

# **FINANCIAL SERVICES AND MARKETS ACT 2000**

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## **EXPLANATORY NOTES**

### **COMMENTARY ON SECTIONS**

#### **Part II: Regulated and Prohibited Activities**

54. This Part provides the mechanism for defining the scope of regulation under the Act and for establishing the extent of the prohibition on issuing unapproved financial promotions.

#### ***Section 19: The general prohibition***

55. This section contains the basic prohibition on unauthorised persons carrying on regulated activities in the United Kingdom. It is referred to in the Act as “the general prohibition” and prohibits persons who are not authorised or exempt under Part III from carrying on any regulated activity in the United Kingdom. Section 418 elaborates on when regulated activities will be considered to be carried on in the United Kingdom. Contravention of the general prohibition is a criminal offence (see section 23). Agreements made in the course of carrying on an activity in contravention of the general prohibition may be unenforceable (see sections 26, 27 and 29).

#### ***Section 20: Authorised persons acting without permission***

56. Authorised persons may only carry on in the United Kingdom those regulated activities for which they have been given permission by the Authority under Part IV or by or under any other provision of the Act, for example under Schedule 3, 4 or 5.
57. If an authorised person carries on regulated activities for which he does not have permission the consequences may include any of the sanctions available under Parts IV (Permission to Carry on Regulated Activities), XIII (Incoming Firms: Intervention by Authority) or XIV (Disciplinary Measures). However, if an authorised person acts outside the scope of his permission, he will not commit a criminal offence, and any contract which a person enters into when acting outside the scope of his permission will not be made unenforceable simply by virtue of that fact. *Subsection (3)* permits the Treasury to prescribe cases in which a breach permission gives rise to a right of action for damages.

#### ***Section 21: Restrictions on financial promotion***

58. This section prohibits unauthorised persons from issuing financial promotions, unless the content of the promotion is approved by an authorised person (who will be subject to rules made by the Authority), or unless an exemption applies. The regulation of financial promotions under the Act is similar to the regulation of investment advertisements and cold-calling under the FS Act 1986. However, section 21 reflects changing technologies and the fact that the borderline between advertisements and

unsolicited calls has become blurred. Sections 238 to 241 contain additional provisions relating to the promotion of collective investment schemes.

59. The prohibition applies to “invitations” or “inducements” to engage in investment activity, which are made in the course of business. The Treasury are given power, if necessary, to determine the meaning of “in the course of business”. The prohibition will potentially catch communications whether they are made in the United Kingdom, into the United Kingdom from elsewhere, or from the United Kingdom to another country. Communications from outside the United Kingdom can potentially be caught only if they can have an effect in the United Kingdom (*subsection (3)*). It is expected that the exemption order which the Treasury intends to make under *subsection (5)* will further limit the territorial application of the financial promotion regime, so that communications issuing from overseas will generally only be caught if they are directed at the United Kingdom. This will be of particular significance in the context of internet communications.
60. *Subsection (5)* confers a power on the Treasury to make exemptions from the prohibition, similar to the power to make exemptions from the investment advertisement prohibition under the FS Act 1986. It is possible for these exemptions to be made conditional on compliance with rules made by the Authority under section 145.
61. *Subsection (6)* makes clear that the circumstances that can be specified under *subsection (5)* extend to circumstances for which *subsection (3)* expressly makes provision. *Subsection (6)* thus clarifies that an exemption can be made for communications which originate outside the United Kingdom even if they are capable of having an effect here. *Subsection (6)(a)* and *(b)* deal expressly with the possibility of exemptions for communications originating in specific countries, or specific groups of countries such as EU countries. *Subsection (6)(d)* would allow all communications originating overseas to be exempted if that became appropriate. If such provision were made, *subsection (7)* would allow the Treasury to repeal *subsection (3)*.
62. *Subsections (8) to (12)* govern what constitutes “engaging in investment activity”. *Subsections (9) and (10)* give the Treasury power to determine the scope of the prohibition on financial promotion. It is expected that “controlled activities” will be the activities which are regulated under the Act, together with activities which would be regulated, but for an exclusion in an order made under section 22(1). This broad approach reflects the position under the FS Act 1986.

