FINANCIAL CONDUCT AUTHORITY

Perimeter Report

2020/21

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Contents

Nikhil Rathi, Chief Executive

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Chief Executive's message

In our recent Business Plan, my first since becoming Chief Executive, we set out our key priorities for the year ahead and how we are transforming the FCA to face the future. We explained how we are building a culture that embraces risk, is more inquisitive, and acts decisively to tackle harmful behaviour as soon as we suspect it. Central to this is being proactive at the boundaries of our perimeter.

Our 'perimeter', which is decided by the Government and Parliament, determines what we do and do not regulate. It is a perennial challenge. The sophisticated nature of financial services in the UK means that it is not defined by a single piece of legislation or regulatory approach, and can be complex for firms and consumers to understand.

Profound forces are reshaping financial services- the transition to a net zero economy, Brexit, rapid technological change and the growing digitalisation of financial services. These affect how people access and use financial services, as well as the structure of global wholesale markets. The impact of these changes, such as the emergence of new products and services or the emergence of new risks, can

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sometimes mean that the perimeter needs to be updated. Any changes to the perimeter require new legislation or amendments to existing legislation.

As the FCA improves our technology and capabilities, we will be able to identify and make better, faster judgements about harm. This involves gathering and analysing data both from activities within the perimeter and, where we can, those outside it.

Even where we don't have powers, we don't turn a blind eye. We provide information and warnings for consumers, alerts about unauthorised firms and individuals and carry out targeted campaigns. Where we cannot take direct action, we share concerns with our partners so they can act where they are able to. This is an ongoing process, working closely with fellow regulators, law enforcement agencies, government departments and wider stakeholders.

Our remit is large and it's growing. While our major investment in our technologies and capabilities will help us act more effectively, we will still need to make judgements to focus our efforts, and need to ensure that any significant expansion to our remit is appropriately planned and resourced so that we can act effectively.

I am therefore pleased that the Government and the FCA are working together to assess the state of our perimeter each year. Key to this assessment is our perimeter report. This annual report helps to clarify some of our perimeter's complexities, explain more about what we are doing in response, and highlight where we see gaps in legislation and the potential for harm – especially where these are linked with our business plan priorities.

The Economic Secretary to the Treasury (EST) and I will discuss the content of this report and steps we can take later this year. The results of our discussion will be published by the Government, to ensure transparency around the actions we are taking on the perimeter.

Ultimately, our aim is to act assertively to give consumers greater confidence in financial services and ensure that firms are clear about their obligations.

Nikhil Rathi, Chief Executive

Examples of actions we take

We have worked with HMT to amend the perimeter

Funeral plans – The pre-paid funeral plans market comes under regulation from **29 July 2022**.

We are working with HMT to support their consultations on possible perimeter changes

Cryptoassets – Our research found that **4.4% of UK adults** (2.3 million people) **own cryptoassets.**

We provide information and warnings for consumers

Our enhanced **FS Register**, which up to **7.5 million** people view every year.

We call out where further regulatory change is needed to prevent harm

Online harms – We received **30,000 reports** of potential scams in April 2020-March 2021.

We are taking supervisory action to mitigate harm

Appointed Representatives – We are **carrying out targeted supervision** to reduce the most significant risks, and are introducing fees which will raise £7.2 million per year to help fund our work.

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The wider context

The environment in which we operate

We are an organisation with immense responsibility. We act as the regulator of around 51,000 financial services firms and financial markets in the UK, and the prudential supervisor for around 49,000 firms.

Our actions have a profound effect on people's daily lives. For example, almost 9 in 10 adults have at least 1 insurance product, and 70% of people who haven't yet retired have a pension in accumulation.

Our actions also have a profound effect on the UK economy. UK financial services employ over 1.1 million people and contribute around £75.6 billion in tax to the UK economy.

The last 18 months have had a significant impact on financial services and on people's lives. Our Covid-19 panel survey, conducted in October 2020, found that 3 in 8 adults saw their financial situation worsen because of coronavirus.

Through the pandemic, we acted with confidence, energy and effectiveness to stand up for consumers and businesses all over the UK. We issued guidance on payment deferrals- between March and October 2020, 1 in 6 (17%) mortgage holders (3.2m) told us they took up a mortgage payment deferral. We obtained legal clarity from the Supreme Court regarding business interruption insurance- thousands of policyholders have now had their claims paid (see Chapter 8). And at the same time, the global markets we oversee proved resilient at a time of unique stress and volatility – laying the foundations for record capital raising to support economic recovery.

We continue to look to the future. Profound forces are reshaping financial services- the transition to a net zero economy, Brexit, rapid technological change and the growing digitalisation of financial services. These affect how people access and use financial services, as well as the structure of global wholesale markets. We continue to prepare for and meet these challenges.

Our objectives and our role

Our strategic objective is to ensure that financial markets function well. We aim to provide public value by advancing our 3 operational objectives:

- to secure an appropriate degree of protection for consumers
- to protect and enhance the integrity of the UK financial system
- to promote competition in the interests of consumers

Our role focuses on 2 main themes, which stem from our objectives:

- We use our authority and influence to improve overall market outcomes in financial services. We enable competition and innovation to prosper in the interest of consumers and ensure market integrity.
- We stop and prevent serious misconduct that leads to harm. We enforce our rules to maintain trust and integrity in markets. We aim to act quickly and assertively to stop immediate harm and impose sanctions to punish offenders and deter others.

These objectives and our role are the lens through which we view issues, both within and outside of our perimeter. As an organisation with a large and growing set of responsibilities, we need to make complex trade-offs to focus our work where we can have the most impact.

Our business plan priorities and links with our perimeter

Our 2021/22 business plan sets out our current priorities, and our commitment to achieving measurable outcomes across these priorities. Many of these priorities are linked with our perimeter.

One of our key consumer priorities is enabling consumers to make effective financial decisions. This includes ensuring that rules on financial promotions are fit for purpose, as we outline in Chapter 6 ('Consumer investments').

Another consumer priority is ensuring that consumer credit markets work well. In Chapter 8 we discuss aspects of our perimeter linked to lending, including our work to support the Treasury in bringing Deferred Payment Credit (unregulated buy-now pay-later products) into our perimeter.

Our wholesale markets priorities include our work on the Appointed Representatives regime. Chapter 5 ('Firm business models') includes an update on this work.

A key cross-market priority is taking action to tackle fraud. We discuss in Chapter 4 action we are taking to prevent such harm where it is linked to the perimeter. Chapter 7 ('Technological changes') includes details on how we believe the Government's Online Safety Bill (OSB) could be altered to help protect consumers from illegal online scams.

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The FCA's perimeter and the potential for harm

What we regulate

The UK financial services industry carries out a wide range of activities for UK and international clients. Some of this activity requires FCA regulation and some of it does not. When we do regulate something, we say it is inside our 'perimeter'. The Government and Parliament set the limits of our perimeter through legislation.

The activities we regulate are primarily set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order (the RAO). The RAO contains the financial services activities, known as 'regulated activities', that require our authorisation before firms or individuals can carry them out. The RAO also sets out some regulated activities, such as arranging, advising and dealing, which require authorisation if they involve particular types of financial products, such as shares, debt instruments, fund units and derivatives.

Firms that we authorise for regulated activities can also undertake unregulated activities. These can include unregulated financial services activities. We have more limited powers over these unregulated activities. We explain these limited powers further in Chapter 4.

The RAO is also key to determining the perimeter of the Prudential Regulation Authority (the PRA), which we do not address in this report. It is also largely the basis on which we can make decisions on what activities are protected by the Financial Services Compensation Scheme (FSCS) and what activities are in the compulsory jurisdiction of the Financial Ombudsman Service ('Ombudsman Service').

The Government and Parliament have historically taken into account a range of factors when setting our perimeter. These include the activity and its potential for harm, and who is the end customer of the activity. A financial services activity is more likely to be within our perimeter if it is provided to the general public rather than to businesses or high net worth people. This is because they are seen to need more protection. For example, most lending to consumers is a regulated activity, while almost all lending to businesses is not (see our section on 'SME lending' in Chapter 8).

The RAO regime governing 'regulated activity' is not the only basis for our regulatory responsibilities and powers. Other UK and onshored EU legislation helps to define our perimeter, including:

- We act as the UK's listing authority. The listing regime applies to firms whether they are authorised under FSMA to conduct regulated activities or not.
- The market abuse regime applies to the behaviour of any person, whether or not they are authorised by us.
- The Payment Services Regulations set out a regime (separate to FSMA) for registering or authorising payment service providers and give us a different set of responsibilities and powers for these providers.
- The Money Laundering Regulations 2017 (MLRs) give us specific responsibilities beyond those we have for authorised firms conducting regulated activities.
- We have concurrent competition powers shared by the Competition and Markets Authority (CMA) and other regulators. All these regulators can use these powers to address 'financial services activity' rather than being limited to the regulated activities in the RAO.
- Some provisions in the Consumer Credit Act 1974 (CCA) can apply in principle to non-authorised persons or non-regulated firms. For example, provisions giving the courts powers for unfair credit relationships, which can also apply to non-regulated credit agreements.
- We can use our powers under general consumer protection legislation in respect to both regulated and unregulated activities.

Our powers and responsibilities regarding activities that fall under the above pieces of legislation often differ from our powers and responsibilities over regulated activities specified in the RAO. This means that our powers to act if we see harm are different depending on which legislative regime or regimes a firm or activity falls under. For example, if a firm is only registered with us under the MLRs our powers are focused on the prevention of money laundering, and are much more limited than they are for authorised firms conducting regulated activities set out in the RAO.

This description is necessarily a simplified version of the perimeter. Given that the boundary between what we do and do not regulate is complex, there are a wide range of exclusions and exemptions we do not cover here.

In some cases, the broader definitions which can create complexity at the perimeter can bring benefits. For example, the wide definition of a Collective Investment Scheme (CIS) can give us more opportunities to act where we see misconduct, particularly where we may be the only agency with the powers to prevent harm. However, in other cases, the perimeter's complexity can sometimes result in harm. We discuss below how harm linked to the perimeter may occur.

Future legislative changes

The Government is adapting the UK's framework for financial services regulation, following the UK's withdrawal from the EU and in line with the Chancellor's vision for financial services. The Future Regulatory Framework Review proposes transferring some rule-making responsibilities previously done by the EU to regulators like the FCA and strengthening accountability, scrutiny and transparency. In addition, the Government has recently consulted on potential reforms to competition and consumer policy.

Harm linked to the perimeter

The perimeter's complexity and changes to financial services

Whether an activity is within our perimeter can be complex for firms and consumers to understand. It is made more complex by the development of new products and services which were not envisioned when a piece of legislation was written. Or, when the way longstanding financial products or services are used or delivered, or their context, changes in ways that were not foreseen when the relevant legislation was written.

There are many factors driving these changes to financial services. As set out in our Business Plan, these include rapid technological change (including the use of 'big data' and machine learning), the increased digitalisation of financial services, the pandemic, Brexit and the drive to a greener economy.

Why harm can occur

In some instances, the development of products and services outside our perimeter, or confusion about where our perimeter sits and what exactly it means, can result in harm.

Firstly, harm can occur due to the development of new products, activities or services that sit outside our perimeter and that are also harmful. This is because these will generally not be subject to our rules designed to prevent harm, and we have only limited powers to act when harm occurs outside our perimeter.

Secondly, consumers may suffer harm if they believe they are dealing with an authorised firm or individual carrying out a regulated activity when this is not the case. Or, if they believe they will be able to get redress through the Ombudsman Service or the FSCS when this is not the case. This is because some of these consumers may get a false sense of protection (the so called 'halo effect'), and may make riskier financial decisions as a result. They may also become more susceptible to fraud. Our research into consumer understanding, which we discuss in Chapter 4, will look at what consumers understand from the terms 'authorised' and 'regulated', and how this influences their decisions.

