Title: The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) (No. 2) Order 2023	De minimis assessment
SI (Statutory Instrument) No: TBC	**Date:** 16/10/2023
Other departments or agencies: N/A	**Type of regulation:** Domestic
Contact: edwin.ferguson@hmtreasury.gov.uk	**Date measure comes into force:** 31/01/2024
Cost of Preferred (or more likely) Option Familiarisation costs: £306,619	**Equivalent Annual Net Direct Cost to Business per year -** Zero

1. What is the problem under consideration? Why is Government intervention necessary?

A financial promotion is a communication that contains an invitation or inducement to engage in a financial product or service. Such communications can take a wide variety of forms, including advertisements placed through print, broadcast or online media; marketing brochures; direct mail; or use of social media. Financial promotions are often consumers' first contact with an investment opportunity and so can have a significant influence over their financial decisions. The communication of financial promotions is subject to regulatory safeguards, which seek to ensure that consumers are appropriately protected such that they are able to make informed and appropriate decisions.

Section 21 of the Financial Services and Markets Act 2000 (FSMA) contains what is known as the 'financial promotion restriction'. This restriction is broad in scope and provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity or claims management activity. The financial promotion restriction does not apply if:

- the communication is made by an authorised person;
- the content of the communication is approved by an authorised person; or
- the financial promotion otherwise meets the conditions of an exemption within the Financial Services and Markets Act 2000 (Financial Promotion) Order (FPO) 2005.

The FPO and the Promotion of Collective Investment Schemes (Exemptions) Order 2001 (PCIS) both provide exemptions from the restriction on communicating financial promotions. These exemptions include:

- the certified high net worth individual exemption (introduced in 2001)
- the self-certified sophisticated investor exemption (introduced in 2005)

These exemptions enable investments related to unlisted companies to be marketed to high net worth and sophisticated investors, such as business angel investors. Financial promotions that are made in scope of the exemptions do not require the approval of an FCA-authorised firm, and are not subject to the detailed FCA rules that authorised firms must otherwise comply with when communicating or approving financial promotions. In this way, the exemptions support SMEs to raise finance without the cost of having to comply with the financial promotions regime.

Since the exemptions were introduced, there have been significant economic, social and technological changes to the context in which the exemptions operate. These changes are set out in more detail in chapter three of 'Financial promotion exemptions for high net worth individuals and sophisticated investors: A consultation'.[1] These changes mean that the current criteria to self-certify as high net worth or sophisticated no longer meet the policy intention behind the exemptions. This

[1] https://www.gov.uk/government/consultations/financial-promotion-exemptions-for-high-net-worth-individuals-and-sophisticated-investors-a-consultation

brings a risk of consumer detriment, as promotions made within the scope of the exemptions are not subject to the safeguards of the financial promotions regime.

In addition, the government is aware of concerns about misuse of the exemptions, including some businesses seeking to use the exemptions to market products inappropriately to ordinary retail investors. This issue was recognised in the Treasury Select Committee's report on the failure of London Capital and Finance, and led to a recommendation for the government to "re-evaluate the Financial Promotion Order exemptions to determine their appropriateness and consider what changes need to be made to protect consumers".[2]

2. What are the policy objectives and the intended effects?

In light of the changing context and the recommendation from the Treasury Select Committee set out in section one above, HM Treasury reviewed the exemptions and developed policy proposals for updating the exemptions, which were tested through a public consultation from December 2021 to March 2022.

The following objectives underpin the reforms to the exemptions:

- Ensure that financial thresholds for exempt investors are calibrated to reflect investors' experience or their ability to absorb losses.
- Reduce the risk that investors receiving financial promotions under the exemptions do not meet the relevant conditions.
- Ensure that where exemptions are used, investors understand the regulatory protections they are losing and are able to take responsibility for their investment decisions.

