

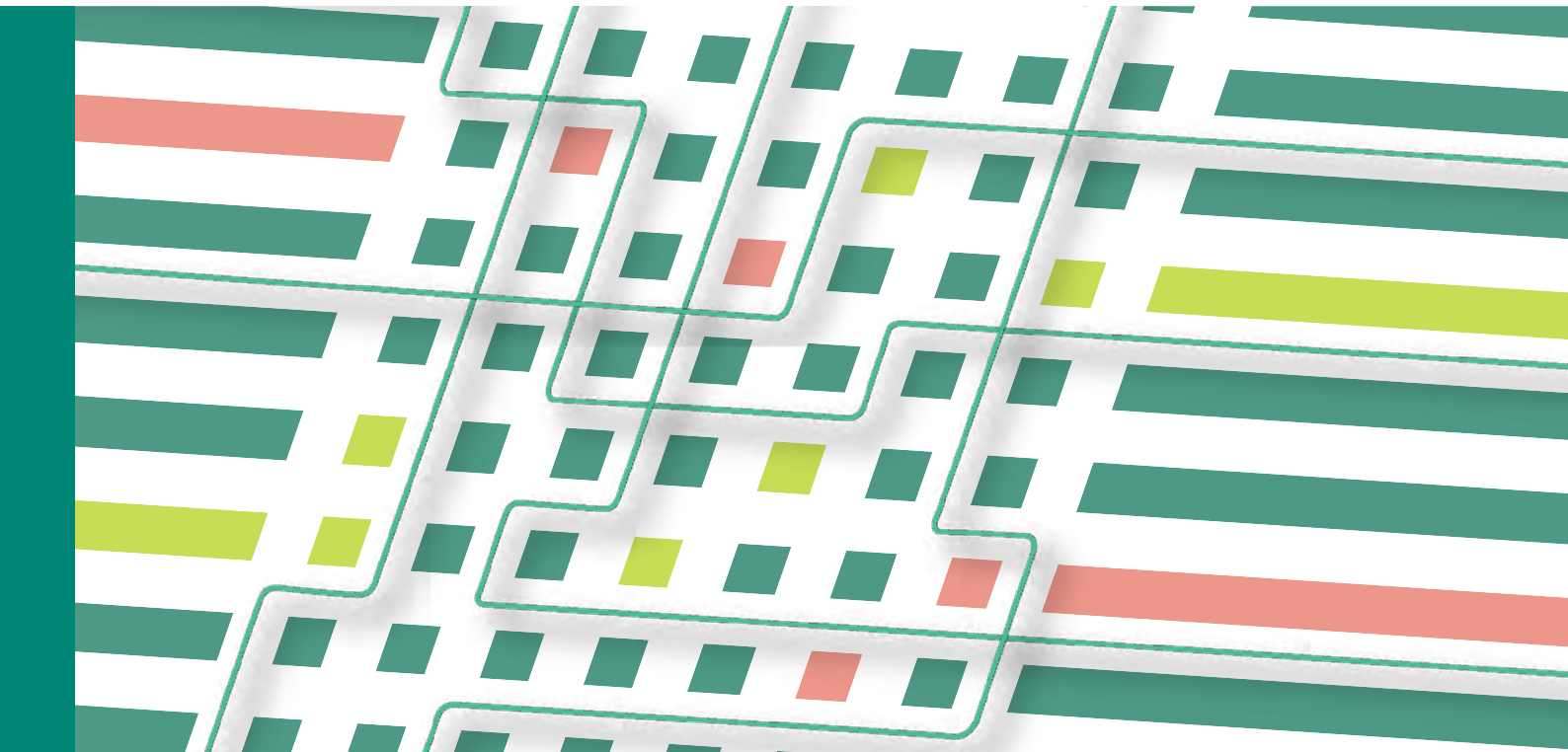
Marketing Social Investments - An Outline of the UK Financial Promotion Regime

RESEARCH REPORT CITY OF LONDON CORPORATION

SOCIAL
INVESTMENT
RESEARCH
COUNCIL



Cabinet Office



Marketing Social Investments - An Outline of the UK Financial Promotion Regime

RESEARCH REPORT CITY OF LONDON CORPORATION

SOCIAL
INVESTMENT
RESEARCH
COUNCIL



Cabi

|



Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Marketing Social Investments – An Outline of the UK Financial Promotion Regime

is published by the City of London Corporation, on behalf of the Social Investment Research Council. Luke Fletcher (Partner) and Oliver Lewis (Of Counsel) of Bates Wells Braithwaite authored the Supporting Technical Manual on which this report is based. Bates Wells Braithwaite is a full service City law firm with the largest team of dedicated charity, social enterprise and social finance lawyers in the UK.

This report is intended as a basis for discussion only. While every effort has been made to ensure the accuracy and completeness of the material in this report, Bates Wells Braithwaite, the City of London Corporation, and the Social Investment Research Council, give no warranty in that regard and accept no liability for any loss or damage incurred through the use of, or reliance upon, this report or the information contained herein. The material within this report is not a statement of policy and does not constitute the official views of any member of the Social Investment Research Council.

The Social Investment Research Council, which launched in October 2013, is formed by Big Lottery Fund, Big Society Capital, the Cabinet Office, Citi, and the City of London Corporation. It is a coordinated initiative which draws together research commissioners from key organisations in the social sector.

June 2014

© **City of London**

PO Box 270

Guildhall

London EC2P 2EJ

www.cityoflondon.gov.uk/economicresearch

Contents

Foreword	4
1. Introduction to this guide	6
1.1. Aims of this guide	6
1.2. Defining the 'Financial Promotion Regime'	7
1.3. Relevance of the Financial Promotion Regime to the social investment market	7
1.4. Defining 'social enterprise' (investees)	8
1.5. Investment types	6
1.6. Investment channels	7
1.7. Defining 'retail investors'	7
1.8. Structure of this guide	8
2. The Financial Promotion Regime – an overview	12
2.1 Other relevant regulatory considerations	13
3. Mapping the Financial Promotion Regime landscape	16
3.1. Reading the maps	16
Map 1: Overview of the Financial Promotion Regime landscape	18
Map 2: Example route to market – community benefit society issuing non-transferable shares	20
Map 3: Example route to market - CLG wanting to issue an unlisted bond	21
Map 4: Example route to market – CIC CLS listed on a stock exchange	22
Map 5: Application of the Financial Promotion Regime	23
Map 6: Application of the FCA Prospectus Rules	26
Map 7: Application of the FCA Crowdfunding Regulations	28
4. Implications of the Financial Promotion Regime regulatory structure	31
4.1. A potential 'untapped' pool of investors for the social investment market	31
4.2. Challenges of the Financial Promotion Regime for ordinary retail investors	32
4.3. Barriers and challenges for investees	33
5. Summary and conclusion	36
Key sources and further reading	38
Glossary	39
Annex One: Social enterprise legal forms	45

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Foreword

Access to finance continues to be a major challenge for social enterprises, and subsequently a barrier to the growth of the UK social investment market.

One means of attracting investment capital is for investees – social enterprises – to issue a ‘financial promotion’: a communication which is an invitation to engage in investment activities. In so doing, the investee will be required to comply with the legislative and regulatory regime applying to financial promotions – the ‘Financial Promotion Regime’. This is understood here to include the Financial Services and Markets Act 2000, the Financial Promotion Order, and FCA Principles for Businesses, among others. Other overlapping regulation such as the FCA Crowdfunding Regulations is also considered where relevant.

In order to help social enterprises and retail investors to better understand this regulatory landscape, the Social Investment Research Council is delighted to have jointly commissioned this research, which provides a practical and accessible introduction to the Financial Promotion Regime. In addition, it considers how it affects the marketing of social investments to ordinary retail investors. This work includes an analysis of the barriers to social investment for investees and investors, and to market growth more generally. The research is particularly timely in light of the FCA Crowdfunding Regulations, published earlier this year, which are certain to have a profound effect upon the marketing of unlisted social investments to retail investors in the future.

The research highlights that the complex and multi-layered nature of the Financial Promotion Regime in application is in itself a challenge for investors and investees alike to understand. This can cause uncertainty as to what rules apply and when, and which course of action is subsequently required. Additional barriers also arise – for example the associated costs of compliance for investees, or the costs of financial advice for investors. Given the relatively small size of most social investments, these costs are likely

to be disproportionately high compared to the level of protection required in the case of social investments which, due to their small size, have low associated risks. In addition, such challenges are likely to be felt most acutely by the smaller-scale social enterprises which make up much of the social sector, and have a significant restrictive impact on their ability as investees to market small investment amounts to retail investors. There are also important considerations raised around the degree and nature of the risk that ordinary retail investors are being protected from, particularly where some investors may be willing to blend financial and social return, or even entertain the prospect of philanthropic donation.

In identifying such areas of challenge for investees and investors, this guide presents valuable insights towards addressing a key barrier to growth for the social investment market – access to finance. It highlights that the nature of the Financial Promotion Regime as it currently stands, in failing to recognise the specific needs and features of many social investment contexts – where investments are often small-scale, localised, involve personal associations and financial return is often a secondary consideration – presents barriers both for investors and investees, which risk stifling the growth of the marketplace. While the Financial Promotion Regime provides valuable and necessary regulatory protection to retail investors, there is scope for the regulatory landscape to be improved and clarified, to enable the growth of the social investment market.

The Government has demonstrated clear support for the growth and development of the nascent social investment market, including the creation of Big Society Capital in 2012, and the establishment of the G8 Social Impact Investment Taskforce in July 2013. Likewise, the commitments made by HM Treasury as set out in its ‘Social Investment Roadmap’ published on 30th January 2014, which culminated in an announcement in the 2014 Budget that the Social Investment Tax Relief (SITR) will be set at 30% for retail investors. For the positive impacts of these developments

to be felt, the commitment to growing the social investment market needs to be reflected across the wider legal, regulatory and policy landscape.

The Social Investment Research Council commends this research for providing much-needed practical guidance on the Financial Promotion Regime and highlighting that there remain a number of barriers to the social investment market in relation to the marketing of social investments to ordinary retail investors.

It also highlights potential opportunities to facilitate such marketing with a view to encouraging the growth of retail investment in the social investment market generally. In so doing this research provides valuable insights for the market's development and will inform wider dialogue on the regulatory landscape and policy framework.



Robert Annibale

Global Director, Community Development
& Inclusive Finance, Citi



Mark Boleat

Chair, Policy & Resources Committee
City of London Corporation



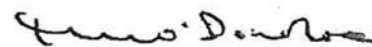
Kieron Boyle

Head of Social Finance
Cabinet Office



Nat Sloane

England Chair
Big Lottery Fund



Nick O'Donohoe

Chief Executive
Big Society Capital

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Chapter 1

Introduction to this guide

Earlier this year, the Social Investment Research Council commissioned Bates Wells Braithwaite (BWB) to undertake research into the UK '**Financial Promotion Regime**' – rules which regulate communications that are an 'invitation' or 'inducement' to engage in investment activities, including communications made to retail investors.

This guide provides a practical summary of the research conducted by BWB. It also seeks to analyse the relationship between the Financial Promotion Regime and the marketing of social investments in the UK. Other overlapping regulation, although not the focus of this guide, is considered where relevant.

A **Supporting Technical Manual** that accompanies this guide and sets out the research in further detail is available separately online¹.

This guide has two key objectives. First, to provide a practical overview of the Financial Promotion Regime and how it impacts the social investment market for social enterprises (investees) and investors. Second, to analyse the implications of the Regime for the social investment market and in so doing, identify potential challenges to market growth. The guide aims to assist investees, retail investors and other relevant stakeholders to understand the implications of the Financial Promotion Regime for the marketing of social investments and should not be interpreted as legal advice. The analysis is neutral and fact-based and is designed to highlight potential areas for further consideration rather than propose regulatory change.

1.1 Aims of this guide

As a practical guide to the Financial Promotion Regime, this report seeks to cover only the key issues and therefore does not go into significant technical detail concerning the Financial Promotion Regime. The Supporting Technical Manual develops the various themes discussed here and contains

additional relevant regulatory detail, employing examples and case studies where relevant, and is available online separately.

This guide first aims to provide an accessible introduction to how the Financial Promotion Regime affects the marketing of social investments to ordinary retail investors, and how social enterprises can seek to raise capital through the communication of financial promotions, through different agents, advisors or channels. It is not however intended to be a comprehensive or definitive assessment of the Financial Promotion Regime. It is intended that the guide will be of practical use to policymakers, product designers, social investors, advisors, social investment and finance intermediaries and investee organisations, as well as other relevant stakeholders.

To achieve this first objective, this guide provides the reader with a series of 'investment journeys' through the Financial Promotion Regime and its implications for the social investment market. It is intended for the non-specialist reader and utilises diagrams to illustrate the relevant regulatory landscape which applies to the marketing and promotion of social investment opportunities to retail investors.

This guide has been designed to plot the application of the Financial Promotion Regime from both the perspective of investees (social enterprises) and retail investors. Retail investors are focused on here as they represent a potential, largely 'untapped' investor group with an appetite for social investments, and which arguably currently lacks the required information, support and level of organisation, to account for large volumes of social investment, when compared to institutional investors (see sections 1.7 and 4.1 for further explanation). The guide also considers the nature of the investment being promoted and the potential investment channels that investees might use to get their product to market (set out in more detail in chapter 3).

To fulfil the second research objective, in addition to providing an overview, this guide includes an analysis of the implications of the Financial Promotion Regime for social investors, investees,

¹ The Supporting Technical Manual is available at the City of London Economic Research webpage: <http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Marketing-social-investments.aspx>

and the market in general, highlighting potential compliance challenges.