This harm could occur if an authorised or unauthorised firm carries out an unregulated activity and the consumer does not understand that this activity is not regulated- and in some cases, that the firm is also not authorised. Or, if the consumer does not understand that they are not able to access redress (eg through the Ombudsman Service or the FSCS) – especially where the firm in question is authorised.

This harm could also occur if an unauthorised person pretends to be authorised, or if an authorised person conducts a regulated activity without the relevant permission from us to do so. Both are illegal, and consumers are at more risk of harm because that firm or individual has not gone through our Authorisations gateway and so has avoided our scrutiny.

> Harm can occur due to the development of new products, activities or services that sit outside our perimeter and that are also harmful.

We know that consumers are often confused about what 'FCA authorised' means and what protections they have. They don't always understand the risks, their rights and their responsibilities, and where to go to for help. While there will always be a certain degree of complexity in the regulatory perimeter, we know there is more we can do to help. We outline steps we are taking in Chapter 4.

Redress

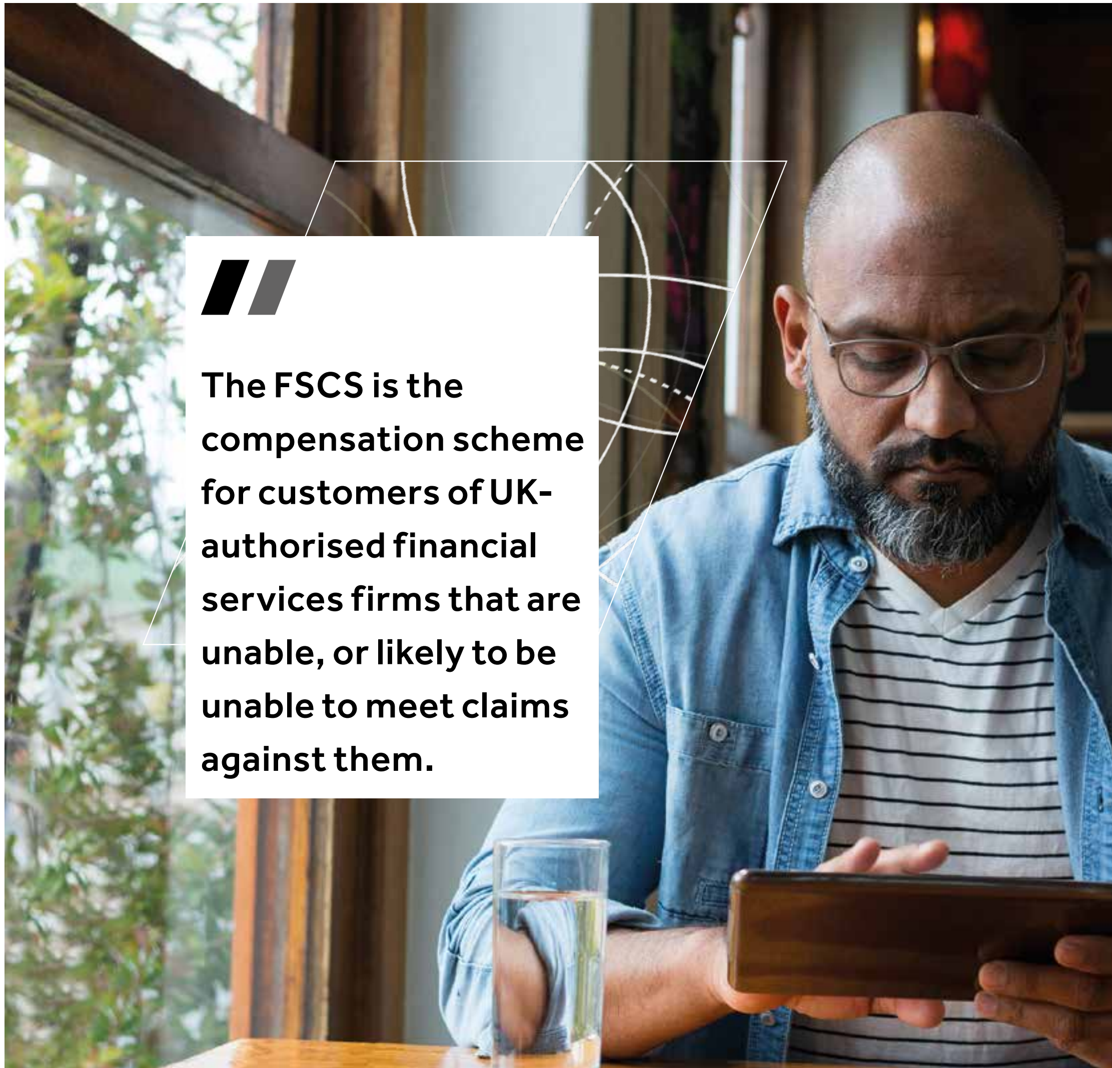
Consumers may be able to access redress by taking a complaint that a firm hasn't resolved to the Ombudsman Service, or potentially claiming from the FSCS if a firm fails. However, consumers cannot always use these routes to get redress. There are eligibility rules for referring complaints to the Ombudsman Service, and not all regulated activities are protected by the FSCS.

To help consumers understand how they may be able to access redress, we require most firms to provide customers with information on how they can make a complaint and on the Ombudsman Service (if the customer is eligible). Firms are generally also required to let their customers know when compensation might be available from the FSCS if the firm cannot meet its liabilities.

The Ombudsman Service's jurisdiction covers complaints against respondents (including firms) arising from their carrying on of regulated activities and other activities which are listed at DISP 2.3.1R within the FCA Handbook – for example, lending money secured by a charge on land. It also covers activities ancillary to these, including advice given in connection with them. There are limits on the amount of redress the Ombudsman Service can award.

The FSCS is the compensation scheme for customers of UK-authorised financial services firms that are unable, or likely to be unable to meet claims against them. FSCS cover applies to protected claims in connection with an activity which is regulated. But it does not apply to all regulated activities. For example, it does not cover all consumer credit activities. There are also limits to the amount of compensation the FSCS can pay, which are different from the Ombudsman Service's compensation limits.

In our Business Plan for 2021/22, we explained that we would review aspects of the compensation framework to ensure it remains appropriate, proportionate, and takes into account changes in the market and in our regulatory approach.



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Our approach to the perimeter

Our general approach to the perimeter

We take many steps to help reduce harm linked to our perimeter. This includes harm from unregulated activities, from firms or individuals carrying out regulated activities without authorisation or the correct permissions, or simply from general confusion about where the perimeter sits and what it means. For example, we:

- monitor and assess the potential for harm linked to the perimeter as part of the normal course of our regulatory activities
- support discussion about the perimeter amongst political stakeholders, and clearly highlight where we see gaps in the legislation and the potential for harm
- take action in some circumstances where we can to reduce harm outside our perimeter
- share our insights and information with our partner agencies
- issue warnings, run targeted campaigns, and work to improve consumers' understanding and enable them to make effective financial decisions
- analyse data and intelligence, and take action against firms or individuals who illegally carry out regulated activities.

We cannot stop all consumers from suffering harm. And, we do not always have the power to act. As in all our work, we prioritise issues where we can have the greatest possible impact. Our remit is large and growing, so we need to make complex trade-offs when deciding where to monitor or take action, to ensure we use our finite resources efficiently and effectively.

Whether or not consumers are dealing with an authorised person or a regulated activity, they will sometimes suffer loss. This could be because of the way the market performs and the risks consumers have taken, or because of dishonesty or misconduct by authorised or unauthorised persons.

Normal market losses, such as investment losses, are not generally covered but, in some cases, consumers may be able to go to the FSCS or the Ombudsman Service if an authorised firm or appointed representative was carrying on regulated activities without our permission.

Our powers to act against unregulated activities

Our powers to act against unregulated activities, whether conducted by an authorised or unauthorised firm, are limited. Where firms are conducting unregulated activities, our rules will generally not regulate the conduct between them and their customers. Depending on the nature of those involved in the relationship and the circumstances, other consumer protection legislation or other legal duties, such as fiduciary duties, may apply to the relationship.

Our powers to act against unauthorised firms conducting unregulated activities are extremely limited. We have some powers over FCA authorised firms when they conduct unregulated activities. However, these powers are generally much more limited than for firms' regulated activities. For example, our Principles for Businesses can be applied to unregulated activities in certain circumstances, such as ancillary activities. Similarly, we may be able to take action under the Senior Managers & Certification Regime (SM&CR) against individuals for unregulated activities.

> "We coordinate our enforcement of consumer protection legislation with the Competition and Markets Authority.

We can use our powers under general consumer protection legislation in respect to both regulated and unregulated activities.

In particular, we have powers under the Consumer Rights Act 2015 and the Unfair Terms in Consumer Contracts Regulations 1999 to take action if we consider a term in a consumer contract is likely to be unfair or insufficiently transparent. We can also use our powers as a designated enforcer under Part 8 of the Enterprise Act 2002 to enforce other consumer protection legislation such as the Consumer Protection from Unfair Trading Regulations 2008. This can help us to tackle unfair commercial practices, even where our rules do not apply.

We coordinate our enforcement of consumer protection legislation with the Competition and Markets Authority, and can agree we will lead on taking action for issues that fall outside the perimeter.

Where we might act against unregulated activities

Financial services markets are dynamic and always changing, and given our large and growing remit we need to prioritise where we take action. Also, as we outlined above, we have only limited powers to act against unregulated activities. So defining where and how we might act against harm caused by unregulated activities is not simple. This applies to both authorised and unauthorised firms carrying out unregulated activities.

However, we are more likely to act where the unregulated activity:

- is illegal or fraudulent
- has the potential to undermine confidence in the UK financial system
- is closely linked to, or may affect, a regulated activity

As well as taking direct action where we can against harm caused by unregulated activities, we take various additional steps to prevent harm caused by unregulated activities or otherwise linked to our perimeter. We outline these below.

> Financial services markets are dynamic and always changing, and given our large and growing remit we need to prioritise where we take action.

Other actions we take to monitor and reduce harm

We proactively take a variety of steps to monitor and reduce harm caused by unregulated activities or otherwise linked to our perimeter.

Working with our partner agencies

We work closely with our partner agencies, with the aim of preventing harm and supporting consumers if things go wrong. Our partner agencies include:

- bodies that provide consumer protection and guidance in financial services, such as the Ombudsman Service, the FSCS and the Money and Pensions Service (MaPS) who deliver free and impartial money, debt and pensions guidance to consumers through the MoneyHelper consumer website.
- other regulators and public bodies such as the Prudential Regulation Authority (PRA) and the Bank of England, the Payment Services Regulator (the PSR), the Competition and Markets Authority (CMA), the Equality and Human Rights Commission (EHRC), and the Pensions Regulator (TPR)
- other law enforcement agencies, such as the Serious Fraud Office (SFO), the National Crime Agency (NCA) and the National Economic Crime Centre (NECC)

We take a proactive approach to communicating and sharing information to prevent harm from happening or reduce it. This is particularly the case when our partners have the power to act and we don't, or when they are better placed to do so.

We aim to give consumers clarity where possible, and we collaborate on problems as and when they emerge. For example, we:

- are working with the Insolvency Service to protect consumers who need debt advice and ensuring co-ordinated regulation across the 2 organisations
- have created a 'consumer investment coordination group' with the FSCS, the Ombudsman Service and MaPS

Enabling consumers to make informed financial decisions

A key part of our work to prevent and to mitigate harm, including harm caused by activities we do not regulate, is our work to enable consumers to make informed financial decisions. As part of our routine work, we set and enforce standards for the information firms give to consumers. Additionally, we go beyond this to provide information and warnings for consumers, alerts about unauthorised firms and individuals and carry out targeted campaigns, such as ScamSmart. This includes highlighting concerns about scams, products or services that may take advantage of consumer confusion about what falls within our perimeter.