The government intends to achieve these objectives by making the following updates to the exemptions:

1) Increasing the financial thresholds to be eligible for the high net worth individual exemption to income of £170,000 or more in the last financial year (from the current threshold of £100,000), or net assets of £430,000 or more throughout the last financial year (from the current threshold of £250,000), reflecting inflation since the thresholds were last set;
2) Amending the criteria to be eligible for the self-certified sophisticated investor exemption[3] by:
    a. Removing the criterion of having made more than one investment in an unlisted company in the previous two years; and
    b. Increasing the company turnover required to satisfy the 'company director' criterion to £1.6m (i.e. directors of companies with at least £1.6m turnover will remain eligible for the self-certified sophisticated investor exemption), reflecting inflation since the threshold was last set at £1m;
3) Requiring businesses to provide details of themselves in any communications made using the exemptions;
4) Updating the title of the certified high net worth individual exemption by removing 'certified';
5) Updating the high net worth individual and self-certified sophisticated investor statements so they engage investors more effectively; and

[2] This recommendation can be found in paragraph 180 of the Treasury Select Committee report, found at: https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/149/14909.htm#_idTextAnchor067.

[3] The self-certified sophisticated investor exemption allows individuals to self-certify as sophisticated, by signing a prescribed statement, if they meet one of the four criteria:

(i) They are a member of a network or syndicate of business angels (and have been for at least six months prior);
(ii) They have made more than one investment in an unlisted company in the previous two years;
(iii) They are working or have worked in the previous two years in a professional capacity in the private equity sector or in the provision of finance for SMEs; or
(iv) They are currently or have been in the previous two years a director of a company with an annual turnover of at least £1 million.

6) Updating the investor statements for promotions of collective investment schemes made under relevant exemptions.

In raising the financial thresholds, tightening the eligibility criteria for the self-certified sophisticated investor exemption, and strengthening the investor statements, the government intends to both reduce the risk of consumer detriment and preserve the ability of SMEs to raise finance under the exemptions.

Overall, respondents to the government's consultation were mostly supportive of the updates that the government is making to the exemptions. A summary of the responses to the government's proposals is set out in chapter two of 'Financial promotion exemptions for high net worth individuals and sophisticated investors: Consultation response'.[4]

3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option

The government has considered the options set out below, having regard to the better regulation principles that regulation should be proportionate, accountable, consistent, transparent and targeted.

Option 1: Retaining the status quo (i.e. no changes to the exemptions). The government considered and rejected this option, as this option does not take account of the changes to the context in which the exemptions operate, and would not address the growing risk that ordinary consumers may be promoted to under the exemptions.

Option 2: Removal of the exemptions. The government considered and rejected this option, as the exemptions continue to play a role in enabling SMEs to raise finance from high net worth and sophisticated investors, and the government believes that such investors are better placed than ordinary retail investors to manage without the regulatory protections afforded by the financial promotion regime and to absorb any losses resulting from their investments.

Option 3 (preferred option): Updating the criteria to qualify for the exemptions, and strengthening the investor statements. The government has decided to retain the high net worth individual and sophisticated investor exemptions in legislation, while updating the exemptions to reflect current circumstances and to address the risk of the exemptions being misused. As set out above, the government intends to amend the eligibility criteria to qualify for the exemptions, and to strengthen the statements that investors must sign before they can receive promotions within the scope of the exemptions. These changes are designed to ensure that the scope of the exemptions captures only those who are high net worth or sophisticated (including reducing the risk that investors incorrectly self-certify), and aim to increase understanding of the regulatory protections that investors are giving up when receiving promotions subject to these exemptions. In doing so, the government is seeking to both reduce the risk of consumer detriment and preserve the ability of SMEs to raise finance under the exemptions.

In proceeding with this approach, the government has not pursued the consultation proposal to place a greater degree of responsibility on businesses to ensure that individuals meet the criteria. Having considered the risks that currently arise from individuals being able to self-certify against the potential impact on the legitimate operation of the exemptions, the government decided not to pursue this proposal. The government considers that the cumulative effect of raising the financial

[4] https://www.gov.uk/government/consultations/financial-promotion-exemptions-for-high-net-worth-individuals-and-sophisticated-investors-a-consultation

thresholds, tightening the eligibility criteria for the self-certified sophisticated investor exemption, and strengthening the investor statements will reduce the risk of consumer detriment, while preserving the ability of SMEs to raise finance under the exemptions and avoiding new administrative burdens.

Further details of the changes are set out in chapter three of the consultation response.[5]

4. Please justify why the net impacts (i.e., net costs or benefits) to business will be less than £5 million a year.

Evaluating the net impacts for this policy change is complex as there is limited data on the size of the potentially impacted market, and the prevalence with which these exemptions are currently used. However, HM Treasury is of the view that the net impacts will likely be limited as the direct costs to businesses from this measure will arise solely from familiarising themselves with the new legislation; the measure imposes no new ongoing administrative burdens on businesses. The following section sets out our analysis in further detail.

