Financial Promotions and the new media

Financial promotions regulations are tough enough. The requirement to be clear, fair and not misleading is particularly tricky to apply accurately when applied to complex financial products with highly relevant disadvantages and complex fiscal regimes. If one throws in the addition of modern communication techniques, many of which are instant, hard to control and far more powerful than the quill pen, compliance can become something of a nightmare. We turned to Editorial Board Member, regular contributor and compliance consultant, Adam Samuel to shine some light in this area. Adam started his financial promotions experience, dealing with websites, graduated to mass-mailing e-mails and now can be spotted trying to have removed Facebook and Linkedin pages belonging to authorised and unauthorised firms alike before the regulator notices them.

Any discussion of the new media and financial promotion regulation has to begin with a few basic principles. The modernity of technology has no effect on the legality or compliance of otherwise of a financial promotion. Older media like television and even radio pose many of the same problems. Even an advertisement on a train station, perhaps the oldest form of regulated advertisement has a great deal in common from the compliance perspective with a tweet.

The fundamental issue is the nature of the product or service being advertised, not the media being used. The downside of purchasing a magazine, breakfast cereal or legally acceptable washing powder is fairly nominal and limited essentially to the price. In fact, if there are any dangerous elements in the latter two products and they are clearly explained at least on packet, there may be serious legal consequences for the manufacturer and distributor. It is only the potential for significant financial harm that explains why Parliament made it a criminal offence to issue a financial promotion without being either an authorised firm or having the promotion either approved by someone who is or coming within a range of complex exceptions. The application of "clear, fair and not misleading", Principle 7, in this arena is a similar consequence.

One can illustrate the relatively toxic nature of financial promotions by their application in the wholesale markets in the Goldman Sachs affair. There, "clear" and "fair" requirements do not apply on either side of the Atlantic. Nevertheless, the investment bank was seriously disciplined for promoting securitised mortgage debt while knowing that product was put together for and with the help of one of their clients who intended to short it. The focus on the requirements of "clear" and "fair" in the retail market can disguise how without the right balance, a promotion can become highly misleading. For more instant media where control over content, audience and appearance in the hands of the recipient, these concerns are multiplied.

First principles

Any general discussion of financial promotions starts by identifying two different sets of rules and perhaps a third which is connected to the other two.

First, it is a criminal offence to issue a financial promotion unless one is authorised, it has been approved by someone is authorised or the subject matter or means of communication is exempt under the Financial Promotions Order.

Secondly, promotions must be clear, fair and not misleading to comply with Principle 7 and COBS 4. As indicated, in the wholesale market, PRIN removes the requirement to be "clear" and "fair"

although it is questionable how big a difference that makes. Any firm approving a promotion to be communicated by an unauthorised firm must be persuaded that Principle 7 has been observed.

The third requirement that fuels the other two is that of having adequate systems and controls to ensure compliance. This last aspect is particularly pertinent with more instantaneous media because of the inherent difficulty that firms have in limiting their communications to acceptable content.

A promotion is defined as an invitation or inducement to engage in investment activity that is communicated in the course of business. For MiFID, this is expanded to include anything defined as a marketing communication.

Some years ago, it was wrongly suggested that banner advertising was somehow exempt from this. It is not as the FSA had to point out. The other problem as the FSA has also spotted is that a banner advert may contain a click through to an application form or provider's website which contains a far greater significance.

With this in mind, the systems and controls problem is endless. In the past, all promotions were approved and signed off regardless of whether the communication was to be made by an authorised firm and businesses were fined for having inadequate approval systems for this purpose. A tweet simply cannot be approved in that way. While the rules have changed to ensure that approval of an authorised firm's communications are no longer required, the overall need to have systems to ensure compliance may bar the effective use of instant media or at least its instantaneous use.

Communications by unauthorised firms

A development sometimes missed is the Insurance Mediation Directive's requirement that all firms who introduce customers for the purposes of buying insurance must be authorised in the same way as other intermediaries. Many investment or savings products are actually contracts of insurance. Pensions including QROPS, annuities, life assurance bonds are examples. Companies that are not authorised firms going out to find customer leads to hand onto firms can find themselves in trouble. The solution to the problem is simple. The business should become an appointed representative of one of the firms or authorised.