Significant actions we have taken, which help prevent harm caused by unregulated activities as well as regulated activities, include:

- Our ScamSmart campaign, which aims to educate and inform consumers about the warning signs across a range of scams. Our objective is to reduce the scope of opportunity for scammers. Our Consumer Harm Campaign builds on and supplements this work. In 2020/21, our ScamSmart high risk investment campaign drove over 150,000 visits to the ScamSmart site.
- Continuing to answer consumers' questions directly via our Contact Centre. In 2020/21, we answered 150,000 queries from consumers through this route. Recent improvements include updating our policies for answering consumers' questions about regulated firms undertaking non-regulated activities and FSCS protection. We have also established a direct transfer process for FSCS enquiries which enables staff to transfer calls directly to the FSCS.
- Redesigning our Financial Services Register to make it easier for people to use and understand. The FS Register, which up to 7.5 million people view every year, is a key source of information on the firms and key individuals involved in regulated activities. It can help users such as consumers avoid scams and better understand the consumer protections available. We launched the redesigned FS Register in July 2020, and continue to improve it. As of August 2021, it contains more than 900,000 entries made up of 386,000 firms (both active and inactive) and 555,000 individuals (both active and inactive).

Recent improvements to the FS Register

When we launched the new FS Register in July 2020 we designed it to be accessible for a wide range of user needs. It is optimised for mobile devices, reflecting the way an increasing proportion of users access our sites. It now provides clearer explanations of what the Register is for, and how to use it. There is a video guide for consumers and signposts to further checks they can make. The emphasis on 'authorisation' has been replaced by increased visibility of the permissions a firm holds, now displayed at the start of each relevant entry. We have simplified terminology, reflecting the clearer language we use when consumers call us. There is a prominent warning about making sure a firm has permissions for the regulated activities the consumer needs. We provide a link to MoneyHelper and an 'Individual prohibitions' list is prominently displayed.

In March 2021, supporting our objective to protect consumers and in response to the LCF review, we added an additional warning to make clear that some activities undertaken by a regulated firm may be unregulated and so not benefit from any protections.

As we outlined in Chapter 3, we know that consumers do not always understand what 'FCA authorised' means and what protections apply. To address this challenge, we will improve how we engage with consumers. We are carrying out research into consumer awareness and understanding of financial regulation and protections and how this influences their behaviour. For example, what consumers expect from the labels 'authorised' and 'regulated' by the FCA, or from FSCS and/or Ombudsman Service protection, and how their understanding influences their decisions. By better understanding consumers' beliefs, we can improve the information we give and how we give it to protect consumers from potential harm.

We are also reviewing our current approaches to consumer engagement and how we work with our partners to protect consumers. Our new approach will be data and evidence-led. By reviewing what we do now, we can better target our interventions to reach the right consumers, at the right time and with the right information. It will also help us to develop baseline metrics, which we can measure our progress against.

Alongside the review, we have committed to:

- Improve the information we publish for consumers. This will include what 'authorised and regulated by the FCA' means and where protections may or may not apply. We will also explain why we are making rule changes and what they mean for consumers, as they happen.
- Use proactive communications to improve consumers' understanding of risk. This includes a new multi-year investment harm campaign, targeting less experienced investors tempted into taking higher risks than they realise when investing online.
- Publish more data about firms to help inform consumers and influence firms' conduct. This will include regulatory data that we have not shared before, as well as Ombudsman Service complaint and uphold rates.

Supporting dialogue on the perimeter

As well as publishing this perimeter report, we undertake a number of actions to clarify understanding around the perimeter:

- Our Handbook includes guidance on the perimeter, in the perimeter guidance manual. We update this guidance in response to perimeter developments.
- Through our supervisory interactions with firms, we discuss their activities and where they sit in relation to the perimeter.
- We promote innovation in the interests of consumers. Through our Innovation Hub, we help regulated and unregulated firms understand whether or not their planned activities, products, services and business models come within our regulation. We also horizon-scan future market developments and work with the Treasury and the Bank of England to ensure opportunities for healthy innovation while maintaining appropriate safeguards. For example, in October 2020 we and the Bank of England launched the Artificial Intelligence Public-Private Forum, which enables dialogue to aid understanding of the use and impact of AI in UK financial markets.
- Where appropriate, we take enforcement action against breaches of the perimeter and publish details of cases to foster understanding and act as a deterrent.

While this work aims to clarify understanding around the perimeter, this does not remove the requirement for firms and individuals to meet our regulatory requirements. We investigate and take action where we can to tackle harm where we suspect misconduct, or if we suspect unauthorised firms and individuals are carrying out regulated activities.

We highlight where we see gaps in the legislation. Where we think that bringing unregulated activities into our remit is likely to prevent harm and lead to better outcomes, we discuss this with the Treasury and the Government. While financial stability is a consideration, and we contribute to the Bank of England's Financial Policy Committee's work to assess potential financial stability risks linked to the regulatory perimeter, the focus of our own work is on upholding our statutory objectives, including protecting consumers.

Examples of recent actual or planned changes to the perimeter include:

- In January 2021, the Treasury legislated to bring pre-paid funeral planning into FCA regulation from 29 July 2022, to combat significant consumer harms in that market.
- In February 2021, the Treasury confirmed its intention to bring Deferred Payment Credit (Buy Now Pay Later) into FCA regulation.
- In June 2021, the Treasury confirmed its intention to introduce a new regulatory gateway (a 's21 gateway') for firms approving financial promotions for unauthorised persons.

Changing the perimeter can take a considerable period of time, and is not always an effective way to prevent harm. In addition, changes to the perimeter which expand our regulatory responsibilities, for example by increasing the types and numbers of firms that we supervise, have implications for our resources.

Challenges we can face

We are proactive at the boundaries of our perimeter. However, our powers to act against unregulated activities are limited. Separately, we face a number of additional challenges in monitoring and preventing harm caused by unregulated activities or otherwise linked to our perimeter. Despite these challenges we continue to take action wherever we can to mitigate harm.

Collecting intelligence and data on unregulated activities

Our ability to monitor harm caused by unregulated activities and to collect data on such activities is limited- especially if the firms in question are not authorised. This means it can be difficult to identify harm, and to conduct analysis.

While we ask questions and analyse data outside our perimeter, our data is often limited. We do not routinely collect significant data on unregulated activities. Firms must comply with our regulatory reporting requirements, where relevant, but these typically focus on activities that fall within our perimeter. Where we do receive data or intelligence on unregulated activities, for example from other agencies or by consumers contacting us, this is generally after harm has happened.

We are currently significantly investing in our people, technology and capabilities so we can find and stop harm quicker, but will still face significant challenges when the harm is caused by unregulated activities.

Other challenges in preventing harm

Firms and individuals who deliberately exploit consumers will always look for new ways to do so. When we take action to prevent misconduct in 1 product or activity within or outside our perimeter, these often well-resourced players often seek out new opportunities in other products or activities. We seek to reduce this 'waterbed effect' by sharing intelligence with other agencies and issuing warnings on our website, as outlined above.

We seek to provide clarity on the perimeter where we can and to enable consumers to make informed financial decisions. However, the inherent complexity of the perimeter, coupled with the fact that financial services products and services continue to change and evolve, mean that we will never be able to remove all uncertainty and ambiguity.

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Firm business models

In this and the following chapters, we provide detail on specific topics related to our perimeter where we want to provide greater clarity on our position and our work. This chapter covers topics involving firms' business models and the structures they choose to adopt.

Unregulated debt advice lead generators

Last year our perimeter report highlighted concerns about the activities of unregulated lead generators who may seek to direct consumers towards insolvency options where other options may be better for customers.

Lead generators are a significant point of entry to the individual voluntary arrangements (IVA) and Protected Trust Deed (PTD) market. They pass leads to FCA authorised debt packager firms and to Insolvency Practitioners regulated by Recognised Professional Bodies which are overseen by the Insolvency Service. We and the Insolvency Service share concerns about IVA and PTD referral practices. We have been collaborating with the Insolvency Service and other regulators to support the development of a whole market approach to address these issues, improving standards among the firms who accept leads.

We have taken action against debt packagers where we found poor standards of advice. Following our review of debt packager firm practices, 5 firms have stopped providing regulated debt advice and we used our formal powers to stop another firm from providing regulated advice. We will provide an update in the near future on our thinking on measures to tackle consumer harm from the potential for biased advice across this sector.

We have been working with the Insolvency Service on these issues. We published letters between Sheldon Mills, Executive Director of Consumers and Competition, and Dean Beale, CEO of the Insolvency Service, outlining our respective actions and where we are collaborating to reduce harms in this market. We will be working closely with the Insolvency Service to make sure the journey through debt advice to debt solutions works well for consumers.

Appointed Representatives

An appointed representative (AR) is a firm or person who carries out regulated activity on behalf, and under the responsibility, of an authorised firm. This authorised firm is known as the AR's 'principal' and is responsible for the AR's activities, including its compliance with our rules. Firms and individuals may want to be an AR for a range of reasons, including being able to undertake certain regulated activities without the need to get FCA authorisation in their own right.

We have identified potential risks of harm with the AR regime. For example, our thematic reviews of the general insurance sector in 2016 and the investment management sector in 2019 identified significant shortcomings in how well principal firms understood and complied with their regulatory responsibilities for their ARs. These included insufficient oversight of their ARs and inadequate controls over the regulated activities for which they had accepted responsibility. Issues like these can result in a wide range of harm to consumers, including mis-selling and fraud.

> We will consult this year on specific proposals to address the harm we have identified.

Earlier this year, we introduced a new annual fee for firms with ARs, including introducer appointed representatives (IARs) which are only able to distribute financial promotions and effect introductions. Principals will now have to pay an annual fee to the FCA of £250 per AR and £75 per IAR. The fee will assist in funding our work to identify and address harm from the AR regime, across all the sectors which use ARs.

As part of this work, we will carry out targeted and proactive supervision of those aspects of ARs' interactions with consumers, and principals' oversight of their ARs or sectors or groups of firms, where we consider that use of the AR regime is a particular driver of harm. We will also intensify our scrutiny of all principal firms, and applicants which intend to appoint ARs, seeking permissions at the gateway. In a small pilot of this tighter approach, 50% of firms intending to appoint ARs have either withdrawn their applications or we have decided to refuse them.

Alongside this, we will consult this year on specific proposals to address the harm we have identified. We will also continue to work with the Treasury, who plan to issue a Call for Evidence on the AR regime, to determine the most effective ways to further reduce opportunities for misuse of the regime. This work will be informed by further data collection and our supervisory programme.

Outsourcing and third party service providers

Firms increasingly depend on unregulated infrastructure to support the delivery of financial services and provide regulated activities in a digital economy. Some unregulated third party service providers, especially in technology and information systems markets, are gaining much greater market share and becoming more dominant. This can increase firms' dependency on these unregulated service providers, in turn increasing 'concentration risk' and the harm that these providers failing can have on financial markets and their consumers. This raises questions around what role financial services regulators have in ensuring that third party service providers are effectively overseen and managed.

Existing requirements and guidance place responsibility on regulated entities for their third party service providers. Firms are required to identify and manage their third party risks and we require notification and reporting to us of critical, important or material outsourcing. Importantly, firms cannot delegate regulatory responsibility for the process, service or activity that has been outsourced. As many of the third party service providers are not regulated by us, our current approach is through 'indirect' supervision. When required, we assess the management of outsourcing and third party services provided as part of our ongoing supervision of firms, and where we identify risks we take action to reduce them.