1.2 Defining the 'Financial Promotion Regime'

The term 'Financial Promotion Regime' is used in this guide to describe the legislative and regulatory regime applying to financial promotions, including:

- The statutory prohibition on the communication of financial promotions contained in s.21 of the Financial Services and Markets Act 2000 ("FSMA 2000");
- The exemptions and other provisions relating to financial promotions which are set out in the Financial Promotion Order ("FPO");
- The Financial Conduct Authority ("FCA") Principles for Businesses:
 - The FCA rules applying to communications made by authorised persons, as set out in Conduct of Business Sourcebook 4 ("COBS 4"), as they apply to financial promotions and the marketing of social investments; and
 - Other FCA rules applying to financial promotions and the marketing of social investments, including the Crowdfunding Regulations and rules restricting the promotion of Unregulated Collective Investment Schemes ("UCIS") and Non-Mainstream Pooled Investments ("NMPIs").

The term Financial Promotion Regime is also sometimes used in this guide to refer to the relationship between (a) the rules which apply to financial promotions, as mentioned above, and (b) the law which applies to exempt financial promotions, such as advertising and consumer law.

1.3 Relevance of the Financial Promotion Regime to the social investment market

The Financial Promotion Regime is the primary set of domestic rules which regulate the marketing of smaller-scale investments to investors based in the UK.

The Financial Promotion Regime generally applies to any communication which has the purpose or intent of encouraging investment activity and which has a promotional element (outlined in more detail in chapter 2), and which relates to investments of less than €5m over a 12-month period. Investment offers of more than €5m may in certain cases instead be subject to the Financial Conduct Authority's ("FCA") Prospectus Rules² (see chapter 2 and Supporting Technical Manual³ for more detail). All investment offers, regardless of the size of investment to which they relate, will need to comply with general law, in addition to the Financial Promotion Regime or FCA Prospectus Rules, as appropriate (more information is provided in chapter 2 and the Glossary).

The Financial Promotion Regime is particularly relevant to the UK social investment market. Though 90% of lending to this market was in the form of secured loans in 2011/12⁴, social enterprises are increasingly in need of unsecured debt capital. Projections by Boston Consulting Group suggest that by 2015, demand for investment into the market will reach £750m, 58% of which will be in the form of unsecured debt and 15% in equity-like capital⁵. The role of the retail investor in helping to provide this capital is as yet untapped, although there is survey evidence of an appetite among retail investors to make social investments⁶. The creation of a Social Investment Tax Relief ("SITR"), as announced in the 2014 Budget, is also designed to encourage a wider individual social investor base in the UK.

When looking at the size of investments that social enterprises generally seek, 2012 research

² See: <http://www.fca.org.uk/your-fca/documents/prospectus-directive-pd>

³ Supporting Technical Manual available at: <http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Marketing-social-investments.aspx>

⁴ ICF GHK & BMG Research (July 2013) 'Growing the Social Investment Market: The Landscape and Economic Impact', Big Lottery Fund, Big Society Capital, City of London Corporation and Her Majesty's Government. See: <http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Growing-the-social-investment-market.aspx>

⁵ Boston Consulting Group (September 2012) 'The First Billion: A Forecast of Social Investment Demand', Big Society Capital. See: <https://www.bcg.com/documents/file115598.pdf>

⁶ NESTA (April 2011) 'Investing for the Good of Society: Why and How Wealthy Individuals Respond'. See: http://www.ipsos-mori.com/DownloadPublication/1418_Loyalty_Investing_for_the_Good_of_Society.pdf

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

highlights that the vast majority (93%) of social enterprises had sought investments of less than £1m in the preceding year and more than three quarters had sought investment of less than £100k⁷. Therefore the overwhelming majority of promotions by social enterprises seeking investments, will fall within the financial threshold covered by the Financial Promotion Regime because of their relatively small size, and will not be subject to the Prospectus Rules⁸.

Another point of note is that while communications relating to listing and public markets are not subject to the Financial Promotion Regime (though need to meet other regulatory requirements), the vast majority of social enterprises are not listed companies⁹, and therefore their investment communications will generally fall within the scope of the Financial Promotion Regime. Similarly listed investments are largely exempt from the Financial Promotion Regime.

1.4 Defining 'social enterprise' (investees)

While it is acknowledged that there is no single universally-applied definition of 'social enterprise', for the purpose of this guide, a definition encompassing a wide variety of different legal forms¹⁰ is used. This includes:

- **Company forms**, being companies either limited by shares or limited by guarantee, which are:
 - Community interest companies ("CICs") – these may either be limited by shares ("CLS") or by guarantee ("CLG").
 - Most modern operating charities and CICs are constituted as companies limited by

guarantee, which means that they do not issue shares and cannot therefore raise equity investment.

- However, it is also worth noting that social enterprises are increasingly using the company limited by shares (CLS) legal form, with a locked-in social mission¹¹.
- **Industrial and provident society** forms ("IPSs"), which include co-operative ("co-op") and community benefit ("bencom") societies.
- Social enterprises also come in **other legal forms**, such as sole traders, trusts, unincorporated associations, charitable incorporated organisations, Royal Charter bodies, partnerships, limited partnerships and limited liability partnerships, although such legal forms are less common than company and society forms.

It is worth noting that 'charitable status' is a legal *status* rather than an organisational legal *form*, and 'sits on top' or 'across' the legal forms listed here. Definitions for these and other key terms used throughout this guide are set out in the Glossary.

1.5. Investment types

The Financial Promotion Regime does not generally distinguish between different types of investment. Most forms of investment are regulated by the Financial Promotion Order ("FPO"), with the exception of certain alternative forms of 'investment', such as precious metals, wine or art. (See the Supporting Technical Manual for a list of those investment types covered by the FPO).

Listed investments are largely subject to other regulatory requirements outside and beyond the Financial Promotion Regime and are therefore not considered for the purposes of this guide.

⁷ BMG Research (April 2013) 'Small Business Survey 2012: SME Employers, Department for Business, Innovation and Skills'. See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193555/bis-13-p74-small-business-survey-2012-sme-employers.pdf

⁸ For the Prospectus Rules to apply, the communication must be made to more than 150 persons, and the minimum investment amount per investor would need to be below €100k. If these conditions are not met then the promotion may be exempt from the Prospectus Rules.

⁹ A listed company is a company that has satisfied the requirements for any class of its securities to be admitted to the Official List maintained by the United Kingdom Listing Authority. Listed companies are subject to the FCA's Listing Rules, under which they must have their listed securities admitted to trading on a Recognised Investment Exchange.

¹⁰ See Annex One for data on social enterprise legal forms.

¹¹ UnLtd (April 2014) 'Pushing Boundaries: Why Some Social Entrepreneurs are Using a For-Profit Legal Form for their Ventures, and How they are Embedding their Social Mission'. See: http://unltd.org.uk/wp-content/uploads/2014/04/UnLtd_Research_Publication_Number71.pdf

1.6. Investment channels

There are a limited number of ways in which investment opportunities may be distributed. These broadly coincide with the nature of the investment for example, whether it is a listed or unlisted investment.

Most listed investments are distributed via the following channels:

- Financial advisers ("IFAs");
- Investment managers;
- Stockbrokers;
- Execution-only platforms, which enable retail investors to decide how and where to invest on listed markets and to buy and sell shares.

Most unlisted investments are distributed via:

- Crowdfunding platforms, which allow retail investors to invest via the platform into unlisted shares, loans and debt instruments under certain conditions (see chapter 2);
- Direct offer financial promotions, which are investment opportunities concerning unlisted shares, loans and debt instruments that are capable of being communicated directly to retail investors;
- 'Private offer' financial promotions, which involve selling shares through a private offering to small numbers of retail investors, such as high net worth institutions, investment professionals, sophisticated investors and high net worth individuals. Private offers are exempt under the FPO and therefore beyond the scope of this guide.

This guide largely considers the first two investment channels associated with unlisted investments – crowdfunding platforms and direct offer financial promotions. Some consideration is also given to the role of IFAs in advising on social investments for their clients (see 4.2.1).

1.7. Defining 'retail investors'

For the purposes of this guide, a retail investor is defined as an individual who invests in their capacity as a retail client i.e. they are not a professional investor, nor do they invest by way of business. There are different types of retail investor, for example sophisticated investors (those with extensive investment experience), high net worth individuals (HNWIs) (those with an annual income of £100,000 or more or having investable net assets of more than £250,000), and ordinary retail investors (neither sophisticated nor high net worth). (See Glossary for detailed definitions of each of the retail investor groups).

This guide considers the impact of the Financial Promotion Regime solely from the perspective of social enterprises marketing investments to **ordinary retail investors**, which make up the greatest number of the investors in the UK retail investment market, if not the greatest in volume.

There is a growing body of evidence of an appetite for social investment among retail investors (see section 4.1), and as highlighted in the case of the Golden Lane Housing Bond.

Case study: Golden Lane Housing Bond

In February 2013, the charity Golden Lane Housing, working in partnership with Triodos Bank, issued a five-year unsecured charity bond for £10m. The objective of the GLH bond was to raise money to purchase homes for people with learning disabilities. The terms of the bond for investors were for a minimum investment level of £2,000 per investor, with a fixed gross yield of 4% per year for the five-year fixed term. By June 2013, the bond had met its target, and due to over-subscription, had to close early. Significantly, the majority of investment capital raised came from retail investors – 62% – alongside interest from institutional investors.

Source: 'Corporate Finance Case Study – Golden Lane Housing Bond Issue', Triodos Bank, <http://www.triodos.co.uk/en/business/raising-capital/653125/track-record-glh/corporate-finance-case-study-golden-lane-housing-bond-issue/>

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

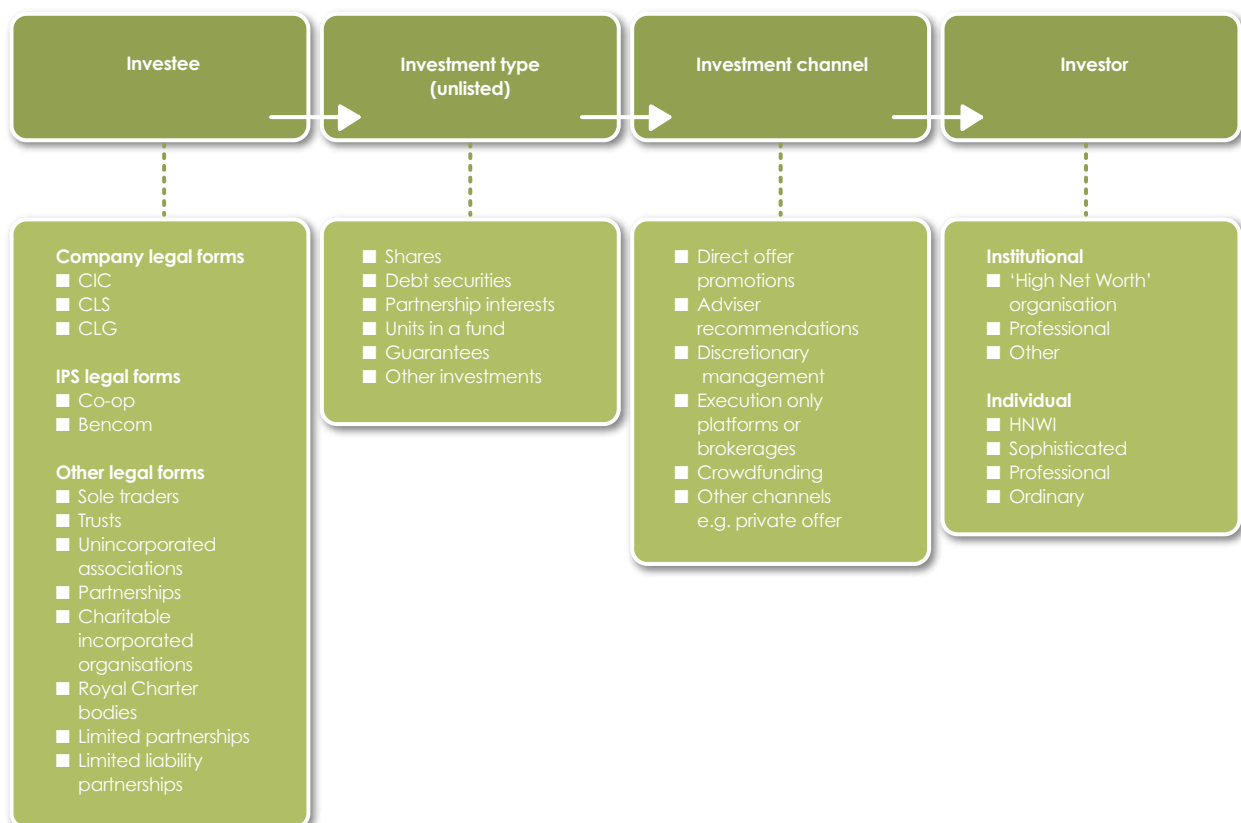
1.8. Structure of this guide

As well as mapping the Financial Promotion Regime, the guide highlights areas where the rules create potential barriers to the marketing of social investments to ordinary retail investors.

To a limited extent, this guide also touches upon other related areas of regulation such as the FCA's recent policy statement (PS14/4) on the regulation of crowdfunding¹², which is certain to have a profound effect upon the marketing of unlisted social investments to retail investors in future.

Following the above, Figure 1 provides an overview of the Financial Promotion Regime landscape in terms of its relevance for the social investment market. These four elements of the regulatory landscape are also considered in detail in the online Supporting Technical Manual (see also the Glossary for definitions of key terms).

Figure 1:
Framework overview of the Financial Promotion Regime for social investment



The remainder of the guide is structured as follows:

Chapter 2 provides a representative and balanced **overview of the regulation of financial promotions**, focusing on the key features of the Financial Promotion Regime. The guide provides a selective summary of regulation and does not purport to provide an exhaustive list of all relevant exceptions and qualifications to the general picture it outlines.

