals with certain aspects of the interpretation of these provisions. *COBS 5 Annex 1* does not affect the application of the *rules* in *COBS 4* to the extent that they are not *financial promotion rules*.

5.1.2 G Generally, this chapter applies to a *firm* in relation to the *communication* and *approval* of a *financial promotion* that is not an *exempt financial promotion*.

It applies in limited cases to information that is not a *financial promotion*.

- 5.1.3 R The *rules* in this chapter apply in a way that is appropriate and proportionate, taking into account, for example, the means of communication, and the information that the communication is intended to convey to the *clients*.

[Note: recital 46 to the *MiFID implementing Directive*]

- 5.1.4 G The provisions in *COBS 5.2* also alter the application of the *financial promotion rules* in relation to prospectus advertisements.

## 5.2 Fair, clear and not misleading financial promotions

### Guidance on fair, clear and not misleading financial promotions

- 5.2.1 G All of the *rules* in *COBS 4* apply in relation to a *financial promotion*, subject to the detailed exceptions in this chapter.

- 5.2.2 G A *firm* should ensure that a *financial promotion*:

- (1) in relation to a product or service that places a *client's* capital at risk makes this clear;
- (2) that quotes a yield figure gives a balanced impression of both the short- and long-term prospects for the *investment*;
- (3) that promotes a *relevant investment or relevant business* whose charging structure is complex or in relation to which the *firm* will receive more than one element of remuneration, includes the information necessary to ensure that it is fair, clear and not misleading and contains sufficient information taking into account the needs of the recipients;
- (4) that names the *FSA* as its regulator and refers to matters not regulated by the *FSA* makes clear that those matters are not regulated by the *FSA*;
- (5) offering *packaged products or stakeholder products* not produced by the *firm* gives a fair, clear and not misleading impression of the producer of the product or the manager of the underlying investments.

- 5.2.3 G A *firm* designing a *financial promotion* relating to a *deposit* with a view to complying with the *fair, clear and not misleading rule* may find it helpful to take account of the Banking Code.

### Identifiable and consistent financial promotions

- 5.2.4 R A *firm* must ensure that a:

- (1) *financial promotion*; or
- (2) marketing communication in relation to *MiFID business* or the *equivalent business of a third country investment firm* (including

*ancillary services*);

is:

- (3) clearly identifiable as such; and
- (4) consistent with any information the *firm* provides to a *retail client* in the course of carrying on *designated investment business* or *ancillary services*.

[Note: article 19(2) of *MiFID*, article 29(7) of the *MiFID implementing Directive*]

#### Prospectus advertisements

- 5.2.5 R (1) The *financial promotion rules* do not apply if *PR 3.3* applies, except that the *MiFID information rules* apply in relation to *MiFID business* or the *equivalent business of a third country investment firm*.
- (2) In relation to a *financial promotion* relating to an offer to the public of securities on to admission to trading on a *required market* that is an advertisement of a type to which the prospectus advertisements *rules* in *PR 3.3* would apply but to which those *rules* do not actually apply, for example because the *rules* in *PR* do not apply to the communicator, the only *financial promotion rule* that applies is this *rule*.
- (3) A *firm* must ensure that a *financial promotion* to which this *rule* applies:
- (a) states that a *prospectus* has been or will be published and indicates where investors are, or will be able to, obtain it;
  - (b) is clearly recognisable as an advertisement;
  - (c) does not contain information that is inaccurate, or misleading; and
  - (d) does not contain information if that information is inconsistent with the information contained in the *prospectus*, if already published, or with the information required to be in the *prospectus*, if the *prospectus* is published afterwards.
- 5.2.6 G The *rule* on prospectus advertisements (*COBS 5.2.5R*) applies standards, equivalent to the standards in *PR*, to prospectus advertisements to which the *rules* in *PR* do not apply. This could be the case, for example, because the advertisement is communicated by a *person* other than the *issuer*, *offeror* or *person* requesting *admission to trading*.
- 5.3 Past, simulated past and future performance
- 5.3.1 R (1) This section applies in relation to all information addressed to, or

disseminated in such a way that it is likely to be received by, a *retail client*.

- (2) But in the case of business that is neither *MiFID business* nor the *equivalent business of a third country investment firm*, this section only applies in relation to information in a *financial promotion*.
- (3) The *rule* on future performance (*COBS 5.3.7R*) applies in relation to information other than a *financial promotion* only if the information relates to a *financial instrument*.