Since the previous perimeter report, we have published our final Operational Resilience policy. This was developed in partnership with the Bank of England and the PRA. Operational resilience is the ability of firms, and the sector as a whole, to prevent, adapt, respond to, recover and learn from operational disruptions. From 31 March 2022, our policy will apply new rules to banks, building societies, designated investment firms, recognised investment exchanges, insurers, enhanced scope SM&CR firms and payments and e-money firms.

While these new rules do not apply directly to third party service providers because they are outside our regulatory perimeter, the policy will require in-scope firms to ensure they work effectively with third party providers where they are providing important business services. This is to make sure the way these services are provided is mapped and tested so that firms can identify and address vulnerabilities. We consider this will better enable regulated firms to identify, understand and take steps to remedy problems from third party service providers.

We have worked with the PRA and the Bank to develop a shared understanding to guide our supervision of the policy. We have approached the largest firms that fall within the requirements to request information on how they are implementing the policy. This enables us to identify any significant divergences from our expectations. We have also worked with firms to ensure the practical implementation of operational resilience is industry led.

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Deposit aggregators

Deposit aggregators provide intermediary services to retail consumers with savings accounts. The services they offer vary but can include keeping customers informed of changes in the savings rates available in the market. They also offer a convenient service for customers to spread deposits around different banks and building societies, to take advantage of these rates and to maximise FSCS protection for high balances by benefiting from the protection available for each individual bank.

Deposit aggregation is a relatively new and growing service and can bring benefits to consumers. However, there are also risks. Depending on the particular business model, the core activity of a deposit aggregator may not be regulated. We have no remit to supervise unregulated deposit aggregators and this limits our ability to act where there is potential for harm.

Deposit aggregators will often hold deposit accounts on trust for their customers. In these cases, these customers do not become direct customers of the bank or building society where the account is held. As beneficiaries under such a trust, the customers should benefit from FSCS protection as long as the trust arrangements are set up correctly. But customers may not know that if a bank or building society fails, FSCS payments for deposits held in this way can take longer than the FSCS's standard pay-out time, which typically aims to pay compensation within 7 days of a bank or building society failing.

There are also scenarios where customers may have less FSCS protection than they expected. For example, they may not always know that if they hold a deposit account at a bank or building society in their own name and:

- hold an interest in another deposit account with the same provider through a deposit aggregator trust, and
- the balances on both those holdings together exceed £85,000

then compensation would be limited to £85,000 and the customer would not be protected for the residual amount. Another example might be where deposits are placed at overseas banks and so are not covered by the FSCS.

There is also a risk for deposit-takers that deposits from a deposit aggregator may be a significant portion of their balance sheet. The flow of these deposits could be influenced by recommendations the deposit aggregator makes to its customers, potentially leading to concentrated liquidity risk for the deposit taker.

We encourage innovation in the interests of consumers. As such, we want banks and building societies to be aware of any potential risks with deposit aggregation services their customers use.

On 14 April 2021, the PRA and the FCA issued a joint Dear CEO letter to all banks and building societies to ensure they suitably mitigate any risks from deposit aggregation. This letter was informed by our multi-firm work with a group of deposit aggregators. We reminded banks and building societies of their responsibilities for the content of and conduct around financial promotions for savings accounts where a deposit aggregator advertises products as their agent.

We said we expected any customer-facing messages in promotions that are subject to FCA rules to be fair, clear and not misleading. This includes any claims made about FSCS protections. The letter also asked banks and building societies to plan ahead so that client-specific information is available to ensure swift FSCS pay-outs. We also reminded firms to factor into their management of liquidity risk and funding needs that the flow of deposits from deposit aggregators may be correlated.

We expect banks and building societies to consider addressing any relevant issues, and to consider measures to achieve a faster customer repayment by the FSCS in the event of need. We have explained we expect senior management to have appropriate oversight of a firm's relationship with deposit aggregators and that we may seek evidence on this in the future.

Unregulated mortgage book purchasers

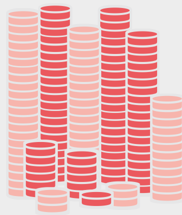
Some stakeholders have been concerned that where mortgages are sold to unregulated entities, borrowers may face an additional worry that they might see a reduction in their protection compared with mortgages held by regulated lenders. Mortgage books can be sold on to a new firm without the borrower's consent.

In practice, we have found that currently in the majority of cases, where books have been sold to unregulated entities, they have delegated key decision-making responsibilities on interest rate changes and forbearance to regulated firms. We noted this in our previous perimeter report, and section 8 of our Statement on Mortgage Prisoners (published in July 2020) also discusses this matter in further detail.

We are carrying out a review to develop further detail, using our data, on the characteristics of mortgage prisoners, many of whose mortgages are owned by unregulated entities. The review is also considering the effects of our recent interventions designed to remove regulatory barriers to switching for mortgage prisoners. We published the terms of reference for the review in July 2021. We will report to the Treasury on the outcome of this review, which will be laid before Parliament by the end of November 2021.

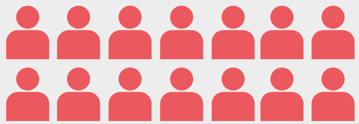
Funeral Plans

In January 2021 the Treasury legislated to bring pre-paid funeral planning activity into FCA regulation. This is to combat significant consumer harm seen in the current market, for example products that don't meet customers' needs. There has been significant growth in the funeral plans market in the last 2 decades. The below graphic, which we published in CP21/4, provides estimates of the scale of the market.



£4bn
estimated value of existing plans

Source: FPA statistic

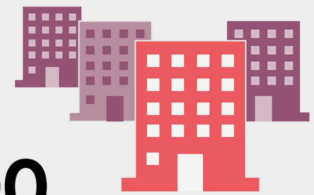


1,400,000
Estimated number of undrawn plans (customers)

Source: FPA statistic

Up to 60
funeral plan providers

Source: FCA estimates



2,000-3,000
expected number of intermediaries

Funeral plans are products through which a consumer pre-arranges and pre-pays for their funeral with a provider, generally for a fixed cost. The funeral plan could be sold by a third-party intermediary, such as a funeral director, financial advisor or will writer, or directly by the provider firm. Currently, where these plans are then backed by an insurance product or a trust meeting specific conditions set out in the RAO, they benefit from an exemption to regulation.

The current exemption will end on 29 July 2022. From this date, firms arranging funeral plans, as well as those undertaking the activities of entering into or carrying out funeral plans, will need to have correct permissions. It will be a criminal offence for unauthorised firms to carry out funeral planning business, including the carrying out of plans bought before the regulation started.

We made most of our final conduct and prudential rules in an instrument published alongside a policy statement (PS21/8) on 5 July 2021, and published a further consultation paper (CP21/20) on the same date covering resolution and FSCS rules in the event of regulated firm failure. This consultation closed on 31 August 2021, and we intend to make rules in Q4 2021.

Our authorisations gateway opened in September 2021, and we are now processing applications from plan providers and intermediaries before regulation starts on 29 July 2022.

The general insurance perimeter

The RAO does not provide a complete definition of insurance. This means court decisions about whether particular contracts amount to insurance are relevant in determining where our remit applies. There has sometimes been uncertainty as to whether certain contracts should be classed as insurance. As a result, there have been situations where firms have structured the products they sell in an attempt to take them outside our remit, but where we consider those products should properly be regarded as insurance.

We have identified concerns in 2 areas:

- Insurance requires an undertaking to pay money or provide a corresponding benefit to a recipient. In some contracts, the provider claims to have absolute discretion not to pay out. But this may be in circumstances where we consider the discretion to have no real content or to be an unfair term. In these cases, our view is that the contracts should properly be categorised as insurance.
- We have also seen firms claim that their warranties are mainly service contracts providing repair services, with a minor indemnity element that pays benefits if the product is lost or damaged. We believe many of these contracts artificially describe the repair services and, on more detailed analysis, are really contracts of insurance.

We are considering what further action we could take to give both the industry and consumers greater clarity about our position on these types of products. This might include potential amendments to our perimeter guidance on insurers (PERG 6) and action to ensure that individual firms are not acting illegally by providing insurance contracts without appropriate authorisation.

The Money Laundering Regulations (MLRs)

Tackling anti-money laundering (AML), counter terrorist financing (CTF) and financial crime is a priority for the FCA. Financial crime harms society and the wider economy and erodes confidence in the UK financial system. It is imperative that the UK, as an international finance services hub, has a strong and effective AML/CTF system which depends on collective commitment and collaboration across authorities and between the public and private sector. A key facet of the regulation underpinning this system is the Money Laundering Regulations 2017 (MLRs).

We are 1 of the supervisory authorities under the MLRs. More specifically, we are the supervisory authority under the MLRs for a wide variety of financial services firms. Some of these firms, such as banks, insurers and investment firms, are authorised, and therefore supervised by us under FSMA. However, some of these firms are not. Where these firms are only supervised by us under the MLRs, our responsibilities and powers are limited as they are focused on the prevention of money laundering rather than consumer protection.

One group of firms not authorised under FSMA but supervised by us under the MLRs, are described in the MLRs as Annex I Financial Institutions (FIs). They include, for example, commercial lenders, securities registrars, and firms trading foreign exchange on their own account. Another group of firms supervised by us under the MLRs and for the most part not authorised under FSMA are cryptoasset exchange providers and custodian wallet providers (firms that safeguard cryptoassets or cryptographic keys on behalf of customers). Together these are called cryptoasset businesses in the MLRs but this only applies where they are undertaking business in the UK not from other countries.

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We are required by the MLRs to maintain a register of cryptoasset businesses and are permitted to and do maintain a register of Annex I FIs. We are permitted to apply certain registration standards under the MLRs, which also provide a basis on which we can cancel or suspend registrations. Such firms not on those registers cannot (subject to some exceptions) conduct certain activities specified in the MLRs. Firms on those registers can, however, legitimately claim to the public to be registered and supervised by the FCA.

We are concerned, based on our experience under the MLRs and as has previously been made public in our correspondence with the Treasury Select Committee (TSC), that the registration standards we are permitted to apply under the MLRs are far less demanding than those applicable under FSMA. This means we do not have the same broad remit and powers to supervise and (where necessary) enforce against these registered firms for their activities as we would for authorised firms conducting regulated activities under FSMA. We consider that the regime could be strengthened if the criteria used to determine fitness or propriety included, for example, specific criteria in relation to adequate governance and financial resilience.

We therefore welcome the call for evidence recently published by the Treasury, which expressly includes the question whether supervisory authorities under the MLRs have the powers they need to support an effective gateway into the MLR perimeter and therefore encompasses our concern.

6

Consumer investments

One of our Business Plan priorities is 'enabling consumers to make effective financial decisions'. This includes decisions about consumer investments. In this chapter, we cover topics which are linked to consumer investments and our perimeter.

The Gloster Report and the Parker Report (the independent reviews) contained a number of recommendations relating to consumer investments. We separately provided a general update (in July 2021) on our overall work to implement recommendations from the independent reviews.

Consumer Investments

We published our Consumer Investments Strategy in September. It sets out the work we will deliver over the next 3 years to protect consumers from investment harm. This includes how we tackle firms and individuals who cause this harm, as well as giving context on the work we have done so far. Alongside this, we published our second data report, with more detail on our work to protect consumers from investment harm in the previous financial year.

Some of the most serious harm we see involves investments outside our regulatory perimeter and online scams, many based overseas. We have limited powers and capabilities to tackle these, in particular in our ability to deal with online promotions. Across our strategic work, we continue to work with the Government to address these harms which fall outside our perimeter.

