

Temporary intervention on the marketing of speculative mini-bonds to retail investors

November 2019

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1 Summary of temporary intervention

Introduction

- 1.1 We are introducing temporary product intervention measures for 12 months from 1 January 2020 to address risks of consumer harm from the promotion of speculative mini-bonds to retail investors. It reflects our concerns with the widespread marketing of these products, particularly online, despite being high risk and difficult for most retail investors to understand.
- 1.2 Features of speculative mini-bonds often include one or more of the following:
 - they are usually issued by an unauthorised person who is not subject to FCA oversight, and will generally not be covered by the Financial Services Compensation Scheme (FSCS)
 - they are unlisted and commonly issued through a special purpose vehicle (SPV)
 - they offer a high fixed rate of interest (often 8% or more) to investors if they commit to invest for a period of time (eg 3 or 5 years), with little or no opportunity to sell or transfer the investment before the end of that period
 - they involve an issuer using the capital raised to fund speculative and high-risk activities
 - they often involve high costs or third-party payments being made from the proceeds of the bond issuance
- 1.3 We are particularly concerned about mass-marketing which focuses on the high rates of return and places insufficient emphasis on risks, and may also suggest that the FCA or HMRC offer protection or endorsement of these products, which is misleading. For example, some promotions claim that an investment is eligible to be held in a tax-incentivised 'wrapper' (eg, the Innovative Finance Individual Savings Account (IF ISA) or a self-invested personal pension (SIPP)) when it does not qualify, or if it does, the promotion may misleadingly imply that HMRC's role in overseeing a tax wrapper means the investment is endorsed by government.
- 1.4 Our temporary rules apply in relation to unlisted debentures and preference shares where the issuer uses the funds raised to lend to a third party, invest in other companies, or purchase or develop property. We refer to them as speculative illiquid securities. However, we exclude unlisted securities where a company uses the funds raised to buy or construct property used by them for their own commercial or industrial purpose, and investment vehicles that only invest in a single UK-based property.
- 1.5 Widespread marketing of speculative illiquid securities continues, particularly via the internet, with financial promotions for these products commonly appearing in response to simple online searches for 'high investment returns' or similar phrases. We have significant concerns that increasing numbers of less sophisticated or less wealthy retail investors will be drawn to these products by promotions that focus on attractive 'headline' interest rates, while down-playing key risks and implying products are more secure than they are in practice.
- 1.6 We think the average amount invested by consumers currently in speculative illiquid securities is over £25,000 per investor. This would mean significant losses for

individuals if an issuer failed and little or no money was repaid. We consider this risk is sufficiently serious and immediate to make it necessary to introduce temporary product intervention rules without consultation. Significant consumer harm could arise if retail consumers invest without properly understanding the risks of these products, and later experience unexpected losses. In general, speculative illiquid securities are unlikely to be suitable investments for most retail consumers. However, we do not assume all speculative illiquid securities will fail.

- 1.7 We have limited powers over unauthorised issuers of these products. But we can take action in relation to the marketing of products when an authorised firm approves or communicates a financial promotion, or directly advises on or sells these products. We are actively investigating firms where we have seen breaches of our rules linked to promotions for, or the distribution of, speculative illiquid securities.
- 1.8 We think further steps are necessary to protect consumers and reduce harm from the ongoing 'mass marketing' of speculative illiquid securities. So, we are acting to strengthen our financial promotions rules on a temporary basis by:
 - a. Restricting the marketing of speculative illiquid securities to ensure they can only be promoted to individual retail investors who have been pre-categorised as either sophisticated or high net worth, and where the product has been initially assessed as likely to be suitable for them.
 - b. Mandating a specific risk warning and disclosures of any costs or payments to third parties that are deducted from the money raised by an issuer in any financial promotion for these products.
- 1.9 These new requirements will apply to any promotion approved or communicated by an authorised firm from 1 January 2020, and will apply for 12 months. This ensures our rules are in place before the end of the current tax year in April 2020, when many retail consumers will look for new ISAs or ISA-eligible investment opportunities and would be a prime target for further marketing of speculative illiquid securities.
- 1.10 Our temporary rules will not apply to promotions approved by authorised firms before 1 January 2020, which can still be communicated by an unauthorised person on or after 1 January 2020. However, we have concerns that the quality of promotions approved by many firms for speculative illiquid securities and the associated scrutiny of these investments has been extremely poor to date. So today we have published separate [guidance on the requirements which apply to firms approving financial promotions](#) under our existing rules. We expect firms that have approved financial promotions for speculative illiquid securities before our temporary rules apply to carefully consider this guidance and, if necessary, withdraw their approval if they cannot satisfy themselves that a promotion is clear, fair and not misleading.
- 1.11 We recognise that unauthorised issuers may still promote certain investment opportunities to high net worth or sophisticated retail investors by relying on exemptions under the [Financial Promotions Order](#) (FPO). We consider these exemptions allow relatively restricted marketing activity, preventing the mass marketing of specific investment opportunities to the general public. Instead, communications under these exemptions must only be 'made to' individual investors who have been previously identified as meeting the appropriate conditions.
- 1.12 Unauthorised persons who communicate promotions outside the scope of an FPO exemption, which are also not approved by an authorised firm, will be in breach of

the financial promotion restriction in s21 of the Financial Services and Markets Act (FSMA). A breach of s21 FSMA is a criminal offence, and carries potential liability of up to 2 years imprisonment, or a fine, or both. We will act to enforce against unauthorised business or illegal promotions where we see such cases.

Other work relating to high-risk investments

- 1.13 Our concerns with speculative illiquid securities coincides with an increasing prevalence of other types of 'high risk investments' (HRIs) being marketed to consumers. As a result, we consider our broader financial promotions regime may benefit from further strengthening. We expect to consult on broader, permanent rules relating to HRIs in the first half of 2020. This consultation is likely to include proposals to make these temporary rules permanent, or similar measures.
- 1.14 In parallel, as [announced in June 2019](#), the Treasury is undertaking a review into the regulatory arrangements currently in place for the issuance of non-transferable debt securities (NTDS).

Scope of these measures

- 1.15 The temporary interventions we propose will impact:
 - issuers of speculative illiquid securities
 - authorised firms that approve or communicate financial promotions relating to speculative illiquid securities
 - firms that offer services in relation to these products such as:
 - investment advice
 - arranging deals in investments
 - dealing in investments on behalf of clients
 - companies receiving funding from issuers of speculative illiquid securities
 - law firms and other professional service providers to issuers or firms
- 1.16 These measures will impact prospective retail investors ([retail clients](#)) in speculative illiquid securities. They will ensure marketing of these products is only communicated to sophisticated or high net worth individuals, where the product is also assessed as likely to be suitable for their needs. Promotions received by eligible investors will also have clearer disclosures of key risks and any costs or fees impacting the product.
- 1.17 Existing investors may be affected if our measures have negative effects on existing issuers, who may find it more difficult to raise new funds (although our measures do still allow new products to be marketed to 'eligible' retail investors). Investors may also try to exit their investments early, if this is possible under the terms of the security. If an issuer of speculative illiquid securities is already in financial difficulty, our temporary rules could exacerbate the risk they are unable to make future interest payments or repay investors' capital, even if this is ultimately caused by weakness in the investment proposition. For example, if an issuer is heavily reliant on new capital raising to be able to repay existing investors, it may suggest the product or business model was already unsustainable and likely to lead to losses.
- 1.18 We consider on balance the overall consumer protection benefits of our measures outweighs the short-term risk that losses are brought forward for some investors. This is because our measures should significantly restrict future levels of investment

in speculative illiquid securities by consumers for whom they are unlikely to be suitable. It also makes it less likely that unsustainable issuers can raise more capital over time, risking larger future losses to investors. Our measures also protect market integrity, as failures and unexpected losses for retail investors linked to persistent, widespread and poor marketing of these products may undermine confidence in UK financial markets.

FCA's rationale for intervention

Context for our intervention

London Capital and Finance (LCF)

- 1.19 LCF was the issuer of so-called 'mini-bonds' which it stated it used to make loans to corporate borrowers to provide capital for further investment. LCF issued mini-bonds to 11,625 investors, with a value of £237.2m. On 30 January 2019, LCF appointed administrators after the company was assessed to be insolvent. We had previously intervened to ban misleading promotions issued by LCF. Criminal investigations into LCF have started. Further information about the [administration of LCF](#) can be found on our website.
- 1.20 The Treasury subsequently directed the FCA to begin an [independent investigation](#) into the circumstance surrounding the collapse of LCF and the FCA's supervision of the firm in May 2019. In addition, the Treasury launched its own review of the wider policy questions raised by the case of LCF.

Further work on conduct issues relating to speculative illiquid securities

- 1.21 We have looked at risks posed by the promotion of speculative illiquid securities, both before and after LCF. Our work has focused on FCA-authorized firms involved in approving promotions (under s21 of FSMA), or promoting or distributing speculative illiquid securities themselves. We have examined whether financial promotions approved or communicated by firms comply with our rules. We have also identified conduct issues with some firms that provide advice, portfolio management or arranging or dealing services in relation to these products.
- 1.22 We have also examined promotions for speculative illiquid securities issued by unauthorised persons claiming to rely on an exemption in the FPO to consider whether they have done so correctly, or are breaching the financial promotion restriction.
- 1.23 Overall, our wider work has included:
- Examining the practices of around 50 authorised firms involved in approving promotions for, or directly distributing and selling, speculative illiquid securities or similar products since the start of 2019. Some investigations are ongoing.
 - Investigating 81 cases in 2019 of regulated activities potentially being carried out without having the required FCA authorisation (or a valid exemption), or where marketing activities may have breached the financial promotion restriction.
 - Completing reviews of over 200 financial promotions that may not have complied with our rules from November 2018 to May 2019, which have often led to marketing material being amended or withdrawn.

- Making enhanced assessments of new applicants seeking FCA authorisation or existing firms seeking to vary permissions where they indicate a business model that relates to offering or promoting speculative illiquid securities.