#### Past performance

5.3.2 R A *firm* must ensure that information that contains an indication of past performance of *relevant business* or of a *relevant investment*, satisfies the following conditions:

- (1) that indication is not the most prominent feature of the communication;
- (2) the information includes appropriate performance information which covers the immediately preceding 5 years, or the whole period for which the investment has been offered, the financial index has been established, or the service has been provided if less than 5 years, or such longer period as the *firm* may decide, and in every case that performance information must be based on complete 12-month periods;
- (3) the reference period and the source of information are clearly stated;
- (4) the information contains a prominent warning that the figures refer to the past and that past performance is not a reliable indicator of future results;
- (5) if the indication relies on figures denominated in a currency other than that of the *EEA State* in which the *retail client* is resident, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;
- (6) if the indication is based on gross performance, the effect of commissions, fees or other charges is disclosed.

[Note: article 27(4) of the *MiFID implementing Directive*]

5.3.3 G The obligations relating to describing performance must be interpreted in the light of their purpose. For example, a periodic statement in relation to *managing investments* that is sent in accordance with the *rules* in this sourcebook on reporting to *clients* (see *COBS 17*) may include past performance as its most prominent feature.

5.3.4 G (1) If a *financial promotion* includes information referring to the past performance of a *packaged product*, a *firm* will comply with the *rule*

on appropriate performance information (*COBS 5.3.2R(2)*) if the *financial promotion* includes, in the case of a *scheme*, unit-linked *life policy* or unit-linked *stakeholder pension scheme* (other than a unitised with-profits *life policy* or *stakeholder pension scheme*) past performance information calculated and presented in accordance with the table in this guidance.

- (2) The *firm* should present the information in paragraph (1) no less prominently than any other past performance information.
- (3) This *guidance* does not apply to a *prospectus* drawn up in accordance with *CIS* or *COLL* or a *simplified prospectus* drawn up in accordance with the requirements of *COBS*.

(4)

Percentage growth					
[Fund name]	Quarter /Year - Quarter /Year - pgr%	Quarter /Year - Quarter /Year - pgr%	Quarter/ Year - Quarter/ Year pgr%	Quarter / Year - Quarter /Year pgr%	Quarter/ Year - Quarter/ Year pgr%

Notes:

- The table should show performance information for five (or if performance information for fewer than five is available, all) complete 12-month periods, the most recent of which ends with the last full quarter preceding the date on which the firm first *communicates* or *approves* the *financial promotion*.
- For products with performance data for fewer than five 12-month periods, firms should clearly indicate that performance data does not exist for the relevant periods.
- No allowance should be made for tax recoveries on income for *pension contracts*, *ISAs* or *PEPs*.
- pgr is the percentage growth rate for the year, where:  

$$pgr = ((P1 - P0)/P0)*100$$
and rounded to the nearest 0.1%, with exact 0.05% rounded to the

nearest even 0.1%; and where P0 is the price at the start of the 12-month period and P1 is the price on the same day in the following 12-month period.

5. The prices should allow for any net distributions to be reinvested.

6. The price at P1 must be adjusted for any charges since the date of P0 which are based on a proportion of the fund and are levied by the cancellation of units.

7. The *firm* should use single pricing, or (if this is not available) bid to bid prices, unless the *firm* has reasonable grounds to be satisfied that another basis would better reflect the past performance of the fund.

- 5.3.5 G (1) In relation to a *packaged product* other than a *scheme*, unit-linked *life policy* or unit-linked *stakeholder pension scheme* (other than a unitised with-profits *life policy* or *stakeholder pension scheme*), the information should be given on:
- (a) an offer to bid basis (which should be stated) if there is an actual return or comparison of performance with other *investments*; or
  - (b) an offer to offer, bid to bid or offer to bid basis (which should be stated) if there is a comparison of performance with an index or with movements in the price of *units*; or
  - (c) a single pricing basis with allowance for charges.
- (2) If the pricing policy of the *investment* has changed, the prices used should include such adjustments as are necessary to remove any distortions resulting from the pricing method.

#### Simulated performance

- 5.3.6 R A *firm* must ensure that if information includes or refers to simulated past performance of *relevant business* or a *relevant investment*:
- (1) it relates to an investment or a financial index;
  - (2) the simulated past performance is based on the actual past performance of one or more investments or financial indices which are the same as, or underlie, the investment concerned;

- (3) in respect of the actual past performance, the conditions set out in the *rule* on past performance (*COBS 5.3.2R*) are complied with; and
- (4) the information contains a prominent warning that the figures refer to simulated past performance.

[Note: article 27(5) of the *MiFID implementing Directive*]

#### Future performance

5.3.7 R A *firm* must ensure that where the communication contains any information on the future performance of a *financial instrument* it:

- (1) is not based on and does not refer to simulated past performance;
- (2) is based on reasonable assumptions supported by objective data;
- (3) discloses the effect of commissions, fees or other charges if the indication is based on gross performance;
- (4) contains a prominent warning that such forecasts are not a reliable indicator of future performance.

