

# Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes

Feedback to CP12/19 including final rules

June 2013





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In this Policy Statement we report on the main issues arising from FSA Consultation Paper 12/19 (*Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes*) and publish the final rules.

**Please send any comments or enquiries to:**

Jason Pope  
Policy, Risk and Research Division  
Financial Conduct Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

**Email:** [cp12\\_19@fca.org.uk](mailto:cp12_19@fca.org.uk)

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## Abbreviations used in this paper

<b>AIFMD</b>	Alternative Investment Fund Managers Directive
<b>CIS</b>	Collective investment scheme(s)
<b>COBS</b>	Conduct of Business sourcebook
<b>COCO</b>	Contingent convertible security
<b>COLL</b>	Collective Investment Schemes sourcebook
<b>EU</b>	European Union
<b>EuSEF</b>	European Social Entrepreneurship Funds
<b>EuVECA</b>	European Venture Capital Funds
<b>FCA</b>	Financial Conduct Authority
<b>FPO</b>	FSMA 2000 (Financial Promotion) Order 2005
<b>FSA</b>	Financial Services Authority
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>MiFID</b>	Markets in Financial Instruments Directive
<b>NMPI</b>	Non-mainstream pooled investment
<b>PCIS Order</b>	FSMA 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001
<b>QIS</b>	Qualified investor scheme(s)
<b>RDR</b>	Retail Distribution Review
<b>SPV</b>	Special purpose vehicle
<b>TLPI</b>	Traded life policy investment
<b>UCIS</b>	Unregulated collective investment scheme(s)

## Glossary of terms

<p><b>Non-mainstream pooled investments (NMPIs)</b></p>	<p>Pooled investments or ‘funds’ characterised by unusual, speculative or complex assets, product structures, investment strategies and/or terms and features. They are units in unregulated collective investment schemes (UCIS); securities issued by certain special purpose vehicles (SPVs); units in qualified investor schemes (QIS); and traded life policy investments (TLPIs). Note that not all pooled investments meet the statutory criteria for a ‘collective investment scheme’; pooled investment special purpose vehicles, notably, do not generally amount to a collective investment scheme.</p>
<p><b>Regulated collective investment scheme(s)</b></p>	<p>A collective investment scheme (CIS) is a type of pooled investment defined by section 235 of The Financial Services and Markets Act 2000 (FSMA). Regulated CIS are FCA-authorized or recognised non-UK CIS and, apart from qualified investor schemes, may be marketed to any UK investor. Regulated CIS must comply with detailed rules on how they are to be operated, including investment and borrowing powers, prudent spread of risk, information to investors, fees, and other provisions aimed at setting appropriate standards of investor protection.</p>
<p><b>Unregulated collective investment scheme(s) or UCIS</b></p>	<p>A UCIS is a CIS in relation to which the operator has not applied for or obtained FCA authorised or recognised scheme status. They are not generally subject to FCA or similar overseas rules on the operation of collective investment schemes. UCIS may not be promoted to the general public (including through advised sales). Authorised persons may only promote UCIS to an investor who falls within one of the categories in COBS 4.12 or an exemption in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (PCIS Order).</p>
<p><b>The Promotion of Collective Investment Schemes) (Exemptions) Order 2001(PCIS Order)</b></p>	<p>Section 238 of FSMA prevents the promotion of UCIS by authorised persons except when undertaken in accordance with secondary legislation determined by HM Treasury (the PCIS Order) or rules made by the FCA (in the conduct of business sourcebook (COBS) 4.12). The PCIS Order is available at: <a href="http://www.legislation.gov.uk/ukxi/2001/1060/contents/made">www.legislation.gov.uk/ukxi/2001/1060/contents/made</a> and was amended in 2005: <a href="http://www.legislation.gov.uk/ukxi/2005/270/contents/made">www.legislation.gov.uk/ukxi/2005/270/contents/made</a>.</p>
<p><b>The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (FPO)</b></p>	<p>Section 21 of FSMA prevents the promotion of financial services products by unauthorised persons except when undertaken in accordance with the FPO. The FPO is available at: <a href="http://www.legislation.gov.uk/ukxi/2005/1529/contents/made">www.legislation.gov.uk/ukxi/2005/1529/contents/made</a>.</p>

**Retail investor(s)**

A retail investor is a person who invests in their capacity as a retail client – that is, a client who is neither a professional client nor an eligible counterparty. Professional clients and eligible counterparties are defined in COBS 3 and, generally speaking, are institutional clients and individuals who invest by way of business. In this paper we distinguish between three types of retail customer:

**(i) Sophisticated investor(s)**

Retail clients meeting the criteria for categorisation as sophisticated investors under any of the sophisticated investor exemptions in the PCIS Order, the FPO or in our rules. These are retail clients with extensive investment experience and knowledge of complex instruments, who are better able to understand and evaluate the risks and potential rewards of unusual, complex and/or illiquid investments such as NMPIs.

**(ii) High net worth individual(s)**

Retail clients meeting the criteria for categorisation as high net worth individuals under any of the high net worth investor exemptions in the PCIS Order, the FPO or in our rules. Among the criteria are having an annual income of more than £100,000 or having investable net assets of more than £250,000. These criteria are subject to review and may be updated in future.

**(iii) Ordinary retail investor(s)**

In this Policy Statement we use the term 'ordinary retail investor' to refer to retail clients who are neither sophisticated investors nor high net worth individuals. These are the investors of ordinary means and experience who make up the vast majority of the retail market in the UK. As discussed in a 2012 consultation paper by the International Organization of Securities Commissions (IOSCO), such investors face difficulty understanding the terms and features of complex financial products.<sup>1</sup> Such investors are at particular risk in relation to inappropriate promotion of non-mainstream pooled investments.

<sup>1</sup> Suitability requirements with respect to the distribution of complex financial products, Consultation Report, CR 03/12, IOSCO, February 2012





# 1. Overview

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## Introduction

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- 1.1** In Consultation Paper (CP) 12/19<sup>2</sup> the Financial Services Authority (FSA) – our predecessor organisation – proposed a solution to serious problems identified in the distribution of high-risk, complex investments to ordinary retail investors.<sup>3</sup> While sophisticated or high net worth retail clients may be better able to protect their own interests, ordinary retail investors face significant risk of detriment from these investments.
- 1.2** The CP proposed to ban the promotion of unregulated collective investment schemes (UCIS) and close substitutes in relation to ordinary retail investors in the UK. The investments captured by this marketing restriction are collectively referred to in this paper as ‘non-mainstream pooled investments’ or NMPIs.
- 1.3** Having considered the feedback we received to the consultation, we (the FCA) are now making rules based on the FSA proposals. In this paper, we summarise this feedback and set out our response to it.

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## Who does this affect?

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- 1.4** This Policy Statement (PS) will be of interest to:
- firms promoting products, now classified as NMPIs, to retail customers ;
  - product providers offering these products or which allow access to them through investment wrappers;
  - discretionary portfolio managers who may include NMPIs in portfolios;
  - providers that create these investments;
  - compliance consultants and other firms that assist distributors; and
  - consumers and consumer organisations.

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<sup>2</sup> CP12/19: [www.fca.org.uk/your-fca/documents/consultation-papers/fca-cp1219](http://www.fca.org.uk/your-fca/documents/consultation-papers/fca-cp1219) <http://www.fca.org.uk/your-fca/documents/consultation-papers/fca-cp1219>

<sup>3</sup> We use the term ‘ordinary retail investor’ to refer to retail clients who are neither sophisticated investors nor high net worth individuals. See the Glossary of useful terms for more detail.

### Is this of interest to consumers?

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- 1.5** This PS will be of interest to consumers and consumer organisations. The rules we are making protect ordinary retail investors by reducing the risk of detriment from inappropriate promotions of UCIS and close substitutes. But the rules still allow firms to promote these products to high net worth or sophisticated investors, for whom the products are more likely to be appropriate.

### Context

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- 1.6** In its supervisory work the FSA found that most retail promotions and sales of UCIS reviewed were inappropriate and failed to meet existing requirements, exposing ordinary retail investors to significant potential for detriment.
- 1.7** The FSA published its first review into the UCIS market in 2010, together with guidance to firms on the expected standards with the aim of improving market practice.<sup>4</sup> A series of enforcement cases against firms and individuals should also have created a deterrent to further poor sales.<sup>5</sup> However, ongoing supervision of this market – looking at the quality of promotions and sales at a range of firms, including individual financial advisers of all sizes as well as wealth managers – found that standards did not improve. So the FSA proposed changing restrictions that already applied to the promotion of UCIS to strengthen the regime and reduce the scope for poor practice.
- 1.8** Concerns were not solely related to the promotion of UCIS, however. The same investment strategies as are often seen in UCIS are reaching the market using a variety of other legal structures. To provide equivalent consumer protection in relation to these other structures and to reduce the risk of arbitrage, the CP therefore proposed the creation of a uniform marketing restriction for a wider group of products.
- 1.9** The proposals were designed to advance the FSA's objective of securing the appropriate degree of consumer protection by preventing the promotion of NMPIs to consumers for whom these products are unlikely to be suitable. Promotion of these products to high net worth and/or sophisticated retail investors will be permitted. The rules do not affect marketing to professional and institutional investors. As the FCA has now replaced the FSA as the conduct regulator for financial services in the UK, we will take the proposals forward as part of our own consumer protection mandate.

### Summary of feedback and our response

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- 1.10** The consultation period closed on 14 November 2012. There were 145 responses from a range of respondents, including consumer organisations, individual consumers, trade bodies, product providers, distributors and other firms with an interest in this market.
- 1.11** The vast majority of respondents supported the primary objective of seeking to protect ordinary retail investors from receiving inappropriate promotions. Many also suggested ways in which the approach could be refined.

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<sup>4</sup> *Unregulated collective investment schemes: project findings*, FSA, July 2010 and *Unregulated collective investment schemes: good and poor practice report*, FSA, July 2010

<sup>5</sup> Details of relevant enforcement notices: [http://www.fsa.gov.uk/smallfirms/your\\_firm\\_type/financial/investment/ucis-enforcement-  
notices.shtml](http://www.fsa.gov.uk/smallfirms/your_firm_type/financial/investment/ucis-enforcement-<br/>notices.shtml)

- 1.12** Feedback was specifically requested on whether the NMPI definition caught products that respondents believed are not close substitutes for UCIS and should not face restrictions to their marketing. Most detailed responses focused on this question.
- 1.13** After analysing responses, we carried on talking to key stakeholders to give them enough opportunity to raise concerns. We also shared a draft of the final rules with selected trade bodies before publishing this PS, to identify any difficulties or areas where clarification was needed.
- 1.14** See Annex 4 of this paper for a flow diagram setting out how the marketing restrictions will work in relation to communications with retail clients.
- 1.15** In the final rules set out in this PS we maintain the original, central aim of protecting ordinary retail investors from NMPIs but have refined the NMPI definition and focused more tightly on products posing the greatest risk of inappropriate distribution to ordinary retail investors. We have also considered firms' concerns about requirements applicable to marketing to high net worth or sophisticated retail clients.
- 1.16** This is not to say that we necessarily believe that the products no longer falling within scope of the marketing restriction should be marketed to all types of retail customer or that they are generally suitable for all retail investors. We remind providers of existing guidance setting out their role in helping to ensure good customer outcomes.<sup>6</sup> In particular, where products are designed for a specific target customer group, we expect providers to consider the implications of sales outside that group. Distributors should also bear in mind that being able to promote a product does not mean it is suitable for a particular client and they should take great care when distributing more complex, unusual or riskier products to the retail market.
- 1.17** We will continue to review market developments. This may not be the final consultation on NMPIs and, should we discover similar issues in the future that lead to significant potential for consumer detriment, particularly where arbitrage is taking place to avoid the marketing restriction, we may need to consider an extension of scope, bringing more pooled investments under the marketing restriction. If necessary we can use a temporary product intervention rule to make this change before consultation.
- 1.18** We already plan work on a new consultation introducing marketing restrictions for other products which are not pooled investments. The industry is beginning to introduce a range of securities – including contingent convertibles (CoCos), building society deferred shares and similar instruments – that carry risks unfamiliar to and inappropriate for many ordinary retail investors. We intend to consult on the introduction of a new marketing restriction in relation to these types of products. See chapter 3 for further discussion of this.

### Next steps

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#### What do you need to do next?

- 1.19** Given the unavoidable complexity of the legislative and regulatory framework in this area we are allowing firms until the end of this year to implement the new rules. The rules will take effect from 1 January 2014 but firms may wish to comply with them sooner, in particular given the significant risk of inappropriate or unsuitable sales to ordinary retail investors, which these rules seek to address.

<sup>6</sup> *The Responsibilities of Product Providers and Distributors for the Fair Treatment of Customers*

- 1.20** Firms affected by the new rules should use this time to consider what changes, if any, they need to make to their systems and to make sure they are ready to follow the new rules when they come into force.
- 1.21** Investors who already hold a NMPI may want to seek advice on whether it is or remains suitable for their needs.