The nature of the products we are concerned with

1.24 The key risks of the speculative illiquid securities we have seen include:

- the promise of high annual returns, often presented as 'fixed', often starting at 6-8% - well above rates offered by traditional cash-savings products
- exposure to high-risk, speculative assets that are difficult for an investor to value or verify, and which present a mismatch to the implied 'security' of returns and capital repayment
- an unauthorised issuer, or an issuer that is authorised but where the issuing of securities is unregulated, which usually means there is no FSCS protection
- complex legal structure to a product, or between a promoter and issuer
- high upfront or embedded costs and charges
- often misleading financial promotions that:
 - focus on attractive headline returns
 - imply capital protection or other features (diversification, asset-backed) as reducing risk, which may not be effective protections in practice
 - do not disclose costs and charges to the investor or embed them in the arranging or structuring of the product, with fees of 20% or more of funds raised in some cases (undermining the likelihood of being able to deliver advertised rates of return)
 - use the 'approving' role of an FCA-authorized firm, or the fact the issuer or distributor is authorised for certain activities, to imply regulatory protection or FCA endorsement of a product
 - advertise that the investment is eligible to be held in a tax-incentivised 'wrapper' (eg, an IF ISA or SIPP) when it does not meet the qualifying criteria
 - use the role of HMRC in overseeing tax wrappers (eg, IF ISAs or SIPPs) to imply oversight or endorsement by the government

1.25 Although legally structured as a bond (debt security) with fixed returns, or occasionally as preference shares, the risks associated with speculative illiquid securities are often similar to unauthorised collective investment schemes (UCIS). The likelihood of investors receiving interest and capital repayment often depends on an issuer achieving pooled returns from lending to, or investing, in other third parties or property, usually involving a high degree of speculation and risk. Significant costs and charges or third-party payments deducted from the amounts raised by an issuer also makes the feasibility of achieving promised returns even more challenging. We do not think most retail clients can easily understand or assess such risks.

FCA rules and legislation applying to the promotion of these products

1.26 An unauthorised issuer of a speculative illiquid security would currently need to follow 1 of the following 3 approaches when promoting a product:

- Financial Promotions Order (FPO) exemption: An unauthorised issuer of unlisted debt securities can lawfully communicate financial promotions relating to those securities, without it being approved by an authorised firm, if

the communication falls within one or more exemptions in the FPO. The FPO includes exemptions for promotions which are made only to certain types of investor, such as high net worth individuals and sophisticated investors. Financial promotions communicated within the scope of FPO exemptions are not subject to our rules. The FPO exemptions do not generally enable marketing to the general public, eg via the internet. Rather, an unauthorised issuer seeking to promote its securities only to high net worth or sophisticated investors within the FPO will need to have in place processes to ensure these promotions are only addressed to such persons.

- ii. Promotion approved by an authorised firm subject to our rules for non-mainstream pooled investments (NMPIs): NMPIs include a unit in a UCIS or a qualified investor scheme, a security issued by an SPV (with certain exceptions), a traded life policy investment, and rights to or interests in these investments. The NMPI definition excludes more mainstream funds and exchange-traded products. Financial promotions relating to NMPIs cannot be approved by an authorised person where the relevant promotion is likely to be received by retail clients. There are, however, a number of categories of exemption from this general restriction. Subject to ensuring that prospective recipients of promotions fall within a relevant exempt category, promotions can then be made individually to investors, similar to the FPO approach. The NMPI rules therefore also prevent general marketing of a product's terms via the internet (see [COBS 4.12](#) for our detailed rules).
- iii. Promotion approved by an authorised firm subject to our rules for non-readily realisable securities (NRRSs): NRRS broadly comprise unlisted shares or corporate debt (see our [glossary definition](#)). The financial promotions rules for NRRS restrict a 'direct offer financial promotion' from being communicated to certain retail investors. The rules are particularly relevant to investment-based crowdfunding. As such, the NRRS rules are such that terms and rates of a product can be broadly advertised provided the promotion does not include an immediate invitation to invest. Consumers can, however, register interest to receive a direct offer financial promotion (see [COBS 4.7.7R](#) to [4.7.10R](#)).

1.27 Where an authorised firm approves a financial promotion for communication by an unauthorised person (approaches (ii) and (iii) above), the 'approving' firm is subject to requirements in COBS 4. These include:

- requirements to ensure a promotion is clear, fair, and not misleading, including when describing certain features of a product as 'guaranteed', 'protected' or 'secure', or using similar terms ([COBS 4.2](#))
- requirements to ensure information presented is accurate and that relevant risks are fairly and prominently presented alongside references to potential benefits of a business or investment ([COBS 4.5](#) or [COBS 4.5A](#))
- a general systems and controls obligation, and requirements for firms to confirm a promotion complies with our financial promotion rules before approving it ([COBS 4.10](#))

1.28 Authorised firms are also subject to our Principles for Business, which include obligations on a firm to:

- conduct its business with due skill, care and diligence ([Principle 2](#))
- pay due regard to the interests of its customers and treat them fairly ([Principle 6](#))
- pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading ([Principle 7](#))

- 1.29 An authorised firm approving or communicating its own promotions is also subject to COBS 4 more broadly, including the marketing restrictions for NRRS and NMPIs.

Drivers of harm and the interaction with our rules

- 1.30 We think there is a significant risk of immediate consumer harm from unsuitable retail investment in speculative illiquid securities due to:
- a. the open, mass-marketing of these products that focuses on the high returns on offer, while understating the risks involved, and targets consumers for whom these products are unlikely to be suitable
 - b. insufficient risk warnings and a lack of transparency around fees being deducted from the proceeds raised in a bond issuance, which may impact the prospects of investors receiving interest payments or capital repayments.
- 1.31 We think our existing rules can be strengthened to better address these risks as:
- Promotions approved or communicated by authorised firms about speculative illiquid securities may currently fall outside our more restrictive marketing rules for NMPIs. If such products are instead characterised as NRRS, specific products and their terms can be marketed to the general public provided the eligibility of a retail investor is assessed before they receive a direct offer to invest.
 - We do not currently require the inclusion of specific risk warnings in financial promotions relating to speculative illiquid securities, even if our Principles and rules require appropriate information must be provided to consumers. More specific requirements will strengthen our existing requirements to ensure that retail investors (to whom such securities can still be marketed) are provided with promotions which properly disclose the significant risks involved and the costs or third-party fees deducted from amounts invested.
- 1.32 We consider that it is necessary and expedient to introduce immediate temporary intervention measures, detailed below, without consultation in order to advance our consumer protection objective given the risks of ordinary retail investors investing in speculative illiquid securities. Without these measures, more consumers will be at risk of buying products which are unsuitable for them based on wide-spread and overly positive marketing. If products subsequently under-perform or fail, consumers will face potentially unexpected and large losses. We estimate that the average investment in speculative illiquid securities is over £25,000, so a total loss of funds could have a significant negative impact on individual consumers.
- 1.33 We also have concerns about the quality of financial promotions being approved by authorised firms for communication by unauthorised issuers or other third parties. We consider our rules in COBS 4, including the requirement to ensure a promotion is fair, clear and not misleading, already require an approving firm to analyse and carry out due diligence regarding the substance of a promotion before approving its content. If a promotion is likely to be received by retail investors, it must disclose and explain relevant risks alongside any benefits. To assess a promotion, a firm may need to consider (among other things):
- the authenticity of a proposition, which may mean undertaking checks on the directors, controllers or other key individuals associated with the issuer
 - the commercial viability of a proposition and whether advertised rates of return are reasonably capable of being achieved

- whether any fees, commissions or other charges within the investment's structure or related to it could materially affect the ability of the issuer to deliver promised rates of return
- whether any claims that a product is secured, protected, asset backed or similar are clear, fair and not misleading, and if the operation of such protection(s) and any weakness or deficiencies in them are sufficiently explained

1.34 To improve current practices, we have today published guidance on our existing rules to explain our expectations and practical implications for firms that approve financial promotions for unauthorised persons, particularly when concerning retail investment products. We encourage firms to consider if their approval of promotions to date, and any prospective approvals before our temporary rules apply, have met these standards. We may also propose new rules or guidance to improve conduct in this area as part of our planned consultation paper (CP) in 2020 (see below).

Wider risks of harm

1.35 We also recognise there may be other risks of harm from the distribution of 'high risk investments'. We use this as a broader term to include speculative illiquid securities, NMPIs, and NRRS. Some consumers may be gaining exposure to high-risk investments in a way that is not appropriate in light of, for example, their knowledge, experience or attitude to risk, or are investing without being given all necessary information. In some cases, we think our financial promotions rules could be strengthened to ensure retail investors are better protected from the risks inherent in high-risk investments and to ensure firms are meeting appropriate standards when promoting or distributing them.

1.36 We intend to consult on these broader issues and propose changes to our rules or guidance in the first half of 2020. This CP will also likely seek views on whether our temporary measures should be made permanent. We expect to include a range of options to strengthen our approach to high-risk investments and seek feedback on our proposals with a view to finalising rules by the end of 2020, before our temporary measures cease.

How it links to our objectives

1.37 These measures will temporarily restrict the marketing of speculative illiquid securities and improve disclosure within financial promotions for these products where promotions are approved or communicated by an authorised firm. We are introducing these rules as we consider them necessary to further our consumer protection objective. We have seen, and continue to see, harm to retail clients arising from the inappropriate marketing and sale of speculative illiquid securities to less sophisticated or wealthy investors, and poor disclosure of key risks. These measures are also relevant to our market integrity objective, as our actions should improve confidence in UK financial markets.

1.38 In terms of our competition objective and duty (s1B(4) FSMA), we do not consider it to be in the interests of consumers for firms to compete based on poor quality promotions, which are likely to attract investors into products that do not meet their needs. We recognise our marketing restriction may lead to some reduction in apparent competition if issuers' products are less accessible to retail consumers. This may also lead to fewer issuances in the future (whether by new entrants or existing

issuers) and arguably disadvantages these products versus other securities. However, as we consider the risks of speculative illiquid securities to be comparable to NMPIs, our measures effectively equalise their treatment. Limiting access for most retail investors is an intended effect of the rules.