[Note: article 27(6) of the *MiFID implementing Directive*]

5.3.8 G A *firm* should not provide information on future performance if it is not able to obtain the objective data needed to comply with the *rule* on future performance. For example, doing so in relation to *EIS shares* may be difficult.

#### 5.4 Financial promotions containing offers or invitations

- 5.4.1 R (1) A *firm* must ensure that a *financial promotion* or other marketing communication to which this *rule* applies contains:
- (a) such of the information referred to in the *rules* implementing articles 30 to 33 of the *MiFID implementing Directive* (including *COBS 7.1.4R*, *COBS 7.1.6R*, *COBS 7.1.7R*, *COBS 7.1.8R*, *COBS 15.3.2R* and *COBS 15.3.3R* as is relevant to that offer or invitation; and
  - (b) if the *financial promotion* is not in relation to *MiFID business* or the *equivalent business of a third country investment firm*, appropriate information about the *relevant business* and *relevant investments* so that the *client* is reasonably able to understand the nature and risks of the *relevant business* and *relevant investments* and consequently to take investment decisions on an informed basis.
- (2) This *rule* applies if a *financial promotion*, or in relation to *MiFID business* or the *equivalent business of a third country investment firm* any other marketing communication, is addressed to, or disseminated in such a way that it is likely to be received by a *retail client* and

contains:

- (a) an offer to enter into:
  - (i) a *controlled agreement*; or
  - (ii) otherwise, in relation to *MiFID business* or the *equivalent business of a third country investment firm*, an agreement relating to an *ancillary service*,  
with any *person* who responds to the communication; or
- (b) an invitation to any *person* who responds to the communication to make an offer to enter into an agreement of that kind;

and specifies the manner of response or includes a form by which any response may be made.

- (3) However, this *rule* does not apply to a communication if, in order to respond to an offer or invitation contained in it, the *retail client* must refer to another document or documents, which, alone or in combination, contain that information.

[Note: article 29(8) of the *MiFID implementing Directive*]

- 5.4.2 G In relation to *MiFID business* or the *equivalent business of a third country investment firm*, the *firm* may be required to make additional disclosures before entering into an agreement (see *COBS 2.2*).
- 5.4.3 G If a series of communications ends in a communication falling within this section the requirements under this section apply to that communication.
- 5.4.4 G In order to enable a *client* to make an informed assessment of a *relevant investment or relevant business* that is promoted, a *firm* may wish to include in a *financial promotion* that contains an offer or invitation:
  - (1) a summary of the taxation of any *investment* to which it relates and the taxation consequences for the average member of the group to whom it is directed or by whom it is likely to be received; and
  - (2) a statement that the recipient should seek *advice on investments* if he has any doubt about the suitability of the *relevant investment* or *relevant business* being promoted.

5.5 Cold calls and other promotions that are not in writing

Restriction on cold calling

- 5.5.1 R A *firm* must not make a *cold call* unless:
  - (1) the recipient has an established existing *client* relationship with the

*firm* and the relationship is such that the recipient envisages receiving *cold calls*; or

- (2) the *financial promotion* relates to a generally marketable *packaged product* which is not:
  - (a) a *higher volatility fund*; or
  - (b) a *life policy* with a link (including a potential link) to a *higher volatility fund*; or
- (3) the *cold call* relates to a *controlled activity* to be carried on by an *authorised person* or *exempt person* the only *controlled investments* involved or which reasonably could be involved are
  - (a) *readily realisable securities* (other than warrants); and
  - (b) generally marketable non-g geared *packaged products*.

Promotions that are not in writing

- 5.5.2 R If a *firm* initiates a non-written *financial promotion communicated* to a particular *person* outside the *firm's* premises, it must ensure that the individual communicating:
- (1) only does so at an appropriate time of the day;
  - (2) identifies himself and the *firm* he represents at the outset and makes clear the purpose of the communication;
  - (3) clarifies if the *client* would like to continue with or terminate the communication, and terminates the communication at any time that the *client* requests it; and
  - (4) gives a contact point to any *client* with whom he arranges an appointment.

5.6 Financial promotions for overseas persons

- 5.6.1 R (1) A *firm* must not *communicate* or *approve* a *financial promotion* which relates to a particular *relevant investment* or *relevant business* of an *overseas person*, unless:
- (a) the *financial promotion* makes clear which *firm* has *approved* or *communicated* it and, where relevant, explains:
    - (i) that the *rules* made under the *Act* for the protection of *retail clients* do not apply;

- (ii) the extent and level to which the *compensation scheme* will be available, or if the scheme will not be available, a statement to that effect; and
    - (iii) if the communicator wishes, the protection or compensation available under another system of regulation; and
  - (b) the *firm* has no reason to doubt that the *overseas person* will deal with *retail clients* in the *United Kingdom* in an honest and reliable way.
- (2) This *rule* does not apply in relation to *communicating a financial promotion* for *MiFID business* or the *equivalent business of a third country investment firm*.