### ***Section 22: The classes of activity and categories of investment***

63. This section makes provision as to the classes of regulated activity, if carried on by way of business, and types of investment which are to be regulated under the Act. These are to be prescribed by the Treasury by order to be made under *subsection (1)*. An activity will only be a regulated activity if it is carried on by way of business and is specified in the order under *subsection (1)*. The Treasury will have the power under section 419 to specify circumstances in which an activity shall or shall not be regarded as being carried on by way of business.
64. **Schedule 2** indicates the general range of activities and investments that the Treasury may include within the order defining the scope of regulation, but it does not exhaustively list them. It is therefore possible that other activities or investments may be brought within the scope of the regulation under the Act. However, the general nature of the activities set out in Schedule 2 serves as a limitation on the extent of the Treasury’s power to bring further activities within the scope of the Act.

### ***Section 23: Contravention of the general prohibition***

65. This section makes carrying on a regulated activity in breach of the general prohibition a criminal offence. It is a defence for a person to prove that he exercised due diligence and took all reasonable precautions to avoid committing the offence.

66. A person convicted of this offence, which is referred to as an “authorisation offence”, may be subject to a term of imprisonment of up to 2 years if convicted on indictment (6 months on summary conviction) and/or a fine (the current statutory maximum for a fine on summary conviction is £5,000).

***Section 24: False claims to be authorised or exempt***

67. This creates an offence of falsely describing oneself, or holding oneself out, as authorised or exempt in relation to a particular regulated activity. It is a defence for a person accused of this offence to prove that he exercised due diligence and took all reasonable precautions to avoid committing the offence.
68. Under *subsection (3)* a person found guilty of this offence is liable on summary conviction to a maximum of 6 months imprisonment and/or a fine not exceeding level 5 on the standard scale (currently £5,000). If the offence results from the public display of material, *subsection (4)* permits a fine of up to the statutory maximum (currently £5,000), to be multiplied by the number of days for which any material giving rise to the offence was on public display.

***Section 25: Contravention of section 21***

69. This section provides that it is an offence to breach the financial promotion prohibition. The sanctions are the same as those which apply under section 23 for a breach of the general prohibition.
70. *Subsection (2)* provides a defence for a person accused of the offence if he can prove either that he believed on reasonable grounds that the content of the communication was prepared or approved by an authorised person, or that he exercised due diligence and took reasonable precautions to avoid committing the offence.

***Section 26: Agreements made by unauthorised persons***

71. Under this section, agreements concluded in the course of carrying on business in breach of the general prohibition will generally be unenforceable against the customer. However, the customer can still recover any money paid or property transferred and obtain compensation for any loss.

***Section 27: Agreements made through unauthorised persons***

72. Under this section, agreements made by an authorised person in the course of his authorised business may also be unenforceable by that person if the agreement was entered into as a result of a third party’s unauthorised regulated activities. This might arise if, for example, a contract was entered into as a result of investment advice given by an unauthorised third party.

***Section 28: Agreements made unenforceable by section 26 or 27***

73. This section gives the court discretion to allow the contract which would otherwise be unenforceable under section 26 or 27 to be enforced against the customer. The section also allows for the method by which the amount of compensation which a person may obtain is to be fixed. In order to enforce the contract, the court must be satisfied that it would be “just and equitable” to do so having particular regard to whether:
- where the person contravening the prohibition is a party to the agreement, that he reasonably believed that he had not acted in breach of the prohibition; or
  - where the contravention was by a third party, that the authorised person providing the service did not know that the agreement resulted from a contravention.

***Section 29: Accepting deposits in breach of the general prohibition***

74. This section concerns deposits accepted in contravention of the general prohibition under section 19. If the deposit agreement does not entitle the depositor to immediate repayment on demand, the section provides that the depositor may apply to the court to direct immediate repayment.
75. The court has discretion not to direct repayment if it is satisfied that it would not be just and equitable to direct repayment, having particular regard to whether the deposit-taker reasonably believed that it was not contravening the prohibition.

***Section 30: Enforceability of agreements resulting from unlawful communications***

76. When a customer enters into an agreement or exercises any rights as a result of a communication in breach of the financial promotion prohibition, the agreement will be unenforceable against him. The customer will also be entitled to recover any property transferred and to receive compensation for losses incurred, but if he chooses to recover property transferred or not to continue the contract, he must return any money received.
77. However, in certain circumstances the courts may enforce agreements made in contravention of the prohibition and allow money and property transferred under the agreement to be retained if it is satisfied that this would be just and equitable, having regard to whether:
  - where the person seeking to enforce the agreement was the illegal promoter, that he reasonably believed that the promotion had not been made in breach of the prohibition; or
  - where the contravention was by a third party, that the person seeking to enforce it did not know that the agreement resulted from an illegal promotion.