The problems start when a firm is spotted making a marketing effort in this way. It is relatively easy to pull down a website or at least block it. The modern compliance adviser, though, has to check Facebook , Twitter and Linkedin to ensure that there is nothing else out there promoting the service. Moving an introducer outside the European Economic Area might be a solution. However, the risk of doing that is just to expose a source of business to another financial services regulatory regime not to mention an advertising one. The danger of that approach is that again a Linkedin, Facebook page or Twitter might indicate a presence in the UK which will rightly bring down the wrath of the FSA on the firm.

Firms who receive leads from these types of firms run the constant risk of having the flow of business dried up by regulatory action and what should be FSA suspicion that they are in some senses encouraging a breach of the criminal law by seeking the promotional activities while legally seeking to distance themselves from them.

A hugely controversial area concerns the use of click-throughs on generic advice sites to websites of authorised firms and sometimes even application forms for their products. There is a media exemption in Article 20. However, that requires the communication to come within Article 54 of the Regulated Activities Order. This means that the principal purpose of the publication or service, taken as a whole and including any advertisements or other promotional material contained in it, must not be to encourage customers to buy investments or take out regulated mortgage contracts.

In practice, the FSA is concerned by the ambiguity of the rules and does not take enforcement action against these types of sites while encouraging firms setting up new sites to become authorised. The problem is that providing a website with click-throughs has a predominant purpose to generate revenue through the click-throughs, rather than educating the public. However, proving that is not easy. This uncertainty creates an unlevel playing field in this market and prevents FSA effective control of communications about investments.

Other exemptions can help compliance in this area since excluded communications are excluded from the fair, clear and not misleading rule in COBS 4.2.1R. These are essentially occurrences that are excluded from the promotions prohibition through the Financial Promotions Order. Communications for investment professionals and the press can escape a degree of scrutiny. However, they have to be marked clearly as such. Reputable firms password protect investment professional material and press releases left on their websites for this reason. Again, though, while possible, this is more difficult with networking sites.

Clear, fair and not misleading

The first rule to be worried about is COBS 4.3.1R which requires a promotion addressed to a client (which is defined as including a potential client) to be clearly identifiable as such. The Court of Appeal in the Fox Hayes case interpreted that as meaning that the promotional purpose of the communication must not be disguised. A tweet about the merits of a product or service is unlikely to be made by a financial services business without the idea of interesting followers in purchasing the product. Equally, Facebook and Linkedin pages have been found expressing enthusiasm for businesses whose sole purpose is to generate advice business. Even worse, on one occasion, the Facebook individual was apparently fictitious. This is something of a compliance officer's nightmare.

As the *Fox Hayes* and *Atlantic Law* cases illustrate, any firm approving a promotion has to know what its true purpose is. The accumulation of friends on Facebook, a network on Linkedin or followers on Twitter can become the secondary excuse for a promotion being issued to the private group concerned. The Court of Appeal in Fox Hayes found advertising where the purpose was disguised to be a breach of what is now COBS 4.3.1R.

Image advertising is excluded from the clear identification requirement. However, firms have to be careful to stick to the definition. Such advertising must be limited to the name of the firm, a logo or associated image, a contact point and a reference to a type of regulated activity or its fees or commissions. Any enthusiastic remark about the business immediately removes the protection of the exemption.

The bigger problem, though, concerns the general requirement to ensure that a promotion is fair, clear and not misleading (to use the MiFID formulation). A promotion for a product or service that

puts the client's capital at risk must make this clear according to COBS 4.2.4G. An effective and accurate risk warning is not consistent with most instant media. Telling readers that funds can go down in value on a pension is all well and good but actually they may go up but falls in annuity rates could damage the value of the amounts invested. Promoting pensions generally is a hazardous business because of the lack of accessibility and tight limits on the way in which funds can be accessed. Things become more complex with every extra element added. QROPs which is typically promoted on websites is subject to collosally complex requirements and involve all the usual hazards that arise when firms transfer pensions generally in terms of lost benefits and charges. Essentially, Principle 7 requires balance in advertising between any positive comment with all the negative features. This is probably inconsistent with the nature of tweets at the very least. Promoting a service, particularly an investment advice, is difficult here. This can put the customer's capital at risk. So, some form of risk warning is a consequence of COBS 4.2.4G. Any information communicated to a retail investor must not emphasise any potential benefits of "relevant business" without also giving a "fair and prominent indication of any relevant risks".