Industry background

The UK angel investment market is composed of the following participants:

- Unlisted companies, and collective investment schemes investing in unlisted companies;
- Intermediaries (authorised and unauthorised), e.g. angel networks and investment platforms, and other groups who help facilitate angel investment. Angel networks are often unauthorised and run on a not-for-profit basis; and
- Investors (includes high-net worth individuals and self-certified sophisticated investors), such as business angel investors.

Due to the private nature of angel investing, there is no comprehensive data available on the size of the market. The British Business Bank stated in their “The UK Business Angel Market 2020” report (“the BBB report”) that “the angel investor market is difficult to calculate with any degree of accuracy” and that “there are no robust figures available on the size of the UK or any other angel market”.[6] The BBB report, which was produced in collaboration with the UK Business Angels Association (UKBAA), is the most recent and comprehensive assessment of the overall UK business angel market.

One potential indicator of the size of the angel investing market is through data relating to the uptake of the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS). The EIS and SEIS schemes are designed to help small or medium sized companies grow by attracting equity investment, offering tax reliefs to individuals who buy and hold new shares, bonds or assets for a specific period of time.

HMRC data[7] shows that £2.5 billion was invested via EIS and SEIS in 2021-22. The HMRC data is a useful indicator for understanding the size of the angel investment market as the BBB report found that 86% of angel investors surveyed used the EIS and SEIS during the tax year 2018-19. However, it is challenging to evaluate the amount of this angel investment that takes place via these FPO and PCIS exemptions. Further descriptions of these limitations are set out below.

[5] https://www.gov.uk/government/consultations/financial-promotion-exemptions-for-high-net-worth-individuals-and-sophisticated-investors-a-consultation

[6] https://www.british-business-bank.co.uk/wp-content/uploads/2020/10/20201008-BBB-Business-Angels-Report-Final.pdf

[7] https://www.gov.uk/government/statistics/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-may-2023/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-statistics-2023

Option 3 (preferred option): Updating the criteria to qualify for the exemptions, and strengthening the investor statements.

How many businesses will this impact per year?

Number of businesses for whom financial promotions may be made under the exemptions

As described above, there is no comprehensive data available on the size of the angel investing market. Equally, there is no comprehensive data on the number of businesses making financial promotions under the exemptions, or for whom financial promotions are made under the exemptions.

HMRC data shows that in 2021-22, 4,480 companies obtained investment through EIS, and 2,270 companies obtained investment through SEIS in 2021-22. It can therefore be assumed that the lower bound of companies that successfully raised capital in 2021-22 (and may have used the exemptions) is 6,750.

However, some companies may have raised capital outside of EIS and SEIS. The BBB report found that 86% of angel investors surveyed used the EIS and SEIS during 2018-19. If it were consequentially assumed that 86% of companies who raised capital from angel investors used EIS and SEIS, and that 14% therefore did not, this would mean that an upper bound of 7,850 companies raised capital from angel investors. This is the best estimate that can be made given there are no comprehensive data sources that disclose details of all investment activity in unlisted companies.

Not all promotions of unlisted companies to high net worth and self-certified sophisticated investors will be made under the FPO and PCIS exemptions that are the subject of this measure. FCA-authorised firms may follow exemptions within the FCA's own Handbook, which are distinct from the FPO and PCIS exemptions, when seeking to promote investments in unlisted companies to high net worth individuals and self-certified sophisticated investors. In particular, engagement with the sector suggests that use of the FCA exemptions is more common in relation to investment being raised through EIS funds, with FPO exemptions more commonly being used in relation to material relating to individual companies who are raising capital. The number of entities that are directly affected by these HMT reforms may therefore be lower than set out in this assessment.