#### Financial promotions for an overseas long-term insurer

- 5.6.2 R A *firm* must not *communicate* or *approve a financial promotion* to enter into a *life policy* with a *person* who is not:
- (1) an *authorised person*;
  - (2) an *exempt person* who is exempt in relation to *effecting or carrying out contracts of insurance* of the *class* to which the *financial promotion* relates;
  - (3) a *company* which has its head office in an *EEA State* other than the *United Kingdom* and which is entitled under the law of that State to carry on there *insurance business* of the *class* to which the *financial promotion* relates;
  - (4) a *company* which has a branch or agency in an *EEA State* other than the *United Kingdom* and is entitled under the law of that State to carry on there *insurance business* of the *class* to which the *financial promotion* relates; or
  - (5) a *company* authorised to carry on *insurance business* of the *class* to which the *financial promotion* relates in any of the following countries or territories:
    - (a) the Bailiwick of Guernsey;
    - (b) the Isle of Man;
    - (c) the Commonwealth of Pennsylvania;
    - (d) the State of Iowa; and
    - (e) the Bailiwick of Jersey.

For the purposes of this *rule*, Gibraltar shall be regarded as if it were an *EEA*

*State.*

- 5.6.3 R A *financial promotion* for an *overseas long-term insurer*, which has no establishment in the *United Kingdom*, must include:
- (1) the full name of the *overseas long-term insurer*, the country where it is registered, and, if different, the country where its head office is situated;
  - (2) a prominent statement that 'holders of policies issued by the company will not be protected by the Financial Services Compensation Scheme if the company becomes unable to meet its liabilities to them'; and,
  - (3) if any trustee, investment manager or *United Kingdom* agent of the *overseas long-term insurer* is named which is not independent of the *overseas long-term insurer*, a prominent statement of that fact.
- 5.6.4 R A *financial promotion* for an *overseas long-term insurer* which is authorised to carry on *long-term insurance business* in any country or territory listed in this section must also include:
- (1) the full name of any trustee of property of any description which is retained by the *overseas long-term insurer* in respect of the promoted contracts;
  - (2) an indication whether the investment of such property (or any part of it) is managed by the *overseas long-term insurer* or by another *person* and the full name of any *investment manager*;
  - (3) the registered office of any such trustee and of any *investment manager* and of his principal office (if different); and
  - (4) where any *person* in the *United Kingdom* takes, or may take, any steps on behalf of the *overseas long-term insurer* to enter into a promoted contract, the following details:
    - (a) the full name of the *overseas long-term insurer*;
    - (b) the registered office, head office or principal place of business of that *person* in the *United Kingdom*; and,
    - (c) if there is more than one such *person*, the principal or main *person* in the *United Kingdom*.
- 5.6.5 R If a *financial promotion* relates to a *life policy* with an *overseas long-term insurer* but does not name the *overseas long-term insurer* by giving its full name or its business name:
- (1) it must include the following prominent statement: "This financial promotion relates to an insurance company which does not, and is not authorised to, carry on in any part of the *United Kingdom* the class of insurance business to which this promotion relates. This means that the

management and solvency of the company are not supervised by the Financial Services Authority. Holders of policies issued by the company will not have the right to complain to the Financial Ombudsman Service if they have a complaint against the company and will not be protected by the Financial Services Compensation Scheme if the company should become unable to meet its liabilities to them"; and

- (2) if it also refers to other *investments* it must make this clear.

5.7 Approving and communicating financial promotions and compliance with the financial promotion rules

Systems and controls

- 5.7.1 G The *rules* in SYSC 3 and SYSC 4 require a *firm* that *communicates* or *approves* a *financial promotion* to put in place systems and controls or policies and procedures in order to comply with the *rules* in this chapter.