Unregulated Collective Investment Schemes

A Collective Investment Scheme (CIS) – sometimes known as a 'pooled investment' – is a type of fund that usually has contributions from several people. The fund manager of a CIS will put investors' money into 1 or more types of asset, such as stocks, bonds, property or other types of asset, including cryptoassets.

A CIS may be an authorised UK scheme, or a 'recognised' scheme from other countries. If a CIS is not authorised or recognised then it is considered an Unregulated Collective Investment Scheme (UCIS). While we do not directly supervise the UCIS themselves, we regulate the fund managers who operate them, the promotion of these schemes in the UK and how UK firms can advise or sell them.

UCIS are high risk investments and cannot be promoted to the general public in the UK. Despite this, we have seen evidence that ordinary members of the public are unlawfully being sold UCIS. In some cases, this also involves fraud or scams. In many cases it does not, but the individuals and firms involved are still breaking our rules. Before firms establish investment opportunities or offer them to the general public, they need to consider whether these meet the definition of a CIS or UCIS.

We have taken direct action, including a number of successful prosecutions, against firms and individuals involved in the promotion and sale of UCIS to the general public. We continue to take direct action where we see this harm occurring. Where fraud or scam activity is involved, we work closely with other law enforcement agencies such as the SFO.

Mass-marketing of high-risk investments to retail consumers

As highlighted in our 2019/20 perimeter report, we remain concerned about the marketing of high-risk investments to retail consumers. We have limited powers over many issuers of high-risk investments because they are often not carrying out a regulated activity when they issue an investment product. This means that we cannot generally impose requirements on the issuers of high-risk investments themselves as they are often not authorised persons.

However, marketing these investments is generally subject to the financial promotion regime, unless an exemption applies. Financial promotions are often consumers' first contact with an investment opportunity. So, the regime is vital in ensuring that consumers can take appropriate and informed decisions and that only appropriate investments are mass-marketed to ordinary retail consumers. This is principally achieved through our rules, which are based on the level of risk in what is being promoted and who it's being promoted to. Where the risks are higher, or less clear, marketing restrictions are in place to protect consumers.

Where we identify harm to consumers from particular products, we may take steps to restrict promotions (eg our interventions which banned the mass-marketing of non-mainstream pooled investments and speculative illiquid securities). This also means that it is vital that the legislative exemptions from the financial promotion restriction (which allow unauthorised persons to communicate promotions without the involvement of an authorised firm and the application of FCA rules) are suitable and appropriate for consumers (see Financial Promotion Order exemptions below).

Speculative Illiquid Securities (SIS)

In our 2020 perimeter report we highlighted the harm we had seen in the mass marketing of Speculative Illiquid Securities, including speculative mini-bonds. These products are generally opaque, complex and difficult for consumers to understand.

To address this, we made a temporary product intervention in January 2020 to ban the mass marketing of these products to retail investors. In December 2020 we made the ban permanent and extended it to certain listed bonds with similar features to Speculative Illiquid Securities which are not regularly traded, as we saw firms attempting to avoid our rules.

Financial Promotions

Exemptions in the Financial Promotion Order

We are concerned that unauthorised persons are increasingly relying on exemptions in the Financial Promotion Order (FPO) relating to 'high net worth' and 'sophisticated' investors ('the exemptions') to market high risk investments. Promotions which are communicated within the scope of the exemptions are not required to comply (in their capacity as financial promotions) with our rules, including with the requirement to be clear, fair and not misleading, and with our mass-marketing bans. We have seen evidence that strengthening our financial promotion rules has resulted in more unauthorised issuers using, or purporting to use, the exemptions to target ordinary consumers with high-risk investments and scams.

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The exemptions were last reviewed in 2005 and we are concerned that they are no longer fit for purpose. One way to self-certify as a 'sophisticated' retail investor is for the consumer to confirm that they have made more than 1 investment in an unlisted company in the last 2 years. Previously, this would have required the consumer to have some private business experience. However, in recent years with the advent of investment-based crowdfunding, ordinary consumers can now easily meet this criteria. For example, our latest Financial Lives Survey, conducted in October 2020, shows that at least 1.6 million consumers hold investments in unlisted companies.

Currently, to self-certify as a 'high net worth' investor, a consumer needs an annual income of £100k or more, or £250k or more in net assets excluding their primary residence and pension assets. This is significantly lower than the threshold used in other comparable jurisdictions to classify consumers as 'high net worth'. The introduction of pension freedoms has also weakened the effect of excluding pension assets from the calculation of 'net assets', as older consumers can now readily convert their pension into cash.

There is also no requirement for firms to check that consumers meet the relevant criteria to self-certify as 'high net worth' or 'sophisticated'. We have seen evidence of unauthorised firms abusing these exemptions by coaching ordinary consumers to self-certify. Investors who do not meet these tests are being 'pushed' through them, often by unregulated firms. This unscrupulous behaviour is sometimes helped by the appeal to some retail investors of self-certifying themselves as 'sophisticated' or 'high net worth' and the sense of exclusivity that the exemptions offer. We act when we find evidence of this abuse of our exemptions, but it is inherently difficult for us to police as it generally involves individuals we don't authorise. Many of them prove difficult to trace and are sometimes based overseas.

We believe the exemptions are a significant vulnerability in the financial promotion regime. We believe there need to be significant changes to address the harms we see, particularly in reforming the relevant thresholds and the ability for consumers to self-certify. Leaving this aspect of the legislation unchanged will continue to result in significant consumer harm that we are unable to mitigate.

The Treasury's consultation on Non-transferable debt securities (NTDS)

On the 19 April 2021, the Treasury published a consultation on the regulation of Non-Transferable Debt Securities (NTDS). This sets out various proposals for bringing the issuing of NTDS within the regulatory perimeter. In particular:

- making the direct-to-market issuance of certain types of NTDS a regulated activity, or
- extending the scope of the Prospectus Regulation to cover public offers of NTDS

The NTDS market has declined significantly due to a shift towards ensuring transferability to allow securities to be eligible for the IF ISA wrapper, and following our ban on the mass-marketing of SIS, as described in the research paper by London Economics and YouGov for the Treasury. This has addressed much of the harm in the market. However the consultation highlights that our SIS marketing ban does not apply to promotions to high net worth and sophisticated investors, and it is unclear whether these investors (as currently defined in the FPO exemptions) are better placed to understand the risks of these products.

We are constrained in our ability to apply our financial promotion rules (including marketing restrictions) to promotions which fall within the scope of the exemptions. If the exemptions were removed, or the exemptions were no longer to apply to NTDS, issuers could only market NTDS if the promotion was communicated or approved by an authorised firm and complied with FCA rules including our marketing restrictions. Therefore, we could more effectively apply our rules to ensure that all investors who would benefit from regulatory protections designed to help them better understand the risks of the investment would do so.

For further interventions in this market to be effective, it is important to consider the interaction with wider changes that are currently being considered to the ways that securities can be offered and distributed to retail investors. In particular, changes to the Prospectus Regulation that the Treasury is consulting on, following the UK Listing Review by Lord Hill, may propose alternative approaches for private companies wanting to make public offers of securities. If these reforms are taken forward, we will work with the Treasury to consider whether it is possible to have a consistent regulatory approach and framework for non-transferable and transferable securities that adequately addresses the risk of harm to investors.

New Regulatory Gateway (s21 Gateway)

Currently, any authorised firm can approve the financial promotions of an unauthorised firm, regardless of their expertise or experience of the relevant market (as laid out in s21 FSMA 2000). We have seen instances of firms approving financial promotions without a proper understanding of the product or service and so being unable to properly ensure that the promotion meets our standards.

On 22 June 2021, the Treasury confirmed its intention to introduce a new regulatory gateway (a 's21 gateway') for firms approving financial promotions for unauthorised persons. Any authorised firm wanting to do this will first have to pass through the s21 gateway, unless the exemptions for intra-group approvals or those for the authorised firm's appointed representatives apply.

This s21 gateway means we will assess whether the authorised firm has the necessary competence and expertise to act as a s21 approver before they can approve financial promotions for unauthorised persons. The s21 gateway will also enable us to better understand, monitor and record the population of firms approving financial promotions in this way, which we have not previously been able to do effectively. However, the s21 gateway will not apply to intra-group approvals or to the approval of authorised firms' own promotions for communication by unauthorised persons, eg by appointed representatives, where the standard may fall short.

Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions

In April 2021 we published a Discussion Paper (DP21/1) on our financial promotion rules for high risk investments. One of the issues it sought views on is how we can ensure that consumers are better equipped to take informed and appropriate decisions before investing in high risk investments. The paper discussed a number of measures to do this, including helping consumers better categorise themselves by improving the categorisation declarations, improving risk warnings and introducing more positive barriers to buying. These types of measure might help to reduce the risk of retail consumers investing in inappropriate products. We are aiming to consult on these proposals at the end of the year.

Marketing of CFDs and other high-risk investment products

There are a number of issues around the marketing of contracts for difference (CFDs) and other high-risk investment products to retail clients. Particular concerns we have identified include firms encouraging clients to trade with entities in third country jurisdictions rather than their UK business, and the use of introducers and affiliates who may be carrying out unregulated activities.

We are aware that some providers of retail derivatives (CFD and Futures) are encouraging retail clients to trade with firms in third country jurisdictions, by using comparison tables to highlight that retail consumers can get higher leverage through third country intra-group entities. Some firms have also failed to highlight the protections that retail consumers may lose by transferring their account, such as the loss of negative balance protections. This could also be part of a longer-term trend as firms become more global and deliver services predominantly via online platforms and mobile apps.

CFDs and other complex leveraged derivatives are increasingly marketed through social media, with the use of Instagram and messaging platforms such as Telegram to encourage people to trade high risk products. This is exacerbated by firms' use of introducers and affiliates including unregulated 'educators' and 'influencers' with the promise of positive returns on investments and promoting the potential to achieve a celebrity-like lifestyle by trading.

We have found that educators and influencers often use images of holidays and expensive cars to promote the trading of CFDs and the returns that can be made. This conflicts with the standardised risk warnings that are in place for CFD providers, which show the majority of clients will lose money. Recent evidence suggests that this is leading to firms taking on younger consumers for whom the product may not be appropriate.

We have intervened, and will continue to do so, when firms use language that does not properly present the risks of trading on higher leverage. We will continue to focus on firms' financial promotions and marketing activities on both of these issues in our supervision work.

7

Technological changes

Rapid technological change is transforming the entire landscape of financial services. We target our action to foster healthy, innovative markets, where developments in technology can deliver better outcomes for consumers. In some cases, technological developments lead to the emergence of new products and services, or the development of harm, that weren't envisaged when legislation setting our perimeter was written. In this chapter, we explore perimeter topics linked to technological changes.

Online Harms

Online platforms, such as search engines and social media platforms, are playing an increasingly significant role in disseminating promotions of financial products and services. This includes adverts which expose consumers to significant risk of harm such as promotions for high risk investments which are unsuitable for most investors, adverts which make false or misleading claims and scams which may or may not fall within our jurisdiction.

Scams and frauds

There are few practical barriers for online scams. Fraudsters have unprecedentedly cheap access to an online population of consumers who find it difficult to differentiate legitimate offers from fraudulent ones. There are promotions online for firms that do not exist, for firms that falsely claim to be regulated, for firms that claim to be based in the UK but are not, for products for which spurious claims of returns are made and for clones of legitimate authorised firms. This is a fast growing problem: From April 2020 to March 2021 consumers reported 30,000 potential scams to us. This is 77% higher than in the previous 12 months.

Legislative framework

Since the end of the Brexit Implementation Period earlier this year, an exemption to the financial promotion restriction which could be used by online platforms has fallen away. As a result, we have been looking at the operations of the major online platforms to determine whether they are now subject to the restriction and, if so, whether they are compliant. Where they are not, we will take action to ensure consumers are protected.