#### **What will we do?**

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- 1.22** We will supervise the market, both under current rules and under the new rules when they are implemented. In particular, we are interested to check that firms are not seeking arbitrage opportunities to bypass the rules in a way likely to lead to detriment for investors. If they are, we will consider options to address these new issues.

## 2. Summary of responses

- 2.1** This chapter outlines the views of the 145 respondents to the proposals made in CP12/19. We have provided a full list of non-confidential respondents to this chapter in Annex 1.
- 2.2** We also set out our views on these responses and how we have decided to proceed.

### Non-mainstream pooled investments

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- 2.3** The rule changes proposed in the CP aim to improve retail consumer outcomes by ensuring that NMPIs are recognised as specialised products unsuitable for general promotion in the UK retail market. As providing financial advice generally includes making a financial promotion, by limiting the ability of firms to bring these products to the attention of consumers, the FSA also aimed to limit the scope for retail clients being wrongly advised to invest in them.
- 2.4** Specifically, the FSA proposed the following measures:
- changing the financial promotion rules to limit the type of customer to whom firms may promote products within scope of the NMPI definition;
  - Handbook guidance on the appropriate use of exemptions and on the effect of the financial promotion rules on advised sales to clarify that personal recommendations generally amount to a financial promotion and, as a result of the marketing restrictions, advice on a NMPI may result in an unlawful promotion if no valid exemption is available;
  - a rule requiring firms to keep a record of the basis on which a NMPI promotion has been made and requiring distribution firms to ensure their compliance oversight function confirms the compliance of each financial promotion, including financial promotions in the context of advised sales, with the marketing restriction rules; and
  - updating the *retail investment product* definition to clarify the position on advice on UCIS and substitutable products in relation to Retail Distribution Review (RDR) independence requirements.

### Responses to individual questions from CP12/19

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**Q1:** *Do you agree that we should look to impose restrictions on the promotion of non-mainstream pooled investments to ordinary retail investors?*

- 2.5** Of the 119 respondents who answered this question most agreed in principle that ordinary retail investors should be protected from promotions inviting investment in complex, higher risk products, but there were differences in opinion on how best this should be achieved.
- 2.6** Almost one-quarter of respondents agreed with the proposals in full and a further third of respondents agreed with them for a narrower range of products, as is taken forward in the final rules attached to this PS. Some responses suggested that the problems lie only with certain asset classes and the focus should be on asset types rather than product structures. Three respondents called for a wider range of products to be covered, two of whom noted the potential for investments outside the regulatory perimeter (i.e. investments in relation to which we have no authority) to lead to similar risks of detriment.
- 2.7** Other responses argued that the problems instead relate to distribution and suggested that the RDR would resolve problems arising from inferior advice and conflicts of interest created by the high levels of remuneration previously available from NMPIs.
- 2.8** Some responses argued that the current regulatory framework for UCIS works adequately and any problems are a result of poor regulatory supervision and inadequate enforcement of existing rules.
- 2.9** Some firms questioned the legal basis of the extension to the UCIS marketing restriction, noting that section 238 of the Financial Services and Markets Act (FSMA) applies only to collective investment schemes.
- 2.10** Some responses also asked for further detail of how the marketing restriction relates to EU developments, particularly the Markets in Financial Instruments Directive (MiFID) and the Alternative Investment Fund Managers Directive (AIFMD).
- 2.11** One respondent asked why we do not simply ban the sale of NMPIs. On the other hand, three asked why we do not regulate these products more closely, for example in terms of their accountancy practice and their management of conflicts of interest.

### Our response

We note that the majority of respondents agreed with the general aim of the proposals to protect ordinary retail investors from the risks arising from inappropriate promotion of NMPIs. But we recognise that it is appropriate to narrow the scope of our proposals in some areas. So we have made various changes, discussed elsewhere in this PS, in relation to the products within scope of the NMPI definition and the way the exemptions to the marketing restrictions will work.

Regarding the suggestion that not all asset classes used within NMPIs are problematic, we note that the risks identified for ordinary retail investors from NMPIs in the CP are three-fold:

- first, that the underlying assets may be speculative, illiquid and/or difficult to value accurately;
- second, that the investment strategies and/or terms and conditions are often highly complex; and

- third, that less regulated product structures carry heightened governance risks.

These factors may be present in varying degrees in individual NMPIs but we consider that, in the retail market, it is sophisticated and/or high net worth investors who are most likely to be able to protect their own interests either by being able to evaluate complex propositions themselves or by being able to afford specialist advice. We have found too much bad practice and extensive potential for consumer detriment in relation to promotions for UCIS and other NMPIs to ordinary retail investors. However, we have incorporated asset-specific considerations into the special purpose vehicle and traded life policy investment elements of the NMPI definition.

We do not share the view that the existing rules on UCIS work as intended, and do not believe that problems in this market are a result of a lack of regulatory supervision and enforcement. For some years now there have been regular regulatory updates to the industry, including good and poor practice guidance and a series of enforcement cases that should have deterred poor practice. Our subsequent work suggests that promotion and sales quality has not improved, in spite of our work to raise standards. The softer measures proposed by respondents have not worked sufficiently to date and it is not clear that they will do so in the future.

We have found that existing rules do not provide sufficient protection to consumers in relation to UCIS, and furthermore they do not extend to close substitutes, promotion of which poses similar risks. As so many of the products are outside the regulatory remit or based outside the UK, we cannot regulate the products more closely. To protect ordinary retail investors, we therefore consider it important to take the steps set out in this PS.

We agree that the coming into force of the RDR rules should lead to improved customer outcomes and better sales quality. However, we do not consider that these improvements will be enough to address the specific concerns identified in relation to NMPIs. NMPIs are niche, risky products almost certainly inappropriate for ordinary retail investors: they are more likely to be suitable for promotion to professional or institutional investors, and to those retail customers who meet the criteria to be treated as sophisticated or high net worth investors.

While improved competence requirements and the introduction of adviser charging will reduce the likelihood of unsuitable advice, the search for yield and belief in low-risk, high-return investments (which do not exist in reality) remain and can lead ordinary retail investors to mistake the risks they would take with NMPIs. The marketing restrictions therefore act as safeguards, directing marketing efforts for these products towards the types of clients who are best placed to evaluate them (or better able to afford specialist advice).

NMPIs will still be an option for firms dealing with sophisticated investors or high net worth individuals (as well as non-retail clients) and we expect to see improved standards under the RDR for sales to customers in these groups.

With regard to the legal basis underlying the marketing restrictions, we note that the UCIS marketing restriction is not being extended to all NMPIs. The

marketing restriction from section 238 FSMA will continue to apply to UCIS and a similar restriction is being created for other types of NMPI under the FCA's general rule-making and financial promotion rules powers.

We believe that this approach is consistent with EU legislation.

- By default, alternative investment funds under the AIFMD may only be marketed to professional investors (articles 31 to 32 AIFMD) unless the national authority decides to allow them to be marketed to retail customers (article 43). The proposals in the CP therefore take advantage of the article 43 option for national regulators to allow promotion of AIFs to retail clients, subject to 'stricter requirements' determined by the national regulator. Even though the AIFMD imposes some governance requirements on managers of alternative investment funds, we believe restricting the marketing of some alternative investment funds in relation to ordinary retail investors is an appropriate approach. This recognises the nature of the risks and the difficulties this category of consumers typically faces in evaluating these unusual and/or complex investment propositions.
- Our understanding is that, while MiFID has some provisions relating to the conduct of marketing, it does not harmonise rules in relation to marketing limitations and that the existing marketing restriction in relation to UCIS, long in place in the UK, is consistent with MiFID. This also explains why we have not considered a sales ban for NMPIs, as that would interfere with a range of activities which are subject to harmonised MiFID rules.

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**Q2: *Are there any other investments that should be treated in the same way?***

- 2.12** We received 57 responses to this question. 23 respondents suggested other investments that they felt should be within scope of the marketing restriction. Examples included: venture capital trusts, enterprise investment schemes, carbon credits, spread betting, investments in land, forestry, timber or hotel rooms, derivatives, hedge funds, non-CIS pooled investments and UCIS-style investment strategies being wrapped into offshore life assurance structures.
- 2.13** Others requested clarity on whether specific product types would be within scope of the NMPI definition.

### **Our response**

As described in our feedback to the next question, at present we are fine-tuning and narrowing the scope of the NMPI concept compared to the range on which the FSA consulted, rather than expanding it.

This is not to say that products taken out of scope are necessarily 'mainstream'. We will continue to review market developments and, if we find poor practice in the market leading to similar concerns, we have now established a mechanism that can be applied to deal with those issues. Should further concerns be identified, we may consult on widening the NMPI concept or otherwise apply a marketing restriction to additional products, including any product which we have excluded from scope in these final rules.



The FCA is also able to make temporary product intervention rules.<sup>7</sup> We can make these before consulting so we deal promptly with the risk of significant consumer detriment. In appropriate situations, we will be able to use this process to widen the NMPI concept or introduce other marketing restrictions, and thus protect ordinary retail investors from inappropriate promotions of other products, in line with the FCA's early intervention strategy.

**Q3: *Are there any investments caught by the non-mainstream pooled investment definition in the draft rules that you believe should not be?***

**2.14** We had 144 responses to this question. Industry respondents suggested a wide variety of investments that they considered should not be caught by the rules. In particular, respondents mentioned:

- exchange traded products;
- listed investment funds and non-UK regulated funds that have not been recognised in the UK;
- products that allow investors to benefit from Business Property Relief or Business Premises Renovation Allowance;
- qualified investor schemes;
- real estate investment trusts and other property investments;
- retail structured products that take the form of securities issued by a special purpose vehicle (SPV); and
- venture capital trusts.

**2.15** Some respondents challenged the inclusion of arrangements which were not in fact caught by the draft rules in the consultation:

- direct investment in asset-backed securities, including retail mortgage backed securities (the rules only capture pooled investments);
- loans to companies or individuals (as above);
- syndicates (which are not caught unless the arrangement amounts to a UCIS or is incorporated as an SPV of the specified type); and
- trading companies, limited liability partnerships (LLPs), joint ventures and commercial funding vehicles (the rules do not capture incorporated entities which are not SPVs of the specified type).

**2.16** There was also significant interest in whether enterprise investment scheme funds and seed enterprise investment scheme funds, which are arguably similar to venture capital trusts, would be included in scope.

<sup>7</sup> <http://www.fca.org.uk/your-fca/documents/policy-statements/fsa-ps133>

- 2.17** There was some degree of concern that the proposals could restrict the development of crowd funding or social investments which take the form of products within scope of the NMPI definition. In particular, we were asked about the implications of the marketing restriction on charity investments.
- 2.18** A number of responses argued either that no products should be subject to the marketing restrictions or that, rather than look at product structures, the approach should focus on underlying asset types.
- 2.19** A minority thought that the marketing restriction should apply broadly to all products subject to the consultation.
- 2.20** A few respondents said that they felt unable to answer the question as they needed greater clarity of the definition of NMPI and more prescription as to the specific investments the rules were intended to catch.

### Our response

The FSA's starting position was to seek to avoid regulatory arbitrage in the future and to protect ordinary investors from products that should be more properly targeted at sophisticated or high net worth investors. We welcome responses and views on the scale and scope of this approach.

As noted in our response to question 2, we are taking forward a more limited approach than the one proposed in the CP, calibrating our interventions to focus on the products of greater concern. However, this might be an incremental approach where, if necessary and subject to further evidence from ongoing reviews, we will consider extending the scope in the future.

We confirm that the following products now lie out of scope of the marketing restrictions:

- securities issued by SPVs that pool investment in listed or unlisted shares or bonds;
- exchange traded products;
- overseas investment companies that would meet the criteria for investment trust status if based in the UK;
- real estate investment trusts; and
- venture capital trusts.

We also confirm that enterprise investment scheme funds and seed enterprise investment scheme funds that are not structured as UCIS are outside the scope of this work. Those that are structured as UCIS will be restricted in the same way as other UCIS. A number of other arrangements that are fund-like but do not take the legal form of an NMPI will remain unaffected by the new rules.

The following investments are subject to marketing restrictions:

- units in qualified investor schemes (QIS);
- traded life policy investments;
- units in UCIS; and
- securities issued by SPVs pooling investment in assets other than listed or unlisted shares or bonds.<sup>8</sup> See questions 8 and 9 for further discussion on this subject.

Equity and debenture-based crowd funding, peer-to-peer lending and similar investment platforms may or may not amount to UCIS and those that do will be caught by the marketing restriction in the same way as for any UCIS. Other arrangements, depending on how they are structured, may amount to SPVs, although SPVs that pool investment in shares or debentures are not NMPIs under the final rules.

We are not providing any exemptions for the promotion of social investments that take the legal form of a UCIS or an SPV of the type specified under the rules. The risks inherent in these product structures mean they are unlikely to be suitable for ordinary retail investors and should only be promoted in the retail market to high net worth and sophisticated investors.