However, the FCA has tended to replicate relevant conditions from the FPO and PCIS exemptions in their own exemptions for high net worth individuals and self-certified sophisticated investors. This seeks to mitigate the risk that authorised firms are incentivised to make promotions using the FPO and PCIS exemptions, noting that whereas the FPO exemptions remove a promotion entirely from the FCA's rules on financial promotions, some financial promotions rules within the FCA's Handbook (including the requirement for promotions to be clear, fair and not misleading) still apply where the exemptions in the FCA regime are used. Following the implementation of the reforms, the FCA may decide to consult on updating their exemptions to reflect some or all of the changes being made to the FPO and PCIS exemptions. It is not possible, using the data sources available, to distinguish between use of the FCA exemptions and of the FPO and PCIS exemptions.

Intermediaries

Intermediaries play an important role in matching angel investors, and potential angel investors, with investment opportunities. These can unauthorised angel networks, or FCA-authorised angel networks or investment platforms.

There is no comprehensive database of angel investors or intermediaries, but based on engagement with the sector, HM Treasury estimates that the lower bound for the number of intermediaries is no lower than 150. Noting the lack of comprehensive data on the market, it is assumed that a further 50 intermediaries could be active in the market, and so the upper bound estimate for the number of intermediaries is 200.

Engagement with the sector has indicated that a majority of angel groups share financial promotions with their membership under the exemptions, with a minority of angel groups having become authorised under the FCA regulatory framework (in which case, the group may follow the FCA's own exemptions for making promotions to high net worth and sophisticated investors, rather than these FPO exemptions).

Investors

Investors (high-net worth individuals and self-certified sophisticated investors) who use the exemptions are not themselves businesses for the purposes of receiving promotions using the exemptions, and so business impacts on this group are not accounted for in this assessment.

Summary table: the number of businesses potentially affected

Type	**Number of businesses that make financial promotions per year**
Number of businesses for whom financial promotions may be made under the exemptions	Lower bound: 6,750 Upper bound: 7,850
Intermediaries (such as angel networks)	Lower bound: 150 Upper bound: 200
Total number of businesses impacted by the updates to the exemptions	**Lower bound: 6,900** **Upper bound: 8,050**

Table 1; Number of businesses impacted by the changes to the exemptions

Using the available data and making the assumptions above, HM Treasury estimates that between **6,900** and **8,050** businesses and intermediaries will be impacted by the reforms. However, as described above, not all promotions of unlisted companies to high net worth and self-certified sophisticated investors will be made under the exemptions subject to this measure. In addition, other businesses may make financial promotions under the exemptions but are not captured in the available data, as they fail to obtain investment.

What will businesses have to do differently?

Businesses seeking to make promotions under the exemptions will need to familiarise themselves with the legislation, including the updated exemption criteria and investor statements.

From the date that the changes come into force, businesses wishing to make a financial promotion to a prospective investor will need to have a reasonable belief that the investor has completed and signed the updated investor statement before a financial promotion is made. This process of confirming eligibility is part of business-as-usual processes when making a financial promotion. Stakeholders have not raised concerns related to familiarisation with the legislation and ensuring investors are providing the updated investor statement.

Having considered the feedback to the consultation, the government has dropped the separate proposal to place a greater degree of responsibility on businesses to ensure that individuals meet the criteria. Whereas that proposal would have imposed new administrative burdens on businesses, the updates to the exemptions that the government is taking forward will introduce no new ongoing administrative burdens on businesses. Further details on this are set out in chapter three of the consultation response.[8]

What is the direct cost/benefit per business per year?

As mentioned above, HM Treasury is of the view that the direct costs to businesses from this measure will arise solely from familiarising themselves with the new legislation, as the measure imposes no new ongoing administrative burdens on businesses.

Familiarisation costs

Businesses and intermediaries seeking to make financial promotions under the exemptions will need to familiarise themselves with the updated legislation.

The total word count of the legislation, including investor statements for the relevant exemption, is just over 1500 words. Assuming a reading speed of 100 words per minute, it would take around 15 minutes to read the legislation and investor statements.

HM Treasury anticipates that a minimum of 3 persons at each business or intermediary will read the updated statements, and that it will therefore take 45 minutes for each entity to familiarise themselves with the legislation. Based on the hourly rates that were assumed when funerals plans were recently brought into regulation[9], and where familiarisation with new policy was required, it is assumed that the hourly rate for small businesses is £45 and that the hourly rate for medium-sized businesses is £63. It is not possible from the data available to determine which affected businesses are small and which are medium-sized, and so the lower bound figure will assume that all affected businesses are small, and the upper bound figure will assume that all affected businesses are medium-sized.