Approving financial promotions

- 5.7.2 R (1) Before a *firm* *approves* a *financial promotion* for *communication* by an *unauthorised person*, it must confirm that the *financial promotion* complies with the *financial promotion rules*.
- (2) If, at any time after a *firm* has complied with paragraph (1), a *firm* becomes aware that a *financial promotion* no longer complies with the *financial promotion rules*, it must withdraw its *approval* and notify any *person* that it knows to be relying on its *approval* as soon as reasonably practicable.
- (3) For these purposes, the *firm* should have regard to the *financial promotion rules* that would have applied if the *financial promotion* had been communicated by a *firm* other than in relation to *MiFID business* or the *equivalent business of a third country investment firm*.
- 5.7.3 G (1) Section 21(1) of the *Act* (Restrictions on financial promotion) prohibits an *unauthorised person* from *communicating* a *financial promotion*, in the course of business, unless an exemption applies or the *financial promotion* is *approved* by a *firm*. Many of the *rules* in this chapter apply when a *firm* *approves* a *financial promotion* in the same way as when a *firm* *communicates* a *financial promotion* itself (the detailed application provisions appear in *COBS 5 Ann 1*).
- (2) A *firm* may also wish to *approve* a *financial promotion* that it *communicates* itself. This would ensure that an *unauthorised person* who then also *communicates* the *financial promotion* to another *person* will not contravene the restriction on *financial promotion* in the *Act* (section 21).
- 5.7.4 R A *firm* must not *approve* a *financial promotion* to be made in the course of a

personal visit, telephone conversation or other interactive dialogue.

- 5.7.4 R If a *firm* approves a *financial promotion* in circumstances in which one or more of the *financial promotion rules*, or the prohibition on approval of promotions for *collective investment schemes* in section 240(1) of the *Act* (Restriction on approval), are expressly disapplied, the *approval* must be given on terms that it is limited to those circumstances.
- 5.7.5 G For example, if a *firm* approves a *financial promotion* for *communication* to a *professional client* or an *eligible counterparty*, the *approval* must be limited to *communication* to such *persons*.
- 5.7.6 G If an *approval* is limited, and an *unauthorised person* communicates the *financial promotion* to *persons* not covered by the *approval*, the *unauthorised person* may commit an offence under the restriction on financial promotion in the *Act* (section 21). A *firm* giving a limited *approval* may wish to notify the *unauthorised person* accordingly.

#### Communicating financial promotions

- 5.7.8 G If a *firm* continues to *communicate* a *financial promotion* when the *financial promotion* no longer complies with the *rules* in this chapter, it will breach those *rules*.
- 5.7.9 G A *financial promotion* which is clearly only relevant at a particular date will not cease to comply with the *financial promotion rules* merely because the passage of time has rendered it out-of-date; an example would be a dated analyst's report.

#### Relying on another firm's confirmation of compliance

- 5.7.10 R (1) A *firm* (A) will not contravene any of the *financial promotion rules* in circumstances where it *communicates* a *financial promotion* which has been produced by another *person* provided that:
- (a) A takes reasonable care to establish that another *firm* (B) has confirmed that the *financial promotion* complies with the *financial promotion rules*;
  - (b) A takes reasonable care to establish that it *communicates* the *financial promotion* only to recipients of the type for whom it was intended at the time B carried out the confirmation exercise; and
  - (c) so far as A is, or ought reasonably to be, aware:
    - (i) the *financial promotion* has not ceased to be fair, clear and not misleading since that time; and
    - (ii) B has not withdrawn the *financial promotion*.
- (2) This *rule* does not apply in relation to *MiFID business* or the *equivalent*

*business of a third country investment firm.*

- 5.7.11 G A *firm* should inform anyone relying on its confirmation of compliance if it becomes aware that the *financial promotion* no longer complies with the *rules* in this chapter.

#### Record keeping

- 5.8.1 R (1) A *firm* must make an adequate record of any *financial promotion* it *communicates* or *approves*, other than a *financial promotion* made in the course of a personal visit, telephone conversation or other interactive dialogue.
- (2) For a telemarketing campaign, a *firm* must make an adequate record of copies of any scripts used.
- (3) A *firm* must retain the record:
- (a) in relation to a *financial promotion* relating to a *pension transfer, pension opt-out* or *FSAVC*, indefinitely;
  - (b) in relation to an *life policy, OPS, a SSAS, a personal pension scheme* or a *stakeholder pension scheme*, for six years;
  - (c) in relation to a *financial promotion* relating to *MiFID business* or *ancillary services* or the *equivalent business of a third country investment firm*, for five years; and
  - (d) for three years in any other case.
- 5.8.2 G A *firm* should consider maintaining a record of why it is satisfied that the *financial promotion* complies with the *financial promotion rules*.
- 5.8.3 G If the *financial promotion* includes market information that is updated continuously in line with the relevant market, the records required by the record keeping *rules* will be adequate without recording that information.

#### Annex 1R : application

This annex forms part of *COBS 5.1.1R*.