We have included an exemption to make it clear that European Social Entrepreneurship Funds (EuSEF) and European Venture Capital Funds (EuVECA) may be marketed to eligible investors.<sup>9</sup>

Some respondents asked if the marketing restriction would interfere with the ability of firms to promote charity investment funds to charities. We confirm that it will not (category 3 in COBS 4.12.4R(5) allows firms to promote NMPIs in these cases). The Treasury is consulting on charity common deposit funds as part of the implementation of the AIFMD.

Respondents also queried how the rules apply to LLPs and listed investment companies. These arrangements may or may not be NMPIs, depending on whether they are UCIS or SPVs (of the specified type) as opposed to trading businesses with commercial objectives other than the securitisation of assets.

As noted above, some respondents asked about products which were not, in fact, in scope. This suggests we need to further help the industry to understand the rules. We have added a flow chart to this PS at Annex 4 to help firms assess whether a product is a NMPI under the finalised rules.

See the discussion in question 6 for further information on non-UK regulated funds that have not been recognised in the UK and products that allow investors

<sup>8</sup> This category will include asset backed securities, LLPs and retail structured products where they take this legal form and do not invest in listed or unlisted securities.

<sup>9</sup> The EU Commission has introduced new Regulations in relation to social entrepreneurship funds (<http://register.consilium.europa.eu/pdf/en/12/pe00/pe00074.en12.pdf>) and venture capital funds (<http://register.consilium.europa.eu/pdf/en/12/pe00/pe00073.en12.pdf>). These funds may only be marketed to professional clients and other investors (including retail clients) who commit to invest €100,000 or more and state in writing that they are aware of the risks.

to benefit from Business Property Relief or Business Premises Renovation Allowance. Question 8 provides further detail on our approach to QIS and question 9 on our approach to securities issued by SPVs.

**Q4: Do you agree that we should remove the general ability of firms to promote UCIS under COBS 4.12.1R(4) category 1?**

- 2.21** COBS 4.12.1R(4) category 1 allows firms to promote UCIS to people who are already participants in a UCIS or who have been in the last 30 months. There were 60 responses to the question asking whether we should remove the general ability of firms to promote UCIS to these customers. Just over half agreed that this is a sensible approach.
- 2.22** Some of those respondents who said the category should remain unchanged felt that the existing rule works adequately but that our enforcement and supervision of the rules could be more stringent. Others were emphatic that removing category 1 would not solve the issue.
- 2.23** Two respondents suggested that clients of IFAs, private banks and wealth managers expect to be provided on an ongoing basis with detail of schemes, particularly tax-incentivised investments.

#### Our response

Our ongoing experience is of poor market practice. A substantial amount of supervisory and enforcement resource has been directed at this issue but standards have remained stubbornly poor. We cannot continue to rely on promises of future improvements and a line must be drawn to protect ordinary retail investors from further detriment.

As noted in the CP, the quality of UCIS promotion and sales in the past has been so poor that retaining this category could compound potential consumer detriment by allowing further promotion to investors on the basis of an investment that may have been unlawfully promoted and/or unsuitably recommended. So it would not be appropriate to retain this category, and we have not been offered persuasive arguments to the contrary. In general, therefore, we are stopping firms promoting UCIS to retail customers under this category, permitting only certain promotions (see question 5 below). An equivalent approach is being introduced in relation to other NMPIs.

Regarding those respondents who felt that clients should be able to receive promotions on an ongoing basis, particularly of tax-incentivised investments, we consider that this approach is only likely to be suitable for retail investors who meet the criteria to be considered either high net worth or sophisticated. See our response to question 6 for further discussion on this point. We still believe that NMPIs should not generally be promoted to ordinary retail investors, even if they have been promoted to those individuals in the past.

However, we have carefully drafted the marketing restrictions so existing investors are not left without access to ongoing advice. Firms may continue to provide advice on existing investments and whether they should be retained or sold. The marketing restriction simply stops the promotion of further investment (other than as set out in the next question).

**Q5: Do you agree that firms should still be able to promote replacement UCIS to retail customers where the original product is being replaced or liquidated?**

- 2.24** While proposing that category 1 would generally be unavailable in the future, the CP suggested it should be retained for situations where the UCIS being promoted is intended to absorb or take over the assets of the investor's existing holding, or where the investment is offered by the operator of the investor's existing product as an alternative to cash on its liquidation. There were 59 responses to the question asking for thoughts on this approach. The majority of these responses agreed with the proposal.
- 2.25** Some respondents, agreeing with the approach, noted that there are other events besides replacement or liquidation that should be brought to an investor's attention. As an example, a proposed restructuring, such as a rights issue, of the product may need consultation and agreement of existing investors.

#### Our response

We are of the opinion that, while there is a risk that the original investment may have been mis-sold and the replacement investment may not be any more appropriate than the original one, it is preferable for customers to hear about a planned replacement product than have to accept encashment without any choice in the matter. We are therefore retaining the ability of firms to promote new NMPs that are intended to replace or absorb an existing scheme.

With regards to product restructuring events, in many cases, communications will not amount to a promotion to invest further money so will not be subject to the marketing restriction and may proceed in a similar way as advice on an existing NMPI investment. However, where there is a rights issue, the communication is likely to amount to a promotion and we are therefore widening the exemption to allow firms to communicate the promotion to existing customers.

**Q6: Do you agree that we should remove the ability of firms to promote UCIS under COBS 4.12.1R(4) category 2?**

- 2.26** Category 2 of COBS 4.12.1R(4) allows authorised firms to promote UCIS to people for whom they have assessed the product to be suitable. The CP proposed the complete removal of this category. We have found that this category is the most often used exemption for inappropriate promotions of UCIS to retail clients, with many firms appearing to regard the exemption as allowing promotion to any retail client so as long as advice is given. Combined with persistently poor standards of advice on UCIS, we have found that the availability of the exemption significantly undermined the protections intended by the statutory marketing restriction regime. The CP proposed that firms would only be able to promote UCIS to retail clients meeting the criteria to be certified sophisticated investors, self-certified sophisticated investors or certified high net worth individuals in the Promotion of Collective Investment Schemes (PCIS) Order.
- 2.27** There were 64 responses to the CP question asking for thoughts on this approach. While the majority of those responses argued that this category should remain, many respondents agreed with its removal.

- 2.28** Some of those who disagreed with removing this category noted that the self-certified sophisticated investor and the certified high net worth individual exemptions in the PCIS Order are only available where the scheme invests wholly or predominantly in the shares or debentures of one or more unlisted companies. This would mean that UCIS with other underlying assets were only available to retail clients meeting the criteria to be certified sophisticated investors. Respondents said, in particular, that certain property investments are granted tax incentives which may be particularly desirable for high net worth individuals.
- 2.29** Others who disagreed noted that the PCIS Order exemptions require the certificates to be signed by one authorised firm and promotions to be made by another. This approach, respondents argued, could effectively act as a sales ban as no authorised firm would take the risk of certifying clients for another firm.
- 2.30** Three respondents noted that funds regulated in other jurisdictions that have not been recognised in the UK are, technically, UCIS and subject to the marketing restriction. This leads to two concerns.
- First, regulated US mutual funds are likely to be more suitable than EEA-regulated funds for US citizens temporarily resident in the UK and expecting to return to the USA. At present, firms promote funds in this scenario under COBS 4.12.1R(4) category 2.
  - Second, where a UCITS fund has been approved by a home state regulator but the fund manager has not applied for recognition of the fund in the UK, the fund is regarded as a UCIS and can only be promoted in accordance with the marketing restriction. At present, firms wishing to promote funds in this scenario also follow the requirements under COBS 4.12.1R(4) category 2.
- 2.31** As already noted in question 1, some respondents were of the view that the RDR will address the problems with the sale of UCIS.

### Our response

As noted earlier, we do not share the view that the existing rules work as intended. We are therefore removing category 2 in general for ordinary retail investors.

However, we agree with the points made in relation to the practicality of relying on the exemptions in the PCIS Order (which also apply to the Financial Promotion Order (FPO)). So we are introducing new exemptions in our rules to provide greater flexibility. These new exemptions will allow firms to:

- certify clients meeting the criteria set out in the high net worth or sophisticated investor exemptions, rather than requiring a third-party firm to sign the certificates;
- promote any NMPI to retail clients who meet the criteria to be certified as sophisticated investors; and
- promote any NMPI to retail clients who meet the criteria to be certified as high net worth individuals or self-certified investors, provided the firm making the promotion considers that the NMPI is likely to be suitable for

that client following a preliminary assessment of the client's profile and objectives (a full suitability assessment must be undertaken if advice is being given).

The exemptions in the PCIS Order and the FPO will also remain available to firms if they wish to use them to promote UCIS and other NMPs respectively.

The FPO and PCIS Order thresholds for high net worth individuals were set in 2001. While the final rules introduce a new exemption that applies equivalent wealth thresholds, we plan to consult on whether these criteria remain appropriate or if the thresholds in our exemption should be higher.

As a further safeguard, as noted above, this new category will require that, before making the promotion, the firm must carry out a preliminary assessment of the client's profile and objectives and only proceed with the promotional communication if it believes that the NMPI is likely to be suitable for that client. This means that firms must not use the exemption to promote NMPs indiscriminately to any high net worth client but only promote NMPs which it believes are likely to be suitable for that client. If advice is being offered, the firm should carry out a full suitability assessment before recommending the product. In relation to any exemption, firms must bear in mind that permissibility of promotion does not mean the product is necessarily suitable for the client in question.

We are also introducing a new category that will allow firms to promote US mutual funds to US citizens temporarily resident in the UK. This category will allow firms to promote investments either with or without advice.

Finally, we are introducing a new exemption permitting promotion of non-UK UCITS funds that have not been recognised in the UK to all retail investors subject to the preliminary suitability assessment as set out above. Firms wishing to promote these funds will also be required by the terms of the exemption to provide product information in the same way as they would if the UCITS was recognised. As UCITS funds are intended for retail clients and the funds will have been authorised by the home state regulator as meeting directive requirements, we accept the rationale for allowing their promotion to retail investors generally, provided appropriate safeguards are in place to account for the fact that these schemes have not applied for or obtained recognition in the UK. If fund managers wish their UCITS fund to be promoted to the general public in the UK they should follow the product passport process for the fund to be recognised in the UK.

This exemption will not apply to non-UCITS funds regulated in other jurisdictions; if such funds are not otherwise recognised schemes in the UK, they will be subject to the marketing restriction as with any other NMPI. The UCITS regime creates a retail fund structure intended to be used on an international basis. Other regulated non-UCITS collective investment schemes may not have the same controls as UCITS funds and may not be intended or appropriate for general promotion to the retail market; for example, the UK qualified investor scheme is not intended for ordinary retail investors.

**Q7: Do you agree that we should remove the exemption in COBS 4.12.1R(4) category 8?**

- 2.32** Essentially, category 8 customers in COBS 4.12.1R(4) are intended to be sophisticated, highly experienced investors. With the removal of the suitability-based exemption currently applicable to category 2 customers, the CP noted the probability that firms would turn to category 8 as a gateway to promote UCIS inappropriately to ordinary retail investors.
- 2.33** There were 64 responses to the CP question asking for thoughts on this approach. As with the previous question, a majority believed that this category should remain. Again, the RDR was cited as a reason not to remove this category; the rationale being that in the future, with IFAs better trained and qualified, firms would be better equipped to assess expertise, experience and knowledge.

**Our response**

As noted in question 1, we regard UCIS as niche products almost certainly inappropriate for ordinary retail investors. The existing category 8 exemption does not set out specific requirements or indicators of sophistication and we believe it presents similar risks of misuse as category 2, potentially undermining the intended protections of the regime. Other routes will be available for firms wishing to promote UCIS to high net worth or sophisticated retail investors, including the new exemptions applying to NMPIs generally (see our response to question 6 above). These other approaches set out procedural requirements and prescribed warnings to investors, and should offer more protection against firms wrongly classifying retail investors for the purposes of marketing UCIS.

Alternatively, in relevant situations, retail clients can elect to be treated as professional clients. If they meet the criteria and opt to be treated in this way, NMPIs may be promoted to them under COBS 4.12.1R(4) category 7 (which allows promotion to non-retail clients).

We are proceeding with the proposal to remove COBS 4.12.1R(4) category 8.

**Q8: Do you agree that we should limit the ability of firms to promote qualified investor schemes (QIS), securities issued by special purpose vehicles (SPVs) and traded life policy investments in the retail market?**

- 2.34** The CP noted that other legal forms are increasingly being used that expose investors to substantially similar or the same risks as UCIS. The CP listed QIS, securities issued by SPVs and traded life policy investments as the product types regarded as close substitutes to UCIS.
- 2.35** There were 71 responses to the question asking whether the ability of firms to promote these schemes should be limited in the same way as for UCIS. Responses varied. Most generally supported the FSA's approach, particularly when the reduced scope as set out in this PS is taken into account and the NMPI definition is clarified.
- 2.36** Of those respondents who discussed QIS in particular, some expressed surprise that they were included as NMPIs but others agreed that QIS promotion should be restricted.