Chapter 3 sets out an overview of the regulatory landscape using **diagrammatic 'maps'**. It takes the reader through the steps required for compliance with the Financial Promotion Regime, considering the perspective of ordinary retail investors and social enterprise investees alike. It also takes a selection of likely hypothetical journeys to exemplify the impact of the Financial Promotion Regime. Social investment types, investment channels and other relevant considerations such as the role of financial advisers are briefly considered.

Chapter 4 provides an analysis of the issues highlighted in chapter 3 and discusses some of the **challenges and potential opportunities** of compliance with the Financial Promotion Regime for investors and investees alike.

Chapter 5 summarises the analysis and concludes the guide.

The end of this guide includes a list of **key sources and references and glossary**.

Further detail on the Financial Promotion Regime and other relevant areas of regulation is provided in the online **Supporting Technical Manual**, available separately¹³.

This guide does not constitute legal advice and any person considering engaging in a financial promotion should, where appropriate, obtain independent legal advice.

¹³ See: <http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Marketing-social-investments.aspx>

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Chapter 2

The Financial Promotion Regime – an overview

A financial promotion is an 'invitation or inducement to engage in investment activity'. The terms 'invitation' and 'inducement' have a very wide meaning and generally include any communication which relates to an investment, with the purpose or intent of encouraging investment activity and which has a promotional element. 'Engaging in investment activity' includes most forms of common investment activity.

Under section 21 of the Financial Services and Markets Act 2000 ("FSMA")¹⁴ there is a general restriction on communication of financial promotions made in the course of business (as opposed to, for example, personal communications made between individuals for private purposes).

As a result, when a person seeks to communicate a financial promotion in the UK, the communication will need to fall into one of three categories:

1.

The person **issuing** the communication is a person authorised¹⁵ by the Financial Conduct Authority ("FCA")¹⁶ – for example, deposit-taking institutions, investment managers, brokers and arrangers, and authorised crowdfunding platforms. Offers made by these institutions are therefore regulated and fall within the Financial Promotion Regime.

2.

A financial promotion communicated by an unauthorised person requires **approval by an FCA-authorised person where it is being communicated 'by way of business'** to recipients in the UK who are not exempt from the Financial Promotion Regime. The costs of approving a financial promotion are likely to range from thousands to tens of thousands of pounds depending on the length, detail and complexity of the communication.

Authorised persons capable of approving financial promotions for clients include law firms, accountancy firms, corporate finance firms, investment banks and other intermediaries. A number of factors need to be taken into account in determining whether the communication is made in the course of business rather than being a personal communication, including, but not limited to:

- The degree of continuity;
- The existence of a commercial element;
- The scale of the activity;
- The proportion which the activity bears to other activities carried on by the same person but which are not regulated.

3.

The communication is subject to an **exemption** – the exemptions available to the 'financial promotion restriction' are set out in the Financial Promotion Order¹⁷, ("FPO") which lists approximately 65 different exemptions of different kinds (communications made to sophisticated investors and HNWI are exempt, hence the focus here on ordinary retail investors). Examples of exempt and therefore unregulated offers include most 'community shares' offers, such as community co-operative or community benefit society offers to buy local assets, such as pubs and shops. Other exemptions in the FPO which are directly relevant to social investment are discussed in chapters 3 and 4, and in more detail in the Supporting Technical Manual. Where an offer is exempt from the Financial Promotion Regime¹⁸, it will still need to comply with the general law relating to advertising and consumer contracts, which is in any case applicable to all financial promotions (see also Supporting Technical Manual).

¹⁴ FSMA is the principal legislative foundation for financial services regulation in the UK.

¹⁵ Note on terms used in this guide: The term 'authorised' is used to refer to the authorisation by the FCA of certain organisations or individuals who are permitted as a result to carry out certain regulated activities. The term 'approved' is used to refer to the approval by an FCA-authorised person of a financial promotion issued by a person who is not FCA-authorised.

¹⁶ There are two regulatory bodies for financial services and markets in the UK – the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) – see Glossary for definitions of these and the roles they play.

¹⁷ The full title is the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529) (as amended). The Financial Promotion Order came into force on 1 July 2005 (replacing the original Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (SI 2001/1335) (as amended)).

¹⁸ Exemptions for certain kinds of communications are numerous and are set out in the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, as amended.

A deliberate breach of section 21 of FSMA amounts to a criminal offence, which is subject to a maximum of two years imprisonment and an unlimited fine. However, it is a defence for a person to show that s/he took all reasonable precautions and used all due diligence to avoid committing the offence.

The financial promotion restriction applies in principle to all forms of promotional communication such as **advertising, broadcasts, websites, e-mails and all other forms of written or oral communication**, whether sent to one person or many.

Communicating a financial promotion – Chapter 4 of the Conduct of Business Sourcebook (COBS 4) applies to financial promotions and all other communications made by an FCA-authorized person. Therefore, whilst a promotion by an FCA-authorized person may be exempt from the Financial Promotion Regime, the promotion may still need to comply with COBS 4 rules. The overarching COBS 4 rule is that all communications (including financial promotions) should be fair, clear and not misleading. This includes advertising and marketing material, communications made face-to-face and over the telephone, and casual communications made by employees (see Supporting Technical Manual for more detail).

2.1 Other relevant regulatory considerations

FCA Prospectus Rules

These Rules apply to the majority of legal forms (with certain exceptions – see chapter 3 for more detail), though they are unlikely to be relevant for most of the social investment market. Most social investment-related offers will not cross the €5m threshold (they tend to be for £1m or less) and therefore will largely be subject to the domestic UK-wide Financial Promotion Regime, unless exempt. A small number of community and social offers may exceed the €5m threshold and, if not exempt, will need to comply with the Prospectus Rules.

For the Prospectus Rules to apply, the communication must be made to more than 150 persons, and the minimum investment amount per investor must be below €100k. If these conditions are not met then the promotion may be exempt from the Prospectus Rules.

General law

All investment communications will need to comply with the general law, for instance in relation to advertising and consumer contracts (see Supporting Technical Manual).

FCA Crowdfunding Regulations

Crowdfunding is a way of financing businesses, organisations and individuals, usually involving a number of people pooling money through a website platform. The FCA recognises five different types of crowdfunding. These are:

- Donation-based;
- Pre-payment or rewards-based;
- Exempt: people invest or lend money using organisations or investments that satisfy the requirements in statutory exemptions and are therefore considered exempt from the Financial Promotion Regime;
- Loan-based: where people lend money to individuals or businesses in the hope of a financial return in the form of interest payments and a repayment of capital over time (this excludes some business-to-business loans);
- Investment-based: people invest directly or indirectly in new or established businesses by buying shares or debt securities, or units in an unregulated collective investment scheme.

Following a consultation paper issued on 24th October 2013 (CP13/13)¹⁹, the FCA published its policy response (PS14/4) on 6th March 2014²⁰. This confirmed that only those firms engaged in loan-based and investment-based crowdfunding activities will be subject to the Financial Promotion Regime.

¹⁹ See: <http://www.fca.org.uk/your-fca/documents/consultation-papers/cp13-13>

²⁰ See: <http://www.fca.org.uk/news/firms/ps14-04-crowdfunding>

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

The new rules²¹ in relation to investment-based crowdfunding are particularly significant because they restrict the extent to which unlisted securities, whether or not they are placed on a crowdfunding platform, are capable of being promoted to retail investors. The regulation requires that, before being offered the opportunity to invest, all retail investors must:

- Be certified as either a high net worth investor, sophisticated investor, an investor who has received regulated advice or investment management services, or a restricted investor (restricted here means that the investor will only invest less than 10% of their investable wealth); and
- Pass an 'appropriateness test' where they have not received regulated investment advice or investment management services. The appropriateness test is applied to determine that the investor has the appropriate level of knowledge and experience to invest in non-readily realisable securities (for further information see the Supporting Technical Manual).

These new rules are therefore likely to have significant implications for direct offer financial promotions of unlisted securities in general, including those of social enterprises. It will make it harder, for example, for social enterprises to do offline crowdfunding through direct mail or other campaigns, because of the requirement that retail investors must be certified/self-certify as one of the above categories and have passed an appropriateness test.

Regulated Collective Investment Schemes

A regulated collective investment scheme ("**CIS**") is defined in section 238 of FSMA as an arrangement that enables a number of investors to pool their assets, which are managed by or on behalf of an operator of a CIS, with a view to participants sharing profit or income from the purchase, holding, management or disposal of the assets or sums paid out of such profits or

income. For example, an investment fund will usually be a CIS.

Unregulated Collective Investment Schemes

A CIS is unregulated (a "**UCIS**") when the scheme is not authorised by the FCA or recognised by the FCA as an authorised overseas scheme. Investment funds which are constituted as limited partnerships or limited liability partnerships are likely to be UCIS. These make up most investment funds in the UK social investment market.

UCIS are illiquid investments (meaning it is difficult to realise or sell them before they have come to full term), which are not considered by the FCA to be suitable for ordinary retail investors. The FCA therefore prohibits the promotion and sale of UCIS and close substitutes (which together, the FCA terms non-mainstream pooled investments ("**NMPI**") to the general public and ordinary retail investors. They may only be promoted to certain limited categories of recipients, including high net worth companies and associations, high net worth individuals and sophisticated and professional investors.

21 'Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014'. See: http://hb.betterregulation.com/external/FCA_2014_13.pdf

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Chapter 3

Mapping the Financial Promotion Regime landscape

This chapter is comprised of a set of 'maps', intended as a visual aid to understanding the Financial Promotion Regime as relevant to the social investment market.

These maps seek to highlight how the Financial Promotion Regime applies to the disparate legal forms of social enterprise when, as investees, they are marketing a social investment to ordinary retail investors and how the Financial Promotion Regime relates to the investment channels used. The chapter begins by providing a short summary of how to use the maps for the reader. This is followed by an overview map (map 1) – building on Figure 1 – of the regulatory landscape of the Financial Promotion Regime, as considered in this guide.

- **Maps 2, 3 and 4** provide **example routes to market** which might be taken by an investee, and highlight which regulation would apply in each case. The three example routes have been selected because they illustrate how the different types of relevant regulation might apply to different legal forms and investment types, based on several relatively common investment routes to market.
- **Map 5** sets out the journey for the application of the **Financial Promotion Regime** (for investment offers of less than €5m).
- **Map 6** sets out the journey for the application of the **FCA Prospectus Rules** (for investment offers of more than €5m).
- **Map 7** sets out the journey for the application of the **FCA Crowdfunding Regulations**.

Each map is accompanied by a short explanation of what it shows and a summary analysis.

3.1. Reading the maps

The maps seek to provide an overview of applicable regulation and demonstrate the 'journey' for social enterprises, the investees, looking to make investment offers. They also highlight regulatory considerations that ordinary retail investors interested in making social investments will wish to understand. In so doing the

maps also highlight some of the implications of the Financial Promotion Regime for investees/ordinary retail investors. These are analysed and discussed in detail in chapter 4.

In each case, the maps consider the investor the communication is being made to (ordinary retail investors); the investee (social enterprises); the investment channels available (direct offer/crowdfunding platform); and the investment types that might be on offer. When reading the maps, it is worth noting that only those areas considered applicable and relevant for the purposes of this guide, are included. Therefore, the maps:

- **Do not consider communications relating to listing and public markets**, which are exempt from the Financial Promotion Regime – as the vast majority of social enterprises are not listed on a stock exchange²². Listing can be challenging for social enterprises, as it generally means giving up ownership of the enterprise to investors who may or may not be aligned with the mission of the enterprise. There are also associated costs with listing which are often unaffordable for social enterprises, which tend to be relatively small in size. Co-operatives and community benefit societies are not suitable for listing, as shares are not freely transferable and membership is based on participation and not anonymous ownership.

However, the Social Stock Exchange is in the process of establishing a community of listed companies with characteristics similar to those of social enterprises. It is therefore likely that in future years there will be more listed social enterprises.

Investment communications relating to listing and public markets, while exempt from the Financial Promotion Regime, must comply with other regulatory requirements.

²² For the purposes of this guide, this exclusion applies also to the Threadneedle Bond Fund, which is available to both retail and institutional investors, and the London Stock Exchange's Order Book for Retail Bonds (ORB) platforms.

■ **Only consider financial promotions made to ordinary retail investors** i.e. direct offer communications concerning shares, loans and debt instruments. This guide does not consider investment offers made through private offers; private offers are exempt under the FPO and beyond the scope of this guide.