1. Application
- 1.1 Who? General
- 1.1.1 R This chapter applies to a *firm* (including an *ICVC*) which *communicates* or *approves a financial promotion* or, where indicated, a marketing communication.
- 1.1.2 R *COBS 5.3* also applies where appropriate and proportionate to a *firm* in relation to information that is not a *financial promotion* communicated to a

*retail client* and which contains information on past, simulated past or future performance and which relates to *MiFID business* or the *equivalent business of a third country investment firm*.

[Note: recital 46 to the *MiFID implementing Directive*]

Who? Appointed representatives

- 1.1.3 R A *firm* is required to comply with the *financial promotion rules* in relation to a *financial promotion communicated* by its *appointed representative* even where the *financial promotion* does not require *approval* because of the exemption in article 16 of the *Financial Promotion Order* (Exempt persons).

[Note: see section 39 of the *Act*]

Who? Professional firms

- 1.1.4 R (1) The *financial promotion rules* do not apply to an *authorised professional firm* if the following conditions are satisfied:
- (a) the proportion of income the *firm* derives from *professional fees* is, during its annual accounting period, at least 50% of the *firm's* total income (a temporary variation of not more than 5% may be disregarded for this purpose);
  - (b) the *financial promotion* is made for the purposes of and incidental to the promotion or provision by the *firm* of its:
    - (i) professional services; or
    - (ii) *non-mainstream regulated activities*; and
  - (c) the *financial promotion* is not *communicated* on behalf of another *person* who would not be able lawfully to *communicate* the *financial promotion* if he were acting in the course of business.
- (2) In (1)(b)(i), "professional services" means services:
- (a) which do not constitute a *regulated activity*; and
  - (b) the provision of which is supervised and regulated by a *designated professional body*.
- (3) This *rule* does not apply in relation to *MiFID business* or the *equivalent business of a third country investment firm*.

1.2 Application: what?

Interpreting the rules in this section

- 1.2.1 R If there is a conflict between two *rules* in this section, the *rule* that appears first

takes precedence over the later *rule* except and to the extent specifically provided in the first *rule*. The fact that the first *rule* is specifically subject to a later *rule* does not mean that the later *rule* takes precedence over any *rule* that comes between it and the first *rule*.

#### Rules about application and interpretation

- 1.2.2 R The *rules* in COBS 4.1, COBS 5.1 and COBS 5 Ann 1 always apply to a *financial promotion* or other marketing communication.

#### Promotion of unregulated collective investment schemes

- 1.2.3 R [The *rules* on the promotion of *unregulated collective investment schemes* (COBS 5.9) always apply (and apply without territorial limitation).]<sup>1</sup>

#### Mortgages, general insurance and prohibited promotions

- 1.2.4 R The *financial promotion rules* do not apply in relation to a *financial promotion* to the extent that:
- (1) it is a *qualifying credit promotion*;
  - (2) it is in respect of a *non-investment insurance contract*; or
  - (3) its *communication* by a *firm* would contravene section 238(1) of the *Act* (Restrictions on promotion).

#### Image advertising

- 1.2.5 R (1) The *fair, clear and not misleading rule* is the only *financial promotion rule* that applies to "image advertising", that is a *financial promotion* which consists only of one or more of the following:
- (a) the name of the *firm*;
  - (b) a logo or other image associated with the *firm*;
  - (c) a contact point; and
  - (d) a reference to the types of *regulated activities* provided by the *firm*, or to its fees or commissions.
- (2) But this *rule* is subject to:
- (a) the *rule* on approving *financial promotions* (see COBS 5 Annex 1.2.8R); and
  - (b) in relation to business other than *MiFID business* and the *equivalent business of a third country investment firm*, the

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<sup>1</sup> The FSA expects to consult in the second quarter of 2007 on the rules on the promotion of unregulated collective investment schemes to which this provision relates.

general exemptions (see *COBS 5 Annex 1, 1.2.9R*).

[Note: recital 41 of the *MiFID implementing Directive*]

MiFID business and the equivalent business of a third country investment firm

- 1.2.6 R (1) The *MiFID information rules* apply in relation to a *financial promotion* for *MiFID business* or the *equivalent business of a third country investment firm*.
- (2) However, the *MiFID information rules* do not apply if such a *financial promotion* consists of a *firm* providing a *client* with a copy of a prospectus that has been drawn up and published in accordance with the *Prospectus Directive* if the *firm* is not responsible under that directive for the information given in the prospectus.