- 2.37** There was wide support for limiting the promotion of traded life policy investments.
- 2.38** Most of the discussion on SPVs related to the definition of the concept. Many respondents were concerned that the concept is too widely defined and could capture products that should not be subject to the marketing restriction as well as those that should. In particular, many of the product types discussed in question 3 were mentioned here. There was some recognition that securities issued by SPVs could carry broadly similar risks to units in UCIS but a few responses argued that SPV-issued securities should not be regarded as NMPIs at all.
- 2.39** Two respondents commented that private equity funds and alternative investment funds under the AIFMD are able to include shares in the investment as part of the remuneration package for their staff. COBS 4.12.1R(4) category 4 allows the promotion of UCIS to eligible employees but there is no equivalent for NMPIs taking other legal forms and it was suggested that we should consider introducing one.

### Our response

While in the past unusual and exotic investment strategies would tend to be created with a UCIS structure, the market is evolving and using new investment forms to bring the same strategies to investors. There is a risk of regulatory arbitrage if consumer protection measures are strengthened in relation to the promotion of UCIS but not for products that are closely substitutable. On the other hand, it is important that any restrictions we impose are correctly calibrated to the risks identified and that we have regard to the benefits of choice and competition in the market. It is important to find the right balance among these factors. We have therefore sought to ensure the final rules deliver a smarter, more focused intervention.

QIS will remain in scope of the NMPI definition. The relevant regime was set up to allow greater investment flexibility to more sophisticated investors and professional investors within a regulated investment framework. The current guidance in the collective investment schemes sourcebook (COLL) 8.1 already explains that these investments are intended for institutional and sophisticated investors only. Inclusion within the NMPI definition therefore reinforces the regime's original purpose.

Traded life policy investments (TLPIs) will also face a similar marketing restriction to UCIS, regardless of the legal form the product takes. This is in keeping with the approach indicated in the guidance on the promotion of TLPIs published in April 2012. As noted above, respondents broadly supported including these products within the marketing restriction.

We are taking forward the marketing restriction for securities issued by SPVs but making some changes to the approach set out in the CP. See the next question and our response to question 3 for further discussion on this.

As our intention is to create a broadly comparable regime for all NMPIs, the final rules allow firms to promote any NMPI to eligible employees of that investment as part of their remuneration package in the same way as previously permitted in relation to UCIS.

**Q9: Do you have any comments or suggested improvements for our approach to SPV-issued securities, including structured products?**

- 2.40** Recognising the subject of securities issued by SPVs would lead to debate, the CP posed a specific question on the subject. We received 65 responses.
- 2.41** Many of the products taken out of scope of the NMPI definition in question 3 would have been included under the SPV concept. So, as with responses to question 3, there was considerable support for excluding the same product types listed there. Respondents making these points included individual consumers, firms and industry associations.
- 2.42** Many firms responding to this question argued it would be difficult for distributors to apply the proposed rules in practice as it may not be clear whether an individual security was within scope of the marketing restriction or not. A few respondents said that it would be inappropriate to rely on the waiver process to determine if a SPV should fall out of scope of the NMPI definition.
- 2.43** Many other respondents however supported the approach to SPV-issued securities, agreeing that it is sensible to guard against arbitrage by treating them in the same way as units in UCIS.

### Our response

We expect that the rules we are making should be easier to apply in practice. Distributors wanting to promote an investment company will need to check if the SPV is of the type caught by the NMPI definition. If an SPV pools investment in shares and bonds (as opposed to more exotic or speculative securities or assets), or if it is specifically excluded, it will not be a NMPI and its marketing will not be restricted.

It is therefore only where the SPV holds other assets (i.e. where returns are not based on shares or bonds) that it would fall within scope of the NMPI definition and be subject to the marketing restriction. This includes structured products which do not invest in exotic assets directly, but which provide returns to investors which are predominantly determined with reference to the performance of assets other than share or bonds (for instance, through the use of derivatives). Such structured product SPVs will be NMPIs and subject to the marketing restriction.

To be clear, securities issued by the following types of incorporated company structures are not caught by the NMPI definition:

- trading companies (that is, businesses set up for commercial purposes rather than the securitisation of assets);<sup>10</sup>
- non-UK investment companies that would qualify as investment trusts if based in the UK;
- venture capital trusts; and

<sup>10</sup> This means that investing directly in unlisted securities on a crowdfunding platform or in individual enterprise investment schemes are not subject to the marketing restriction.

- SPVs that pool investment in listed or unlisted shares or bonds.

We do not expect significant numbers of investments designed for ordinary retail investors to fall within the refined scope of the SPV definition. This may be the case for some property-based arrangements, for example – but not all. We have been unable to identify a way of clearly separating out acceptable arrangements from those which are not appropriate for distribution to ordinary retail investors. In the circumstances, we consider that the waiver process is the most appropriate solution in providing case-by-case exceptions to the marketing restriction to accommodate those few arrangements which fall within the NMPI definition but which may be appropriate for general distribution to the retail market.

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**Q10: Do you have any comments on the Handbook guidance we propose to add regarding the use of exemptions in the FPO and PCIS Order?**

- 2.44** The CP proposed to introduce guidance in our conduct of business sourcebook (COBS) to help firms understand their obligations when relying on the exemptions in the PCIS Order and the FPO. In essence, this guidance noted that firms should not promote a product, even where an exemption is technically available, if it would not be appropriate or not in the customer's best interests. We had 56 responses to the question asking for comments on this guidance.
- 2.45** Several respondents welcomed the provision of Handbook guidance.
- 2.46** Some firms, however, argued that the effect of the guidance is that it becomes easier for unregulated firms to promote UCIS under the FPO and PCIS Order than regulated firms, creating an incentive for unregulated advice and potentially lower standards. Of these, some were concerned that the guidance implies a need for sophistication, even for high net worth investors, and that it conflates issues of promotion and advice.
- 2.47** Three respondents felt that the thresholds set in the high net worth individual exemptions are too high. One felt that any customer who regards themselves as high net worth should be entitled to be treated as such, without having to meet specific wealth criteria, and another said that having to meet criteria for both income and net assets was too difficult. On the other hand, one respondent felt that verification of assets by an accountant would be desirable to avoid incorrect assessment.
- 2.48** A few also questioned whether firms will be any better at assessing if customers qualify to be treated as sophisticated than they were at assessing suitability. Some respondents suggested that investors may lose protections if they are treated as sophisticated or self-certified sophisticated investors rather than ordinary retail investors, for example by limiting the ability of the investor to make a successful complaint to the firm or the Financial Ombudsman Service.
- 2.49** One industry respondent asked for clarity on how the guidance applied to non-advised sales. We were asked whether firms producing a Key Investor Information Document or other similar mandatory disclosure documents for certain products would be in breach of the marketing restrictions.

- 2.50** One respondent suggested that the guidance should recommend a maximum proportion of the customer's wealth that could be invested in NMPs, and another called for practical examples to be provided to clarify acceptable situations.
- 2.51** We were also asked about some existing guidance (COBS 4.12.1R(4)(note 5)) on which the CP did not consult and whether it was being maintained. This guidance confirms that, for the purposes of determining if a client is a professional client in order to decide whether a promotion may be made (under COBS 4.12.1R(4) category 7), the non-MiFID criteria are relevant.

### Our response

We consider that the guidance proposed in the CP is useful and are introducing it into COBS 4.12.

The situation for high net worth individuals is discussed in question 6. We note here, however, that the exemptions require the individual to have **either** an income **or** net assets meeting the criteria, not both.

We disagree that unregulated firms will be better able to promote NMPs than authorised firms under the FPO and PCIS Order. An authorised firm must certify that an individual meets the requirements to be regarded as a certified sophisticated investor, so the standards will be the same for these customers regardless of who makes the promotion. The new categories of allowable promotion that we are introducing will also mean that authorised firms are able to consider promoting a wider range of investments, limiting any incentive for unregulated advice. Furthermore, authorised firms have always been subject to the Principles on which the guidance is based and should already be in compliance with it. The guidance does not introduce higher standards than those which already apply. In any event, we believe a consumer receiving promotional communications from a regulated firm is entitled to expect higher standards than if the promotion was issued by an unregulated firm.

The guidance was developed to guard against the risk identified by some respondents of inappropriate use of the exemptions. We remind firms that their duties towards clients are not suspended when a promotion is permissible under an exemption provided in statute or under our rules. These duties include but are not limited to fair treatment, acting in the client's best interests and ensuring advice is suitable (if advice is provided). We expect firms to take their responsibilities seriously and the guidance acts as a steer of our expectations. We will continue to supervise the market to check that good standards are maintained.

We are not proposing to offer more detailed guidance. It would be difficult to cover all relevant situations and we consider that it is better for the guidance to be phrased at high level.

There is no rule that reduces regulatory protection for sophisticated or high net worth investors; they have the same rights to complain or seek recourse from the Financial Ombudsman Service and Financial Services Compensation Scheme. We appreciate that, in practice, if a consumer is correctly regarded as sophisticated for the purposes of the investment under consideration this is

likely to be relevant when assessing the quality of the advice. This is because sophisticated clients are commonly regarded as better able to make their own evaluation of investment propositions. However, where sophistication has been improperly assessed, such an assumption does not apply.

We do not consider that this risk is of sufficient magnitude as to warrant either abandoning our attempts to protect ordinary retail investors or limiting the ability of firms to promote NMPIs to sophisticated or high net worth investors. There are retail investors who are sufficiently experienced and knowledgeable and for whom NMPIs will represent potentially valuable extra investment choice. We believe this approach strikes the right balance.

Where NMPI promotions are non-advised, firms must still know enough about their clients to be able to assess that the customer meets one of the available exemptions to the marketing restriction. It is not possible to market NMPIs to the general public but only to individuals meeting the criteria set out in the exemptions.

The guidance reminds firms of their existing obligations to make promotions in line with the Principles and the client's best interests rule. Where the distributor firm makes no promotion (for instance where the transaction is made within a discretionary service or is on an execution-only basis) the marketing restriction does not apply, but the firm remains subject to both the Principles and more specific duties to the clients arising from our rules and from UK and EU law.

Discretionary portfolio managers in particular should take note that the marketing restriction expresses a regulatory view that NMPIs are unlikely to be suitable for ordinary retail investors. So a discretionary manager should exercise particular care when placing ordinary retail investors' money into these products, to satisfy him or herself that it is suitable for each particular client and is in the best interests of that client.

On the question on mandatory disclosure documents, the marketing restrictions limit firms' ability to make a financial promotion. A financial promotion is an invitation or inducement to engage in investment activity that is communicated in the course of business. Giving a customer a disclosure document does not always amount to a promotion. For example, the document could be supplied as information (rather than a promotion) after the decision to invest is made by a manager in a discretionary management service.

It is also worth noting that most NMPI providers are not required to produce standardised disclosure documents (as these products are not subject to COLL rules). Where they are and where the provision of that document amounts to an invitation or inducement to invest, the marketing restrictions will apply. The distribution of prospectuses and certain prospectus-related communications are not restricted and benefit from specific exemptions provided by the FPO.

Lastly, we confirm that we are maintaining the guidance in COBS 4.12.1R(4) (Note 5) but are updating it to try to make it clearer. The decision on whether a promotion can take place or not is outside MiFID scope so, when categorising clients as professional to determine whether a promotion may be made under the non-retail client exemption, the non-MiFID criteria are relevant, even if the MiFID criteria are relevant when the business is transacted.

**Q11: Do you agree that we should require firms to retain a record of the basis on which the promotion of a non-mainstream pooled investment has taken place for each financial promotion?**

- 2.52** To improve compliance with the rules and thus secure better consumer outcomes, the CP proposed a rule requiring firms to document and retain records of the basis on which they make each NMPI promotion. We received 63 responses to this.
- 2.53** Most agreed with this proposal. Some felt that it is consistent with the existing high-level systems and controls requirements and firms exhibiting good practice should already be doing this.

**Our response**

We agree that retaining a record of the basis for each promotion would be best practice under existing rules but, in our supervisory work, we find too often that this has not been done. So we are introducing a specific rule that requires firms to retain a record of the basis on which NMPI promotions are made.

**Q12: Should we require confirmation of compliance with the marketing restriction for each promotion?**

- 2.54** The CP also asked if this record should be retained for each promotion or if a different model should be considered. We received 60 responses to this question, evenly split on the subject. Those who argued against this proposal generally raised practical concerns about the volume of confirmation exercises that would need to be undertaken at large firms by the CF10 individual. This is addressed in the next question.

**Our response**

We believe that requiring a record for each promotion is likely to result in fewer inappropriate promotions, so our new rule will require confirmation of compliance for each promotion.