We continue to believe the protection of consumers from illegal online scams would be strengthened through clear legal obligations on platform operators within the Government's Online Safety Bill (OSB) and that the duties in the OSB should extend to paid-for advertising, as well as user-generated content. We also hope that the OSB can be amended to designate content relating to fraud offences as 'priority' illegal content and so require monitoring and preventative action by platforms.

Digital Markets

Digital markets are rapidly changing the way we live, including how financial services are provided and used. The social changes driven by coronavirus are likely to further accelerate the development of digital markets in financial services, particularly online payments and virtual interactions with financial services providers. While these changes can potentially have positive impacts on consumer outcomes, as we recognised in our response to the Digital Markets Taskforce call for information, they also pose challenges, particularly to existing regulatory frameworks established in an analogue age.

Against this background, last year we worked closely with officials from the CMA, Ofcom and the ICO (the Digital Markets Taskforce) as they formulated proposals on a new pro-competitive regime for digital markets. Since these proposals were published in December 2020, we have continued to give support to Government on the functions, processes, and powers needed to deliver greater competition and innovation in digital markets. This has included work involving the Taskforce's recommendation (14b) that the Government should consider, in consultation with Ofcom and the FCA, empowering these agencies with joint powers with the Digital Markets Unit (DMU) for the new regime, with the DMU being the primary authority. We continue to work with the Government on these issues in light of its consultation 'A new pro-competition regime for digital markets'.

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In recent years the payments market has experienced an increase in intermediation and innovation, leading to new business models which are currently outside the perimeter.

Payments

In recent years the payments market has experienced an increase in intermediation and innovation, leading to new business models, some of which are currently outside the perimeter. In July 2019, the Chancellor announced the Payments Landscape Review, led by the Treasury. It is important that regulation balances risk mitigation with supporting innovation and we have been working closely with the Bank of England/PRA, the PSR and HMT to that aim.

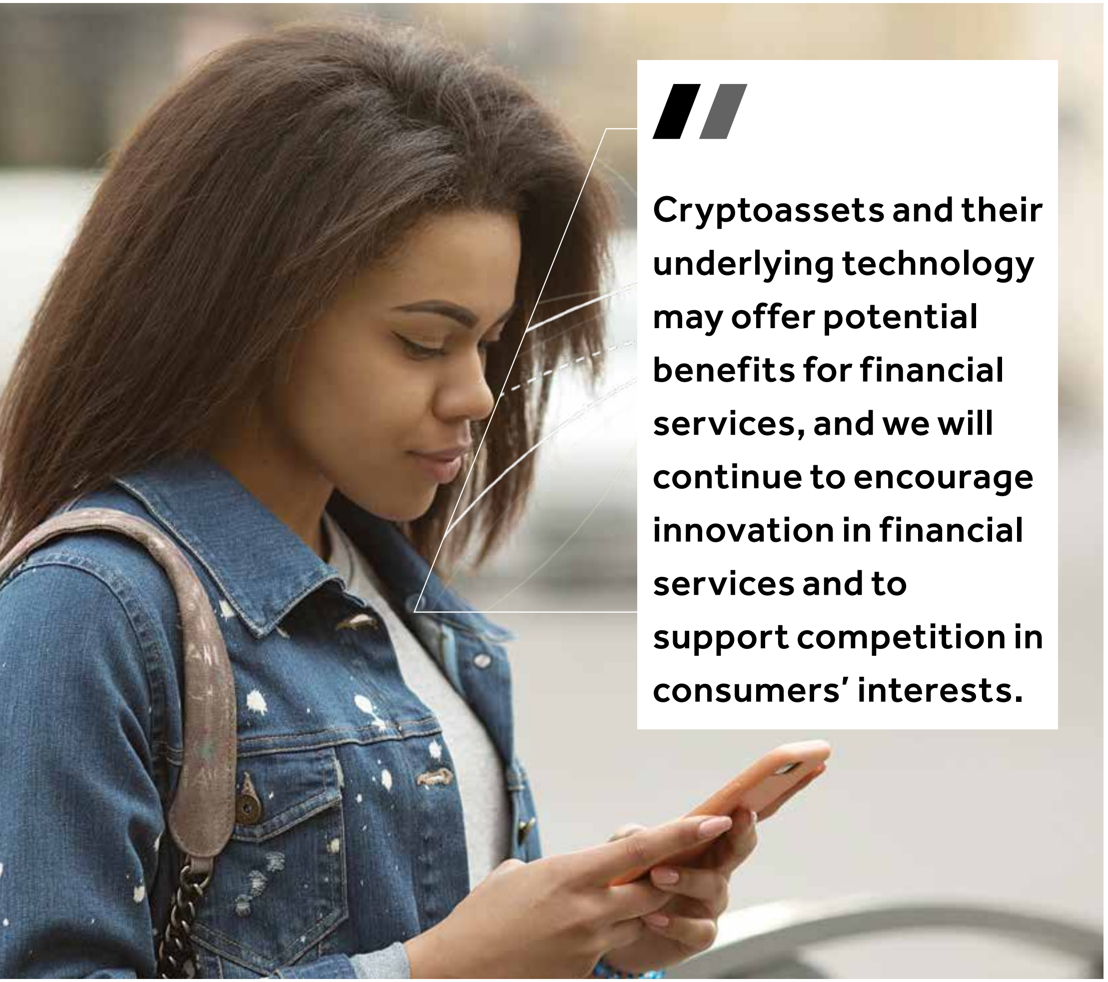
In October 2021, the Government published its response to its initial 2020 Payments Landscape Review: Call for Evidence. In its response, the Government sets out its vision for a payments sector at the forefront of technology, ensuring consumer protection and choice, operational resilience, competition, and harnessing innovation. It identified 4 priority areas and actions for the Government, regulators and industry:

- strengthening consumer protections within Faster Payments
- unlocking the future of Open Banking enabled payments
- enhancing cross-border payments, and
- future-proofing the regulatory and legislative framework that governs payments

Whilst the publication of the response concludes the Treasury's formal Review, we will be working closely with the Treasury in the coming months to lay the foundations to delivering on these priorities.

Cryptoassets

Cryptoassets and their underlying technology may offer potential benefits for financial services, and we will continue to encourage innovation in financial services and to support competition in consumers' interests. However, like in other areas, different types of cryptoassets and different types of business models bring different risks of harm for consumers and markets. We have repeatedly warned consumers that they should be prepared to lose all their money and that they were unlikely to be protected due to the likely unregulated nature of the products and services. As the use of cryptoassets and its underlying technology develops, we will continue to monitor the market and consider whether activities fall within our perimeter – a sometimes complex assessment to carry out. We will continue to act where we see harm and where we have the powers to do so; however, our current powers over many types of cryptoasset-based activities are limited. We will also continue to work with the Treasury and other regulators to inform thinking on where further regulatory or legislative change is needed.



"Cryptoassets and their underlying technology may offer potential benefits for financial services, and we will continue to encourage innovation in financial services and to support competition in consumers' interests.

The use of cryptoassets and distributed ledger technology (DLT) has continued to grow. The UK market remains relatively small but is growing quickly and the global nature of the market means it is not limited to traditional, geographical boundaries. Our consumer research shows that 4.4% of UK adults (or 2.3 million people) own crypto and more regulated firms are getting involved in this market.

We recognise the positive impact that some cryptoassets, cryptocurrencies and innovative technologies like DLT and blockchain could have in financial services. DLT and crypto technology may provide opportunities to reduce costs, increase firms' efficiency and allow greater ability to track the movement of money through the system (both for the retail and wholesale markets).

Our Innovate function, including through our regulatory sandbox, direct firm support, and RegTech has continued to engage with many DLT and/or crypto-focused business models and we remain committed to supporting firms conducting regulated activities through these functions. This year, since we opened our market-facing services, we have supported 43 firms with cryptoasset or DLT-based innovations in our regulatory sandbox to enable live market testing, and 34 firms in our other support services (as of early October 2021). We are also supporting the Treasury and the Bank of England following the announcement of the development of a sandbox focused on financial market infrastructure.

Changes to the perimeter

Cryptoassets and cryptoasset-related activities often sit outside the regulatory perimeter. For the purposes of combatting money laundering and terrorist financing, in 2020 certain cryptoasset firms became subject to the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs).

We expect applicant firms to have robust AML control frameworks in place to manage the increased financial crime risks from cryptoassets. A relatively large number of applications to us have been of poor quality and we have identified significant concerns during many of our assessments. By early October we had registered 12 firms, and approximately 90% of firms assessed by that point had chosen to withdraw their applications, or were being refused, following robust engagement with us.

The Treasury also published 2 consultations, in 2020 and 2021 respectively, proposing to extend the scope of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005 (FPO) to certain unregulated cryptoassets. The proposals also include introducing a regime for a subset of cryptoassets – stablecoins – used as a means of payment. We are working closely with the Treasury and other relevant regulators in progressing both initiatives. Through this work, the FCA perimeter is likely to capture more parts of the cryptoassets market.

We note that any changes to our perimeter for cryptoassets would not impact on spot FX transactions. These would principally remain outside our perimeter as they are not a specified investment for the purposes of the RAO.

Cryptoassets and stablecoins used for payments

We recognise the potential benefits cryptoassets could have, particularly for payments. Stablecoins, for example, could pave the way for faster, cheaper payments. They can potentially play an important role, particularly for retail cross-border and remittance payments (including settlement). DLT can increase speed, efficiency and resilience and potentially support financial inclusion.

Since we published the previous report, the Treasury published a consultation and call for evidence on the UK regulatory approach to cryptoassets and stablecoins for payments. This seeks views on how the UK can ensure its regulatory framework is equipped to harness the benefits of new technologies, supporting innovation and competition, while managing risks to consumers and stability. We are working with the Treasury, the Bank of England and the Payment System Regulator as part of the UK Cryptoasset Taskforce (CATF) to consider the appropriate regime for cryptoassets used for payment.

Cryptoassets used for investment

Where consumers are speculating on the value of cryptoassets – buying them more like an investment – we have seen significant developments and increased risks for retail customers and the market, especially as more complex products are being offered to UK consumers. This includes a range of activities, from speculative investments directly into cryptoassets to more complex propositions claiming to offer retail consumers significant long-term returns. Such complex propositions include, for example, firms offering consumers a chance to 'lend' cryptoassets to them in exchange for very high claimed rates of return.

Consumers may lose all their money for a number of reasons, including volatility, firm failure, comingling of funds, cyber-attack, etc. Also, they may not understand products that are offered because, for example, they are very complex, or they may be misled by

> To help address the potential risks consumers face, we are continuing our work on the financial promotions regime.

advertisements. Consumers are unlikely to be protected if anything goes wrong. Firms carrying out these activities will often not be subject to regulatory conduct of business requirements. We have issued consumers with warnings that they should not buy these products unless they are prepared to lose all their money.

The wholesale market is also seeing changes where regulated firms are creating infrastructures, such as custody services or exchanges, to facilitate the activity of cryptoasset firms or to trade cryptoassets. The products they create and/or support may also carry risks of harm, similar to those identified in the retail market and, again, consumers may lose all their money for the same reasons.

Our latest consumer research, published in June 2021, shows that attitudes are shifting, with fewer cryptoasset users regarding cryptoassets as a gamble and more seeing them as an alternative or complement to mainstream investments. Half of cryptoasset users said they intend to invest more. However, the level of understanding of cryptoassets is also declining, suggesting that some cryptoasset users do not fully understand what they are buying. Our research also finds that 5% of cryptoasset users wrongly believe that some form of regulatory protection exist for these assets.