- 1.39 We have sought to limit the potential unintended consequences of our measures for other forms of mini-bond used by companies when defining speculative illiquid securities (discussed below). Overall, we consider the consumer protection benefits of our restriction outweigh any potential negative competition effects. We have not identified an alternative approach that better promotes competition while ensuring appropriate consumer protection from the risk of harm posed by these products.

What we are changing

- 1.40 We are introducing temporary measures, which will last for 12 months and be included as a new section in COBS 4. The measures require:
- a. Any promotions for speculative illiquid securities targeted at retail investors to be restricted to sophisticated or high net worth retail investors. Firms will also need to carry out a preliminary assessment of the suitability of a security for any high net worth or self-certifying sophisticated investor to whom it is marketed (eg considering a client's profile and investment objectives). This ensures speculative illiquid securities are subject to similar marketing restrictions as currently apply to NMPIs (described above).
 - b. Any marketing material indicating benefits of speculative illiquid securities must also include specific and prominent disclosure including:
 - i. A standardised risk warning, which clearly states that investors may lose all their money, that these products are high risk, and ISA eligibility does not protect consumers from losing their invested money.
 - ii. Costs and charges associated with the security, and any third-party payments made by the issuer that are deducted from the capital raised, which should be indicated as a percentage of the capital raised and illustrated as a cash sum.
 - iii. The date on which the promotion was approved.
- 1.41 We are defining a speculative illiquid security as a bond or preference share that involves an issuer using the proceeds to lend money to third parties, invest in other companies or construct or buy property (subject to an exemption discussed below). Given issuers are often pooling investors' funds and using these to seek financial returns from speculative lending or investment, we view these securities as having similar risks to UCIS, despite legally being a debt instruments or shares. We are only addressing unlisted bonds or preference shares with these rules, as they typically have no prospect of a secondary market for investors to sell their holdings and do not have a prospectus, unlike bonds or shares admitted to listing on an exchange.
- 1.42 Our definition and measures are not intended to apply to:
- Unlisted debt securities or preference shares issued by companies to purchase property or pay for the construction of property where the relevant property will be used by the company (or a group company) for a general commercial or industrial purpose. We exclude from this exemption cases where an issuers' ability to pay interest or repay capital to investors is dependent or heavily contingent on the return generated from the purchase of construction of the

property; in other words, speculative property investments. We also exclude property development and the provision of construction services from being general commercial purposes.

- Products involving a single UK property or properties within a single development in the UK, purchased via a holding company with shares or bonds issued to investors to provide a return based on the rental income and any capital appreciation of the property. A property would need to be income-generating, and the issuer's activities are limited, to preclude property development activities. These products do not give discretion to an issuer in how investors' funds are used, and appear less complex for retail investors to understand.

- 1.43 Both of the above types of investment are likely to remain subject to our rules for NRRS and are still relatively high-risk investments. But we have not seen the same risks arise, to date, from how they are marketed and promoted.
- 1.44 Our restrictions will not apply to a business raising debt or equity capital for its own purposes, or for a group entity, which fall outside of those activities listed above. We also exclude credit institutions. Finally, we make clear that readily realisable securities (broadly, securities admitted to listing or trading on an EEA exchange), peer-to-peer agreements, and products that already fall with our NMPI definition are not caught by these temporary rules. Peer-to-peer agreements remain NRRS, however, so are still subject to other existing restrictions.

Outcome we are seeking

- 1.45 We expect our temporary product intervention measures should:
- a. Prevent widespread marketing of speculative illiquid securities to ordinary retail investors where a promotion is approved or communicated by an authorised firm. We expect this to reduce the number of retail investors accessing these investments.
 - b. Improve the quality of promotions provided to eligible retail investors to allow them to make better informed investment decisions based on clearer, mandated risk warnings and disclosure of costs, charges and third-party payments linked to a speculative illiquid security.
- 1.46 Reducing the number of retail consumers investing in these products, and those that do invest better understanding the risks, should reduce the likelihood of consumers investing in unsuitable products and potentially experiencing unexpected losses if a product underperforms or fails.
- 1.47 We recognise that unauthorised issuers will still be able to communicate financial promotions relating to their products within the scope of the FPO exemptions. We do not have powers to change these statutory exemptions or impose rules or guidance on activity outside our regulatory perimeter. But, as noted above, we consider the FPO exemptions do not allow mass-marketing to the general public of specific investments, including speculative illiquid securities and interest rates being offered.
- 1.48 We can and will act if we think firms are not correctly applying the FPO exemptions, and as a result are in breach of s21 FSMA. We expect such cases will be more visible following our rules. This is because our temporary measures will prevent promotions approved or communicated by authorised firms from being widely marketed, including over the internet.

- 1.49 Our temporary rules also do not apply to promotions approved by an authorised firm before 1 January 2020, when subsequently communicated by an unauthorised person. Our guidance published separately today seeks to ensure those promotions have been properly assessed by authorised firms based on our existing rules. We expect relatively few promotions approved prior to 1 January 2020 will continue to be communicated by unauthorised persons much after this date given both:
- a. our ongoing scrutiny of firms' compliance with our rules with respect to past approvals, which may result in some firms withdrawing approvals
 - b. the practical time-limited nature of financial promotion approvals, which as new speculative illiquid securities are brought forward or terms change over time, will likely require new promotions to be approved
- 1.50 Finally, we intend to launch a communications campaign shortly to improve consumer awareness of risks and to inform consumers about what they should consider before investing in high-risk investments such as speculative illiquid securities. As part of this, we will ensure links to FCA pages and warnings are more accessible and visible to consumers, particularly online. This includes looking at ways to increase the likelihood that a consumer actively searching for high return investments comes across FCA messages, to 'interrupt' the customer journey. If more consumers engage with FCA material on key features and risks of high-risk products, it may help counter the influence on investors' decisions of overly-positive or misleading marketing for these investments.

Equality and diversity considerations

- 1.51 We have considered the equality and diversity issues that may arise from these measures.
- 1.52 Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the intervention period. We welcome your input on this.

Next steps

- 1.53 These temporary measures will take effect from 1 January 2020 for a period of 12 months, expiring on 31 December 2020.
- 1.54 We cannot renew temporary intervention measures beyond 12 months, but as stated above we expect to consult on proposals during 2020. This is likely to seek views on whether to make permanent rules to apply on or before the date our temporary measures cease, to ensure there is no gap in consumer protection.

What you need to do next

- 1.55 Authorised firms approving promotions relating to speculative illiquid securities will need to ensure that they comply with our temporary rules for any promotions they approve from 1 January 2020. An authorised firm will also need to comply with our new rules when communicating any promotions from that date, including their own marketing material.

- 1.56 Unauthorised issuers of speculative illiquid securities seeking approval for a promotion from 1 January 2020 will need to ensure the contents and target audience of the promotion is consistent with our rules, to enable an authorised firm to approve it. If an unauthorised person communicates a promotion from 1 January 2020 that has not been approved, or where an approving firm has withdrawn its approval, and they do not rely on an FPO exemption, they are likely to be breaching s21 of FSMA.
- 1.57 Temporary product intervention rules are, by their nature, made without prior consultation or full cost benefit analysis, and so do not undergo the usual process for testing draft rules and receiving feedback from the public before they are made. While every effort has been made to ensure these temporary rules have the effect described in this statement, we do welcome comments if our rules are considered to be unclear in how they apply or have unintended consequences.
- 1.58 If an authorised firm considers the rules to be unduly burdensome or do not achieve their purpose, and non-compliance would not adversely affect our operational objectives, a firm can approach us to apply for a waiver or modification (s138A of FSMA). We will consider an application on its merits and decide whether to grant it. However, we may not be able to consider and reach a decision on applications before our rules take effect on 1 January 2020.
- 1.59 Comments on these rules can be emailed to speculative.minibondsTPI@fca.org.uk or posted to the Retail Distribution Policy Team, FCA, 12 Endeavour Square, London E20 1JN. We will keep the rules under review and may consider changes if comments received suggest it would be beneficial to do so.

What we will we do next

- 1.60 These measures will apply until 31 December 2020, unless we choose to withdraw them sooner. At that stage, they will lapse and cannot be extended.
- 1.61 We plan to consult during 2020 on rules to further enhance consumer protections addressing high-risk investments more broadly. That CP may include measures that will give permanent effect to these temporary measures, or similar proposals.

2 Considerations for the use of the temporary product intervention rule-making power

2.1 This Chapter sets out our considerations and reasons for making rules using our temporary intervention power under s137D of FSMA.

Intended outcomes and links to FCA's objectives

2.2 Our interventions are intended to restrict promotions of speculative illiquid securities to a subset of retail investors, and to require clients' eligibility to be assessed before they can receive any financial promotions for these products. This is designed to prevent 'mass market' promotion of speculative illiquid securities. We also propose measures to mandate certain disclosures to improve the content of marketing provided to 'eligible' investors.

2.3 The intended outcome of these measures is to:

- a. reduce the number of retail investors investing in high-risk speculative illiquid securities when these products are unsuitable for their needs (for example, because they do not want to risk the loss of all their capital)
- b. ensure that investors for whom they may be suitable can make an informed investment decision based on clear and prominent disclosures of the risks and certain features of a product, which may currently be omitted or diminished

2.4 This primarily relates to our operational objective to ensure an appropriate degree of consumer protection, although it also supports our market integrity objective. Our measures should reduce future cases of retail investors experiencing unexpected losses from speculative illiquid securities and, if fewer people invest overall, lower aggregate losses if a product underperforms or fails. Our rules may have mixed effects on our competition objective, but we consider any negative impacts are justified and we have sought to minimise unintended consequences.