[Note: recital 52 to *MiFID*]

Deposits and certain pure protection contracts

- 1.2.7 R (1) To the extent that a *financial promotion* relates to:
- (a) a *deposit*; or
  - (b) a *pure protection contract* that is not a *long-term care insurance contract*;
- the only *financial promotion rules* that apply are the *fair, clear and not misleading rule*, the general rule on communications with *retail clients* (*COBS 4.3.2R*) and the rule on comparative information (*COBS 4.3.7R*).
- (2) If the *financial promotion* relates to a *structured deposit* then the rules on past, simulated and future performance (*COBS 5.3*) also apply.
- (3) If the *financial promotion* relates to a *cash deposit ISA* or a *cash deposit CTF* the rule on referring to tax (*COBS 4.3.9R*) also applies.
- (4) This rule is subject to the general exemptions (see *COBS 5 Annex 1, 1.2.9R*).

Approving financial promotions

- 1.2.8 R In relation to the *approval* of a *financial promotion* by a *firm*, the rules that always apply are:
- (1) the *fair, clear and not misleading rule*;
  - (2) (a) the rules on approval of a *financial promotion* for an *unauthorised person* (see *COBS 5.7.2R*);
  - (b) the rule on *financial promotions* for *overseas persons* (see

COBS 5.6.1R); and

- (c) the rules on *financial promotions* for overseas long term insurers (see COBS 5.6.2R to 5.6.5R).

#### General exemptions

1.2.9 R The *financial promotion rules* do not apply in any of the following cases, (except that the *fair, clear and not misleading rule* does apply to the extent that the communication relates to the provision of services covered by the *general application rule* to a client):

- (1) The promotion is an *exempt financial promotion*.
- (2) The promotion;
  - (a) is made only to recipients who the *firm* reasonably believes are *eligible counterparties* or *professional clients*; or
  - (b) is directed only at recipients who are *eligible counterparties* or *professional clients*.

In the case of an *elective professional client* or an *elective eligible counterparty*, this exemption applies only for a *financial promotion* that relates to the *designated investments* or *designated investment business* for which he has been so classified.

- (3) The promotion is from outside the *United Kingdom* and would be exempt under articles 30, 31, 32 or 33 of the *Financial Promotion Order* (Overseas communicators) if the office from which the *financial promotion* is *communicated* were a separate *unauthorised person*.
- (4) The promotion is subject to, or exempted from, the *Takeover Code* or to the requirements relating to takeovers or related operations in another *EEA State*.
- (5) The promotion is a personal quotation or illustration form.
- (6) The promotion is a "one-off" *financial promotion* that is not a *cold call*. If the conditions set out in (a) to (c), below, are satisfied, a *financial promotion* is "one-off". If not, the fact that any one or more of these conditions is met is to be taken into account in determining if a *financial promotion* is "one-off". However, a *financial promotion* may be regarded as "one-off" even if none of the conditions are met. The conditions are that:
  - (a) the *financial promotion* is *communicated* only to one recipient or only to one group of recipients in the expectation that they would engage in any investment activity jointly;
  - (b) the identity of the product or service to which the *financial promotion* relates has been determined having regard to the

particular circumstances of the recipient;

- (c) the *financial promotion* is not part of an organised marketing campaign.

- 1.2.10 R A *firm* may rely on more than one exemption (and also on *COBS 5 Annex 1.3.1R* (Application: where)) in relation to the same *financial promotion*.
- 1.2.11 G A company's annual report and accounts issued in accordance with a requirement of the *Companies Act 1985* (or corresponding Northern Ireland or EEA provisions) are exempt under the *rule on exempt financial promotions* (see *COBS 5 Annex 1, 1.2.9R(1)*). But this exemption does not extend to the report and accounts of *ICVCs*, other types of *OEIC*, and *unit trust schemes*.
- 1.2.12 G A *financial promotion* included in a newspaper, magazine or periodical which is printed and published overseas, but which may be brought into the *United Kingdom* and made available to *persons* in the *United Kingdom*, will be exempt provided that the *financial promotion* is not *communicated* to *persons* inside the *United Kingdom*.

1.3 Application: where?

Default position

- 1.3.1 R The *financial promotion rules* generally apply to a *firm* only in relation to:
  - (1) the communication of a *financial promotion* to a *person* inside the *United Kingdom*;
  - (2) the communication of a *cold call* to a *person* outside the *United Kingdom*, unless:
    - (a) it is made from a place outside the *United Kingdom*; and
    - (b) it is made for the purposes of a business which is carried on outside the *United Kingdom* and which is not carried on in the *United Kingdom*; and
  - (3) the *approval* of a *financial promotion* for *communication* to a *person* inside the *United Kingdom*.
- 1.3.2 G The effect of *COBS 5 Annex 1, 1.3.1R* is to alter the application of the *financial promotion rules* compared with the *general application rule*. *COBS 4* applies in accordance with the *general application rule* to the extent that the chapter does not relate to a *financial promotion*.

