COMMENT LETTER

April 30, 1999

Comment Letter on U.K. Web Communications Proposal, May 1999

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Regulatory Reform Team
H M Treasury
Parliament Street
London SW1P 3AG England

Re: Comments on Financial Services and Markets Bill: Financial Promotion Consultation Document

To Regulatory Reform Team:

The Investment Company Institute appreciates the opportunity to comment on the Treasury's proposed approach to financial promotions under the draft United Kingdom Financial Services and Markets Bill. The Institute provided comments last November on the draft Bill itself, and has continued to follow with interest the UK's proposals to modernize its financial regulatory system. The Institute is the national association of the US investment company industry. Its membership includes 7,470 open-end investment companies ("mutual funds"), 458 closed-end investment companies and 8 sponsors of unit investment trusts. As of April 30, 1999, its mutual fund members had assets of about $5.554 trillion, accounting for approximately 95 percentof total industry assets, and had over 73 million individual shareholders.

The Institute's comments are focused on the proposed exclusion in the Consultation Draft for Web site communications not directed at the UK. This issue is of great importance to US investment companies. US mutual funds that are not directing their sales to the UK want to be able to operate their Web sites without being subject to enforcement actions or civil suits in the UK merely because their Web sites are accessible in the UK. We have also provided comments on the need to preserve in the new legislation the scope of certain existing exemptions from UK advertising rules. Finally, our letter also comments on the interaction of prospectus requirements and advertising regulations and recommends that a company should be permitted to make solicitations to those persons to whom it can sell its securities on a non-public basis.

The Consultation Process

The Treasury’s decision to consult in two stages on the Order concerning exemptions from the basic prohibition on making financial promotions that is set out in Clause 17 of the draft Bill is well-considered, in the Institute’s view. This two stage-approach—inviting comment on the broad approach set out in the Consultation Document and, thereafter, on consideration of those comments, publishing for consultation the draft Order and inviting further detailed comments on the draft legislation—will help assure that the UK’s efforts to modernize the financial promotion regime are well-informed, responsive to the needs of consumers and financial services firms, and consistent with the Treasury’s aim of ensuring that the legislation is sufficiently flexible to adapt to the changes in technology that will continue to affect the financial services industry.

Proposed Exclusion of Web site Communications Not Directed at the United Kingdom

The Consultation Document takes a reasoned approach to the proposed territorial scope of the new financial promotion regime and its application to the Internet. From the Institute’s point of view, it is critical that the new UK financial regulatory system provide firms with Internet Web sites reasonable certainty about the scope of the Financial Services Authority’s regulation of financial promotions. We are encouraged by the fact that the Treasury listened to those consultation respondents, including the Institute, that supported exclusion of financial promotions in the form of Web site communications originating outside the UK that, although they are "capable of having an effect in the UK," are not directed at persons in the UK. The Treasury, in the Institute’s view, should press ahead with its plan to exempt from the financial promotion regime communications issued from overseas that are not directed at the UK.

Of the three approaches to framing the exclusion of Web site communications from the financial promotion regime that are offered in the Consultation Document, the Institute believes that the third approach would be optimal, as it would accommodate the use of the Internet while not weakening the protection of UK investors. Under this approach, communications not directed at the UK would be exempted; a list of non-exclusive "indicators" would be used to ascertain if financial promotions issued from outside the UK are directed at the UK.

We believe this approach is preferable to the other two described. The first approach (exempting communications originated overseas but not directed at the UK, without defining or amplifying directed at), because it does not provide any guidance as to how to interpret the standard, could result in financial services firms feeling compelled to seek, on a continuing basis, UK regulators’ confirmation that the firms’ Web sites were operating consistent with UK law.[1] The second approach (exempting communications originating overseas but not directed at the UK, and defining "conclusively" when a promotion will, or will not, be considered to be directed at the UK), seems especially ill-suited to a rapidly changing technology such as the Internet. Tying jurisdiction to a static list of "indicators" would thwart the ability of both the financial services industry and UK regulators to respond flexibly to advances in Internet technology that cannot be anticipated.