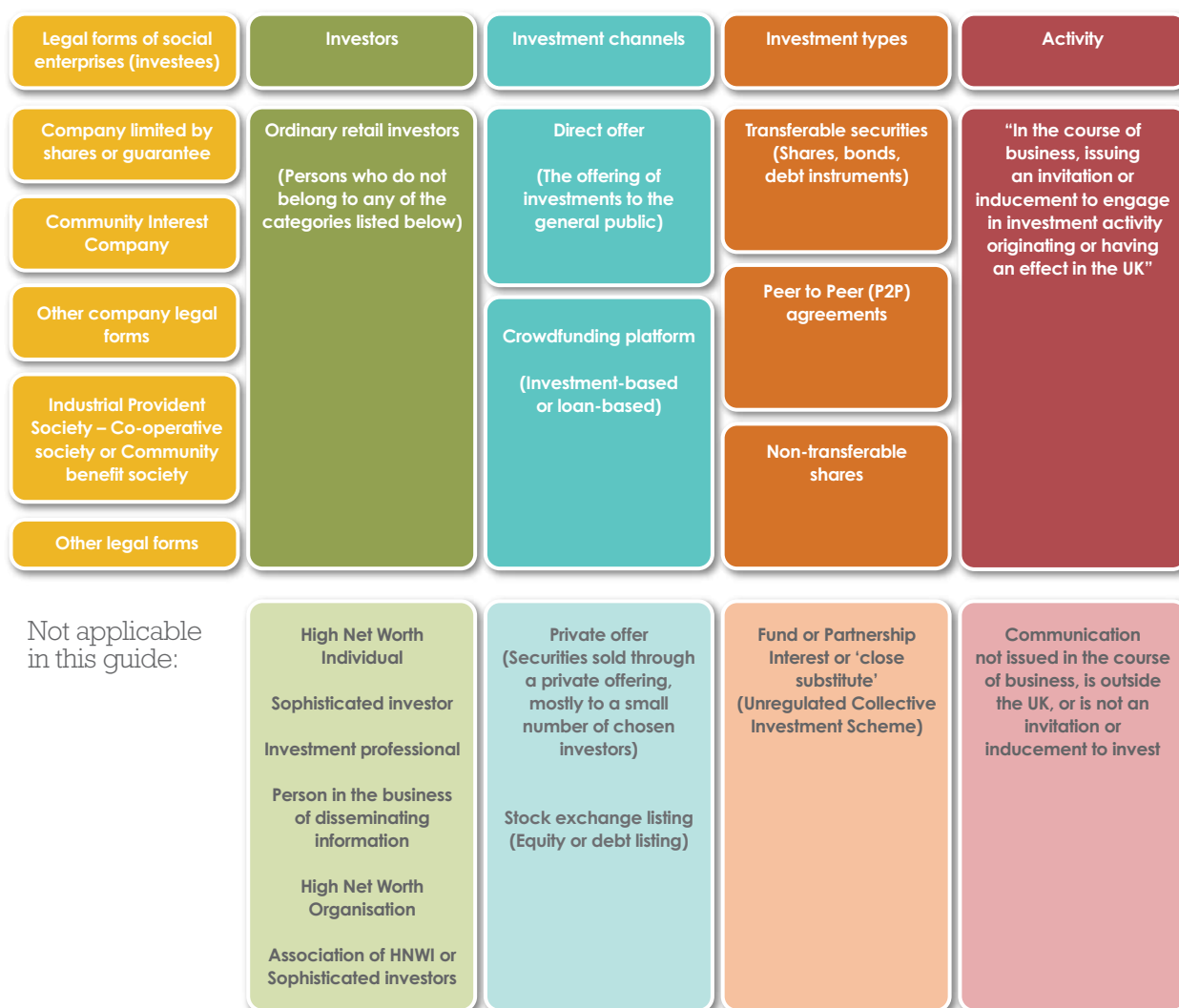
Some of the most commonly used exemptions set out in the FPO allow for investment by high net worth institutions, high net worth individuals, sophisticated investors and investment professionals. To date these have been significant players in the social investment market, albeit frequently their levels of interest have fallen 'under the radar' in that their contribution is not fully known or quantified. In policy terms, these categories of investor are generally considered sophisticated enough to be able to determine the risks which apply to potential investments for themselves and are not considered to need the protection of the Financial Promotion Regime.

Further detail on each of these areas is provided in the **Supporting Technical Manual**.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Map 1:
Overview of the Financial
Promotion Regime landscape



Summary

In the Introduction to this guide, Figure 1 sets out an overarching framework for the regulatory landscape of the Financial Promotion Regime, as it applies to unlisted social investments. It identifies the various relevant considerations – investees; investment channels; investment types and investors – which might be impacted by the Financial Promotion Regime.

Map 1 builds on Figure 1 to illustrate which aspects of the Financial Promotion Regime are relevant to the unlisted social investment market in terms of the same four considerations. Map 1 also shows which areas are not addressed in this guide or in subsequent maps – those boxes which are shaded out are not addressed. This is because they are not relevant to unlisted social investments communicated to ordinary retail investors and therefore fall outside the scope of this guide. Definitions for the terms used in Map 1 are provided in the Glossary to this guide.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Map 2:

Example route to market –
community benefit society
issuing non-transferable shares



Map 2 (reading from left to right) provides one example of how a social enterprise might seek to communicate an investment opportunity. In this case the investee organisation has the legal form of a community benefit society (bencom), and is seeking to communicate its investment opportunity to ordinary retail investors, through a public offer of non-transferable shares²³ of less than €5m in total. In this case, the investee would be exempt from the Financial Promotion Regime, but would of course nonetheless be bound by general law. The investment offer is outside the scope of the Prospectus Rules, as the investment offer is for less than €5m.

IPSs and investment products:

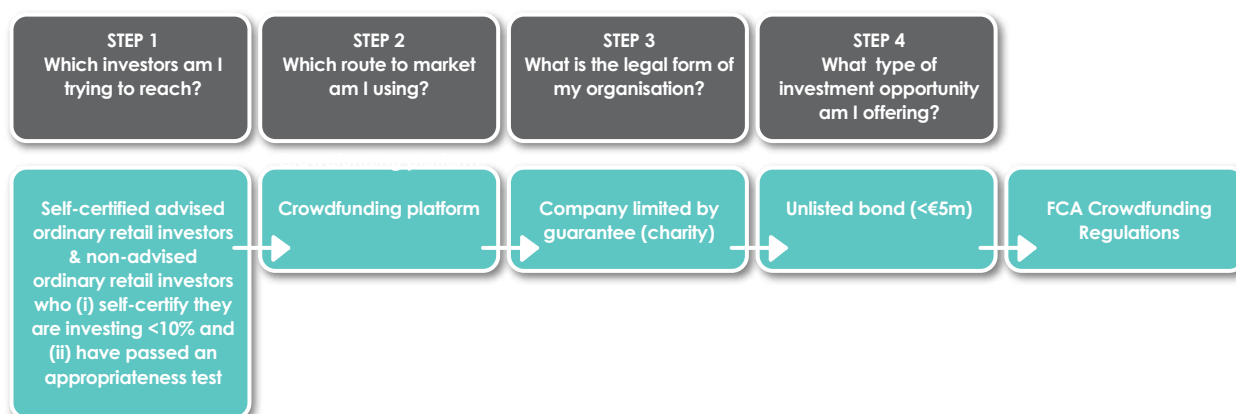
- IPSs (co-ops and bencoms) are exempt from the Financial Promotion Regime when offering debt²⁴ or non-transferable securities²⁵.
- IPSs are not divided into private and public forms and may make investment offers to the public at large, meaning to ordinary retail investors.
- IPSs are not suitable for listing, as shares are not freely transferable and membership is based on participation and not anonymous ownership.

²³ A non-transferable share is not the same as a withdrawable share, although the two concepts overlap. Withdrawable share capital may be either transferable or non-transferable. In this guide, the term “withdrawable” means share capital that may be either transferable or non-transferable.

²⁴ Where ‘debt’ is shorthand for any instrument creating or acknowledging indebtedness, which is exempt from the FPO when issued by an IPS, under s.35 of the FPO.

²⁵ See footnote 23.

Map 3: Example route to market – CLG wanting to issue an unlisted bond



A second example of a route to market for social enterprises is provided in Map 3 (reading from left to right). Map 3 shows that a company limited by guarantee (a charity, for example) offering unlisted bonds through a crowdfunding platform would be able to make this offer to ordinary retail investors that had received financial advice. The offer can also be made to non-advised ordinary retail investors who have self-certified that they will not be investing more than 10% of their total investment portfolio in unlisted shares or unlisted debt securities. Where an ordinary retail investor has not been advised, the investor would also need to pass an 'appropriateness test' to demonstrate they have the appropriate knowledge and experience to invest in the unlisted bond. The investment offer would need to be issued or approved by an FCA-authorised person.

A company limited by guarantee is a private company and is therefore unable to issue securities to the public at large. Any security issue will need to be made to a predetermined and limited class of investors, as opposed to a section of the public.

There are potential issues with making investment offers to ordinary retail investors through the use of a crowdfunding platform (explored in further detail in Map 7).

It is also of note here that companies limited by guarantee are unable to issue shares and so can only issue loans or debt securities (hence why an unlisted bond is provided as the example investment type in Map 3).

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Map 4: Example route to market – CIC CLS listed on a stock exchange



Map 4 sets out the third example route to market presented in this guide (for illustrative purposes only). Map 4 (reading left to right) shows that a community interest company limited by shares wanting to reach ordinary retail investors through a stock exchange listing (and issuing shares) would need to arrange for its prospectus to be approved by the FCA and to go through the listing process.

It is worth noting here that this guide does not consider the listing rules as these are outside the scope of this research – the example is provided here to help illustrate, alongside Maps 2 and 3, how the different types of regulation might apply to social investments.

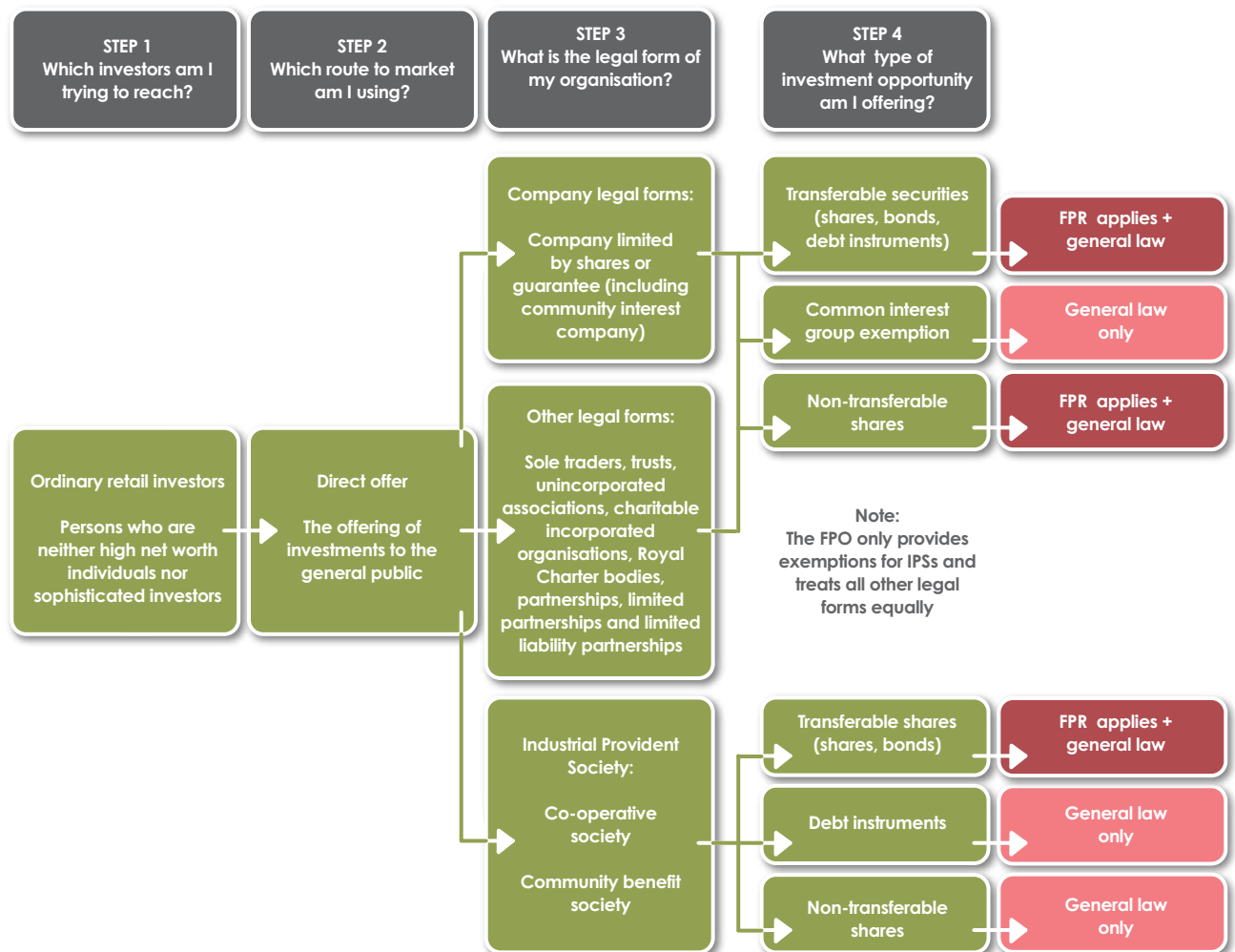
Example routes to market – summary

Maps 2, 3 and 4 are just three examples of how social enterprises might choose to communicate an investment offer to ordinary retail investors. They provide a brief illustration of the complexity of the Financial Promotion Regime and the rules which apply to promoting social investments – different regulatory requirements apply depending on:

- The route to market the investee chooses to use;
- The legal form of the investee;
- The size of the investment opportunity on offer;
- The type of investment being offered.

The remaining maps in this chapter consider each of these issues in further detail, and explore the different 'layers' of the regulatory landscape of the Financial Promotion Regime for social enterprises communicating investments to ordinary retail investors.

Map 5: Application of the Financial Promotion Regime



Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Map 5: Application of the Financial Promotion Regime

Summary

Following the overview of the regulatory landscape illustrated in Map 1, Map 5 illustrates the application of the Financial Promotion Regime to investment communications ("FPR" is used as shorthand in the maps).

Reading from left to right, Map 5 sets out the financial promotion journey for social enterprise investees, starting with the question 'Which investors am I trying to reach?' In this case only ordinary retail investors are considered – other retail investors are outside the scope of this guide. Similarly, when an investee is considering how to get their investment to market, Map 5 only presents the option of a direct offer. This is because private offers are made only to exempt categories of investor and are therefore outside the scope of this guide. Crowdfunding platforms as an alternative route are considered in Map 7.

Map 5 shows that the Financial Promotion Regime applies to direct offers to ordinary retail investors by company legal forms of transferable securities and non-transferable shares, where the total investment monies being raised through the highlighted channels are less than €5m (the general law will apply in any case). It also shows that IPSs offering non-transferable shares and debt instruments are exempt from the Financial Promotion Regime and are instead covered by general law only. The Financial Promotion Regime does not exempt other legal forms issuing non-transferable shares.