Modifications to comply with EU law

- 1.3.3 G The *EEA territorial scope rule* modifies the default territorial scope of the *financial promotion rules*, and, more generally, the *rules* in *COBS 4*, under this Annex and under *COBS App 1* to the extent necessary to be compatible with European law. This means that in a number of cases, the *financial promotion*

*rules* will apply to communications made by *UK firms* to persons located outside the *UK* and will not apply to communications made to persons inside the *UK* by *EEA firms*. Further guidance on this is located in *COBS Appendix 1*.

- 1.3.4 G Other parts of this annex also incorporate some territorial elements. For example:
- (1) the exemption for *financial promotions* originating outside the *United Kingdom* (section 21(3) of the *Act* (Restrictions on financial promotion)),
  - (2) the exemptions for overseas communicators; and
  - (3) the *rules* on *unregulated collective investment scheme* promotions and *approving financial promotions*.

- 1.3.5 G The *financial promotion rules* do not apply to incoming communications in relation to *MiFID business* or the *equivalent business of a third country firm*. For the purpose of article 36 of the *Financial Promotion Order* the *FSA* does not make any *rules* in relation to such incoming communications.

#### 1.4 Words and phrases used in the financial promotion rules

- 1 G The *financial promotion rules* adopt various concepts from the restriction on *financial promotion by unauthorised persons* in section 21(1) of the *Act* (Restrictions on financial promotion), including *approve* and *financial promotion*.

- 2 R For the purposes of this chapter, the words and phrases set out in the following table have the meaning set out in the row immediately below them:

- (1) made to, directed at and recipient

The words "made to", "directed at" and "recipient" are to be interpreted as though article 6 of the *Financial Promotion Order* (Interpretation: communications) applied to them.

- (2) directed only at

(a) If all the conditions set out in (c) are met, a communication is to be regarded as "directed only at" a certain *group of persons*.

(b) In any other case in which one or more of those conditions are met, that fact is to be taken into account in determining whether the communication is directed only at a certain *group of persons* (but a communication may still be regarded as so directed even if none of the conditions in (c) are met).

(c) The conditions are that:

- (i) the communication includes an indication of the

description of *persons* to whom it is directed and an indication of the fact that the *investment* or service to which it relates is available only to such *persons*;

(ii) the communication includes an indication that *persons* of any other description should not rely upon it;

(iii) there are in place proper systems and procedures to prevent recipients other than *persons* to whom it is directed engaging in the investment activity, or participating in the *collective investment scheme*, to which the communication relates with the *person* directing the communication, a *close relative* of his or a member of the same *group*.

(3) communicated to a *person* inside or outside the *United Kingdom*

(a) a *financial promotion* is communicated to a *person* outside the *United Kingdom* if it is:

(i) made to a *person* who receives it outside the *United Kingdom*; or

(ii) directed only at *persons* outside the *United Kingdom*; and

(b) a *financial promotion* is communicated to a *person* inside the *United Kingdom* if it is communicated to a *person* other than as described in (a);

and see (3), above, which amplifies this *rule*.

(4) directed only at *persons* outside the *United Kingdom*

(a) If the conditions set out in (d)(i), (ii), (iii) and (iv) are met, a *financial promotion* directed from a place inside the *United Kingdom* will be regarded as directed only at *persons* outside the *United Kingdom*.

(b) If the conditions set out in (d)(iii) and (iv) are met a *financial promotion* directed from a place outside the *United Kingdom* will be regarded as directed only at *persons* outside the *United Kingdom*.

(c) In any other case in which one or more of the conditions in (d)(i) to (v) is met, that fact will be taken into account in determining whether a *financial promotion* is directed only at *persons* outside the *United Kingdom* (but a *financial promotion* may still be regarded as directed only at *persons* outside the *United Kingdom* even if none of these conditions is met).

(d) The conditions are that:

(i) the *financial promotion* is accompanied by an indication that it is directed only at *persons* outside the *United Kingdom*;

(ii) the *financial promotion* is accompanied by an indication that it must not be acted upon by *persons* in the *United Kingdom*;

(iii) the *financial promotion* is not referred to in, or directly accessible from, any other *financial promotion* which is made to a *person* or directed at *persons* in the *United Kingdom* by the same *person*;

(iv) there are in place proper systems and procedures to prevent recipients in the *United Kingdom* (other than those to whom the *financial promotion* might otherwise lawfully have been made) engaging in the investment activity to which the *financial promotion* relates with the *person* directing the *financial promotion*, a *close relative* of his or a member of the same *group*;

(v) the *financial promotion* is included in:

(A) a website, newspaper, journal, magazine or periodical publication which is principally accessed in or intended for a market outside the *United Kingdom*;

(B) a radio or television broadcast or teletext service transmitted principally for reception outside the *United Kingdom*.

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