Familiarisation formula

Staff time (minutes) x average cost of time per minute x number of businesses

Lower bound: 45 x £0.75 x 6,900 = £232,875

Upper bound: 45 x £1.05 x 8,050 = £380,362.50

Assuming that the costs fall midway between the lower bound and the upper bound, HM Treasury estimates that the total familiarisation costs for businesses will be approximately **£306,619**.

Equivalent Annual Net Direct Cost to Business per year

There are no significant additional yearly costs to businesses from this measure.

IT costs and staff training

No significant IT costs and staff training costs are expected to arise as a result of this measure, as the changes will not require businesses to implement new processes, beyond ensuring that they are familiar with the new legislation and investor statements.

Indirect costs on businesses

As set out in section two, the measure aims to ensure that financial thresholds for exempt investors are calibrated to reflect investors' experience or their ability to absorb losses. As a result, it is anticipated that fewer retail investors (i.e. those who are not high-net worth or sophisticated) will use the exemptions.

[8] https://www.gov.uk/government/consultations/financial-promotion-exemptions-for-high-net-worth-individuals-and-sophisticated-investors-a-consultation
[9] https://www.fca.org.uk/publication/consultation/cp21-4.pdf

The reforms could have an indirect impact on businesses seeking to raise capital under the exemptions, and on businesses who are making promotions on behalf of capital-seeking businesses. However, HM Treasury is of the view that these impacts will not be significant or disproportionate. The exemptions will continue to facilitate angel investment in early-stage businesses as, for example, potential investors who do not meet the financial thresholds to qualify for the HNWI exemption – or who would have relied on the SCSI exemption criterion relating to previous investment in unlisted companies – may still qualify for the self-certified sophisticated investor exemption, where they have been a member of a network of business angels for more than six months.

In addition, the nature of the changes to the financial thresholds means that these will directly affect those individuals with lower income and net assets compared to the overall population investing under the exemptions, and so the changes are expected to indirectly affect a small proportion of investment under the exemptions.

Benefits to consumers

It is expected that benefits to consumers will arise from the changes to the eligibility criteria to use the exemptions, and the changes to the investor statements.

The changes to the eligibility criteria aim to address the risk that a significant and growing proportion of the population qualify for the exemptions, even where they could not be considered high net worth individuals or sophisticated investors. The changes to the investor statements should reduce the likelihood that investors who are not high net worth or sophisticated complete the statements, reducing the potential for detrimental impacts on their financial wellbeing.

While it is not possible to provide a quantitative estimate of the benefits that will accrue to consumers as no comprehensive data exists, the measure should benefit consumers by reducing the risk that they receive marketing for investments that are not appropriate to them, leading to better financial wellbeing.

5. Please confirm whether your measure could be subject to call-in by BRE (Better Regulation Executive) under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:

a) **Significant distributional impacts (such as significant transfers between different businesses or sectors)**

   No: the measure will not have significant distributional impacts between different businesses or sectors.

b) **Disproportionate burdens on micro, small, and medium businesses (below 500 employees).**

   No: while the measure will have an impact on businesses, including micro, small, and medium businesses, these impacts are proportionate in light of the potential risks to ordinary consumers that may result from receiving promotions outside the protections of the financial promotions regime. These risks apply to consumers in the same way whether they receive promotions from smaller or larger businesses. In order to manage the impacts on businesses, including small or micro businesses, the government will provide for a familiarisation period before the SI comes into force on 31 January 2024.

c) **Significant gross effects despite small net impacts**

   No: there are no significant gross effects resulting from this measure.

d) **Significant wider social, environmental, financial or economic impacts**

   No: the measure is not expected to have significant wider impacts beyond its impact on the businesses and consumers concerned.

e) **Significant novel or contentious elements**

No: the measure updates the application of an existing regulatory exemption and does not introduce significant new regulatory requirements for businesses to follow.

<u>Sign-off for de minimis assessment: SCS</u>

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

SCS of Personal Finances and Funds

Signed: ***Anna Harvey*** Date: 16/10/2023

SCS of Better Regulation Unit

Signed: ***Phil Witcherley*** Date: 16/10/2023

<u>Sign-off for de minimis assessment: Minister</u>

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

(Andrew Griffith MP, Economic Secretary to the Treasury)

Signed: Date: 16/10/2023