Analysis

Authorisation to promote opportunities

Section 21 of FSMA 2000 prohibits financial promotions unless they are issued by a person authorised by the FCA or, where issued by an unauthorised person, approved by an FCA-
authorised person, or exempt.

Map 5 illustrates that the Financial Promotion Regime does not generally distinguish between different types of investment. Most forms of investment are regulated under the Financial Promotion Regime (see Supporting Technical Manual for a list of those investment types covered by the Financial Promotion Regime).

Investor exemptions

The Financial Promotion Order (FPO) contains a number of exempt categories of investor capable of receiving financial promotions which are not issued or approved by an FCA-
authorised person. Ordinary retail investors and other investors not fitting within one of the exempt categories of investors or benefitting from another exemption must only receive financial promotions which are issued or approved by an FCA-
authorised person.

Application of the general law

Representation of the investment opportunity

As highlighted in chapter 2, all financial promotions must comply with general law. Therefore, when an offer is exempt from the Financial Promotion Regime²⁶, it will still need to comply with the requirements of the general law in relation to advertising and consumer contracts. More broadly, exempt financial promotions are subject not only to the law of advertising and consumer contracts but also to the law of negligent misstatement, misrepresentation and criminal law.

In the most general terms, where a person offering an investment opportunity fails to honour a promise or commitment or recklessly makes a misleading statement on which an investor relies to their detriment, there is likely to be a civil law claim of some description. Where there is deliberate deception or fraud, there are likely to be criminal offences and penalties which will apply.

Map 5 shows in which cases the general law might apply – specifically of note is where an investment offer is being communicated by a CLG/CLS

²⁶ Exemptions for certain kinds of communications are numerous and are set out in the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, as amended. See Supporting Technical Manual for more information.

investee to a 'common interest group'. A common interest group is an identified group of persons who at the time the communication is made might reasonably be regarded as having an existing and common interest with each other and the investee company in (a) the affairs of the company and (b) the application of any proceeds arising from any investment to which the communication relates.

Analysis

The general law does not set out detailed requirements or standards for the communication of investment offers which are directly comparable to those found in the Financial Promotion Regime. However, the level of protection the general law provides to consumers investing in FPR-exempt offers is generally consistent with other consumer contexts. Consumer contract law prohibits misleading sales practices and unfair contract terms. As a result, the standards of the general law require exempt offers to be of an overall standard not significantly dissimilar to that required by the more specific and prescriptive Financial Promotion Regime.

It is also of note that while compliance with the Financial Promotion Regime requires investees to have their investment offer approved by an FCA-authorised person – which comes at a cost – this is not the case for compliance with general law.

As a result, there is a mismatch between the magnitude of the increased costs of compliance with the FPR over general law (high) and the magnitude of the increased consumer protection from the FPR over general law (comparatively little).

Application of the Financial Promotion Regime to Industrial and Provident Societies (IPs) (co-ops and bencoms)

As Map 5 highlights, there are exemptions available under the FPO for IPs in their two forms:

co-operatives and community benefit societies, when offering debt²⁷ or non-transferable shares²⁸. Nonetheless, the general law will apply to investment communications made by IPs. This exemption under the FPO for IPs is based on the fact that co-operatives and community benefit societies are largely local, community-based organisations and investors will generally know the risks associated with investment into such societies on the basis that investors will usually have established personal associations with the relevant society.

This distinction between legal forms in the application of the FPO is specific to IPs. The FPO does not otherwise generally distinguish between the different legal forms of investee organisations – for example the exemptions do not extend to charities or community interest companies. This suggests an inconsistency in the application of the FPO – charities and CICs are often tied to their local communities. It also suggests the FPO does not recognise where the investor lives locally to the investee seeking investment, and by the same logic as the IPS exemption, therefore may be well-acquainted with the associated risks of investment into the enterprise.

As of 6th April 2014, individuals are able to subscribe up to a new limit of £100,000 in withdrawable share capital in certain circumstances. Non-withdrawable shares are also a type of share available for societies to issue. Unlike withdrawable share capital, the amount that can be invested in non-withdrawable shares is unlimited.

Note on withdrawable and non-transferable shares:

- Withdrawable shares may only be issued by IPs.
- Withdrawable shares are also usually non-transferable.
- Non-transferable shares issued by an IPS are exempt under the FPO.
- Non-transferable securities are exempt under the Prospectus Rules if issued by a bencom, charity, housing association or certain similar not-for-profit organisation.

²⁷ Where 'debt' is shorthand for any instrument creating or acknowledging indebtedness.

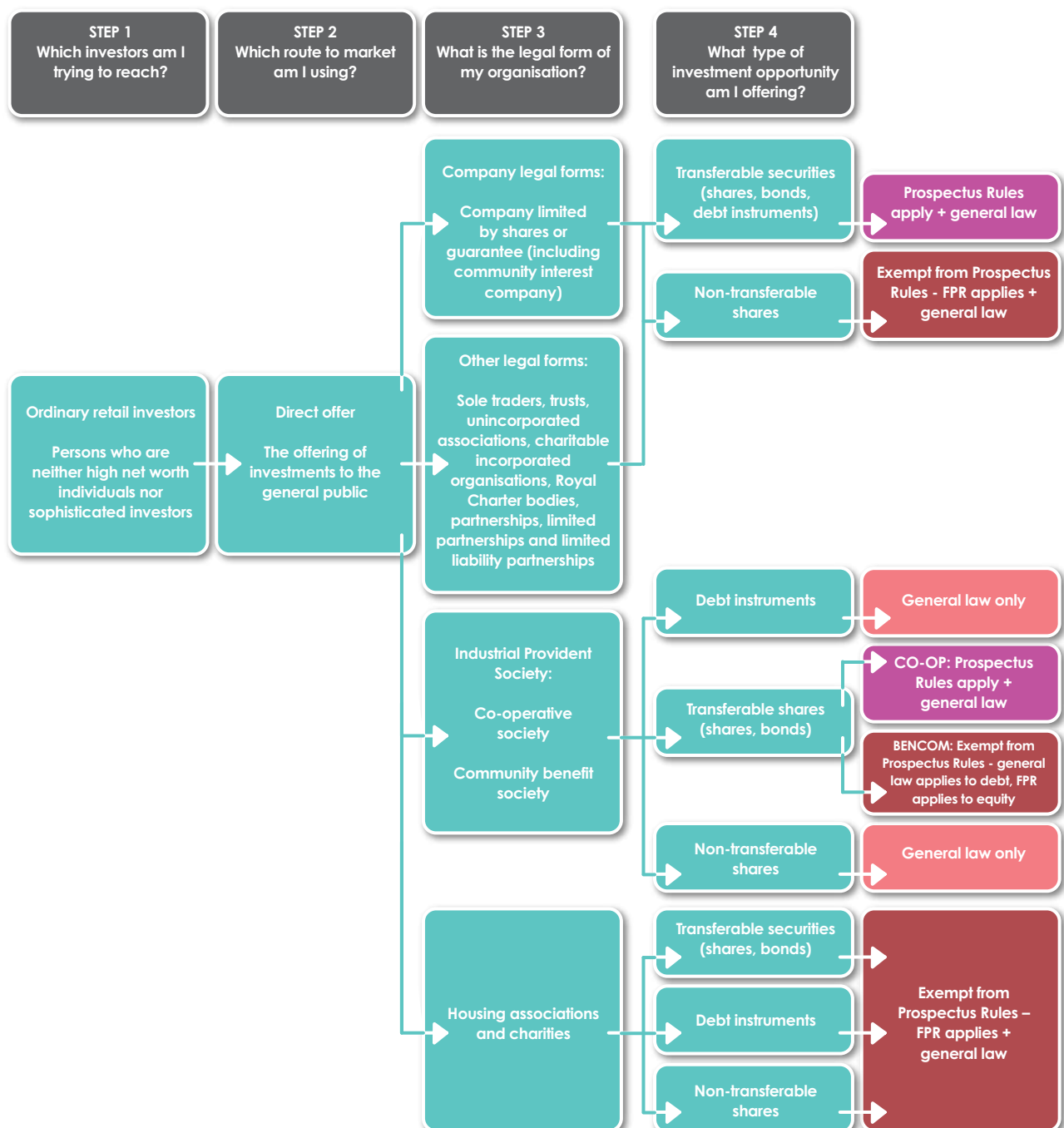
²⁸ A non-transferable share is not the same as a withdrawable share, although the two concepts overlap.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Map 6:

Application of the FCA Prospectus Rules –
route to market for investees communicating
offers of more than €5m



Map 6: Application of the FCA Prospectus Rules

Summary

Map 6 (reading from left to right) illustrates where the FCA Prospectus Rules might apply to investment communications made by social enterprises to ordinary retail investors (unless a relevant exemption applies). The Prospectus Rules may apply where an investment offer of more than €5m is being communicated. In effect, a communication which is exempt from the Prospectus Rules will always be subject to general law but may also be subject to the Financial Promotion Regime.

The Prospectus Rules apply to most legal forms equally when promoting opportunities to the retail market through a public offer. However, the Prospectus Rules only apply to transferable securities and not to non-transferable securities.

Analysis

Thresholds and exemptions to the Prospectus Rules and Financial Promotion Regime

As identified in chapter 2, the Prospectus Rules only apply to investment offers of more than €5m and are therefore unlikely to be relevant for most of the social investment market. Most social investment-related offers are for less than £1m and therefore will largely be subject to the domestic UK-wide Financial Promotion Regime, unless exempt.

Application of the FCA Prospectus Rules to IPSs

As Map 6 highlights, while co-ops issuing transferable shares are required to comply with the Prospectus Rules, bencoms offering transferable shares are exempt from the Prospectus Rules even where an investment offer of more than €5m is being made.

It should also be noted that charities, housing associations and other not-for profit associations or bodies with similar objectives to those of a bencom, charity or housing association, are also exempt from the Prospectus Rules.

Analysis

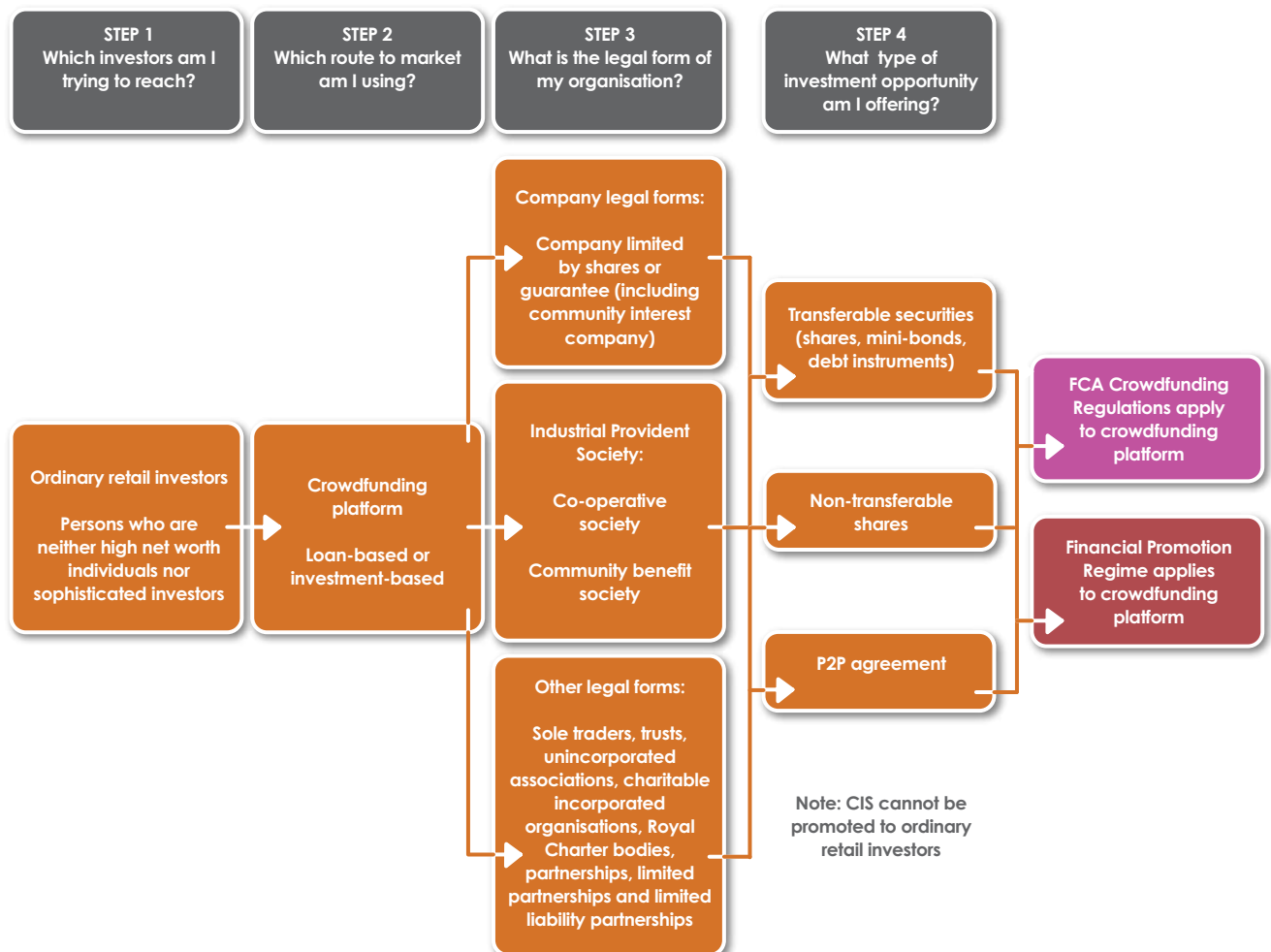
Maps 5 and 6 highlight that raising share capital in general is likely to be much easier for an IPS than for other legal forms because the available routes to market are not as restricted as other legal forms, which are less likely to benefit from exemptions and will need to comply with the Financial Promotion Regime.