2.5 It will not prevent fraudulent schemes claiming to be legitimate speculative illiquid securities that are in fact scams. Nor will it stop those unauthorised firms seeking to promote products under FPO exemptions but failing to comply properly with the law. We will use our normal enforcement and investigatory powers in these cases. Our intervention may make it easier for us to detect breaches since compliant firms or issuers should no longer be openly marketing specific products.

Whether prompt action is necessary

2.6 We have identified a considerable number of speculative illiquid securities and ongoing marketing of such products. From November 2018 to May 2019, we concluded reviews for over 200 financial promotions relating to speculative illiquid securities. Based on the extensive marketing and poor quality of many promotions targeting retail investors, we consider there to be a considerable risk of further

consumer harm if we fail to act and products later under-perform or fail. This risk may be exacerbated if the UK economy experiences a downturn.

- 2.7 We are proposing to apply these restrictions for 12 months to allow us time to consult on measures to strengthen our financial promotions rules for high-risk investments and consider whether to make our temporary rules permanent. This will also allow us to assess the impact of these temporary measures.

Appropriate and effective means of addressing actual or potential consumer harm associated with a particular product or group of products

- 2.8 We consider the wide-spread marketing of speculative illiquid securities combined with limited disclosure of certain product characteristics poses a considerable risk that ordinary retail investors access these products without understanding the key features and likelihood of losses. Current marketing may lead retail consumers to assume such products are more likely to deliver the high returns promised, and are more secure if an issuer fails, than is really the case. Retail consumers may also think these securities are similar to much safer savings products, such as cash ISAs.
- 2.9 As a result, consumers targeted by promotions may invest where these products are entirely unsuitable for their needs, or may invest a larger amount than they would have otherwise, had they better understood the risks.
- 2.10 The marketing restriction will ensure promotions are carefully targeted at more sophisticated or wealthy retail clients who are better able to understand the risks involved or bear potential losses. The risk warning and disclosure requirement ensures those eligible investors who are still targeted with promotions receive better information to inform their decision-making, and that this information is not omitted or diminished in favour of marketing the benefits of a product, or more spurious features.
- 2.11 The new measures enable issuers to promote their securities to a niche retail market for whom they are likely to be suitable, but remove the ability to 'mass market' specific products to the public. The rules do not permit marketing to retail investors who certify they will not invest more than 10% of their net assets in speculative illiquid securities (ie there is no 'restricted investor category' of eligible investors as there is under the NRRS rules). We consider this to be appropriate given the complexity of the use of funds or underlying assets that speculative illiquid securities involve, which is more similar to risks of NMPs, where our marketing restrictions also exclude the 'restricted investor category'.
- 2.12 For these reasons, we consider the temporary measures are appropriate and should be effective in addressing the risk of consumer harm posed by promotions of speculative illiquid securities where communicated or approved by a firm.

A proportionate and deliverable means of addressing actual or potential harm

- 2.13 Our marketing restriction will require firms approving promotions for communication by unauthorised persons or communicating their own promotions to ensure they are only targeted at high net worth or sophisticated clients for whom the product is likely

to be suitable from 1 January 2020. This will prevent future mass-marketing of specific speculative illiquid securities. Firms will instead need to:

- i. Read and understand our temporary rules, and assess where their existing processes will need to change to meet the new standards.
- ii. Identify investors who meet the criteria for high net worth or sophisticated investor status, or who have already been certified as such, or investors who are self-certified sophisticated investors.
- iii. For certified high net worth individuals or self-certified investors, conduct a preliminary assessment of the client's profile and objectives to determine whether a speculative illiquid security is likely to be suitable for them.
- iv. Ensure promotions for speculative illiquid securities are only communicated to retail investors that are sophisticated, or high net worth or self-certified sophisticated for whom these investments are deemed likely to be suitable.

- 2.14 This will require a process whereby prospective investors are pre-vetted based on the relevant conditions, to enable promotions to target only a restricted set of eligible investors. The main change will be developing processes to perform checks prior to communicating promotions and, potentially, developing a list of vetted, eligible clients.
- 2.15 Firms will also need to ensure any promotions they communicate or approve for speculative illiquid securities contain the standardised risk warning and disclose prominently any costs or fees. This should be relative easy and have only small, one-off costs for either a firm or third-party issuer to include in a promotion, particularly as marketing is predominantly online and so only requires changes to digital text.
- 2.16 Based on internal FCA data, we are currently aware of around 50 authorised firms which have approved promotions for what appear to be speculative illiquid securities. However, only a third of those firms approved promotions for more than 1 product. This suggests a much smaller number of firms regularly approve third party promotions so may be likely to promote speculative illiquid securities in the future. The higher proportion of firms that only approved promotions for 1 product may not regularly do this activity, and so may not be significantly affected by our new rules. It may also affect some firms that directly distribute speculative illiquid securities, including a small number of crowdfunding platforms specialising in debt securities.
- 2.17 We have identified nearly 100 issuers of speculative illiquid securities, which issued collectively approximately 200 bonds. Over 80% had issued a single bond, with the remainder issuing more than 1. Given financial promotions will be most pertinent when marketing a new bond issue, we assume our rules may have more impact on repeat issuers.
- 2.18 Our previous [Consultation Paper](#) and [Policy Statement](#) on the NMPI rules provided an estimate of costs from applying similar measures (see Annex 2 of [PS13/3](#)). This outlined potential one-off costs from £17.5m to 32.5m and ongoing costs of £0.5m to £1.3m. However, the costs of our temporary product intervention rules are likely to be much lower than even the bottom range estimates for the NMPI reforms. This is because promotions for speculative illiquid securities:
- a. are already subject to NRRS rules (eg investor categorisation is already required, which accounted for £3-9m of the estimated one-off costs for the NMPI rules)

- b. appear to involve fewer authorised firms that approve promotions than the numbers affected by the NMPI rules (250-750 distributors)
- 2.19 We presume costs will be absorbed either by the authorised firm or passed on to an issuer or third party that pays a firm to approve a promotion. As firms and other market participants (eg consultants) have experience of NMPI measures, we think it is feasible for our rules to be delivered and implemented, despite the short timeframe provided.
- 2.20 Issuers of speculative illiquid securities will also find it harder to raise funds after our intervention as they will only be able to promote to a smaller pool of eligible investors. However, this is consistent with our policy intention.
- 2.21 There is some risk of intended consequences from these rules, mainly for:
- Companies seeking to raise funds using mini-bond products in future
 - A subset of consumers who may be negatively impacted if they:
 - are existing holders of speculative illiquid securities
 - could be suitable prospective investors in these products, but are not sophisticated or high net worth, or are eligible investors who face less choice if the market contracts following our interventions.
- 2.22 We have sought to carve out companies that issue mini-bonds to fund the purchase or construction of property where it is for their own, non-speculative, business operations. We also note the possibility for firms to approach us for a waiver if a specific product is caught by our rules that we did not intend. We think such cases should be limited.
- 2.23 We recognise our rules may have a possible negative impact on existing investors in speculative illiquid securities (see also paras 1.17 and 2.47). If an issuer of a bond is already under financial pressure and our measures increase this, they may be less likely to meet interest payments or repay capital to investors. As this is likely to primarily reflect existing weaknesses in an issuer's business model, we do not think our measures cause harm directly, but may contribute to losses occurring sooner for some investors.
- 2.24 We consider it highly unlikely that there will be many, if any, retail investors for whom speculative debt securities could be suitable, but who are cut off from opportunities in future because they are not eligible. To the extent there are such cases, other products remain more widely available that provide exposure to eg small companies, such as equity crowdfunding or peer-to-peer investments. Speculative illiquid securities will remain available to eligible investors and should be able to attract investment if they are robust propositions. Our rules should mainly affect weaker issuers and products, which are not sustainable, for the benefit of investors.
- 2.25 Overall, we think the scale of potential harm for the majority of retail investors from these products if we fail to act outweighs costs for firms, issuers or a small minority of investors from our intervention. We do not consider that less restrictive measures would adequately mitigate the risks to consumers we are seeking to address and provide an appropriate degree of protection for consumers. So we consider our measures are proportionate.

Compatible with the FCA's duty to promote effective competition in the interests of consumers

- 2.26 The temporary measures will cause a potential reduction in apparent choice and access to certain investments for ordinary retail investors. However, we consider this to be appropriate given the risks of harm posed by the way speculative illiquid securities are currently promoted. Our measures do not prevent targeted promotions of investments to a niche retail market for whom they may be suitable, subject to the required risk disclosure and details of any costs or fees deducted from monies raised.
- 2.27 Issuers will remain able to compete in providing speculative illiquid securities within a framework that should ensure adequate consumer protection by reducing the risk that retail consumers buy unsuitable products. By contrast, the current targeting of an excessively wide retail market with promotions for these products that lack prominent and balanced disclosures of risks and costs or fees does not represent positive competition in the interest of consumers.
- 2.28 There is a small risk our restrictions reduce a source of funding to some businesses. This is more likely for smaller businesses that have novel business models or seek to intermediate lending to individuals or businesses.
- 2.29 However, we do not think there is an alternative approach that would provide appropriate investor protection while promoting competition in the interests of consumers. Overall, reduced investment in speculative illiquid securities should mean that investors' savings are more likely to be invested elsewhere in the economy. This may lead to more investment in businesses that offer non-speculative commercial services or industrial products that contribute to growth in the real economy and have a greater prospect of delivering sustainable returns.
- 2.30 Other investment vehicles that provide small-scale financing to companies, such as equity crowdfunding and peer-to-peer lending, remain accessible to a wider range of retail investors. We think speculative illiquid securities pose greater risks of harm to consumers, justifying similar marketing restrictions to those applied to NMPs. So we consider our rules are compatible with our competition duty (s1B(4) FSMA).