To help address the potential risks consumers face, we are continuing our work on the financial promotions regime. The Treasury consulted in 2020 on bringing the promotion of certain types of cryptoassets within the scope of financial promotions regulation. It is currently considering its response to the consultation, and we are working on the suite of rules that may apply.

As outlined in Chapter 6 under 'Financial Promotions', we published a discussion paper in April 2021 on strengthening our financial promotion rules for high-risk investments and firms approving financial promotions. These proposals will affect financial promotions of high-risk investments generally, as well as promotions of cryptoassets specifically, if the Treasury decides to extend the scope of the financial promotions regime following its consultations.

Since we published the previous perimeter report, we have also finalised the rules banning the sale, marketing and distribution to all retail consumers of any derivatives (ie contract for difference – CFDs, options and futures) and exchange traded notes (ETNs) that reference unregulated transferable cryptoassets by firms acting in, or from, the UK. We published the Policy Statement in October 2020 and the rules came into effect on 6 January 2021. We estimate that retail consumers will save around £53m from the ban on these products.

We also continue to maintain our assertive approach towards registering and supervising cryptoasset firms under the money laundering registration regime and the MLRs. We discussed the MLRs in more detail in Chapter 5.

Challenges to the regulatory perimeter

Many cryptoassets and cryptoasset-related activities sit outside the regulatory perimeter, and will continue to do so, even if the Treasury's proposed extensions of the perimeter are made.

The development of more complex business models, many of which are decentralised, that present themselves as ways cryptoasset owners can generate returns, interest or rewards from their cryptoasset holdings, are also making the perimeter issues for us and other UK Authorities more challenging.

Sometimes these models are structured in a way that is similar to more traditional, regulated financial services but as they use cryptoassets, they might not fall within the perimeter. Alternatively, sometimes they may be structured in a way that is within our perimeter, such as where the arrangements meet the definition of a collective investment scheme or alternative investment fund, or where the cryptoasset is a security or meets the definition of electronic money under the Electronic Money Regulations 2011 (EMRs). It is a criminal offence to engage in activities by way of business in the UK that constitute regulated activities without the appropriate permissions.

However, it can be difficult to determine whether these models are within the perimeter. This can be because of the decentralised nature of these models, and the use of cryptoassets rather than fiat currency, which may challenge our traditional approach to interpreting the perimeter. Additionally, the details of these arrangements – which can vary substantially from case to case – are often unclear and opaque and make it difficult and time consuming to determine whether the models and firms involved are within our regulatory remit.

"Many cryptoassets and cryptoasset-related activities sit outside the regulatory perimeter, and will continue to do so, even if the Treasury's proposed extensions of the perimeter are made.

Given how similar these models can seem to regulated activities, despite often being outside the regulatory perimeter, there is a greater risk of consumer harm as consumers often do not benefit from regulatory protections but may not understand this. We also see an increasing risk for the cryptoasset market, as well as the regulated market, as increasingly complex models emerge and more regulated firms get involved.

We will continue to monitor the market and take actions where appropriate, with the objective of ensuring that we support firms in continuing to innovate for the benefit of consumers and the market, while mitigating the risks of consumer harm. As effective regulation of a digital world requires international cooperation and common standards, we will work with our international partners where we need to. We will work with the Treasury to inform the thinking on whether further regulatory or legislative actions may be required to mitigate the risks these models may present and which are currently not covered through existing powers and regulations.

8

Lending

In this chapter, we explore various aspects of our perimeter involving lending and credit. This includes several consumer credit products, which we have looked at as part of our business plan priority to ensure that consumer credit markets work well.

Deferred Payment Credit

Over the last 2 years, we have seen the significant growth of unregulated buy-now pay-later products (which we refer to as 'Deferred Payment Credit' (DPC)), predominantly supporting digital retail sales. Usage increased threefold during 2020, with transactions valued at £2.7bn. The products often take the form of either deferred payment or short-term instalment loans, commonly providing credit for lower value goods.

The growth in DPC has in part been due to the popularity of online shopping, particularly during the pandemic and with more flexible payment options becoming increasingly popular with consumers.

DPC relies upon an exemption in the RAO that applies where, among other conditions, the credit is provided without interest or charges and is repayable within 12 months by no more than 12 payments. The exemption is longstanding, having been originally provided for in regulations under the Consumer Credit Act 1974.

In February 2021, the Woolard Review included a recommendation that unregulated buy-now pay-later products be brought into the regulatory perimeter to protect consumers. We agreed with this recommendation. The Treasury also agreed with the report's findings and announced its intention to bring these products into regulation in a proportionate way. The Treasury intends to publish a consultation paper setting out potential options on the scope and form of regulation for DPC. Once its approach is finalised, it intends to bring forward secondary legislation to bring activities relating to DPC products into regulation by amending the exemption in the RAO.

We have been working closely with the Treasury to help shape the new regulatory regime for DPC products. Alongside this, we are starting to plan the design and development of a framework to assess firms applying for authorisation and a supervisory strategy for when these firms fall under our remit. We will consult on our proposed approach and changes to our Handbook in due course. The extent of this will be dependent on the Treasury's final decision on the scope of firms and activities to fall under regulation.

Employer Salary Advance Schemes

Employer Salary Advance Schemes (ESAS) allow employees to access, usually for a fee, some of their salary before their regular payday. These schemes are a recent development and are usually administered by specialist scheme operators who promote the scheme to a variety of both public and private sector employers. When used in the right way, ESAS can be a convenient way for employees to deal with unforeseen expenses and occasional short-term cash flow.

We have analysed firms' business models to determine whether the early drawdown of salary might amount to an advance of credit and so involve a regulated credit activity. Our general view is that ESAS will usually operate outside of credit regulation. However, there are a variety of ways the schemes could be structured and so this might not always be the case.

> Employer Salary Advance Schemes (ESAS) allow employees to access, usually for a fee, some of their salary before their regular payday.

On 30 July 2020, we published a Statement concerning ESAS which identified potential risks to consumers that use the product, and made a number of recommendations to scheme providers and employers. Although the product is often promoted as an alternative to certain forms of high cost credit, our understanding is that this remains a very small market and we have not seen any evidence of harm emerging.

The Woolard Review also considered ESAS. It concluded that, given the size and scale of the market, it would currently be disproportionate to introduce a bespoke regulatory regime. It recommended that we should continue to monitor the market and, if the position changes, the question of bringing ESAS within the FCA's perimeter should be re-considered.

The Woolard Review did recommend that ESAS providers and major employers should be encouraged to draw up a code of best practice. We have engaged with some of the major providers and understand that they are working towards developing a code of practice. We have asked them to keep us informed as the code develops and we will be following developments.

SME lending and Business Interruption Insurance

In our 2020 perimeter report we highlighted the challenges SMEs were facing, both as result of the pandemic and from the potential for unfair treatment. We set these in the context of historic harms that had occurred and the FCA perimeter for SME lending. SME lending has been a longstanding perimeter issue, as business lending is generally only a regulated activity where both the loan is up to £25,000, and the borrower is either a sole trader or a 'relevant recipient of credit' (RRC).

We also noted the unprecedented nature and take-up of the Bounce Back Loan Scheme (BBLS) and the need to establish clarity on how these loans would be collected. We worked closely with the Government to ensure that the 'Pay As You Grow options' which are a feature of Bounce Back Loans, where offered, can be delivered in a way that is compatible with our CONC 7 rules and guidance on 'arrears, default and recovery (including repossessions)'. This resulted in our guidance published on 26 January 2021, which clarifies our expectations on the protections available for all borrowers whose loan falls with the perimeter for regulated debt collection if they should enter into default or arrears difficulties.

Collection of these loans has started. We will continue to monitor how firms treat SME borrowers in financial difficulty/arrears and whether they are getting the treatment and protections they are entitled to under our rules. We will also continue to monitor how Senior Managers are discharging their Senior Management responsibilities. However, CONC 7 only applies to regulated debt collection, which under BBLS is limited to loans to that sub-set of SME borrowers outlined above (sole traders and RRCs, borrowing £25,000 or less, or if pursuit of the debt is passed to a third party such as a debt collection agency, the loan can be of any amount).

Our targeted litigation strategy on Business Interruption (BI) insurance helped provide legal clarity and support businesses impacted by the pandemic. In July 2020, we asked the High Court for clarification in a test case to resolve the contractual uncertainty around the validity of many BI claims due to the pandemic. The High Court handed down its judgment on 15 September 2020. This was followed by an appeal to the Supreme Court, with the Supreme Court handing down its judgment on 15 January 2021.

Since the Supreme Court judgment, we have been monitoring insurers' progress in processing and paying valid BI claims and we have been publishing monthly data on this since March 2021. The suite of data we published on 15 September 2021 shows that firms had paid out £696.2m in final settlements to the 22,680 claimants where final settlements have been agreed and paid. £328.9m of interim payments had also been made on 4,568 unsettled claims. There are a further 15,060 accepted claims where settlement and any payments are pending. Firms' handling and payment of BI claims will remain an area of supervisory focus over the coming year.

We are also aware of policyholders and policyholder groups who are disputing issues relating to coverage, causation and/or the calculation of claim amounts and in some cases pursuing court, Ombudsman Service or other proceedings to resolve these issues. These types of issues arise from a lack of certainty regarding what is covered by the policy, both at the point of purchase and when the customer needs to make a claim. We will be considering this issue over the coming year, including through some work with the PRA.

9

Wholesale markets

Wholesale financial markets play a vital role in our economy. They enable companies and governments to access capital and give retail and institutional investors opportunities to invest, facilitate domestic and international trade, and underpin growth and prosperity. Record capital raising this year has helped support economic recovery. In this chapter, we explore various topics that relate to our wholesale markets perimeter.

ESG data and ratings providers

Financial services and markets have a key role to play in the transition to a more sustainable future. We are acting at the forefront of regulatory innovation to put the right requirements in place and, where appropriate, facilitate a market-based transition to a net zero economy. As part of this transition, the debate on Environmental, Social and Governance (ESG) data and ratings is becoming more prominent as ESG becomes more fully embedded in investment and lending decisions.

ESG ratings are rankings of the environmental, social and governance performance of companies or financial instruments. These are distinct from credit ratings which are assessments issued by a Credit Rating Agency (CRA) of a company's or financial instrument's creditworthiness.

ESG ratings, and the provision of ESG ratings, sit outside our regulatory remit. While some registered CRAs are also ESG ratings providers, we only regulate their credit rating activity – their provision of ESG ratings remains an unregulated activity.

The market for ESG ratings has a few large players, including the existing CRAs, but many of the companies in this market are smaller, niche providers who have a specific sector or regional focus. A report by SustainAbility found that by 2018 there were more than 600 ESG ratings and rankings providers globally, while Opimas estimated that in 2019 the market for ESG data and ratings was around US$600 million with the expectation that it could exceed US$1 billion in 2021.

IOSCO recently published a consultation report with a series of recommendations. These aim to address areas including the potential role for regulation of ESG ratings providers, the potential risks associated with ESG ratings and the impact on companies that are the subject of these ESG ratings. We also note that the European

Commission in its updated sustainable finance strategy, published in July 2021, is looking to publish a consultation on ESG ratings in 2021.

In June 2021, as part of our consultation paper on enhancing climate-related disclosures by standard listed companies (CP21/18), we included a discussion chapter which considered the topic of ESG data and ratings. It considered some of the emerging issues from the increasingly prominent role of ESG data – and in particular ratings – providers and highlighted some areas of potential harm including:

- The hardwiring of ESG ratings into investment processes meaning ESG ratings may have greater systemic impacts on consumers' investment outcomes.
- A lack of transparency of methodologies and interpretability of ESG ratings. This could mean that consumers may be unable to understand the role of ESG ratings in their investments, especially given the variability of ESG ratings among providers.
- The need to ensure good governance and management of conflicts of interest. Poor governance could affect the quality of ESG ratings if, among other things, the ratings process is not subject to sound systems and controls or if methodologies are not subject to ongoing review and validation.
- The prohibitive costs for issuers of meeting providers' data requests due to their length and inconsistency across providers, which may lead to market distortion as certain issuers prioritise some ESG rating providers over others.