Both maps also illustrate the complexity of the regulatory landscape for investees seeking to make financial promotions, and for ordinary retail investors looking to make social investments.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Map 7: Application of the FCA Crowdfunding Regulations



Map 7: Application of the FCA Crowdfunding Regulations

Summary

Though it is beyond the scope of this guide to consider in detail the implications of the FCA Crowdfunding Regulations for crowdfunding platforms, Map 7 (reading from left to right) seeks to provide an overview of the regulation and its relevance to the Financial Promotion Regime for social investment. It highlights the application of the Crowdfunding Regulations for social enterprises seeking to promote investment opportunities to ordinary retail investors through a crowdfunding platform²⁹.

Analysis

Promoting unlisted investment opportunities to retail investors

The Crowdfunding Regulations state that investment-based and loan-based crowdfunding platforms need to be authorised by the FCA, unless an exemption applies. This means that crowdfunding platforms will in future need to comply with the requirements of COBS in relation to the making of investment communications.

The Regulations also apply to any company raising capital by issuing unlisted shares or debt securities directly to retail investors.

In the case of unlisted investment-based crowdfunding and direct offers to the public, ordinary retail investors will need to be advised by a regulated adviser or manager or self-certify that they will not be investing more than 10% of their net assets in unlisted shares or unlisted debt securities (not including primary residence, pensions or life assurance). Where retail investors do not receive regulated investment advice or

investment management services, investors will also need to pass an appropriateness test to be exempted from the Crowdfunding Regulations.

In summary, a crowdfunding platform or an investee social enterprise seeking to raise capital must not communicate or approve a direct offer financial promotion relating to a non-readily realisable security, which includes unlisted shares and debt instruments, to a retail client *unless* that retail client:

1.

Is certified or self-certifies as one of the following:

- A **"high net worth investor"** – with an annual income in excess of £100,000 or net assets of £250,000 (excluding primary residence, any benefits in the form of pensions or otherwise and any rights under certain contracts of insurance);
- A **"sophisticated investor"** – retail clients meeting the criteria for categorisation as sophisticated investors under any of the sophisticated investor exemptions in the PCIS Order, the FPO or in FCA rules. These are retail clients with extensive investment experience and knowledge, who are better able to understand and evaluate the risks and potential rewards of investing in unlisted shares and unlisted debt instruments;
- A **"restricted investor"** – an individual who has not invested more than 10% of their net assets in non-readily realisable securities in the 12 months preceding the investment and also commits not to invest above this threshold in the 12 months following the investment (net assets for these purposes does not include any primary residence, any benefits in the form of pensions or any rights under life assurance or other similar contracts of insurance);
- An **"investor who has received regulated advice or regulated investment management services"** from a financial advisor or intermediary who specialises in advising upon or managing investment in non-readily realisable securities.

²⁹ The Financial Promotion Order has also been amended under the Crowdfunding Regulations such that bilateral loan agreements between individuals and businesses, known as peer to peer "P2P agreements", also now fall within the scope of the Financial Promotion Regime. There is no restriction on the amount of money which ordinary retail investors can invest into P2P agreements, which the FCA consider to be less risky than investments into unlisted shares and debt instruments.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

AND, where the investor has not received regulated investment advice:

2.

Has passed an appropriateness test

- Before a non-advised retail investor may invest via a crowdfunding platform s/he must pass an appropriateness test demonstrating that s/he has the appropriate experience and expertise to invest in the relevant non-readily realisable securities.

Implications

The Crowdfunding Regulations are likely to have significant implications for direct offer financial promotions of unlisted securities in general, including those of social enterprises. It will make it harder, for example, for social enterprises to do offline crowdfunding through direct mail or other campaigns, because of the requirement that retail investors must be certified/self-certify as one of the above categories and have passed an appropriateness test (where they have not received regulated investment advice) before receiving a direct offer financial promotion. This has the potential to 'stifle' the very marketplace which the Social Investment Tax Relief is designed to incentivise (individual investors).

From the investees' perspective, the Crowdfunding Regulations are an additional 'layer' of regulation to comply with, in addition to the pre-existing Financial Promotion Regime, increasing transaction costs for investees when raising capital.

Chapter 4

Implications of the Financial Promotion Regime regulatory structure

Chapter 3, through the use of diagrammatic maps, shows how the Financial Promotion Regime applies to investment offers made by social enterprises, to ordinary retail investors. It is clear from the brief analysis set out in chapter 3 that the regulatory landscape is complex, with different requirements depending on the legal form of the investee; the size of the investment offer; the route by which the investment offer will be communicated; and the investment type. Taken together, the Financial Promotion Regime can therefore be confusing and lack clarity for social enterprises and ordinary retail investors.

This chapter takes forward the discussion in chapter 3, to **consider some of the key implications and challenges of the Financial Promotion Regime for investors, investees, and more widely, the development of the social investment market**. It is worth noting that the selection of challenges identified here is to some degree a subjective process, and it is acknowledged that there are difficulties in distinguishing between a legitimate and proportionate restriction and a barrier, respectively.

4.1. A potential 'untapped' pool of investors for the social investment market

While there is a general lack of data on retail investors, there is evidence to suggest that they are a potentially important 'untapped' pool of capital for the social investment market to draw upon³⁰.

Retail investors and investable wealth

- The median amount of household wealth in Britain (excluding pensions) in 2010/12 was £146,200.
- 9% of British households have net financial wealth of £50k to <£100k in 2010/12. This represents circa 2.2 million households.
- The median total of household wealth in this band is £70,000 in 2010/12.

Source: ONS Wealth and Assets Survey 2010/12, <http://www.ons.gov.uk/ons/rel/was/wealth-in-great-britain-wave-3/2010-2012/index.html>

Appetite to invest

When presented with social investment opportunities:

- 40% of ordinary retail investors with investable assets of £50 to £99k said they would be actively interested in making social investments.
- 33% of this group said they would be 'passively' interested.

Source: NESTA (April 2011) 'Investing for the Good of Society: Why and How Wealthy Individuals Respond'. See: http://www.ipsos-mori.com/DownloadPublication/1418_Loyalty_Investing_for_the_Good_of_Society.pdf

The data therefore suggests that there is both an appetite for social investment among retail investors, and a sufficient number of retail investors to be of interest to social enterprises seeking investment capital.

This potential for retail investors as a pool of capital for the UK social investment market is recognised in the introduction by Government of the Social Investment Tax Relief ("SITR"), which is due to become available to retail investors in summer 2014. The SITR provides a tax break of 30% of the value of a qualifying investment which is deductible from income tax for retail investors investing up to £1m in regulated social sector organisations over a three-year minimum period³¹.

30 Evidence on household wealth is taken from the most recent wave of the ONS Wealth and Assets Survey, the only comprehensive data source on household wealth in Britain.

31 For more information see: <https://www.gov.uk/government/publications/social-investment-tax-relief-factsheet/social-investment-tax-relief>

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

4.2.

Challenges of the Financial Promotion Regime for ordinary retail investors

As shown in section 4.1, retail investors are potentially a significant source of investment capital for the social investment market. This is recognised in recent regulatory developments, such as the SITR. However, while the SITR marks the development of a more positive tax environment for investment into social enterprises, this is somewhat in tension with the Financial Promotion Regime. Currently, the Financial Promotion Regime does not recognise the following factors, which describe the kinds of investments which ordinary retail investors make in the social investment market:

- **The total amount being invested by the investor is small;**

- The Financial Promotion Regime does not distinguish between large investments and small investments. Where small investments are being made, the risk of loss will be less but this is not acknowledged. In the social investment market, most investments are likely to be relatively small in size.

- **The total amount being raised as part of the offer is small;**

- Social enterprises typically seek investments of less than £100k.
- Ordinary retail investors therefore provide a good 'match' for social investments in terms of the size of the investment opportunities available. However, the Financial Promotion Regime treats all investment raises beneath €5m in the same way and does not make it any easier for social enterprises to raise small amounts of money.

- **The investor is investing with certain significant non-financial goals;**

- Social investment may often be considered by investors as an alternative to a philanthropic donation, where the key aim is to achieve a social goal rather than a financial return.

- Whilst the Financial Services Act 2012 recognises that investors may invest with non-financial goals, the Financial Promotion Regime does not yet expressly recognise this possibility. There are no exemptions or any lighter-touch regulatory requirements where investors are investing primarily with non-financial goals or with significant non-financial goals in mind, such as the desire to support the cause being furthered by a social enterprise.

- **The investor lives locally to the investee seeking the investment;**

- Arguably, the historic justification for the exemptions for IPSs from the Financial Promotion Regime is that IPSs tend to be local and community-based organisations and investors may be presumed generally to know the risks associated with investment into such societies, based on their personal associations.
- The same could be said of many charities and CICs but the Financial Promotion Regime does not recognise this, even though charities and CICs may also wish to raise investment from their local communities or from other close-knit communities of interest.

4.2.1.

Financial advice as a general restriction to social investments for ordinary retail investors

A related barrier to ordinary retail investors' awareness of social investment opportunities is linked to **the nature of financial advice** they receive. This is a wider challenge for investors and the market, and not attributable to the Financial Promotion Regime. However it is particularly pertinent to ordinary retail investors due to challenges around affordability and access to investment information otherwise.

- Financial advisers are authorised by the FCA to provide investment advice and need to comply with strict standards. Before recommending investments, advisers need to conduct an assessment of a client's financial position and investment objectives to make sure that any investments which are

recommended are 'suitable' and in the client's best interest.

- Partly for this reason, financial advisers therefore tend to recommend mostly liquid and therefore listed investments, thereby excluding investment into social enterprises which tend largely to be unlisted.
- Financial advisers also tend to be reluctant to recommend social investments due to the lack of a track record in the market, which means they tend to be seen as riskier than commercial investments³².
- This reluctance can arguably be linked to uncertainty among advisers as to the application of their obligation to clients – to assess their client's suitability for an investment opportunity and provide advice on their investment decision accordingly.
- Unless a client specifically identifies an interest in social investment/social impacts over and above a financial return on investment, his/her advisor is unlikely to recommend a social investment over more mainstream commercial investments due to a general perception of lower returns and higher risk. (For advisers to consider their clients' as suitable for social investments, clients generally need to flag an interest in social investments to their adviser).
- Even where financial advisers might recommend a social investment opportunity, retail clients with small investible portfolios may not be able to afford financial advice³³.

Therefore retail investors face a dual barrier to their awareness of social investment opportunities:

- The Financial Promotion Regime restrictions on investment offers communicated to retail investors; and
- For the small minority of investors who might have access to a financial adviser – which itself is a challenge due to associated costs – advisers are reluctant to recommend social investment to their clients due to perceived regulatory risks.

4.3. Barriers and challenges for investees

The maps in chapter 3 help to highlight the complexity of the Financial Promotion Regime for investees – there are multiple considerations for whether the Financial Promotion Regime will or will not apply to an investment offer – for example tied to legal form, or the investment type, among others. Once overcoming the challenge of interpreting the Financial Promotion Regime, it may be established that the Regime does not apply to an investee. Where the Financial Promotion Regime does not apply, investees may need to abide by the FCA Prospectus Rules as appropriate. Nonetheless, investees will need to abide by the general law in each case. The multi-layered nature of the regulatory landscape is further complicated by the recent FCA Crowdfunding Regulations which add an additional 'layer' of regulation for investees to consider.

It is possible to draw out a number of implications of the Financial Promotion Regime for investees, based on the overview of the regulatory landscape provided in chapters 2 and 3. These are discussed in the following sections (please note, as mentioned above, that the selection of challenges are to some degree subjective).

³² This is supported by previous research such as a report commissioned by the Social Investment Research Council on institutional investors' perceptions of the social investment market. See: <http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/New-specialist-sources-of-capital-for-the-social-investment-market.aspx>

³³ For further information, see Worthstone, Big Society Capital and Bates Wells Braithwaite (July 2012) 'Advising Clients on Social Investments and Deciding on Suitability', see: <http://www.worthstone.co.uk/wp-content/uploads/2012/03/Advising-clients-on-social-investment.pdf> and NESTA (June 2012) 'Financial Planners as Catalysts for Social Investment', see: http://www.nesta.org.uk/sites/default/files/financial_planners_as_catalysts_for_social_investment.pdf

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

4.3.1.

Costs of approval

- As highlighted in chapter 2, to comply with the Financial Promotion Regime, investees, where they are not FCA-authorised, are required to have their investment offer approved by an FCA-authorised person. This person will need to review or draft the communication, verify underlying statements of fact and challenge and question statements and claims. This involves a process of due diligence and in the case of direct offers can involve multiple revision of offer documentation, in consultation with a number of parties.
- The costs of approval are likely to range from thousands to tens of thousands of pounds depending on the length, detail and complexity of the communication. The cost of approval does not however depend on the size of the investment being offered.
- Whilst mainstream commercial organisations may be able to bear the professional fees involved in authorisation, these costs may not be justified for small community and social investment offers and therefore risk impeding or preventing the growth of the social retail market. Most social enterprises typically seek investments of less than £100k, and in 2012, the median size of investment received by investees was £15k³⁴.

The costs of professional approval are therefore disproportionately high to the investment being sought for social enterprises. In any event, most investees will not have the resources to appoint an FCA-authorised person to approve their promotion.

4.3.2.

Cost of compliance with the Financial Promotion Regime over general law

- As illustrated in Map 6, a communication

which is exempt from the Prospectus Rules is either subject to the Financial Promotion Regime or it is subject to general consumer and advertising law.