Supported by sufficient and appropriate evidence

- 2.31 It is difficult to fully assess this market, as most issuers of speculative illiquid securities are unauthorised. However, there is clear, widespread evidence of poor practices in promotions of these products and how they are targeted. In 2019, we have looked at 50 cases relating to authorised firms' approval of promotions or distribution activities relating to speculative illiquid securities. We have also seen over 80 cases involving companies that appear either to be conducting regulated activities without being authorised, or promotions for speculative illiquid securities that do not appear to have been approved by an authorised firm or rely on an FPO exemption. From November 2018 to May 2019, we also concluded reviews of over 200 financial promotions relating to these products for possible non-compliance with our rules.
- 2.32 Mass-marketing of such promotions to ordinary retail clients, particularly online, has also continued, which we are unable to address based on existing rules. Many of these products appear speculative in nature, hard for a retail client to understand,

and pose a high risk of loss, which less sophisticated investors may overlook due to the attractive interest rates offered. Aside from the collapse of LCF, there have been a number of other reported cases of bond issuers failing. In such cases, investors often receive only a small fraction or none of their original investment back, and the return of any money can take time. We are also seeking to identify existing bonds where high interest rates were offered alongside high costs or fees paid by issuers to third parties, which may pose a higher risk of failure.

- 2.33 We cannot precisely quantify the potential future harm. However, we continue to see widespread internet-based marketing for these products and think overall issuance – and so retail investor exposure – as well as the number of issued bonds is growing. We have also had around a dozen applications for FCA authorisation in 2019 by applicants whose business models suggest a link to the distribution of mini-bond products. This suggests new products will continue to be marketed.
- 2.34 We think the number of investors in speculative illiquid securities, as well as the total amount invested, could increase substantially if current practices continued, particularly in the run up to the ISA deadline at the end of the tax year (April 2020). This increases the likelihood of more unsophisticated retail consumers accessing these high risk and opaque products, and potentially suffering future losses.

Transparent in aim and operation

- 2.35 We have set out and explained in this statement our justification and reasoning for our temporary interventions, alongside the final rules. We also welcome any comments on our rules from market participants if they appear unclear or have unintended consequences. We will consult fully on proposals for permanent rules during 2020. This will allow an opportunity for formal feedback.

Likely to be beneficial for consumers, when taken as a whole

- 2.36 Our temporary intervention measures will ensure promotions of speculative illiquid securities are only targeted at individual retail consumers for whom they are likely to be suitable. They will also improve the disclosure and quality of those promotions. We think this will benefit the vast majority of retail consumers, who may otherwise be attracted by mass-marketing of these products without properly understanding the risks involved. We estimate at least 11,000 clients may currently be invested in these types of products, and potential several times more than this, as well as 11,625 investors affected by the failure of LCF. There is likely to be a much higher number of investors who are being targeted by the current marketing of speculative illiquid securities, and so who could invest in future.
- 2.37 We consider these products are only suitable for a niche retail client market. They pose a significant risk of being promoted in a way that is likely to mislead retail investors or reduce their focus on the risks involved, even if promotions comply with our existing rules. Restricting access to new promotions for speculative illiquid securities for retail investors will mean products are more likely to reach the right target market. Our measures should also ensure those eligible clients then receive promotions with clearer risk warnings and disclosure.
- 2.38 The outcome should be that more retail clients invest in suitable products on an informed basis and fewer invest in unsuitable products based on misperceptions as

to the nature and risks of a product. While our measures will not prevent potential future losses if products underperform, they should ensure those clients who have invested have properly understood and accepted the risks. This aligns with the outcomes we sought when consulting and making rules for NMPIs (CP12/19 and PS13/3) and when we considered changes to the NMPI definition in 2016 (CP16/17).

The impact on protected groups in the Equality Act and whether the rule promotes equality and good relations

- 2.39 We have had due regard to issues concerning discrimination, advancing equality, and fostering good relations between those with protected characteristics, and those who do not (as detailed in [PROD 2.6.3G](#) and the [Equality Act 2010](#)).
- 2.40 We do not anticipate these measures will discriminate against or negatively impact people with protected characteristics. However, we have relatively little information on current investors in speculative illiquid securities since the issuers are usually unauthorised. We think investors or prospective investors will typically be consumers with a reasonable level of savings, since promotions often target consumers with existing ISAs (or, in some cases, savings derived from pensions). This might suggest older consumers will particularly benefit from our new restrictions, as they will be less likely to be targeted by marketing in future, and so be tempted or pressured to invest in these products which are unlikely to be suitable for their investment objectives and profile given the high risk of losses.
- 2.41 It seems unlikely that our temporary product intervention measure would result in unlawful direct discrimination as they will apply to general promotions of products to all retail consumers.
- 2.42 There may be indirect positive or negative effects on people with protected characteristics as they may be (i) existing investors in speculative illiquid securities or (ii) prospective investors. The former may experience harm if market disruption from our measures exacerbates poor performance of existing products and the financial position of issuers that are already struggling, especially if an issuer is reliant on being able to raise further capital from retail investors with new issues and this becomes more difficult.
- 2.43 By contrast, prospective investors will be better protected if the marketing of risky investments is more targeted to those who are sophisticated or high net worth and for whom investments are likely to be suitable. Our measures should ensure that those eligible retail clients then receive promotions that are of better quality with clearer risk warnings and disclosure. On balance, we consider the benefit of our measures in reducing future consumer harm will be greater than the risks to existing investors, and this should be equally true for consumers with protected characteristics.
- 2.44 Otherwise, we do not expect our rules to affect equality or good relations between those with and those without protected characteristics. But we welcome any comments from stakeholders if they feel our measures do impact protected groups in a way we have not considered.

EU considerations

- 2.45 Some speculative illiquid securities may be financial instruments under MiFID II, in addition to being specified investments in UK law under the Regulated Activities Order (RAO). However, our temporary product intervention measures only address financial promotions for these products. We do not consider our intervention measures interfere with the scope of MiFID II under EU law on the basis that approving and communicating financial promotions are not MiFID investment services. For this reason, we are also making these interventions using our domestic rule making powers in FSMA, rather than under Article 42 of MiFIR. Our approach is consistent with our previous view when making rules imposing marketing restrictions for NMPIs and NRRS.
- 2.46 This also means that our temporary intervention measures should not be materially affected in the event that the UK leaves the EU on or before the 31 January 2020, or at a later date during the application period of our rules. However, we may need to make minor changes as a result of EU withdrawal.

Contextual considerations

- 2.47 We have considered the broader market and social context. We summarise these as:
- **The potential scale of detriment in the market:** we anticipate the number of retail investors in speculative illiquid securities has the potential to increase substantially. This may result in a greater number of less sophisticated retail investors investing in products with a poor understanding of the risks and which are likely to be unsuitable, with future harm occurring if these products subsequently underperform or fail.
 - **The potential scale of detriment to individual customers:** based on a sample of bonds, the average amount invested is relatively high at over £25,000 per investor. Promotions also often target ISA savings by indicating eligibility of speculative illiquid securities for inclusion in the IF ISA. In some cases, these securities may not be eligible at all, while in other cases where it is eligible for a tax wrapper (eg IF ISAs or SIPPs) this is used to suggest HMRC or the FCA provides additional protection or scrutiny of the investment itself, which is misleading. The current annual ISA limit is £20,000. Given the risks of 100% capital loss, losses could be acute for individual investors and represent a large proportion of their savings.
 - **The social context:** Persistent low interest rates since the financial crisis make the high rates of fixed return offered by speculative illiquid securities attractive to many retail investors, particularly those who typically keep most of their net wealth in deposits or low-risk bonds. This may include investors seeking a regular income from investments, such as retirees, who may have drawn down pension savings following the pension freedoms. These types of consumers may be tempted to invest a high proportion of their savings into speculative illiquid securities, especially if they take marketing at face value and do not understand the risks. Consumers could lose substantial amounts if a product fails, and investors may struggle to replenish savings if they are no longer earning.
 - **The market context:** we consider speculative illiquid securities are high risk and opaque where an issuer uses funds raised to on-lend to third parties or speculatively invest in other companies, property development or projects. Promotions of these products, as with NMPIs, should be limited to a very niche

retail market that can understand these risks and bear potential losses. Currently, promotions are aimed at the mass retail market and seek to entice investors with high returns, claims of security of the investment, and limited or diminished disclosure of risks. We have purposefully sought to exclude companies that issue unlisted debt securities to fund ordinary business activity that is not highly speculative. This should ensure capital raising for the 'real economy' is not unduly restricted beyond the rules that currently apply to these instruments (e.g. as NRRS) and reflects the different risks and typical marketing practices involved.

- **Possible unintended consequences:** we recognise our definition of speculative illiquid securities may capture the promotion of some securities under our rules that we did not intend to restrict and do not pose the same risks. We welcome comments if this is the case. Authorised firms can also approach us to apply for a waiver if they consider complying with our rules would be unduly burdensome or not achieve its purpose, and would not adversely affect our operational objectives (s138A of FSMA). We will then consider whether a waiver is justified based on the merits of an application against the statutory tests.

Another consequence is that our rules could exacerbate poor performance of an existing issuer of speculative illiquid securities if it finds it harder to raise further capital. This could impact existing investors. Our measures do not, however, prevent *any* future capital raising by an issuer nor should it undermine an issuer's existing activities. Since speculative illiquid securities typically have no secondary market, existing bondholders would not experience an immediate loss of value. If an issuer is dependent on future bond issuances to repay current investors, this may also suggest its proposition was unfeasible at the outset, in which case our rules may accelerate losses, but are not the cause. We consider the reduction of harm to future retail investors by reducing the likelihood they access unsuitable investments outweighs risks to current investors.

Although our measures may also affect better performing issuers of speculative illiquid securities, we consider these issuers are more likely to still be able to attract eligible investors under the new restrictions based on a stronger track record, or could seek other sources of finance (eg, from professional investors). In addition, even if an issuer's securities have been better performing in the past, they remain high risk and complex. So they will still pose a risk of future losses for investors, and are unlikely to be suitable for most retail investors.