The Institute believes that the third approach strikes the right balance. By designating its list of indicators as "non-exclusive," the third approach provides a level of guidance and certainty to the financial services industry that will facilitate innovation while affording UK regulators flexibility to respond to promotions that are directed at UK investors.

In the Institute's view, the four "indicators" the Treasury proposes to incorporate into the exemption are appropriate to determining whether a particular financial promotion is directed at the UK. The indicators reasonably focus both on statements included in the financial promotion and on the promoter's conduct. The Institute urges the Treasury, however, to refine the exemption by specifying in the legislation that the indicators are not only non-exclusive, but that the controlling factor in determining whether a particular promotion has been directed at the UK is whether the promotion raises UK investor protection concerns. Accordingly, the absence of any one factor would not bring financial promotions included on an overseas Web site under UK jurisdiction. This clarification will further the Treasury's stated objective of "ensur[ing] that on one hand, promotions which ostensibly comply with the indicators (say, by including appropriate disclaimers) but which are nonetheless, in substance, directed at the UK, to be caught, but on the other, that promotions which are not actually targeted at the UK, should not be, even if they do not actually comply with the various indicators."

Need to Preserve Substance of Current Exemptions

The Institute welcomes the Treasury's statement that the Government does not intend fundamentally to change the substance of the exemptions currently applying to financial promotions under the existing legislation. We agree with the Treasury's stated approach. There are two exemptions, in particular, that we urge the Treasury to preserve.

First, advertisements contained in a periodical published overseas and circulating principally overseas, or in a sound or television broadcast transmitted principally for reception outside the UK, currently are exempt. It is important that these exemptions be preserved intact. The scope of these exemptions is well understood. It would be unnecessary and burdensome to apply to these communications the indicators set forth for determining whether Web site communications are directed at the UK. For example, we would object to any suggestion that a US mutual fund advertisement in a newspaper or magazine intended for the US market might have to contain prominent statements or disclaimers in order to be exempt from UK jurisdiction.

Second, investment companies currently are permitted to send a prospectus or other promotional material to existing shareholders. This exemption should be retained.[2]

The Interaction of Prospectus Requirements and Advertising Regulations

Under current law, not all offers of securities are considered "offers to the public," which trigger the requirement to produce a prospectus. However, a company that is exempt from the requirement to prepare a prospectus is not exempt from the advertising regime unless a specific exemption from the advertising regime applies. As a result, a company can be exempt from the prospectus requirements, by virtue of selling its securities only to wealthy and sophisticated individuals, but not permitted to make any solicitations of these individuals. There is no investor protection reason to distinguish between the prospectus requirements and the advertising regime in this regard. We recommend that a company be permitted to make solicitations to those persons to whom it can sell its securities on a non-public basis.

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We appreciate the opportunity to comment on the Consultation Draft. We would be happy to provide additional information or clarification of our views.

Sincerely,

Craig S. Tyle
General Counsel

ENDNOTES

1 The possible need to obtain FSA confirmation that a Web site is not directed at the UK would be particularly onerous if there is no mechanism to make FSA guidance available to the public. In our November comment letter we urged the Treasury to provide a mechanism by which interpretive guidance issued to a particular business or industry segment will be made generally available so that similarly situated entities also may rely on it.

2 The proposal also would revise the current journalist exemption to distinguish between financial journalism and communications intended to tout a particular investment service or product. The Treasury would make the exemption unavailable to a journalist or publisher that receives any direct or indirect benefit from persons whose investment services are described in the publication. We believe the language in the draft proposal may suggest that a financial publication, such as a general circulation newspaper or magazine, that accepts paid advertising from investment companies cannot also contain any articles or news stories about particular investment companies. We recommend that this point be clarified.