- However, while compliance with the Financial Promotion Regime involves a requirement to pay an FCA-authorised firm to approve a financial promotion, the general law simply sets standards for the offeror to observe.
- This situation creates a 'cliff-edge' effect for small social enterprises, in which the costs associated with a requirement to comply with the Financial Promotion Regime are significantly in excess of the costs of compliance with the general law.
- However, the standard required by the FPO, whilst it requires professional approval, is not substantially greater than that required by general consumer law in relation to investment communications which are not regulated by the FPO.
- As a result, there is a mismatch between the magnitude of the increased costs of compliance and the magnitude of the increased consumer protection.

The cost challenge for social enterprises is therefore two-pronged; both in terms of the cost of compliance itself raising issues around affordability for social enterprises, as well as the mismatch with only a relatively marginal degree of additional regulatory protection for ordinary retail investors.

4.3.3.

Lack of consistency in the treatment of different legal forms (and consequently a lack of recognition of the distinctiveness of charities and CICs)

- As demonstrated in Maps 5 and 6, industrial and provident societies in their two legal forms, co-ops and bencoms, are exempt from the FPO when promoting debt or non-transferable shares.
- The rationale for this exemption is presumably based on the fact that co-ops and bencoms

³⁴ BMG Research (April 2013) Small Business Survey 2012: SME Employers, Department for Business, Innovation and Skills. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193555/bis-13-p74-small-business-survey-2012-sme-employers.pdf

are largely local, community-based organisations and it is therefore generally safe to assume that investors will largely know the risks associated with investment into such societies, on the basis that investors will have established personal associations with the relevant society.

- These exemptions do not extend to charities or CICs, presumably because charities have historically been less active in raising capital and because the CIC legal form is relatively new and post-dates the FPO.

The Financial Promotion Regime therefore presents a restrictive barrier on communicating investments for certain social enterprises, without a clear and convincing rationale for this distinction.

- Investor knowledge of risk and investment preferences are distinctive in social investment from commercial investment. In the context of social investment, investors are likely to take into account social outcomes in addition to financial returns when making investment decisions. 'Social investors' (whether institutional/retail) will therefore often have a combination of philanthropic and financial goals for their investment. Where a social investment is made and capital is at risk and a financial return does not materialise, investors may be happy to receive returns solely in the form of a social outcome. Therefore while the prospect of little/no financial return is a risk for social investors, it is a risk they are, by definition, willing to take to an extent. Therefore, the logic of the assumption of low investor risk for investment into IPSs is likely to extend to all legal forms in the case of social investments.

4.3.4. FCA Crowdfunding Regulations

Map 7 shows that the FCA Crowdfunding Regulations prohibit the marketing of investment opportunities except to restricted categories of ordinary retail investors who, unless they have received regulated advice or investment management services, also need to pass an

appropriateness test before investing. This presents a new barrier to social enterprises and intermediaries seeking to attract new investors to the social investment market, by adding to cost burdens and further reducing the potential pool of retail investors for social enterprises to access for investment.

- The FCA Crowdfunding Regulations apply to crowdfunding platforms and to all unlisted securities and are therefore applicable to most social enterprises making an investment offer to ordinary retail investors.
- For the social investment market then, the FCA Crowdfunding Regulations provide another 'layer' of regulation to the Financial Promotion Regime, with which investees marketing an investment offer have to comply.
- While the Financial Promotion Regime applies to the *communication* of an investment offer, the Crowdfunding Regulations add a further restriction by first restricting which types of retail investor can receive direct offer financial promotions (see Map 7 and accompanying analysis of investor restrictions). Once the investee has complied with the Crowdfunding Regulations, they will also need to comply with the Financial Promotion Regime requirement for the communication to be approved by an FCA-authorised person.

The consequences of the Crowdfunding Regulations are that:

- **The pool of retail investors, already small, which investees can make investment communications to, are further restricted, therefore limiting opportunities for market growth;**
- **There are likely to be additional costs of compliance;**
- **Understanding the regulatory landscape becomes more difficult.**

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Chapter 5

Summary and conclusion

This research, presented in this guide, sought to achieve two key objectives. First, to provide an overview of the regulatory landscape for investment communications in the UK – the Financial Promotion Regime – and, through a series of 'investment journeys', to unpack what this means in practice for investees looking to communicate an investment offer, and retail investors seeking to make social investments. The analysis undertaken in chapters 2 and 3 highlight that the Financial Promotion Regime is complex - different regulatory requirements apply depending on the route to market the investee chooses; the investee's legal form; the size of the investment opportunity on offer; and the type of investment being offered.

The second objective of this research – an analysis of the Financial Promotion Regime in terms of its implications for investees, retail investors, and the social investment market more widely – is set out in chapter 4.

The Government has undertaken a number of efforts to grow this marketplace, including the creation of Big Society Capital in 2012, establishment of the G8 Social Impact Investment Taskforce in July 2013, and the commitments made by HM Treasury as set out in its 'Social Investment Roadmap' published on 30th January 2014, which culminated in an announcement in Chancellor George Osborne's 2014 Budget that the Social Investment Tax Relief (SITR) will be set at 30% for retail investors.

As set out in this guide, **it is evident that the nature of the Financial Promotion Regime as it currently stands presents a number of barriers to the growth of the social investment market.** This is both in relation to ordinary retail investors interested in making social investments, and for social enterprise investees seeking to raise capital through the marketing of social investments to ordinary retail investors. Taken together, as understood here, these challenges are likely to impede the growth of the UK social investment market.

Arguably most problematic is that the Financial Promotion Regime does not explicitly recognise the distinctive features of many social investment contexts, where investments are often small-scale, localised, involve personal associations and financial return is often a secondary consideration. Until it does so, the financial promotion restriction in FSMA 2000 will remain a very significant impediment to growth for the social investment market.

Following on from this, **the complex and multi-layered nature of the Financial Promotion Regime in application** is in itself a challenge for investors and investees alike to understand. This means that there is uncertainty as to what rules apply and when, and which course of action is subsequently required to be in compliance with the applicable rules. In this context, the lack of any consistent and coherent treatment of charities and CICs alongside IPSs is an understandable source of confusion.

Investees seeking to communicate an investment offer, which falls within the remit of the Financial Promotion Regime, face a double-hurdle in relation to cost. **The financial cost of advice and of compliance with the Financial Promotion Regime is disproportionately high for the majority of social enterprises relative to the investment amount that they seek.** These costs are also disproportionately higher than the cost of compliance with the general law, in relation to the degree of regulatory protection provided. This raises issues around affordability for social enterprises, as well as the mismatch with the degree of regulatory protection.

It is to be hoped that ways can be found to reduce the 'cliff edge' effect for small social enterprises issuing communications on the boundary between exempt offers and regulated financial promotions. In a rational system of regulation, ways would be found to ensure that the increased transaction costs which accompany compliance with the Financial Promotion Regime would be in proportion to the increase in consumer protection which follows

from compliance. The current system does not reflect this kind of proportionality in the sphere of social investment.

The recent introduction of the **FCA Crowdfunding Regulations** has further complicated the regulatory landscape for investees. First, by further restricting the already small pool of retail investors to which investment communications can be made, therefore limiting opportunities for market growth. Second, there are likely to be additional costs of complying with the Crowdfunding Regulations, on top of the Financial Promotion Regime. In addition, the FCA policy is another regulatory consideration for investees seeking to raise equity through unlisted investments, and therefore adds to the challenge around clarification of the regulatory landscape.

The Financial Promotion Regime also creates barriers to **ordinary retail investors** seeking to make social investments, by restricting the investment offers communicated to them, and therefore **limiting the extent to which they are aware of such investment opportunities**. Further, it is unlikely that ordinary retail investors can afford the costs of financial advice, and even for those that can, the nascent nature of the social investment market means financial advisers display a general reluctance to recommend social investments. The effect is a contraction of the pool of capital available to social enterprises from ordinary retail investors, which becomes increasingly harder to access.

The general lack of consideration of social investment contexts within the Financial Promotion Regime is also reflected in the limited extent to which the Regime considers social investor risk appetite and preferences, which are taken into consideration in a range of other regulatory tools. For example, within the FCA Crowdfunding Regulations, non-advised retail investors who pass an appropriateness test demonstrate that they are sufficiently informed of the associated risks and on this basis can participate in crowdfunding. Similarly, high net worth individuals and sophisticated investors are

largely exempt from the Financial Promotion Regime, based on assumed experience with investment and/or knowledge of risk. Yet to date, the Financial Promotion Regime gives little consideration to ordinary retail investors seeking to make social investments in circumstances where such investors are investing primarily to achieve social outcomes, and only secondarily or to a limited extent on the basis of financial risk and return considerations.

This guide does not seek to detract from the value of the Financial Promotion Regime in providing necessary regulatory protection to retail investors. Rather, this research has sought to identify inconsistencies in the treatment of social investment under the Financial Promotion Regime. In so doing, it has sought to highlight where the regulatory landscape could be improved and clarified, to enable the growth of the social investment market.

In conclusion, there is scope for reconsideration and adjustment of the Financial Promotion Regime to take account of social investment. At present, the regime creates barriers both for investors and investees which risk stifling the growth of the social investment marketplace, instead of providing an appropriate level of regulatory protection. It is possible to see how some modest tailored adjustments to the Financial Promotion Regime could enable more retail social investment, whilst ensuring that retail investors are adequately protected. This guide has sought to outline where such adjustments might be made.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Key sources and further reading

European legislation

Directive 2003/71/EC (as amended by Directive 2010/73/EU) – 'The Prospectus Directive'

UK legislation

Financial Services and Markets Act 2000
Financial Services Act 2012

Secondary legislation

Financial Service and Markets Act 2000
(Exemption) Order 2001

The Financial Services and Markets Act 2000
(Promotion of Collective Investment Schemes)
(Exemptions) Order 2001

The Financial Services and Markets Act 2000
(Regulated Activities) Order 2001

The Financial Services and Markets Act 2000
(Financial Promotion) Order 2005

The Prospectus Regulations 2005, 2011, 2012 and 2013

The Financial Services and Markets Act 2000
(Exemption) (Amendment) Order 2007

The Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014

Financial Conduct Authority rules, guidance and papers

The Prospectus Rules

The Conduct of Business Sourcebook

PS 13/3 – Restrictions on the Retail Distribution of Unregulated Collective Investment Schemes and Close Substitutes

CP 13/13 – The FCA's Regulatory Approach to Crowdfunding (and similar activities)

PS 14/4 – The FCA's Regulatory Approach to Crowdfunding Over the Internet, and the Promotion of Non-readily Realisable Securities by Other Media

Glossary

Charity	An organisation that is established exclusively for charitable purposes.
Collective Investment Scheme(s) ("CIS")	A collective investment scheme (CIS) is a type of pooled investment defined by section 235 of The Financial Services and Markets Act 2000 (FSMA). Regulated CIS are FCA-authorized or recognised non-UK CIS and, apart from qualified investor schemes, may be marketed to any UK investor. Regulated CIS must comply with detailed rules on how they are to be operated, including investment and borrowing powers, prudent spread of risk, information to investors, fees, and other provisions aimed at setting appropriate standards of investor protection.
Company Limited by Guarantee	A private company without a share capital; the liability of its members is limited to such amount as the members undertake to contribute to the assets of the company in the event of its being wound up. A company limited by guarantee is not allowed to offer its shares to the general public. The vast majority of charitable companies are companies limited by guarantee.
Company Limited by Shares	A company that has a share capital and which may be a private company or a public company. A private company limited by shares is not allowed to offer its shares to the general public. The liability of its members is limited to the amount unpaid on shares held.
Community Benefit Society ("Bencom")	A society form which is established for the benefit of the community and which is registered with the FCA. A community benefit society, also known as a bencom, is able to issue equity to the public at large and may or may not have charitable status.
Community Interest Company	A community interest company is a business with primarily social objectives and an 'asset lock': its surpluses are principally reinvested in the business or in the community to achieve these social objectives, rather than being driven by the need to maximise profit for shareholders and owners. A community interest company may be limited by shares or by guarantee.
Co-operative Society	A society form which is established for the benefit of its members and which is registered with the FCA. A co-operative society, also described at times as a co-op, is able to issue equity to the public at large and will usually embody the principles and values of the International Co-operative Alliance.
Crowdfunding	Crowdfunding is a way in which people, organisations and businesses (including start-ups) can raise money and other forms of investment via online crowdfunding platforms and other media to finance or re-finance their activities and enterprises.
Crowdfunding Regulations	The Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014, which amends the Financial Promotion Regime.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

Direct Offer Financial Promotion	A direct offer financial promotion is one that contains: (a) an offer by the firm or another person to enter into a controlled agreement 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 the firm or another person to enter into a controlled agreement; and which specifies the manner of response or includes a form by which any response may be made.
Financial Conduct Authority ("FCA")	<p>The Financial Conduct Authority (the "FCA") regulates the conduct of the financial services industry in the UK. The FCA aims to protect consumers, ensure the financial services industry remains stable and promote healthy competition between financial services providers. It has rule-making, investigative and enforcement powers to protect and regulate the financial services industry.</p> <p>The FCA supervises compliance by market actors with the Financial Promotion Regime and other areas of regulation mentioned in this guide governing the marketing of investments.</p> <p>The FCA has an overarching strategic objective of ensuring that the financial markets it regulates function well. To support this it has three operational objectives: to secure an appropriate degree of protection for consumers; to protect and enhance the integrity of the UK financial system; and to promote effective competition in the interests of consumers.</p>
The Financial Promotion Regime	<p>The term 'Financial Promotion Regime' is used in this guide to describe the legislative and regulatory regime applying to financial promotions, including:</p> <ul style="list-style-type: none"> ■ The statutory prohibition on the communication of financial promotions contained in s.21 of FSMA 2000; ■ The exemptions and other provisions relating to financial promotions which are set out in the Financial Promotion Order; ■ The FCA Principles for Businesses; <ul style="list-style-type: none"> ■ The FCA rules applying to communications made by authorised persons, as set out in COBS 4, as they apply to financial promotions and the marketing of social investments; and ■ Other FCA rules applying to financial promotions and the marketing of social investments, including the Crowdfunding Regulations and rules restricting the promotion of UCIS and NMPs. <p>The term Financial Promotion Regime is also sometimes used in this report to refer to the relationship between (a) the FCA rules which apply to financial promotions, as mentioned above, and (b) general advertising and consumer law.</p>
The Financial Services and Markets Act 2000 ("FSMA 2000")	The key statute underpinning the UK financial services industry.