Finally, investors who can no longer access speculative illiquid securities, or issuers who can no longer issue them successfully, may turn to other high-risk investments. In many cases, the promotion or distribution of other products will still be subject to protections under our rules, as an authorised firm is likely to be involved at some stage (eg, the offer of products such as peer-to-peer lending agreements are subject to our rules). However, we will look for potential arbitrage of our temporary rules involving products with comparable risk features. We will also consider whether our broader framework of rules for high-risk investments and financial promotions could be strengthened as part of our planned CP during 2020. In addition, we will actively monitor for and take action against any increase in scams that seek to exploit retail investors once marketing for speculative illiquid securities is restricted after 1 January 2020.

Annex 1 Compatibility with the FCA's regulatory principles

1. This Annex sets out how our temporary intervention measures are compatible with the FCA's over-arching regulatory principles. We set out why we believe our rules are compatible with our strategic objective, advance one or more of our operational objectives, and how we have regard to the regulatory principles in section 3B of FSMA. We have also considered whether the rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

Compatibility with our objectives

2. We consider our temporary measures will help markets function well, and ensure an appropriate degree of protection for consumers. We think our measures will ensure that marketing of speculative illiquid securities when subject to our rules is targeted at a suitable target market, which should effectively prevent retail clients for whom they are unsuitable gaining access to these products. We also want to ensure risks, costs and fees are clearly and prominently disclosed to those investors who remain eligible to receive promotions.
3. In doing so, it will reduce the likelihood of future consumer harm from ordinary retail investors investing in products based on widely available marketing, which may also lack sufficient information on risks and fees or costs and charges. Fewer investors should invest in products that are unsuitable for them or invest based on promotions that under-state the risks involved, reducing the likelihood of unexpected losses.
4. We have also considered the most recent recommendations from the Treasury on aspects of the economic policy of the Government, which we should have regard to when acting to advance our objectives and meet our duties (s1JA of FSMA). We think our product intervention rules are consistent with the economic policy of the government. Our rules are designed to secure better outcomes for consumers and encourage appropriate competition, such that investments are targeted at consumers for whom they are suitable.
5. We consider our measures will enhance confidence in UK markets, and encourage inward investment and growth, by reducing the likelihood of future mis-selling cases linked to the marketing of speculative illiquid securities to retail investors. If some issuers raise less funds in future due to our rules, we consider that is likely to affect those propositions that are most risky and least sustainable. This is positive for the wider economy if consumers savings are instead invested in a way that is more likely to fund productive companies' industrial or commercial operations that are non-speculative, with better prospects of sustainable growth.

The need to use our resources in the most efficient and economic way

6. We are pursuing cases of potential firm misconduct involving the distribution of speculative illiquid securities or similar products using our supervisory and enforcement powers. However, these temporary intervention measures will address

shortcomings in our existing rules that prevent us taking effective action in some cases. The measures should also improve the overall quality of new promotions for speculative illiquid securities across the market. This is more effective and efficient than taking a case-by-case approach to promotions for different products as they appear.

Proportionality of burdens or restrictions imposed on persons or on carrying on an activity

7. We detail above the expected impacts of our rules on authorised firms. We conclude that any costs incurred are outweighed by the reduction in potential harm to consumers. We consider our measures are deliverable and proportionate. They are also temporary in nature. We plan to consult in 2020 on permanent rules, which will include a cost benefit analysis and assess any impacts from these temporary measures.

The desirability of sustainable growth in the economy of the UK in the medium or long term

8. Our temporary measures are targeted at speculative illiquid securities and restrict marketing to non-sophisticated or high net worth retail clients. We have sought to ensure we do not capture issuances of small denomination bonds by firms which do so to fund their ordinary, non-speculative business activity. We are only seeking to address promotions relating to issuers of bonds that have the primary purpose of using funds raised to lend to third parties, or invest speculatively in other investments, third party projects or property to produce a financial return for bond holders (less any costs and fees).
9. We do not think our restrictions will have any material effect on the UK economy in the medium or longer term. Instead, the measures should improve confidence in UK financial markets for participants and may reduce cases of capital being misallocated to poor products that fund lending activity or investments in ventures that are extremely risky and likely to underperform or fail, at a cost to consumers.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons

10. We have sought to ensure we do not capture issuance of small denomination bonds by companies who do so to fund their own (non-speculative) businesses. We are only seeking to cover promotions relating to issuers of bonds that have the primary purpose of using funds for more speculative purposes. We consider that bonds in the latter category present significantly greater risks to consumers. So, we are applying more restrictive requirements to these speculative products.

The responsibilities of senior management

11. Relevant senior management will need to ensure that firms comply with the restrictions we are applying, having regard to their responsibilities under the senior managers and certification regime (SMCR), which applies to most authorised firms from 9 December 2019.

The desirability of publishing information relating to persons

12. We do not think our rules will impact this.

The principle that we should exercise of our functions as transparently as possible

13. We have set out in this statement a full explanation of the rationale for our intervention and described the nature of the rules we are applying. We also welcome any comments on our measures, although this is not a consultation.

The general principle that consumers should take responsibility for their decisions

14. The measures provide a proportionate balance between consumer protection and allowing well-informed or wealthy retail investors to take risks commensurate with their expertise or capacity to bear losses. We do not think the complexity and risks from speculative illiquid securities makes them appropriate for mass-marketing and think such products will only be suitable for a limited subset of retail investors.
15. Where promotions are communicated to eligible retail investors, the additional disclosures required within promotions should ensure sufficient information is available. This will allow investors to make an informed investment decision or recognise the need to seek professional advice before transacting.

Expected effect on mutual societies

16. We do not expect these measures to have any effect on mutual societies.

Legislative and Regulatory Reform Act 2006 (LRRRA)

17. We are required under the Legislative and Regulatory Reform Act 2006 (LRRRA) to have regard to the principles in the LRRRA and to the Regulators' Compliance Code when determining general policies and principles and giving general guidance (but not when exercising other legislative functions). We consider that our proposal is:
 - Transparent: as set out above.
 - Accountable: in making the restrictions as temporary product intervention rules, we are making use of our powers under s137D and s138M of FSMA, and we are following the process set out in the [policy statement on the use of temporary product intervention rules](#). We will use the future consultation paper to seek feedback on whether to make these or similar rules permanent. The temporary product intervention rule will last for a maximum of 12 months.
 - Proportionate: as set out above.
 - Consistent: our approach would apply in a consistent manner to all firms considering marketing or approving promotions in relation to speculative illiquid securities targeting retail clients.
 - Targeted only at cases in which action is needed: we consider there is significant need for the introduction of these measures, which are targeted at high-risk speculative illiquid securities promoted to retail clients.

Annex 2 Abbreviations used in this paper

COBS	Conduct of Business Sourcebook
CP	Consultation paper
EU	European Union
FPO	Financial Promotions Order 2001
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
HMRC	Her Majesty's Revenue and Customs
HNW	High net worth
HRI s	High risk investments
ISA	Individual Savings Accounts
LCF	London Capital & Finance
MiFID II	The Markets in Financial Instruments Directive II
NMPI	Non-mainstream pooled investments
NRRS	Non-readily realisable securities
NTDS	Non-transferable debt securities
RAO	Regulated Activities Order 2001
SIPP	Self-invested personal pension
SPV	Special purpose vehicle
UCIS	Unauthorised collective investment schemes

Appendix 1 Made rules (legal instrument)

**CONDUCT OF BUSINESS (SPECULATIVE ILLIQUID SECURITIES)
INSTRUMENT 2019**

Powers exercised

A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

- (1) section 137A (The FCA’s general rules);
- (2) section 137D (FCA general rules: product intervention);
- (3) section 137T (General supplementary powers);
- (4) section 138M (Consultation: exemptions for temporary product intervention rules); and
- (5) section 139A (1) and (5) (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. Part 1 of Annex A and Part 1 of Annex B to this instrument come into force on 1 January 2020.

D. Part 2 of Annex A and Part 2 of Annex B to this instrument come into force on 31 December 2020.

Amendments to the Handbook

E. The Glossary of definitions is amended in accordance with Annex A to this instrument.

F. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

G. This instrument may be cited as the Conduct of Business (Speculative Illiquid Securities) Instrument 2019.

By order of the Board
21 November 2019

Annex A

Amendments to the Glossary of definitions

Part 1: Comes into force on 1 January 2020

Insert the following new definitions into the appropriate alphabetical positions. The text is not underlined.

- | | |
|-----------------------------------|---|
| <i>income generating property</i> | <p>a single property or multiple properties within a single development which:</p> <ol style="list-style-type: none"> (1) is actually used, or is intended to be used, for residential or commercial purposes; (2) is located in the <i>United Kingdom</i>; (3) is available for occupancy or occupied by <i>persons</i> who have no relationship with the <i>directors</i> of the <i>property holding vehicle</i> and who pay rent at a commercial rate; and (4) has been valued by an independent valuer: <ol style="list-style-type: none"> (a) who is a member of the Royal Institute for Chartered Surveyors; and/or (b) in accordance with the RICS Valuation Standards (The Red Book). |
| <i>property holding vehicle</i> | <p>a <i>body corporate</i> which:</p> <ol style="list-style-type: none"> (1) is the legal or beneficial owner of an <i>income generating property</i>; (2) issues <i>debentures</i> which have a fixed maturity date; (3) issues <i>debentures</i> in a sum which does not exceed the value of the <i>income generating property</i> owned; (4) issues only one tranche of <i>debentures</i>; (5) is only engaged with the holding of <i>income generating property</i> and associated activities including the collection of rent or other income from the <i>income generating property</i> and appointing a manager to maintain the <i>income generating property</i>; and (6) does not enter into any loan agreement whether as the borrower or lender. |
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speculative illiquid security a *debenture* or *preference share* which meets the requirements in COBS 4.14.17R.

Part 2: Comes into force on 31 December 2020

Delete the following definitions. The text is not shown struck through.