**Q13: Do you agree that the CF10 individual is the correct person to confirm compliance?**

- 2.55** The final question posed in the CP on record keeping related to which member of staff is most appropriate to confirm compliance. The proposal was for the individual responsible for a firm's compliance oversight function (the firm's CF10 individual) to sign off each promotion.
- 2.56** We received 59 responses. While there was quite widespread agreement with it, some alternatives were also suggested. A majority of respondents expressed concern that it would be impractical for the CF10 person to confirm compliance for each individual promotion in larger firms that make regular NMPI promotions.

- 2.57** Several respondents suggested there should be some degree of flexibility in the execution of this function and it should be possible for the duty to be delegated, perhaps with the CF10 person taking responsibility for the overall framework within which the sign-off takes place. The process could involve the adviser preparing the record for each promotion, with sign-off by someone in the compliance department, not necessarily the CF10 person.
- 2.58** In smaller firms, on the other hand, one respondent noted that individuals might have multiple responsibilities. It could be the case that the individual promoting the scheme is also the CF10 and this could lead to a conflict of interests.

### Our response

After consideration of the feedback we accept the case for greater flexibility over which staff member confirms compliance with the marketing restriction. We still believe that the compliance department is the relevant area of the firm to undertake this responsibility. But we will allow the CF10 to delegate this responsibility to other compliance staff, subject to them doing annual reviews of the process for reviewing and confirming compliance.

Firms may, if they choose, require the individual preparing the promotion to draft the record but it will remain the responsibility of the compliance function to sign it off.

In recognition of their resource constraints, we are not proposing a more complicated sign-off process for smaller firms. If there are conflicts of interest the firm must develop an appropriate process to manage those risks.

### ***Q14: Do you have any comments on the Handbook guidance we propose to add regarding the link between promotion and advice?***

- 2.59** In ongoing supervision work, we have found that many distributor firms do not understand that providing advice generally includes making a financial promotion. This can mean that firms are in breach of the marketing restriction in FSMA as well as the suitability rules when they give unsuitable advice on UCIS. The CP proposed introducing guidance to explain that promotions in the context of advice are still financial promotions and subject to the marketing restriction rules.
- 2.60** We received 49 responses in relation to the proposed guidance, most of which agreed with the inclusion of the guidance. A minority disagreed.
- 2.61** Some respondents asked for further clarity and detail on what constitutes a financial promotion and what constitutes a real time promotion. One respondent asked whether discussing an investment with a client, prior to its purchase in a discretionary management service, amounts to a promotion.
- 2.62** We were also asked if the reverse is true and all promotions contain advice.

### Our response

While generally supported by many respondents, there was some confusion over the purpose of this guidance. Some respondents suggested that it confuses two separate matters as if, by virtue of advice being provided, no promotion is made.

We disagree with this interpretation. Financial promotions are invitations or inducements to engage in investment activity that are communicated in the course of business. Advice recommending that a client should buy a specific investment generally includes a communication that amounts to a financial promotion. Where it does, the advice must comply with the relevant rules for promotion as well as suitability. The proposed guidance aims to make this link clear. The confusion expressed by some respondents shows the need for this guidance, which we are therefore taking forward.

In a true discretionary service – where investment transactions may be made without the client’s prior approval – prior discussion of the investment will not amount to a promotion if that discussion does not amount to an invitation or inducement to invest.

In response to the question on whether all promotions amount to advice, the answer is no. Promotions may be made in the context of advice, and a communication purported to be merely promotional may amount to advice (this turns on substance not form), but this is not always the case. Similarly, not all advice includes a promotion and advice that does not recommend that a client should enter into an investment (for instance, advice to disinvest or generic advice in relation to asset classes) will not be promotional in nature.

We are also adding an exemption to the rules confirming that solicited advice in relation to a specific NMPI can be provided where the client has not previously received a financial promotion about that product from the firm or individuals connected to the firm. This is intended to ensure that ‘determined’ ordinary retail investors who have come across specific NMPIs through their own research are able to seek advice on such products. The exemption is not available if the firm has itself brought the product to the attention of that investor, or if the client has sought its advice after receiving a promotional communication from someone connected to the firm (for instance, ‘referrals’ by non-authorised or exempt persons).

Additional information on what constitutes a financial promotion, what constitutes a real time promotion and what constitutes advice is available in chapter 8 of the Perimeter Guidance and on our website.<sup>11</sup>

**Q15: Do you agree with our proposed update to the retail investment product definition?**

- 2.63** The FCA Handbook Glossary term *retail investment product* is used in relation to rules introduced by the RDR in relation to adviser charging, independence and adviser competence. The term has a wide scope and includes many NMPIs. This has led to some confusion, with some firms thinking we expect them to sell NMPIs widely. To clarify expectations the CP

<sup>11</sup> Chapter 8 of PERG: <http://fshandbook.info/FS/html/FCA/PERG/8>. The financial promotion section of our website: [www.fca.org.uk/firms/being-regulated/financial-promotions](http://www.fca.org.uk/firms/being-regulated/financial-promotions). Finalised guidance on independent and restricted advice: <http://www.fca.org.uk/your-fca/documents/finalised-guidance/fsa-fg1215>



proposed to update the *retail investment product* definition to note the restrictions on the types of customer to whom the products may be marketed.

- 2.64** We received 51 responses on this subject. A majority supported the proposal. Two respondents expressed uncertainty on the intention behind this guidance.

### Our response

We are making the proposed change to the retail investment product definition. The change clarifies the interaction between the RDR independent advice requirements and the marketing restrictions in COBS 4.12 and so should reduce the scope for misunderstanding and mis-sales.

As we set out in our response to question 1, we do not believe that NMPIs are likely to be suitable for ordinary retail investors and therefore believe it is appropriate to remove them from the relevant market for firms that only promote products to this type of client. We expect the RDR to lead to improved standards where firms deal with high net worth or sophisticated retail investors.

### **Q16: Do you have any comments on the impact of our proposals on existing customers and the distributor firms serving them?**

- 2.65** The CP also considered the possible impact of the proposals on customers with existing investments in NMPIs.
- 2.66** It noted that the proposed marketing restrictions are drafted specifically to permit advice on the ongoing suitability of an investment already held by a customer. Advice to keep a current investment unchanged or to disinvest in favour of a more suitable, more mainstream investment would not be caught by the marketing restriction. However, a recommendation for further investment into an existing NMPI would be subject to the marketing restrictions.
- 2.67** The CP asked readers to comment on the likely impact of the proposals on existing customers and we received 54 responses.
- 2.68** A few responses again reiterated the view that the RDR would solve problems identified with poor sales practices. Some of these responses suggested that RDR-style measures could be taken further with new qualification requirements or new permissions for firms wanting to promote NMPIs.
- 2.69** Some respondents felt that the proposals would limit choice for ordinary retail investors and disenfranchise existing investors. One suggested that the marketing restrictions are against the Human Rights Act and one respondent observed that it will be difficult to obtain professional indemnity insurance for NMPI sales.
- 2.70** We were also asked how the marketing restrictions work for promotions to couples, where only one party meets the criteria to be regarded as high net worth or sophisticated.
- 2.71** Some responses expressed concern that the consultation itself or new rules might lead to concern among existing investors and possibly trigger the liquidity issues often inherent within NMPIs. On the other hand, one respondent called for the FCA to make it clear to investors,

especially those with undiversified portfolios, that there is a real possibility they have bought a product that is unsuitable for their needs. They suggested a press campaign by the FCA or Money Advice Service, or possibly requiring distributors to contact affected customers proactively to review existing investments.

- 2.72** Some industry respondents expressed general agreement with our approach, so long as there is no new requirement for distributors to review promotions using retrospective rules.
- 2.73** A couple of respondents asked how the process would work for non-advised transactions.
- 2.74** A few respondents expressed concern about the possibility that poor practice would re-appear outside the scope of regulation and consumers would be worse off as a result.
- 2.75** One respondent raised a concern with ongoing indirect retail exposure to NMPIs via regulated investments. For example, regulated collective investment schemes are able to invest a proportion of their assets in UCIS.

### Our response

We accept that the marketing restrictions may limit choice for some consumers. However, not all innovation or choice is in the interests of customers. We are making the judgement that the benefits of improving customer outcomes for most retail investors outweigh the costs to the minority for whom they may be suitable. We also note that the minority of retail investors for whom a NMPI may be suitable are likely to be sophisticated investors who will still be eligible to receive promotions for these products. We do not consider that the marketing restrictions are in breach of the Human Rights Act.

We encourage NMPI distributors to review their professional indemnity insurance contracts. We have come across cases where the insurance does not cover UCIS, for example, and this can have a significant impact on the firm and its customers should anything go wrong.

Under the marketing restrictions, promotions may only be communicated to individuals meeting the criteria in an exemption. We would not expect promotions to be communicated to clients simply because their partner meets the criteria.

The CP acknowledges that existing customers wishing to disinvest from a NMPI may find that there are delays in accessing their funds or, for certain products, that early surrender is difficult, costly or not possible. Such delays and difficulties will be due at least in part to the illiquid assets often held in NMPIs. Customers for whom these are suitable investments should understand that such issues may arise and they should not depend on the product for income or immediate access to capital.

As most investment in NMPIs is by customers unaffected by proposals in this consultation, such as institutional investors, we do not expect liquidity problems to arise in many cases, if at all. The telephone helpline established for existing customers concerned about their investments as a result of the CP attracted no calls at all, suggesting that the new rules may not trigger problems with

liquidity. We also note that our approach is forward looking and does not require any changes to existing investments.

While problems have been identified with a number of sales, we are not saying that all existing investments were mis-sold. Existing customers who have questions about their investment may want to contact a financial adviser. Advisers should be able to help explain how the investment works, whether it is still right for them and what their options are

We are not proposing to introduce new rules requiring firms to review clients' existing holdings. Even if we did we would not impose retrospective standards but would expect sales to meet the standards of the day (although the FSA had been saying for some years that market practice failed to meet existing expectations).

As the CP confirmed, the rules do not change the situation for execution-only transactions. The rules only apply where a firm makes a financial promotion for a NMPI. If the firm does not engage in promotional activity, the rules have no impact. This also means that firms are able to provide ongoing advice on whether it is in the interests of the customer to maintain existing investments, for example. We are also adding an explicit exemption to allow firms to provide advice to invest in a specific product when solicited by a client.

Please see our response to question 19 for further information on our thoughts on unregulated investments.

With regard to the observation on the availability of indirect investment in NMPIs for ordinary retail investors, we note that this work is focused on direct retail exposure only. Given the additional controls and protections on regulated products holding NMPIs we are not considering changes to this type of indirect retail access.

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**Q17: Do you have any comments on our analysis of non-mainstream pooled investments?**

- 2.76** The CP summarised the FSA's analysis of the size of the market for NMPIs. As so many of the products are outside the regulatory remit or based outside the UK, it is impossible to gather comprehensive data on all products in the market. The overview was therefore largely based on supervisory experience. The CP asked for comments on this analysis and we received 50 responses.
- 2.77** Some responses suggested that the NMPI definition was unclear and they were therefore unable to comment on the analysis.
- 2.78** Two responses raised points in relation to the CP's suggestion that some currently uncategorised retail customers would be re-classified as high net worth or sophisticated under the proposed rules. They suggested that this would lead to additional compliance costs and it is not obvious that this would lead to any benefits for consumers.

- 2.79** Two responses asked us to further consider the implications of the marketing restrictions on the wider economy by restricting the ability of businesses to raise capital.
- 2.80** One respondent said the existing regime is extremely complicated and the proposals would add to its complexity.
- 2.81** Another respondent suggested that, given the scale of the problem, the Financial Ombudsman Service and Financial Services Compensation Scheme should prepare for cases to be brought to them in the future.
- 2.82** One respondent questioned the evidence base for our analysis, asking if it was entirely based on the 2010 thematic review. Another respondent questioned whether the analysis included sufficient detail on the expected benefits from the proposals.

### Our response

We believe that there will be a clear benefit to consumers if retail promotions are limited mainly to high net worth or sophisticated investors. While there may be an increased compliance cost for re-classifying those clients who do meet the criteria, the benefit will arise from the reduction in inappropriate promotions to ordinary retail investors.

In the CP, the FSA recognised there may be wider implications for the economy as a result of the marketing restriction. The conclusion was that, as not all NMPIs invest in relevant assets and institutional investment accounts for the majority of NMPI investment, the impact should not be significant. The impact should be even less now that we have confirmed that certain investments, like venture capital trusts, are out of scope. While there remains a risk that there may be a reduction in capital raised, no respondent suggested it would be more than the FSA estimate. As noted in our response to question 3, we do not consider that the social benefit of an investment outweighs the need for consumer protection for ordinary retail investors. Certain products should only be promoted in the retail market to high net worth or sophisticated investors.

We agree with the respondent who noted that this is a complicated area of regulation. We have sought to simplify the final rules, for example by consolidating exemptions in a single set under COBS 4.12.4R(5) and removing equivalent provisions in COBS 4.12.1R and COLL 8 Annex 1R. The interplay of domestic and international legislation and existing regulation, combined with the intrinsic variability and increasing complexity of investment products, means that rules affecting distribution are necessarily detailed and, to an extent, irreducibly complex. This is one of the risks that distributors take when dealing with these products. The complexity is unavoidable and, while the steps we are taking will not go as far as we would like in resolving this, we do believe that for many distributors the situation will become far less complicated. For instance, the new rules treat similar products in a similar way regardless of legal structure. Distributors who do not deal with retail customers who meet the criteria to be high net worth or sophisticated should not promote NMPIs.