The various new media invite users to express views and advisers notoriously consider this an appropriate way to sell their services in what can best be described as an advertorial. These are something of a nightmare to control generally but again the new media aggravates the problem. Advertorialising about pensions that everyone needs one is typically greeted by the compliance response that the those who have exceeded their lifetime allowance and those entitled to pension tax credit (the former minimum income guarantee for the elderly) would be better off spending their money or in the former case putting almost anywhere else.

COBS 4.2.2G stresses that this rule applies in a proportionate way taking into account the means of communication and the information that it is sought to convey. However, nobody knows how this really applies as regards the new media. The problem depends on how intense the effort that is made to promote the product or service. Equally, what is perceived as an attempt to achieve a presence in the new media can be interpreted by a regulator as something far more dynamic or at least capable of having more positive impact. The "in-your-face" nature of much instant communication is more dangerous in this respect than many users will appreciate.

There are other rules which require comments to be qualified. References to tax treatment have to be qualified by comments that this may depend on each client's circumstances and may change in the future.

In 2007, the FSA had a look at sponsored links and found some uncomfortable material. Promotions for credit-impaired customers must quote a representative APR under MCOB. A number failed to do this. Others made price claims that could not be substantiated. In some cases, the link information was fine but the search word that led to it combined with it to give a false impression.

One normally regards the new media as referring to internet interactive services. However, this leaves behind the traditional website. The FSA has done numerous surveys of these. It rightly points out that the use of any form of screen makes it imperative that scrolling down is not required to locate balancing material. This applies equally to e-mails. This issue is further complicated by the effects of different browsers on screen images and even colours. Risk warnings must not be on separate pages because they will lack the shared prominence of the more positive material. They

will also not be read. The FSA has already complained of the “poor use of font, position, colour, no use of text boxes and other presentational tools” as regards websites.

Systems and controls

SYSC and Principle 5 require firms to set up systems and controls to ensure compliance with among many other things the financial promotions rules. It is somewhere between difficult and impossible to ensure this type of compliance when new media is being used except under strict supervision or by highly trained responsible individuals who have earned the trust of management.

Procedures have to be developed either to ban the use of new media or place it within very strict guidelines. Image advertising is fine but any positive comment about the company, its services or products immediately poses a risk. However, this is where the problems begin. Since the FSA has not issued any clear guidelines on the extent to which instant communication needs to be balanced, any positive remarks without countervailing negative ones are immediately vulnerable.

Supervision has to take place through the use of what is in effect a police force looking for breaches of the rules on as many social media as exist. In essence, a highly skilled marketing section needs to be using social media and another crowd posing as the public needs to be looking for breaches of the rules. Quite apart from the internal political problems that such an approach is likely to create, it is not the positive approach that the new media demands of its users. There may, though, be no alternative.

This level of systematisation puts the use of new media out of the reach of all but very small businesses who can police all participants reasonably easily and very large companies. Perhaps, the new media is just not designed for financial promotions. Certainly, MiFID makes it very difficult to use them safely. It is vital in any event for compliance staff to be involved in the creation of any modern marketing campaign to ensure clearly understanding of the regulatory requirements from an early stage.

It is one thing to go through all the applicable rules. It is quite another to try to use them in a particular instant media. Is it impossible to tweat about a financial service and add but “ you can lose your money as a result”? As ever, the risk is that a marketing advantage may be gained by non-compliance at the expense of those trying to comply. Since FSA enforcement is far from certain, this is more of a headache than one might think.

Final thoughts

The new media pose serious threats to any form of compliance management. The multitude of activities and communications involved always create a risk that the regulator will spot something that the compliance department fails to pick up.

Investment products and services do not lend themselves well to snap shot advertising. Their many facets, some caused by tax and other legal restraints mean that positives have to be mixed with negatives to create an accurate impression. An instant media approach must be pre-planned and structured or it will fall foul of the rules.

Firms have been complaining since the early days of the FSA that its stricter approach has placed unnecessary restrictions on promotions. However, they were mandated by the rules that for investments go back to 1988. It is no use denying the existence of the problem and then complaining when the FSA comes to visit. That happened with the tip sheets half a decade ago. Embrace, discuss and make compliant your firm's use of the new tricks available.