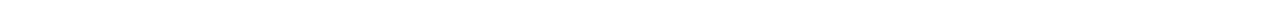
income generating property a single property or multiple properties within a single development which meet the following conditions:

- (1) is actually used, or is intended to be used, for residential or commercial purposes;
- (2) is located in the *United Kingdom*;
- (3) is available for occupancy or occupied by *persons* who have no relationship with the *directors* of the *property holding vehicle* and who pay rent at a commercial rate; and
- (4) has been valued by an independent valuer:
 - (a) who is a member of the Royal Institute for Chartered Surveyors; and/or
 - (b) in accordance with the RICS Valuation Standards (The Red Book).

property holding vehicle a *body corporate* which:

- (1) is the legal or beneficial owner of an *income generating property*;
- (2) issues *debentures* which have a fixed maturity date;
- (3) issues *debentures* in a sum which does not exceed the value of the *income generating property* owned;
- (4) issues only one tranche of *debentures*;
- (5) is only engaged with the holding of *income generating property* and associated activities including the collection of rent or other income from the *income generating property* and appointing a manager to maintain the *income generating property*; and
- (6) does not enter into any loan agreement whether as the borrower or lender.

speculative illiquid security a *debenture* or *preference share* which meets the requirements in *COBS* 4.14.17R.



Annex B

Amendments to the Conduct of Business sourcebook (COBS)

Part 1: Comes into force on 1 January 2020

In this Annex, underlining indicates new text, unless otherwise stated.

- 4** **Communicating with clients, including financial promotions**
- ...
- 4.7** **Direct offer financial promotions**
- ...
- 4.7.11 G ...
- 4.7.11A G Firms are reminded of the restrictions on financial promotions in relation to speculative illiquid securities in COBS 4.14.
- ...
- 9** **Suitability (including basic advice) (other than MiFID and insurance-based investment products)**
- ...
- 9.3** **Guidance on assessing suitability**
- ...
- 9.3.5 G (1) ...
- (g) speculative illiquid securities are subject to a restriction on financial promotions (see COBS 4.14).
- ...
- 9A** **Suitability (MiFID and insurance-based investment products provisions)**
- ...
- 9A.2** **Assessing suitability: the obligations**
- ...

Investments subject to restrictions on retail distribution: MiFID business and insurance-based investment products

- 9A.2.22 G (1) ...
- (d) *contingent convertible instruments* and *CoCo funds* are subject to a restriction on sales and promotions (see *COBS 22.3*);
- (e) *speculative illiquid securities* are subject to a restriction on *financial promotions* (see *COBS 4.14*).

Insert the following new section, COBS 4.14, after COBS 4.13 (UCITS). The text is not underlined.

4.14 Restrictions on the promotion of speculative illiquid securities to retail clients

Application and purpose

- 4.14.1 G (1) This section contains *temporary product intervention rules* and is intended to ensure that *financial promotions* relating to *speculative illiquid securities* are not *communicated* to ordinary retail investors.
- (2) The *rules* in this section therefore restrict *firms approving or communicating financial promotions* in relation to *speculative illiquid securities* which are addressed to or disseminated in such a way that they are likely to be received by a *retail client*, subject to certain exemptions.
- (3) The *rules* also ensure *financial promotions* contain prominent information on key risks, costs and charges related to the *speculative illiquid security*.
- (4) The *rules* reflect the often complex and high-risk nature of *speculative illiquid securities*.
- (5) The definition of *speculative illiquid security* can be found in *COBS 4.14.17R*.
- (6) The *temporary product intervention rules* in this section will cease to have effect on 31 December 2020.

Restriction on the promotion of speculative illiquid securities to retail clients

- 4.14.2 R (1) A *firm* must not *communicate* or *approve a financial promotion* in relation to a *speculative illiquid security* where that *financial promotion* is addressed to or disseminated in such a way that it is likely to be received by a *retail client*.

- (2) The restriction in (1) is subject to *COBS* 4.14.3R.

Exemptions from the restrictions on the promotion of speculative illiquid securities

- 4.14.3 R (1) The restriction in *COBS* 4.14.2R does not apply if the *financial promotion* falls within an exemption in the table in (4) below.
- (2) Where the middle column in the table in (4) refers to promotion to a category of *person*, this means that the *financial promotion*:
- (a) is made only to recipients who the *firm* has taken reasonable steps to establish are *persons* in that category; or
- (b) is directed at recipients in a way that may reasonably be regarded as designed to reduce, so far as possible, the risk of acquisition of a *speculative illiquid security* by *persons* who are not in that category.
- (3) A *firm* may rely on more than one exemption in relation to the same *financial promotion*.

(4)

Title of exemption	Promotion to:	Promotion of speculative illiquid security which is:
1. Certified high net worth investor	An individual who meets the requirements set out in <i>COBS</i> 4.14.14R or a <i>person</i> (or <i>persons</i>) legally empowered to make investment decisions on behalf of such an individual.	Any <i>speculative illiquid security</i> the <i>firm</i> considers is likely to be suitable for that individual, based on a preliminary assessment of the <i>client's</i> profile and objectives. [See <i>COBS</i> 4.14.4G]
2. Certified sophisticated investor	An individual who meets the requirements set out in <i>COBS</i> 4.14.15R, including an individual who is legally empowered (solely or jointly with others) to make investment decisions on behalf of another <i>person</i> who is the <i>firm's client</i> .	Any <i>speculative illiquid security</i> .

3. Self-certified sophisticated investor	An individual who meets the requirements set out in COBS 4.14.16R including an individual who is legally empowered (solely or jointly with others) to make investment decisions on behalf of another <i>person</i> who is the <i>firm's client</i> .	Any <i>speculative illiquid security</i> the <i>firm</i> considers is likely to be suitable for that individual, based on a preliminary assessment of the <i>client's</i> profile and objectives. [See COBS 14.14.4G].
4. <i>Excluded communications</i>	Any <i>person</i> .	Any <i>speculative illiquid security</i> , provided the <i>financial promotion</i> is an <i>excluded communication</i> .

Preliminary assessment of suitability

- 4.14.4 G (1) A *firm* which wishes to rely on exemptions 1 (certified high net worth investor) or 3 (self-certified sophisticated investor) as provided under COBS 4.14.3R(4), should note that these exemptions require a preliminary assessment of suitability before promotion of the *speculative illiquid security* to *clients* (in addition to other requirements).
- (2) There is no duty to communicate the preliminary assessment of suitability to the *client*. If the *firm* does so, it must not do so in a way that amounts to making a *personal recommendation* unless it complies with the rules in COBS 9 or 9A (as applicable) on suitability.
- (3) The requirement for a preliminary assessment of suitability does not extend to a full suitability assessment, unless advice is being offered in relation to the *speculative illiquid security* being promoted, in which case the requirements in COBS 9 or 9A apply (as applicable). However, it requires that the *firm* takes reasonable steps to acquaint itself with the *client's* profile and objectives to ascertain whether the *speculative illiquid security* under contemplation is likely to be suitable for that *client*. The *firm* should not promote the *speculative illiquid security* to the *client* if it does not consider it likely to be suitable for that *client* following such preliminary assessment.

Requirements governing the form and content of financial promotions for speculative illiquid securities

- 4.14.5 R Subject to *COBS* 4.14.2R and *COBS* 4.14.3R, a *firm* must not *communicate* or *approve* a *financial promotion* which relates to a *speculative illiquid security* unless it contains:
- (1) a risk warning that complies with *COBS* 4.14.6R;
 - (2) if applicable, the date on which the *financial promotion* was *approved*; and
 - (3) statements that comply with *COBS* 4.14.9R disclosing all costs, charges and commission.
- 4.14.6 R (1) For the purposes of *COBS* 4.14.5R(1), and subject to *COBS* 4.14.6R(2) and *COBS* 4.14.6R(3), the *financial promotion* must contain the following risk warning:
- You could lose all of your money invested in this product.
This is a high-risk investment and is much riskier than a savings account**
- (2) Where the *financial promotion* contains a reference to an *innovative finance ISA*, the risk warning is as follows:
- You could lose all of your money invested in this product
This is a high-risk investment and is much riskier than a savings account
ISA eligibility does not guarantee returns or protect you from losses**
- (3) Where the number of characters contained in the risk warnings in this *rule* exceeds the character limit permitted by a third-party marketing provider, the following risk warning must be used:
- You could lose all of your money invested in this product**
- (4) Where the *financial promotion* does not appear on a website or mobile application, the risk warning must be provided in a *durable medium*.
- 4.14.7 R The relevant risk warning in *COBS* 4.14.6R must be:
- (1) prominent;
 - (2) contained within its own border and with bold text as indicated;
 - (3) if provided on a website or via a mobile application, statically fixed and visible at the top of the screen even when the *retail client* scrolls up or down the webpage; and
-

- (4) if provided on a website, included on each linked webpage on the website.
- 4.14.8 G The relevant risk warning, including the font size, should be:
- (1) proportionate to the *financial promotion*, taking into account the content, size and orientation of the *financial promotion* as a whole; and
 - (2) published so that it is clearly legible against a neutral background.
- 4.14.9 R For the purposes of *COBS* 4.14.5R(3) the *financial promotion* must contain:
- (1) a statement which expresses as a percentage the total amount of the capital raised by the issue of the *speculative illiquid security* which will be paid out in costs, fees, charges and commissions and other expenses to any third party;
 - (2) a statement which expresses as a cash sum the percentage referred to in (1) above; and
 - (3) in addition to the statements in (1) and (2) above, a statement which provides a breakdown of the actual or potential expenditure to be paid out of an investor's capital and details of the third party (or parties) who will receive it.
- 4.14.10 G
- (1) There is an illustration of how a *firm* should comply with *COBS* 4.14.9R(2) in (2) below.
 - (2) Where a firm pays 30% of the total amount of capital raised by the issue of *speculative illiquid securities* towards costs, fees, charges and commissions and other expenses to any third party, the statement should say: "For every £100 you invest, £30 will be paid to third parties to meet costs, fees, charges and commissions."
- 4.14.11 R The statements providing the percentage figure in *COBS* 4.14.9R(1) and the cash sum in *COBS* 4.14.9R(2) must be:
- (1) prominent;
 - (2) contained together within their own border and with bold text;
 - (3) immediately follow the most prominent reference to the expected return on the *speculative illiquid security*; and
 - (4) published so that they are clearly legible against a neutral background.
- 4.14.12 G The statement providing the breakdown of expenditure in *COBS* 4.14.9R(3) should be included in the *financial promotion* in a clear and prominent way.
-

- 4.14.13 G The purpose of the statements required by *COBS* 4.14.9R is to enable an investor to consider the proportion of capital raised by an issue of *speculative illiquid securities* that will not be invested. This information should help the investor to assess the risk that the *issuer* will be unable to pay any advertised interest payments or otherwise to repay the investor's capital at maturity.