The Financial Ombudsman Service and Financial Services Compensation Scheme are already dealing with complaints in relation to problems with NMPIs. The

Financial Ombudsman Service for example, has commented in its 2011/2012 annual report on the growth in the number of complaints it receives about UCIS.<sup>12</sup>

It is true that the only report we have published into our findings on UCIS sales relates to IFAs. But our work is far wider than this, encompassing IFAs of all sizes and wealth managers. While we are not publishing a new report into our ongoing findings, we can confirm that many cases are still in breach of the requirements and we continue to receive worrying intelligence of further bad practice that needs to be reviewed.

The cost benefit analysis in the CP estimated the benefits of the proposals in terms of customer protection to be substantial, reducing the amount of unsuitable investment by between approximately £680m and £2.3bn (between approximately £135m and £460m each year). In light of the proposed scope changes to the proposals, Annex 2 of this paper provides updated estimates of the costs and benefits of this work.

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**Q18: Do you have any further data on the size of the market?**

- 2.83** Following the last question, the CP asked respondents for further information on the size of the market to help check the accuracy of the data presented. We received 49 responses.
- 2.84** A few responses confirmed that respondents had no further market data.
- 2.85** Some respondents suggested that the market for some product types may be different from the estimates supplied in the CP:
- two respondents felt that the estimate for funds held by retail investors in UCIS may be too low;
  - one respondent estimated that the retail market for traded life policy investments is significantly less than was estimated; and
  - another respondent suggested that the amount held in UCIS by high net worth and sophisticated investors is likely to be higher than estimated.
- 2.86** One respondent observed that, based on the information in the CP, real estate funds account for around 30% of the estimated total held in UCIS funds.
- 2.87** Finally, one respondent said that their 'unsubstantiated estimate' is that there are around 300 unregulated investment products which fall outside the regulatory perimeter and therefore are not covered by the proposed marketing restrictions. They expressed a concern that the proposals might incentivise a move away from regulated advice for unregulated products toward unregulated advice for unregulated products.

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<sup>12</sup> See the Financial Ombudsman Service Annual Review 2011/2012 for more discussion on this subject. In cases referred to it, problems have been identified with record keeping, product classification, understanding the regulatory framework and consumers eager to invest in non-traditional investment opportunities at a time when returns on mainstream savings and investments were disappointing.

### Our response

We thank respondents for their observations on the market for NMPIs and take it into account in the updated cost benefit analysis in Annex 2. We consider that the CP provides a good estimate of the likely total investments but, given the limitations on finding accurate data, we accept that there may be some parts of the market where the estimates are imperfect.

We expect that, if anything, the estimates are too high for the market size rather than too low. The estimates included a margin of error in order to ensure that the cost benefit analysis did not under-estimate costs to the industry. This may explain why the estimate for traded life policy investments may be too high.

The amount quoted in the CP as being held in UCIS by high net worth and sophisticated investors is based on the existing legislative and regulatory framework. It may well be true that other retail investors, who are not currently categorised as high net worth or sophisticated, would meet the criteria to be categorised in that way. At present, however, firms tend not to follow the exemptions in the PCIS Order. For this reason, in the CP the FSA assumed that a greater number of retail customers would be categorised as high net worth or sophisticated in the future under the new rules.

We discuss the situation for unregulated investments further in the next question, including the work we are doing to prevent consumer detriment arising from inappropriate promotions. We do not accept that the existence of yet worse practice by unregulated firms justifies regulatory inaction over issues within our remit.

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**Q19: *Do you have any comments on our overall strategy to deal with the risks to retail customers of investing in UCIS?***

- 2.88** The CP summarised the FSA's overall approach to UCIS, including its ongoing supervisory strategy and asked for further comment. We received 79 responses.
- 2.89** A number of respondents stated their support for the overall strategy. However, many respondents reiterated messages from elsewhere in their feedback. For example, some reiterated concerns about the scope of the proposals and others that they thought an approach focused on named asset types would be better. While some said that an approach focused on improving distribution standards would be preferable, others said that more focus should be placed on providers.
- 2.90** Two respondents argued that we should consider introducing new qualification requirements for advisers selling NMPIs, or new permissions for firms active in these markets.
- 2.91** Some in the industry asked for further assistance in streamlining their due diligence processes. In particular, they stressed the need for the FCA register of collective investment schemes to include fund identifier numbers to allow comparison of the register with other data sets for easier identification of UCIS.

- 2.92** A few respondents also raised concerns with a growing trend for unregulated ‘introducers’ to recommend unregulated assets (such as a direct holding in wine rather than a financial instrument that invests in wine) to retail clients then refer the client to an IFA for advice on a SIPP capable of holding those assets. Often the introducer and IFA are members of the same group. This approach seems designed to game the regulatory perimeter for the purpose of accruing high commissions on the unregulated assets.

### Our response

Where respondents reiterated other messages from their responses, please see the relevant sections of this PS for our answer.

We considered but rejected the option of introducing new qualification requirements at this point in time. In light of the expected reduction in retail sales of NMPIs we do not believe it would be economic for any qualification body to develop an exam and a requirement to hold an extra qualification would effectively ban all sales.

Similarly, we do not think the benefits of a new permission for distributors of NMPIs would outweigh the costs. Introducing a new permission for selling NMPIs would mean changing the existing permissions for all distributors, leading to costs for all firms whether or not they have clients to whom NMPIs may be promoted.

With reference to the request for more detail on the FCA register, we can confirm that a review of FCA data will take place in due course.

The issue of unregulated introducers recommending unregulated assets is already on our radar. We are very concerned by this development. It holds the potential to lead to significant customer detriment. We have already dealt with some of the regulated firms working with unregulated introducers to vary their permissions and stop this type of business.<sup>13</sup> We encourage firms and consumers to provide us with information on any firms involved in this activity and will act quickly to investigate them and take appropriate action to protect new and existing customers.

<sup>13</sup> See the FSA's alert from 18 January 2013 to firms on advising on pension transfers with a view to investing pension monies into unregulated products through a SIPP: [www.fsa.gov.uk/smallfirms/your\\_firm\\_type/financial/pdf/alert-pension-transfers.pdf](http://www.fsa.gov.uk/smallfirms/your_firm_type/financial/pdf/alert-pension-transfers.pdf)

## 3. Further consultation

- 3.1** As discussed earlier in this paper, we are planning to consult again on a new marketing restriction for certain types of security and in relation to the criteria by which retail clients may be classified as high net worth.

### Certain types of complex or higher-risk securities

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- 3.2** Some banks and building societies are seeking new means of raising loss-absorbing capital to meet enhanced prudential requirements and have developed new types of financial instrument to meet this purpose.<sup>14</sup> The amounts banks and building societies are looking to raise suggest that these firms may consider offering these novel, complex and untested financial instruments, not only to institutional investors, but also to ordinary retail investors. We are concerned that these instruments could be promoted to retail consumers who do not have the necessary experience and understanding to evaluate them and who later face unexpected harm as a result. So a consumer could end up unknowingly buying the security for more than a professional investor would pay for it, there could be poor liquidity when the consumer tries to sell it on, particularly if the issuer should become prudentially stressed.
- 3.3** We consider that the risks to ordinary retail investors are of sufficient magnitude to warrant consideration of a new marketing restriction for these products, to steer promotion to customers for whom the products are most likely to be appropriate (e.g. sophisticated or high net worth retail investors as well as professional investors). We plan to consult on a new marketing restriction in due course.
- 3.4** In the meantime, we are working with issuers to ensure these instruments are distributed in a way that stops ordinary retail investors from buying them. One option is to introduce an interim marketing restriction through a temporary product intervention rule to address the risks to consumers while we work on consulting on and introducing permanent rules.

### High net worth individuals

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- 3.5** The criteria by which a retail client may be assessed as being high net worth are, essentially, that they have an annual income of more than £100,000 or investable net assets of more than £250,000.

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<sup>14</sup> In this context, prudential requirements refer to the capitalisation of financial institutions to guard against the risk of the institution's failure. In light of the 2008 crisis, these requirements have been extended and institutions are looking to find methods to raise additional capital.



- 3.6** These criteria, set out in the PCIS Order and FPO, were determined in 2001. For the time being, we have used them in our own high net worth exemption under COBS 4.12.4R(5). While the criteria in the Orders may be appropriate in the limited circumstances for which promotions may be made under the Orders, the exemptions in our rules allow firms to promote a wider range of products to retail clients classified in this way. We are concerned that the criteria may not be set at an appropriate level in relation to the new exemptions in our rules. We therefore plan to conduct research and consult on whether the current thresholds remain appropriate or should be updated and set at a higher level.

# Annex 1

## List of non-confidential respondents

Aberdeen Asset Managers Limited

Aberdeen Private Equity Fund Limited

A L Parker Ltd

Association for Financial Markets in Europe

Association of Investment Companies

Alternative Investment Management Association

AIS Capital Management Limited

AJ Bell

Albion Ventures LLP

Alpha Real Capital LLP

Amati Global Investors Limited

Association of Member-Directed Pension Schemes

Anand Associates Ltd

Angel Coinvestment Fund

AngelRevolutions

Association of Professional Compliance Consultants

Association of Private Client Investment Managers and Stockbrokers

Association of Real Estate Funds

Artemis VCT plc

Ashik Shah & Co. Ltd.

Aviva

AXA Wealth

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Baislee Alexander  
Barclays Bank plc  
Baronsmead  
Berwin Leighton Paisner LLP  
Bestinvest (Brokers) Limited  
Bilfinger Berger  
BioIndustry Association  
BlackRock  
BlueCrest AllBlue Fund Limited  
Bovill Limited  
British Bankers' Association  
British Property Federation  
British Private Equity and Venture Capital Association  
Bates Wells & Braithwaite London LLP  
Cannock Investments Limited  
Capital & Counties Properties PLC  
Charles Campbell  
Charles Stanley & Co Limited  
Clay Rogers & Partners Limited  
City of London Law Society  
Clubfinance Ltd  
CMS Cameron McKenna LLP  
Colin Raynor  
Compos Mentis  
Compound Growth Limited  
Davenport Lyons  
David Bundred

Deutsche Bank AG  
Dickson Minto W.S.  
Downing LLP  
Enhance Support Solutions Limited  
Enterprise Investment Scheme Association  
ETF Securities  
European Life Settlement Association  
Eversheds LLP  
F&C Commercial Property Trust Limited  
F&C Fund Management Limited  
Financial Ombudsman Service  
Financial Services Consumer Panel  
Financial Supervision Commission, Isle of Man  
Future Capital Partners (FS) Limited  
Galvan Research and Trading Limited  
Global Adviser Solutions  
Goodwin Procter (UK) LLP  
Hargreaves Lansdown Asset Management Limited  
Henderson Diversified Income Limited  
Howard Kennedy LLP  
InfraRed Capital Partners Ltd  
International Public Partnerships Limited  
Investec Wealth & Investment  
Investment & Life Assurance Group  
Investment Management Association  
IPP Ltd  
IRP Property Investments Limited

ISIS Property Trust Limited

Joint Associations Committee on Retail Structured Products

Joint response from: Allenbridge Ltd, Artifice Media, BDO LLP, Bird & Bird LLP, Bulletin Marketing, Daedalus Partners LLP, Downing LLP, Enterprise Private Equity Limited, Foresight Group, Graham Associates (International) Ltd, Guinness Asset Management, Invicta Capital Ltd, Kuber Ventures LLP, MediHome Limited, Octopus Investments, Par Fund Management Limited, Prosper Capital LLP, RAM Capital Partners LLP, Stellar Asset Management Limited, Triple Point Investment Management LLP, Wellers

Keystone Law

Kuber Ventures LLP

Law Society of England and Wales

Lewis Jarrett & Co

LLP Services Limited

London Stock Exchange

Listed Private Equity

Macfarlanes LLP

Maclay Murray and Spens LLP

MASECO Private Wealth

MedicX Fund Limited

Merchant Place Corporate Finance Limited

Michael Walters

Mobeus Income & Growth VCT plc

Mobeus Income & Growth 2 VCT plc

Mobeus Income & Growth 4 VCT plc

Money Week Ltd

Nelson Gray

Newton Investment Management Ltd

NVM Private Equity Limited

N W Brown

Octopus AIM VCT plc  
Octopus Apollo VCT plc  
Octopus Eclipse VCT plc  
Octopus Investments Ltd  
Octopus Hygea plc and Octopus VCT plc  
Octopus Second AIM VCT plc  
Octopus Titan VCT 3 plc  
Octopus Titan VCT 5 plc  
Octopus VCT2 plc  
Old Burlington Ventures LLP  
Oriel Securities Limited  
Overseas Property Professional  
Pearson Jones plc  
Peter R T Holden & Partners LLP  
Portal Financial Services LLP  
ProVen Growth & Income VCT plc  
ProVen Health VCT plc  
ProVen VCT plc  
Quoted Companies Alliance  
Rathbone Investment Management Limited  
Richard Waltham  
RW Blears LLP  
Seven Investment Management  
SGH Martineau LLP  
Shore Capital Limited  
Smith & Pinching Financial Services Limited  
Source UK Services Limited

Squire Sanders (UK) LLP

TailorMade Group

Tanager Wealth Management

Tenet Group Limited

The Income & Growth VCT plc

Thompson Taraz LLP

TLT LLP

TMRM Ltd

UBS AG

UBS Wealth Management

UK Business Angels Association

UK Sustainable Investment and Finance Association

Wealthmasters Financial Management Ltd

Westminster Wealth Management

## Annex 2

# Updated cost benefit analysis

### Introduction

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1. FSMA as amended by the Financial Services Act (2012) requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as ‘an analysis of the costs, together with an analysis of the benefits’ that will arise if the proposed rules are made. It also requires us to include estimates of those costs and those benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to produce an estimate.
2. Given the changes to our CBA requirements from those of the FSA and given the changes we are making compared to the proposed rules in CP12/19, we are including a revised CBA in this paper.
3. The main changes that will have an impact on the costs and benefits are:
  - the reduced range of products within the NMPI definition and subject to the marketing restrictions;<sup>15</sup>
  - introduction of new categories of customer in COBS 4.12 to whom firms may market NMPIs; and
  - greater flexibility over the approach to ensure promotions comply with the marketing restrictions.