We also sought views on the role of second party opinion and verification providers. These are increasingly important actors in the market for sustainable debt securities. They provide an assessment of the alignment of an issuance's sustainability characteristics and performance against market standards for ESG bonds (eg in relation to whether these securities meet ICMA's Green Bond Principles) or against a designated set of sustainability criteria.

Risks that might crystallise in this area include conflicts of interest and the potential harms caused by the complexity in analysing and assuring the issuer's performance against sustainability performance indicators.

Our work in this area will be referenced in our refreshed ESG strategy, which we plan to publish later in the autumn. Further steps will be informed by stakeholder feedback to our discussion chapter. We will publish a feedback statement on the other topics covered, including ESG data and rating providers, in the first half of 2022. The Government recently published a roadmap, Greening Finance: a Roadmap to Sustainable Investing, setting out plans for sustainable finance policy, including potential regulation of ESG data and ratings providers. We will continue our engagement with Treasury on this topic. We will also continue to engage with the international initiatives in this area both at IOSCO and in other forums.

Sports and non-financial spread betting

Following a 1991 first instance Court judgment on the financial services legislation which predated FSMA, we and the FSA before have taken the view that sports spread bets (a leveraged form of gambling on the outcome of sports and other non-financial events) can fall within our regulatory perimeter, where the instrument meets the conditions for being a contract for difference under Article 85 of the RAO. Consequently, some firms offering sports spread bets have been authorised and supervised by us whereas others carrying out similar activity, such as BetIndex, have not and should not have been. Whether sports spread bets can and should fall within our perimeter remains open to interpretation and clarification would be beneficial in ensuring a suitable regulatory regime with appropriate consumer protections for the different types of activity.

"

Our regulatory framework is designed to protect consumers from the risks from investment activity. This framework does not account for the risks to consumers from gambling activity.

We consider financial spread betting sits within our perimeter. Financial bets are often placed for investment purposes and, as such, are capable of being within the scope of MiFID regulation in respect of securities and financial markets. By contrast, sports spread bets include bets on the outcome of sporting and political events. They are not capable of being MiFID instruments.

Our regulatory framework is designed to protect consumers from the risks from investment activity. This framework does not account for the risks to consumers from gambling activity. Our view is that an alternative framework for sports spread would, ideally, result in something more tailored to the risks of sports gambling and provide appropriate consumer protections from those risks.

Currently, there are only 2 firms offering consumers sports spread betting and both are dual regulated by the Gambling Commission and us. One of the firms also offers spread betting on financial products.

We will continue to work with relevant stakeholders towards developing an alternative framework for sports spread betting which is aligned with the risk of the activity and delivers appropriate outcomes for consumers. Subject to stakeholders' views, we will pursue the most effective and efficient route towards delivering this outcome.

Senior Managers and Certification Regime

The Senior Managers and Certification Regime (SM&CR) aims to reduce harm to consumers and strengthen market integrity by improving conduct at all levels within firms and enhancing senior management accountability. We see the SM&CR as a key part of transforming culture in the financial industry and an important supervisory tool.

The regime was rolled out to all solo-regulated firms authorised under FSMA on 9 December 2019, including investment firms operating a trading venue (ie multilateral trading facilities and organised trading facilities).

However, the SM&CR does not currently apply universally. For example, it does not apply to Recognised Investment Exchanges (RIEs), Credit Ratings Agencies (CRAs) or payments and e-money firms. This is because they are not authorised under FSMA, and are instead subject to a separate process of recognition (RIEs), registration (CRAs), or authorisation and regulation (payment and e-money firms).

Extending the SM&CR to the payments and e-money sector would enhance individual accountability and governance within firms, and strengthen our ability to supervise such firms by giving us a wider range of tools to drive higher standards and mitigate risks of consumer harm.

Extending the regime to RIEs and CRAs would deliver greater accountability and robust oversight of functions that promote market integrity. It would also ensure consistency in relation to our supervisory expectations of individuals discharging key responsibilities.

In addition, a number of key trading venues are part of the same group as central counterparties (CCPs). The Treasury is currently consulting on creating an SM&CR for Financial Market Infrastructures (FMIs) supervised by the Bank of England (including CCPs), which would closely mirror the existing SM&CR. If these proposals are taken forward, then extending the SM&CR to RIEs would mean more consistency within key firms in the same group.

As outlined above, we see value in extending the SM&CR to these firms, and will continue to work with the Treasury on this issue.

> Extending the regime to RIEs and CRAs would deliver greater accountability and robust oversight of functions that promote market integrity.

Overseas Person Exclusion

The Overseas Persons Exclusion (OPE) allows an overseas person to do specified regulated business with UK counterparties on a cross-border basis without requiring UK authorisation. This is as long as the business is done 'with' or in some cases 'with or through' a UK authorised or exempt person, or in specified cases, where the business has occurred as a result of a 'legitimate approach'.

The OPE forms part of the UK's openness to international business and is considered to have contributed to the growth of London as a globally integrated wholesale financial centre; increasing competition, diversity and liquidity for the benefit of end users.

Activity performed under the OPE is outside our regulatory perimeter, and so not subject to our direct oversight or information-gathering powers. Circumstances have evolved significantly since its introduction in the 1980s, largely due to technology changes, the growing international nature of financial markets and the UK's departure from the EU. As a result, the nature and scale of activity that can be done in the UK without a permanent place of business here has potentially increased significantly over time.

Following the recent Call for Evidence on the UK's overseas framework, the Treasury plans to review the UK's overseas regulatory perimeter ahead of consulting on potential changes to the UK's regime for overseas firms and activities. We are working closely with the Treasury on this review and upcoming consultation. The consultation will consider whether the current operation of the UK's regime for overseas firms appropriately balances openness with managing risks to the resilience of financial markets, protecting consumers and market integrity and promoting competition. It will also look at whether further regulatory powers are needed for the OPE or the Recognised Overseas Investment Exchange (ROIE) regime to address any deficiencies in regulatory oversight.

Overseas Funds Regime

Many collective investment schemes (CIS) marketed to retail investors in the UK are domiciled in EEA jurisdictions. This is a legacy of the EEA UCITS Directive marketing passport, which allows a particular type of CIS called 'UCITS', which are subject to a minimum set of consumer protection rules, authorised in 1 EEA state to be marketed in other EEA states with few restrictions.

Following the UK's exit from the EU, the EEA UCITS Directive passport no longer covers the marketing in the UK of UCITS domiciled in the EEA. To avoid a cliff edge, the 8,000-plus EEA UCITS notified for marketing in the UK were able to take advantage of a Temporary Marketing Permission Regime (TMPR) which allows them to continue to be marketed in the UK after the UK's EU exit on the same basis as before. The TMPR is due to end at the end of December 2025.

The Government has legislated for a new equivalence regime called the Overseas Funds Regime (OFR). This will allow categories of non-UK CIS that are approved by the Treasury to be marketed by UK firms to the general public, including retail investors, in the UK.

We have been working closely with the Treasury, as the lead UK regulator for CIS, to design the OFR and help ensure it is implemented in a way that prevents harm.

The OFR requires the Treasury to decide on an outcomes basis whether the protection given to investors in an overseas jurisdiction's fund is at least equivalent to that given to investors in comparable UK authorised CISs. We may be asked to provide technical advice to the Treasury to help it make this assessment, and will do this in a way that is consistent with our objectives. For example, to ensure an appropriate level of protection for retail investors, we would consider the commonality of regulatory outcomes and strength of supervisory co-operation as part of those assessments.

The OFR will be contained in Part 17 of FSMA. We will need to make amendments to the FCA Handbook to implement the OFR and we will be consulting on proposals nearer the time.

Oil Market Participants and Energy Market Participants

Our regime for commodity derivatives includes a regulatory regime for firms which are referred to as oil market participants (OMPs) and energy market participants (EMPs). The OMP and EMP authorisation statuses are specific applications of the requirements in FSMA, for firms that undertake a limited range of activities. In 2001, our predecessor, the Financial Services Authority (FSA), inherited the regulation of these firms from the Securities and Futures Authority (SFA). The Treasury is currently consulting on changes through its Wholesale Markets Review which would take OMP and EMP firms that are not MiFID investment firms outside of the regulatory perimeter.

MiFID's Ancillary Activities Exemption allows firms whose commodity derivatives activity is ancillary to their main business to be exempted from MiFID requirements. So removing the OMP and EMP regime would ensure consistency and simplicity in the UK's approach to regulation of these markets. It would also reduce the regulatory costs for firms that use the regimes. We will retain some regulatory view of the small number of firms that may be taken out of the perimeter by these changes, through their use of regulated brokers and trading venues, the market abuse regime and the position reporting they are required to make.

Investment Consultants

In previous reports we have outlined concerns around investment consultants. These firms provide unregulated services that can significantly influence the investment strategies of asset owners and asset managers. For example, investment consultants advise pension fund trustees on issues such as asset manager selection.

In our Asset Management Market Study, we identified serious concerns about competition in investment consultancy and fiduciary management. We referred these sectors to the CMA for a detailed investigation. The CMA recommended that investment consultancy services should be brought within our supervisory remit.

Before the pandemic, the Treasury had planned to consult to bring these services into our perimeter. This work was put on hold due to the need to prioritise their response to coronavirus. While we note the decision to restart this work is a decision for the Treasury, we continue to support these services being brought into our perimeter.

Abbreviations used in this paper

Abbreviation	Description
AML	Anti-Money Laundering
AR	Appointed Representative
BBLS	Bounce Back Loan Scheme
CATF	UK Cryptoasset Taskforce
CCA	The Consumer Credit Act 1974
CCP	Central Counterparty
CFD	Contract for Difference
CIS	Collective Investment Scheme
CMA	Competition and Markets Authority
CTF	Counter Terrorist Financing
CRA	Credit Rating Agency
DLT	Distributed Ledger Technology
DMU	Digital Markets Unit
DPC	Deferred Payment Credit
EHRC	Equality and Human Rights Commission
EMP	Energy Market Participant
EMR	Electronic Money Regulation
ESAS	Employer Salary Advance Schemes
ESG	Environmental, Social and Governance
EST	Economic Secretary to the Treasury
ETN	Exchange Traded Note

Abbreviation	Description
FIs	Financial Institutions
FMIs	Financial Market Infrastructures
FPO	Financial Promotions Order
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
IAR	Introducer Appointed Representatives
IVA	Individual Voluntary Arrangements
MaPS	Money and Pensions Service
MLR	Money Laundering Regulation
NCA	National Crime Agency
NECC	National Economic Crime Centre
NTDS	Non-Transferable Debt Securities
OFR	Overseas Funds Regime
OMP	Oil Market Participant
OPE	Overseas Persons Exclusion
OSB	Online Safety Bill
PRA	The Prudential Regulation Authority
PSR	Payment Systems Regulator
PTD	Protected Trust Deed
RAO	Regulated Activities Order
RIE	Recognised Investment Exchange

Abbreviation	Description
ROIE	Recognised Overseas Investment Exchange
RRC	Relevant Recipient of Credit
SFA	Securities and Futures Authority
SFO	Serious Fraud Office
SIS	Speculative Illiquid Securities
SM&CR	Senior Managers & Certification Regime
TMPR	Temporary Marketing Permission Regime
TPR	The Pensions Regulator
TSC	Treasury Select Committee
UCIS	Unregulated Collective Investment Scheme

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