Definitions of certified high net worth and sophisticated investors

- 4.14.14 R A high net worth investor is an individual who has signed, within the period of twelve *months* ending on the day on which the communication is made, a statement in the following terms:

“HIGH NET WORTH INVESTOR STATEMENT

I make this statement so that I can receive promotional communications which are exempt from the restriction on promotion of speculative illiquid securities. The exemption relates to high net worth investors and I declare that I qualify as such because at least one of the following applies to me:

I had, throughout the financial year immediately preceding the date below, an annual **income** to the value of **£100,000 or more**. Annual income for these purposes does not include money withdrawn from my pension savings (except where the withdrawals are used directly for income in retirement).

I held throughout the financial year immediately preceding the date below, **net assets** to the value of **£250,000 or more**. Net assets for these purposes do **not** include:

- (a) the property which is my primary residence or any money raised through a loan secured on that property; or
- (b) any rights of mine under a qualifying contract of insurance; or
- (c) any benefits (in the form of pensions or otherwise) which are payable on the termination of my service or on my death or retirement and to which I am (or my dependants are), or may be, entitled; or
- (d) any withdrawals from my pension savings (except where the withdrawals are used directly for income in retirement).

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on speculative illiquid securities.

Signature:

Date:

4.14.15 R A certified sophisticated investor is an individual who:

(1) has a written certificate signed within the last 36 *months* by a *firm* confirming he has been assessed by that *firm* as sufficiently knowledgeable to understand the risks associated with engaging in investment activity in *speculative illiquid securities*; and

(2) has signed, within the period of twelve *months* ending with the day on which the communication is made, a statement in the following terms:

“SOPHISTICATED INVESTOR STATEMENT

I make this statement so that I can receive promotional communications which are exempt from the restriction on promotion of speculative illiquid securities. The exemption relates to certified sophisticated investors and I declare that I qualify as such.

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on speculative illiquid securities.

Signature:

Date: ”

4.14.16 R A self-certified sophisticated investor is an individual who has signed, within the period of twelve *months* ending with the day on which the communication is made, a statement in the following terms:

“I declare that I am a self-certified sophisticated investor for the purposes of the restriction on promotion of speculative illiquid securities. I understand that this means:

- (i) I can receive promotional communications made by a person who is authorised by the Financial Conduct Authority which relate to investment activity in speculative illiquid securities;
- (ii) the investments to which the promotions will relate may expose me to a significant risk of losing all of the property invested.

I am a self-certified sophisticated investor because at least one of the following applies:

(a) I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;

(b) I have made more than one investment in an unlisted company in the two years prior to the date below;

(c) I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;

(d) I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £1 million.

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me seek advice from someone who specialises in advising on speculative illiquid securities.

Signature:

Date: ”

Definition of speculative illiquid security

- 4.14.17 R For the purposes of this section, and subject to *COBS* 4.14.18R, a *speculative illiquid security* is a *debenture* or *preference share* which:
- (1) has a denomination or minimum investment of £100,000 or less; and
 - (2) has been issued, or is to be issued, in circumstances where the *issuer* or a member of the *issuer's group* uses, will use or purports to use some or all of the proceeds of the issue directly or indirectly for one or more of the following:
 - (a) the provision of loans or finance to any *person* other than a member of the *issuer's group*;
 - (b) *buying* or acquiring *investments* (whether they are to be held directly or indirectly);
 - (c) *buying* property or an interest in property (whether it is to be held directly or indirectly);
 - (d) paying for or funding the construction of property.
- 4.14.18 R A *debenture* or *preference share* is not a *speculative illiquid security* where one or more of the exemptions in (1), (3) or (4) below applies.
- (1) This exemption applies where:
 - (a) the *issuer* or a member of the *issuer's group* uses or purports to use the proceeds of the issue for the purpose of the activities in *COBS* 4.14.17R(2)(c) or (d) (*buying* or constructing property); and
-

(b) the relevant property is or will be used by the *issuer* or a member of the *issuer's group* for a general commercial or industrial purpose which it carries on.

(2) The exemption in (1) will not apply if the ability of the *issuer* to pay in relation to the *debenture* or *preference share*:

(a) any *coupon* or other income; and/or

(b) capital at maturity

is wholly or predominantly linked to, contingent on, sensitive to or dependent on a return generated as a result of the matters referred to in *COBS* 4.14.17R(2)(c) or (d).

(3) This exemption applies where the *debenture* or *preference share* is:

(a) issued, or to be issued, by a *credit institution*;

(b) a *non-mainstream pooled investment*;

(c) a *readily realisable security*; or

(d) a *P2P agreement*.

(4) This exemption applies where the *issuer* is a *property holding vehicle*.

4.14.19 R (1) For the purposes of *COBS* 4.14.18R(1)(b), a general commercial or industrial purpose includes the following:

(a) a commercial activity, involving the purchase, sale and/or exchange of goods or commodities and/or the supply of services (other than property development or construction services); or

(b) an industrial activity involving the production of goods; or

(c) a combination of (a) and (b).

(2) For the purposes of *COBS* 4.14.18R(1)(b), a general commercial or industrial purpose does not include investment to generate a pooled return.

Guidance on general commercial or industrial purpose

4.14.20 G (1) *COBS* 4.14.17R provides that a *debenture* or *preference share* will fall within the definition of a *speculative illiquid security* where the proceeds of the issue are to be used by the *issuer* or a member of the

issuer's group to fund various activities including the *buying* or construction of property.

- (2) However, *COBS* 4.14.18R(1) provides an exemption in cases where the property which is bought or constructed is or will be used by the *issuer* or a member of the *issuer's group* for a general commercial or industrial purpose which it carries on.
 - (3) General commercial or industrial purpose is defined in *COBS* 4.14.19R.
 - (4) The effect of the exemption in *COBS* 4.14.18R(1) is that a *debenture* or *preference share* will not be a *speculative illiquid security* where the proceeds of the issue are used by the *issuer* or a member of the *issuer's group* to buy or construct a property which is used by the *issuer* or *group* member for the purposes of its own commercial or industrial activities.
 - (5) For instance:
 - (a) where a retailer issues a *debenture* or *preference share* and uses the proceeds to build a shop, the *debenture* or *preference share* will benefit from the exemption because the property is used by the retailer for its own commercial activities (in this case, the sale of goods);
 - (b) where a property developer issues a *debenture* or *preference share* and uses the proceeds to fund the costs of a property development or construction of property, which is intended to be sold, it will not benefit from the exemption because the development will not be used by the developer itself, and property development and construction services are excluded from the definition of general commercial or industrial purpose.
 - (c) where a company issues a *debenture* or *preference share* to fund the costs of constructing a power station which the company intends to operate itself with a view to selling the electricity it produces, the *debenture* or *preference share* will benefit from the exemption (unless *COBS* 4.14.18R(2) applies). That is because it will use the property for its own commercial or industrial activities (generating electricity). However, *firms* should also consider *COBS* 4.14.18R(2) and the guidance in (6) below.
 - (6) *COBS* 4.14.18R(2) provides that the general commercial or industrial purposes exemption does not apply where the ability of the issuer to pay the *coupon* or other income or to repay capital on maturity in relation to the *debenture* or *preference share* is wholly or predominantly linked to, contingent on, sensitive to or dependent on
-

the return generated as a result of the matters referred to in *COBS* 4.14.17R(2)(c) or (d) (*buying* or constructing property).

- (7) The effect of the above is that where a company issues a *debenture* or *preference share* for the purpose of funding the construction of a particular project and the company's ability to pay interest on the *debenture* or *preference share* or repay capital depends on the success of that project, the exemption in *COBS* 4.14.18R(1) will not apply. In those circumstances, the *debenture* or *preference share* will be a *speculative illiquid security* unless one of the other exemptions in *COBS* 4.14.18R applies.

Part 2: Comes into force on 31 December 2020

4 Communicating with clients, including financial promotions

...

4.7 Direct offer financial promotions

...

4.7.11 G ...

4.7.11A G ~~*Firms are reminded of the restrictions on financial promotions in relation to speculative illiquid securities in COBS 4.14. [deleted]*~~

...

COBS 4.14 is deleted in its entirety. The deleted text is not shown but the section is marked deleted, as shown below.

4.14 Restrictions on the promotion of speculative illiquid securities to retail clients ~~[deleted]~~

Amend the following as shown.

9 Suitability (including basic advice) (other than MiFID and insurance-based investment products)

...

9.3 Guidance on assessing suitability

...

9.3.5 G (1) ...

- (g) ~~*speculative illiquid securities* are subject to a restriction on *financial promotions* (see *COBS 4.14*). [deleted]~~

...

9A Suitability (MiFID and insurance-based investment products provisions)

...

9A.2 Assessing suitability: the obligations

...

Investments subject to restrictions on retail distribution: MiFID business and insurance-based investment products

9A.2.22 G (1) ...

- (d) *contingent convertible instruments* and *CoCo funds* are subject to a restriction on sales and promotions (see *COBS 22.3*);
 - (e) ~~*speculative illiquid securities* are subject to a restriction on *financial promotions* (see *COBS 4.14*). [deleted]~~
-

Disclaimer

We have developed the policy in this Temporary Product Intervention Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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