### Market failure analysis

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4. The market failure analysis in the CP remains relevant and we refer readers to it for further information.<sup>16</sup> In summary, it noted that NMPIs have complex risks and it can be difficult for investors to judge their quality until long after the sale. These features – combined with providers and distributors having greater information and expertise on, and experience of, these investments – puts ordinary retail investors at a serious disadvantage (information asymmetry) when dealing with promotions inviting investment in these products. Where distributors have strong incentives to promote these investments, this market failure can motivate promotions that lead to unsuitable sales. There is also a clear regulatory failure, shown in our thematic work, of non-compliance with current rules limiting promotions of UCIS.

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<sup>15</sup> In summary, we estimate that the £1.5bn of non-UCIS NMPIs originally expected to be affected will be reduced by 10.66% for venture capital trusts, 10.6% for enterprise investment scheme funds and 3% for exchange traded products. This leads to a total reduction of 24.26%. The total non-UCIS NMPI market expected to be affected is now about £1.1bn.

<sup>16</sup> See annex 3: <http://www.fca.org.uk/your-fca/documents/consultation-papers/fsa-cp1219>



5. Were we to focus regulatory attention exclusively on UCIS, we could expect to see the same UCIS investment strategies repackaged in other legal forms to allow promotion and sales patterns to continue unchecked. Therefore, unless we apply similar restrictions to a wider range of products than UCIS, ordinary retail investors could continue to be induced to make inappropriate investment into NMPIs. The consultation process has been useful in focusing this work on the products most likely to allow for arbitrage.

## Costs

### Direct costs to the FCA

6. The CP estimated ongoing resource costs of £400,000 per annum. In the longer term, the CP suggested there may be a reduction in the need for FCA resource as the market adapts to the new regime and the risks to ordinary retail investors recede. In light of the reduced scope set out in this PS and as a result of our ongoing plans to monitor the market for signs of arbitrage, we do not expect the need for resource to reduce rapidly or by a significant amount.

### Incremental compliance costs to firms

7. The original CBA in the CP included a table summarising the expected incremental compliance costs across the industry as a result of the proposals. The table below updates that table to reflect the changes we are making compared to the proposed rules.

Incremental costs	One-off costs	Ongoing costs per year
Client categorisation	£3m to £9m	£130,000 to £170,000
Compliance confirmation	Included in the training costs	£360,000 to £960,000
Record keeping	Minimal	£50,000 to £150,000
Amending literature	£10m	Minimal
Training	£4.5m to £13.5m	Minimal
Total	£17.5m to £32.5m	£0.5m to £1.3m

8. This table takes the details in the CP CBA as the starting point. Estimated costs for client categorisation, record keeping, amending literature and training remain unchanged from the CP CBA. We do not expect the changes we are making compared to the proposed rules to affect the number of customers categorised as high net worth or sophisticated, the number of firms involved or the amount of training needed in the future. On balance, we think that the number of promotions subject to the rules is likely to stay the same as in the CP. The changes will, however, have an effect on the costs for confirmation of compliance.

### Compliance confirmation

9. The rules we are taking forward require the compliance department at distribution firms to confirm compliance with the marketing restriction for each NMPI promotion to retail clients. The CP proposed that the person allocated the compliance oversight function (CF10) would be responsible for this but we are allowing some flexibility. Compliance staff will be able to sign off on individual promotions, subject to annual sign-off of the standards and procedures by the CF10 person who, of course, retains oversight responsibilities in any event.

10. We estimate that the ongoing cost for CF10 persons to approve the framework for compliance confirmation each year will be between £150,000 and £750,000.<sup>17</sup>
11. We are also updating the estimated industry-wide cost of confirming compliance for each promotion. With the ability to delegate confirmation within the compliance department, the cost of each confirmation will fall. Reductions to the range of products in the NMPI definition should reduce the number of confirmation exercises that take place. We note, however, that the rules we are introducing grant greater flexibility to firms dealing with certified high net worth individuals and self-certified sophisticated investors than was the case under the proposed rules in the CP. The CP proposed that only NMPIs investing wholly or predominantly in unlisted shares or bonds could be promoted to these customers. The rules we are introducing will allow firms to promote any investment to these customers, subject to a preliminary assessment of suitability. This should increase the number of promotions to these groups of customers. So some of the changes we are introducing act to increase the number of confirmation exercises and others will reduce the number.
12. If these two changes were to balance out then the number of promotions subject to confirmation would be the same as that estimated in the CP. In this case, assuming a cost per hour of £18.50 for compliance staff, this will lead to aggregate costs each year for the industry of £210,000.<sup>18</sup> Adding this to the ongoing cost for the CF10 persons above, we estimate total ongoing costs of compliance confirmation of between £360,000 and £960,000 per year. However, this may be an over (under) estimate to the extent that there is in fact a net decrease (increase) from the two changes in the rules set out here.

#### Indirect costs

13. We expect providers and distributors to make fewer promotions and sales of NMPIs to retail customers as a result of the proposals in this consultation. Retail use of NMPIs will reduce if ordinary retail investors no longer receive promotions inviting investment in them. We expect advisers to channel these ordinary investors into more mainstream investments; so, while NMPIs could potentially lose funding, other, more traditional investments could see a corresponding increase in funding. This impact should be limited, however, since we estimate retail investment represents only a small proportion of investment into NMPIs.
14. The CP estimated direct retail funds under management of around £900m under the proposals, reduced from the current £4bn. In light of the changes set out in this PS, we estimate the affected volume of funds will be smaller. We estimate that direct retail funds under management in the current market, based on the narrower range of products within scope of the marketing restrictions, is £3.4bn and that this is now expected reduce to £700m under the revised proposals.<sup>19</sup>

17 As in the CP, we have assumed a cost per hour of a compliance director's time of £42.60 for a large firm manager and £71 for a large firm senior manager. To provide a margin for error, we have assumed that this process will take two seven-hour working days to complete. In practice, particularly in subsequent years where an existing system is reviewed, we expect less time to be needed. As in the CP CBA, we estimate that the number of distributor firms affected is between 250 and 750. This leads to a range for the ongoing costs of about £150,000 (£42.60x14 hoursx250) to £750,000 (£71x14 hoursx750).

18 Standardised hourly rates for management costs are drawn from Estimation of FSA administrative burdens, June 2006, Real Assurance Risk Management. To account for growth in income since then, hourly costs have been increased in line with average earnings as per the Office of National Statistics Index of labour costs per hour, Q4 2011. As in the CP, we have assumed that it will take two hours to confirm compliance.

19 This revised estimate of £700m is calculated by reducing the original estimate in the CP (£900m) by same proportion as the reduction in the total funds covered by the marketing restriction (i.e. about 76% of the funds covered by the original restriction will now be covered by the marketing restriction). However, this is likely to overstate the reduction in NMPIs invested because, by removing some products from the NMPI definition, we are increasing the range of products that can be promoted without restriction, where they may be substitutes for those covered by the restriction.

15. There may also be a few ordinary retail investors for whom some NMPIs may be suitable and who will not hear about these products as a result of the new rules. Instead, their choice will be limited to more mainstream investments. We do not expect many customers to be affected by this. We expect that most retail investors for whom a NMPI may be suitable are likely to meet the criteria to be categorised as sophisticated or high net worth and will still be eligible to receive promotional communications about these products.
16. There may be a few NMPIs that are dependent on continuing investment from retail investors. These firms will need to adapt to changes in their investor base. In the short term, at least, this may lead to liquidity issues for some products where new investment is reduced but outgoings continue. Existing customers in these products may find that there are delays, costs or other difficulties in accessing their funds. There is a risk that existing customers may react to the new rules and request redemptions that may in turn lead to liquidity problems and, possibly, to capital losses for customers. As noted in our response to question 16, we do not expect this risk to materialise in practice.
17. Finally, there may also be wider implications for the economy where NMPIs are used to raise capital for enterprises, particularly start-up entities. The CP estimated a reduction of approximately £400m to capital-raising ventures as a result of the proposals. Changes to the scope set out in this PS are expected to reduce this impact significantly, as we have confirmed that most of the primary capital-raising vehicles are out of scope of the new rules.

### Benefits

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18. The CP noted that the key benefits of the proposed rules would be a better mitigation of the market failures in the future, significantly reducing the amount of mis-selling and guarding against arbitrage. In summary, the marketing restrictions aim to ensure firms only promote products to ordinary retail investors that are more likely to be suitable for them and that will be more in line with their preferences and attitude to risk. However, we do not provide a monetary estimate of benefits we expect to accrue, because we do not think it is reasonably practicable to do so, given the data available to us.
19. There are difficulties in estimating the benefits for ordinary retail investors obtaining more suitable investments. In particular, inappropriate promotions and unsuitable advice do not always result in monetary loss and, typically, less suitable investments are higher risk but also capable of providing higher returns. For example, a customer who should only have money held in a deposit may actually profit through unsuitable advice to invest in the stock market at a time when the relevant shares increase in value. That does not mean that the advice is suitable, however: the customer has still been exposed to an unsuitable amount of risk and at some point may lose more money than they are willing or able to afford. A consumer may also suffer detriment in other ways, for example, if they were unknowingly sold an illiquid investment thinking it was liquid, will suffer detriment if they try to sell the investment and cannot do so or can only do so at a loss.
20. Also, as was the case in the CP, one of the key difficulties we face analysing the market is that our regulatory oversight is to some extent limited as NMPIs are not subject to the same regulatory and data gathering requirements of other investments, such as UK-authorized CIS. With so many firms in this market operating outside our jurisdiction it is impossible to gather full sales data, even where the transaction involves a UK-regulated firm providing advice.

21. For some consumers who lose out from having been sold a less suitable investment, there is some data available that may provide a metric of detriment. For example, where customers have lost money by investing in NMPs and the distributor has gone out of business, the Financial Services Compensation Scheme has confirmed that, where they find in favour of a claimant, the average compensation paid is over £30,000. However, we have decided not to use this data to estimate benefits because the sample of consumers who lose from the distributor becoming insolvent, and the amount they lose, is not representative of all those consumers who may suffer detriment from investing unsuitably in NMPs. And, as consumers who are reimbursed by the Financial Services Compensation Scheme have suffered significant losses from the failures of firms, using this as an estimate of benefits per consumer as a result of the new rules would risk overstating the benefits.
22. The CP also considered the findings of the FSA's 2010 review into the sale of UCIS. The majority of firms sampled, nine out of 14, or 64%, failed to understand or follow the rules restricting promotion of UCIS in the retail market. Of the 131 UCIS transactions that were reviewed, at least 90 transactions (or 76%) had been inappropriately promoted to retail investors. This provides some insight into current behaviour by firms operating in this market. Clearly, this represents significant potential consumer detriment. The new rules seek to protect these and other retail investors from being targeted by unlawful promotions, to prevent them from investing into unsuitable investments.
23. There could potentially be routes to estimate benefits if we engaged in further research. However, we do not think that it would be a proportionate use of our resources to conduct detailed exploration of the benefits. Looking at the scale of costs to unsuitable investments that the promotion aims to prevent, there are reasons to expect that benefits should outweigh the costs.
24. To see this, recall that the CP estimated total direct UK retail investment in NMPs at approximately £4bn and the impact of the proposals as leading to a reduction in the amount of unsuitable investment by between approximately £680m and £2.3bn (between approximately £135m and £460m each year, assuming that investments are held for five years). Looking at the rules adopted in this paper, we estimate that total direct UK retail investment in the new NMPI definition to be £3.4bn. Given the changes to the rules we are making, we now expect the reduction in the amount of unsuitable investment to be between approximately £550m and £1.9bn (between approximately £110m and £380m each year).
25. We would expect that this unsuitable investment will be substituted by other more mainstream, more suitable investments. The more suitable these investments are for investors, the more these investors will experience a gain in welfare as a result. However, as firms are also likely to try to pass through the additional compliance costs to consumers who would have invested in non-mainstream investments or to their other consumers, this welfare gain should be offset against the additional compliance costs borne by consumers.<sup>20</sup>
26. The total compliance costs are estimated (from the table in the 'Incremental compliance costs' section above) at between £0.5m to £1.3m per year in ongoing costs and one-off costs of between £17.5m to £32.5m. Annualising the one-off costs, by assuming that firms (on average)

<sup>20</sup> Firms may also decide to absorb (some of) the cost, in which case the compliance cost will reduce profits. If firms pass through compliance costs, then this could in principle lead to a reduction in demand, but we would expect these to be minimal, given the size of the compliance costs relative to the scale of the investments. There could also be a welfare effect if the new, more suitable investments are more costly for firms to provide and distribute leading to higher charges for investors and so welfare loss from a reduction in demand. However, we think this would be unlikely since the substitute investments are likely to be more mainstream, already widely sold investments and so, if anything, less costly for firms to provide and distribute than NMPs.

borrow at 5% interest to pay the one-off costs, these one-off costs are tantamount to firms paying an additional £0.9m to £1.6m per year. This puts the total compliance costs, annualised as above, at between £1.4m to £2.9m per year. This yearly cost compares with the estimated yearly reduction in unsuitable investments estimated above at between £110m to £380m.