The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (FPO)	Section 21 of FSMA prevents the making of financial promotions in the course of business by unauthorised persons unless an exemption applies. The FPO contains the majority of the exemptions to the financial promotion restriction set out in the FSMA 2000.
Industrial and Provident Society ("IPS")	An industrial and provident society is an organisation that conducts an industry, business or trade, either as a co-operative or for the benefit of the community, and is registered under the Industrial and Provident Societies Act 1965.
Limited Liability Partnership (LLP)	An LLP is a relatively new form of partnership which is a body corporate with separate legal personality and in which members have limited liability.
Listing Rules	Rules published by the Financial Conduct Authority and contained in the Listing Rules sourcebook which is part of the FCA Handbook. They lay down minimum requirements for the admission of securities to listing, the content, scrutiny and publication of listing particulars, and the continuing obligations of issuers after admission.
Non-mainstream Pooled Investments (NMPs)	Pooled investments or 'funds' characterised by unusual, speculative or complex assets, product structures, investment strategies and/or terms and features. They are, in summary, units in unregulated collective investment schemes (UCIS); securities issued by certain special purpose vehicles (SPVs); units in qualified investor schemes (QIS); and traded life policy investments (TLPs). Note that not all pooled investments meet the statutory criteria for a 'collective investment scheme'; pooled investment special purpose vehicles, notably, do not generally amount to a collective investment scheme.
Non-readily Realisable Security	A non-readily realisable security for the purposes of the Crowdfunding Regulations, which will include the unlisted shares and unlisted debt instruments issued by unlisted social enterprises. Such investments are generally illiquid and not 'readily realisable, as monies invested cannot necessarily be immediately recovered by investors.
Prospectus Rules	The Financial Conduct Authority Sourcebook introduced by the Prospectus Regulations 2005 (SI 2005/1433), which implemented the Prospectus Directive (2003/71/EC) in the UK. The Prospectus Rules set out the form, content and approval requirements for prospectuses, which must be issued whenever there is either an offer of transferable securities to the public in the UK or a request for the admission to trading of transferable securities on a regulated market in the UK, unless an exemption applies.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

P2P Agreements	<p>In accordance with article 36H of the Regulated Activities Order:</p> <p>(a) (in relation to a borrower):</p> <p>An agreement between one person ("the borrower") and another person ("the lender") by which the lender provides the borrower with credit (within the meaning of article 60L of the Regulated Activities Order) and in relation to which the borrower is an individual and either:</p> <ul style="list-style-type: none"> ■ The lender provides credit (within that meaning) of less than or equal to £25,000; or ■ The agreement is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower. <p>(b) (in relation to a lender):</p> <p>An agreement between one person ("the borrower") and another person ("the lender") by which the lender provides the borrower with credit (within the meaning of article 60L of the Regulated Activities Order) and in relation to which either the lender is an individual, or if the lender is not an individual, the borrower is an individual and either:</p> <ul style="list-style-type: none"> ■ The lender provides credit (within that meaning) of less than or equal to £25,000; or ■ The agreement is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.
Prudential Regulation Authority ("PRA")	<p>The PRA, a subsidiary of the Bank of England, is the UK financial services regulator responsible for the macro-prudential regulation of systemically important firms, including banks and insurers. It was established on 1 April 2013 following amendments FSMA made by the Financial Services Act 2012, which transferred the Financial Services Authority's powers to the PRA and FCA.</p> <p>The PRA is responsible for the authorisation, prudential regulation and day-to-day supervision of all banks, building societies and credit unions (collectively 'deposit-takers'), insurers and major investment firms. It promotes the safety and soundness of these firms, seeking to minimise the adverse effects that they can have on the stability of the UK financial system and contributes to ensuring that insurance policyholders are appropriately protected. Firms that fall within the regulatory scope of the PRA are known as PRA-authorised firms, or as "dual-regulated firms", as the FCA remains the conduct regulator for such firms.</p> <p>The PRA has a general objective of "promoting the safety and soundness of PRA-authorised persons". The PRA is required to advance this objective primarily by seeking to:</p> <ul style="list-style-type: none"> ■ Ensure that the business of PRA-authorised firms is carried on in a way which avoids any adverse effect on the stability of the UK financial system; and ■ Minimise the adverse effect that the failure of a dual-regulated firm could be expected to have on the stability of the UK financial system and in particular, adverse effects resulting from the disruption of the continuity of financial services.

Public Limited Company (PLC)	A company which is able to issue shares to the public and which has paid-up share capital with a nominal value of at least £50,000. Not all public limited companies are listed companies.
Retail Investor(s)	<p>A retail investor is a person who invests in their capacity as a retail client – that is, a client who is neither a professional client nor an eligible counterparty. Professional clients and eligible counterparties are defined in COBS 3 and, generally speaking, are institutional clients and individuals who invest by way of business. In this paper we distinguish between three types of retail customer:</p> <p>(i) Sophisticated investor(s) Retail clients meeting the criteria for categorisation as sophisticated investors under any of the sophisticated investor exemptions in the PCIS Order, the FPO or in FCA rules. These are retail clients with extensive investment experience and knowledge of complex instruments, who are better able to understand and evaluate the risks and potential rewards of unusual, complex and/or illiquid investments such as NMPs.</p> <p>(ii) High net worth individual(s) Retail clients meeting the criteria for categorisation as high net worth individuals under any of the high net worth investor exemptions in the PCIS Order, the FPO or in FCA rules. Among the criteria are having an annual income of more than £100,000 or having investable net assets of more than £250,000. These criteria are subject to review and may be updated in future.</p> <p>(iii) Ordinary retail investor(s) In this guide, the term 'ordinary retail investor' is used to refer to retail clients who are neither sophisticated investors nor high net worth individuals. These are the investors of ordinary means and experience who make up the vast majority of the retail market in the UK.</p>
Social Investment	<p>Social investment is investment with a view to the creation of positive social impact as well as financial returns. In the UK, it often involves direct or indirect investment into social sector organisations – organisations which have a different nature and different objectives to mainstream for profit businesses – such as charities, community interest companies, co-operatives and community benefit societies who are raising investment capital.</p> <p>Social investment is distinguishable from mainstream ethical investment and socially responsible investment, which typically involves the screening out of investments which are regarded as having negative social or environmental impact. Instead, social investment involves positively selecting investments on the basis, in part, of expected social impact.</p>
Social Investment Tax Relief ("SITR")	The new social investment tax relief will give individuals who invest in qualifying social organisations a reduction of 30% of the cost of that investment in their income tax bill for that year. Individual investors can invest up to £1,000,000 and can invest in more than one social enterprise. This is independent of any investments under Seed Enterprise Investment Scheme and Enterprise Investment Scheme which are subject to their own annual investment limits.

Marketing Social Investments

- An Outline of the UK Financial Promotion Regime

<p>The Promotion of Collective Investment Schemes) (Exemptions) Order 2001 ("PCIS Order")</p>	<p>Section 238 of FSMA prevents the promotion of UCIS by authorised persons except when undertaken in accordance with secondary legislation determined by HM Treasury (the PCIS Order) or rules made by the FCA (in the conduct of business sourcebook (COBS) 4.12).</p>
<p>Unregulated collective investment scheme(s) ("UCIS")</p>	<p>A UCIS is a CIS in relation to which the operator has not applied for or obtained FCA authorised or recognised scheme status. They are not generally subject to FCA or similar overseas rules on the operation of collective investment schemes. UCIS may not be promoted to the general public (including through advised sales). Authorised persons may only promote UCIS to an investor who falls within one of the categories in COBS 4.12 or an exemption in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (PCIS Order).</p>
<p>Withdrawable share capital</p>	<p>Shares that can be withdrawn by the shareholder by application to the management committee of a co-operative society or community benefit society in accordance with the relevant society's rules. Withdrawable shares may be either transferable or non-transferable.</p>

Annex One: Social enterprise legal forms

The table below, taken from the 2013 SEUK survey of social enterprises³⁵, identifies the legal forms adopted by social enterprises over time.

	2013	2011	2009
Company Limited by Guarantee (CLG)	51%	54%	59%
Industrial and Provident Society (IPS)	19%	19%	37%
Community Interest Company (CIC)	17%	17%	17%
Company Limited by Shares (CLS)	12%	12%	7%
Partnership	2%		
Sole proprietorship	2%		
Limited Company	1%		
PLC	1%		
Other/don't know/not provided	11%		

Note – CICs are either also a CLG or CLS which accounts for the total being over 100%

One of the challenges faced by the social investment market under the Financial Promotion Regime is highlighted in the table below, which sets out those legal forms that are exempt under the FPO. Clearly there is a mismatch between the dominant legal form adopted by social enterprises (CLG) and those forms which are exempt under the FPO (co-ops and community benefit societies):

	Company limited by shares or guarantee	Community Benefit Society	Co-operative Society	Community Interest Company ¹	Other Company Legal Forms ²	Other Legal Forms ³
Debt ⁴	X	√	√	X	X	X
Transferable Shares	X	X ⁵	X	X	X ⁶	X ⁷
Non-Transferable Shares ⁸	X	√	√	X	X	X

√ = Exempt

X = Not exempt

1. A CIC may be limited by shares or by guarantee. It is a legal status rather than a legal form.
2. A charity is an organisation which exists for exclusively charitable purposes and may take a number of different legal forms. It is a legal status rather than a legal form.
3. Other legal forms include sole proprietorships, partnerships, limited liability partnerships, private trusts, charitable incorporated organisations, Royal Charter bodies and unincorporated associations. The Financial Promotions Order does not acknowledge these different forms.
4. For the purposes of this table, 'debt' is shorthand for any instrument creating or acknowledging indebtedness.

5. There is an exemption from the Prospectus Rules for a community benefit society issuing 'transferable securities' under FSMA, s.85(5)(a) and Schedule 11A, Part 2.
6. There is an exemption from the Prospectus Rules for charities issuing 'transferable securities' under FSMA, s.85(5)(a) and Schedule 11A, Part 2.
7. There is also an exemption from the Prospectus Rules for a non-profit making association or certain bodies recognised by an EEA State with objectives similar to those of a charity, bencom or housing association.
8. A non-transferable security is not the same as a withdrawable share, although the two concepts overlap. Please see the analysis accompanying Map 5.

Marketing Social Investments - An Outline of the UK Financial Promotion Regime

RESEARCH REPORT CITY OF LONDON CORPORATION JUNE 2014

**SOCIAL
INVESTMENT
RESEARCH
COUNCIL**



Cabinet Office



The City of London

Corporation is a uniquely diverse organisation with three main aims:

- to support and promote the City as the world leader in international finance and business services
- to provide high quality local services and policing for those working in, living in and visiting the Square Mile
- to provide valued services to London and the nation as a whole, including its role as one of the most significant arts sponsors in the UK.

The City of London Corporation is playing a pivotal role in raising the profile of the social enterprise and social investment sector. The City of London's Economic Research programme provides analysis on issues affecting the City.

For more information visit
www.cityoflondon.gov.uk/socialenterprise
and
www.cityoflondon.gov.uk/economicresearch

The Big Lottery Fund's

overarching social investment goal is to play a catalytic role in developing the social investment marketplace. This is based on the belief that social investment offers new financing tools and access to new sources of capital to enable Voluntary, Community and Social Enterprise (VCSE) sector organisations to operate on a more sustainable footing, so they can better provide their services to people and communities most in need.

Big Society Capital is

the world's first social investment bank. Big Society Capital was launched in April 2012, with an estimated £600 million of capital, £400 million of which will be from unclaimed assets left dormant in bank accounts for over 15 years, and £200 million from the UK's largest high street banks.

Big Society Capital's mission is to develop the social investment market in the UK by investing in social investment finance providers and by acting as a market champion. By improving access to finance for social sector organisations, and by raising investor awareness of investment opportunities that provide a social as well as a financial return, Big Society Capital will be instrumental in connecting the sector to capital markets.

The **Cabinet Office** supports the Prime Minister and Deputy Prime Minister, and ensures the effective running of government. It is also the corporate headquarters for government, in partnership with HM Treasury, and takes the lead in certain critical policy areas. This includes responsibility for growing the social investment market, helping the voluntary sector succeed and work with the state, and making it easier for people to give time and money to good causes.

Citi, the leading global bank, has approximately 200 million customer accounts and does business in more than 160 countries and jurisdictions. Citi provides consumers, corporations, governments and institutions with a broad range of financial products and services, including consumer banking and credit, corporate and investment banking, securities brokerage, transaction services, and wealth management.

Citi's commitment to inclusive finance spans the bank's businesses, products, functions, and geographies to capture all of Citi's work connecting previously underserved consumers with the formal financial system and providing the necessary guidance on how to use financial products responsibly. Expanding access is at the heart of Citi's inclusive finance work, which is advanced by linking the core capabilities of every Citi business unit in a shared effort to broaden financial inclusion, achieve economic empowerment and fuel sustainable growth for underserved communities. Key to these efforts is a robust social investment market that directs capital to ideas and solutions that create value for both investors and society.