- 27.** Whether on a monetised basis the welfare benefit to investors of the new, more suitable investments outweighs additional costs depends on how much more suitable the investments are. It would take further research to estimate this. However, as the scale of the compliance costs is small relative to the reduction in unsuitable investment, it would not take a large welfare benefit to investors from a more suitable investment to offset the compliance costs incurred. Because of this, it seems reasonable to expect welfare benefits from the new rules.
- 28.** An important caveat here is the extent to which firms can offer other non-mainstream products that are no longer covered in the marketing restriction in place of NMPIs being restricted. Were this to occur widely then this could significantly reduce the benefits of the proposal. However, we will be monitoring the market and may act if there are signs of this occurring.
- 29.** We might also expect other benefits. As professional indemnity insurance does not always cover the promotion or sale of UCIS, some firms have been bankrupted when dealing with complaints and paying redress. Liability can then fall on the Financial Services Compensation Scheme leading to costs for the wider industry (and ultimately their consumers). We would not expect such costs to arise so frequently in the future under the new rules.

## Annex 3

# Updated statement of compatibility

1. The CP explained the reasons for concluding that the proposals and draft rules were compatible with the FSA's general duties under section 2 of FSMA and the regulatory objectives, which are set out in sections 3 to 6 of FSMA. As the rules are being implemented by the FCA, this statement must now account for the FCA's objectives. In this annex, therefore, we outline how the rules we are introducing are consistent with newly introduced concepts in FSMA as amended by the Financial Services Act 2012.

### Compatibility with the FCA's regulatory objectives

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

2. The rules we are introducing limit promotions to retail clients where there is the greatest risk of mis-selling and detriment and raise standards for the remaining promotions. The proposals also seek to reduce the scope for regulatory arbitrage, which should avoid, to at least some extent, the need for ongoing intervention in the market as similar issues arise with different product structures. In the medium to long-term, this should reduce the need for regulatory resource in this market.

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

3. The expected benefits of the approach we have adopted is proportionate; it protects ordinary retail investors but allows firms greater flexibility when working with high net worth or sophisticated investors for whom NMPs are more likely to be appropriate.

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

4. The rules we are introducing do not restrict the marketing of as many products as the rules on which the FSA consulted. In particular, the rules do not restrict marketing for products like venture capital trusts that raise finance for young businesses. The rules we are introducing therefore take into account the desirability of supporting growth in the economy.

#### The general principle that consumers should take responsibility for their decisions

5. Consumers can only be expected to take responsibility for their investment decisions where they are in a position to understand products they are offered and the risks to which their money will be exposed. This is not generally the case when ordinary retail investors deal with NMPs. High net worth and sophisticated retail investors are better able to make their own judgements on these products (or afford specialist advice) and so, in recognition of the principle, we are providing greater flexibility to firms dealing with customers in those groups.

#### The responsibilities of senior management

6. The rules we are introducing include a focus on senior management responsibility in the requirement for the compliance director of distributor firms to evaluate the process by which compliance confirmation takes place. If we find systematic failures in a firm in the future, we will be able to take enforcement action against senior management, if appropriate.

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

7. As noted elsewhere in this paper, ongoing supervision of this market – looking at the quality of promotions and sales at a range of firms, including individual financial advisers of all sizes and wealth managers – found that firms are not meeting our expectations. We do not consider that there is sufficient scope to allow flexibility for different types of firm when promoting NMPIs to ordinary retail investors. We do, however, recognise that firms dealing with high net worth or sophisticated retail investors should be treated differently and the rules we are introducing aim to do this and provide those firms with appropriate flexibility.

**The desirability of publishing information relating to persons**

8. We do not consider that the rules will have an impact on this.

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

9. We have followed a consultation process in making these rules and have engaged with key stakeholders prior to publishing this policy statement.

**Expected effect on mutual societies**

10. We do not expect the rules we are introducing to have a significantly different impact on mutual societies. Where mutual societies wish to promote NMPIs, they will be subject to the same requirements as other firms. We do not believe that ordinary retail investors investing with mutual societies should be treated in a different manner to those investing with other firms.

**Compatibility with the duty to promote effective competition in the interests of consumers**

11. The FCA has a duty to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (section 1B(4) FSMA). This duty applies insofar as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.
12. The new rules for NMPIs aim to promote our consumer protection objective by closing loopholes in the existing statutory ban on the promotion of UCIS and by introducing an equivalent ban on the promotion of closely substitutable products to certain groups of investors. This should improve outcomes by limiting the ability of firms to interest consumers in products that are unlikely to be suitable for them and therefore make it more likely that they will choose a more suitable product.
13. After careful consideration of the evidence available, we have come to the view that the new rules are in line with our competition duty. We note, in particular, that previous measures that were less intrusive on the ability of firms and consumers to exercise choice did not remedy the underlying issues of consumer detriment. In particular, the FSA published guidance for firms on these issues, backed up with explicit use of enforcement to achieve a credible deterrent. Although these steps led to some reduction in harm to retail investors, our work has found that promotion and sales quality has not improved, with harmful effects on consumers.

14. We also note that, to exert effective competitive pressure, consumers need to assess quality and price (value) adequately. Information asymmetries between consumers and firms pose a particular problem in this market, where the products are typically complex, not subject to regulated governance requirements, and assets are illiquid, not traded on a transparent market, often unfamiliar to investors and require specialist knowledge. Taking account of these factors, it follows that additional disclosure requirements, as a tool to improve consumers' outcomes, are unlikely to be sufficiently effective in this sector.
15. Finally, we consider it of some significance that for markets to work in the interest of consumers, distributors must not be incentivised to sell the wrong product. We acknowledge that in the lead up to the RDR, and from its implementation on 31 December 2012, distributor training and competence have been improved and commission bias has been reduced. However, with mainstream investments performing poorly in recent years and consumers searching for yield, there remains a problem that NMPIs can appear attractive to investors looking for higher returns and who may not appreciate the accompanying risks. NMPIs are often attractive products for distributors to offer to clients, potentially leading to product bias that is not dependent on commission. We therefore believe that, although the RDR will mitigate aspects of the problems, it will not be enough to address them in full.
16. For these reasons, we have come to the conclusion that imposing conditions and limitations on the marketing of NMPIs is an appropriate way to try to ensure that distributors of investments compete to promote suitable – rather than unsuitable – investments to ordinary retail investors. We expect the measures to improve consumer outcomes by limiting the scope for firms to exploit information asymmetries and consumer biases, so reducing firms' ability to interest ordinary retail investors in products that are unlikely to be suitable for them. We believe this will make competition work more effectively in the interests of consumers by helping refocus competition on the promotion of investment products that are a better match to the investors to whom they are marketed.

#### **Legislative and Regulatory Reform Act 2006 (LRR)**

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17. We are required under the LRR to have regard to the principles in the LRR and to the Regulators' Compliance Code when determining general policies and principles and giving general guidance (but not when exercising other legislative functions).
18. We have had regard to these principles for the parts of the proposals that consist of general policies, principles or guidance and consider that these activities have been carried out in a way that is:
  - Transparent: we have followed a consultation process in making these rules and have engaged with key stakeholders before publishing this paper.
  - Accountable: the proposals were subject to a full consultation exercise and we have taken account of responses in order to create a framework that is proportionate and appropriate to the risks we are seeking to address.
  - Proportionate: the approach we have adopted is proportionate; it protects ordinary retail investors but allow firms greater flexibility when working with high net worth or sophisticated investors for whom NMPIs are more likely to be appropriate.

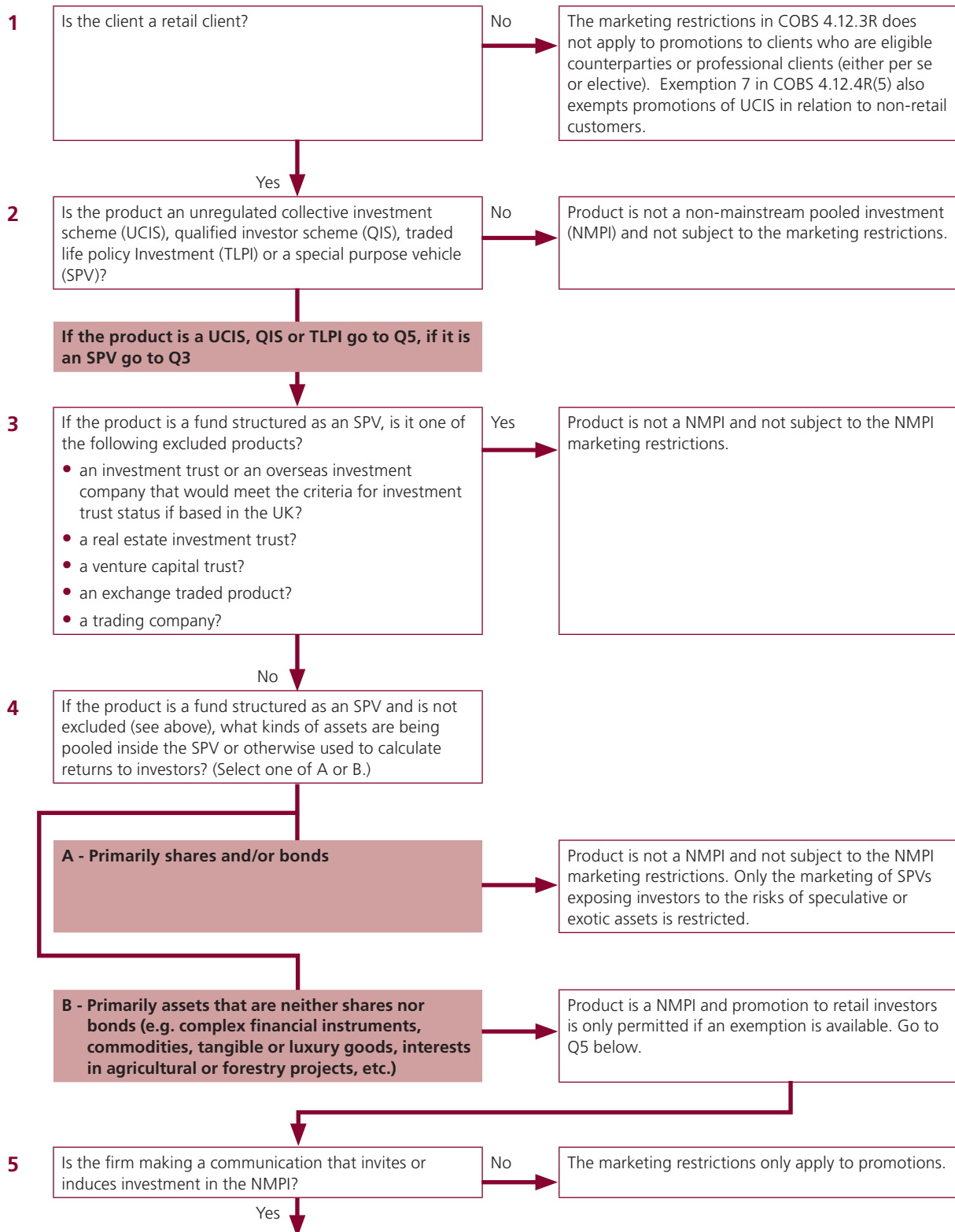


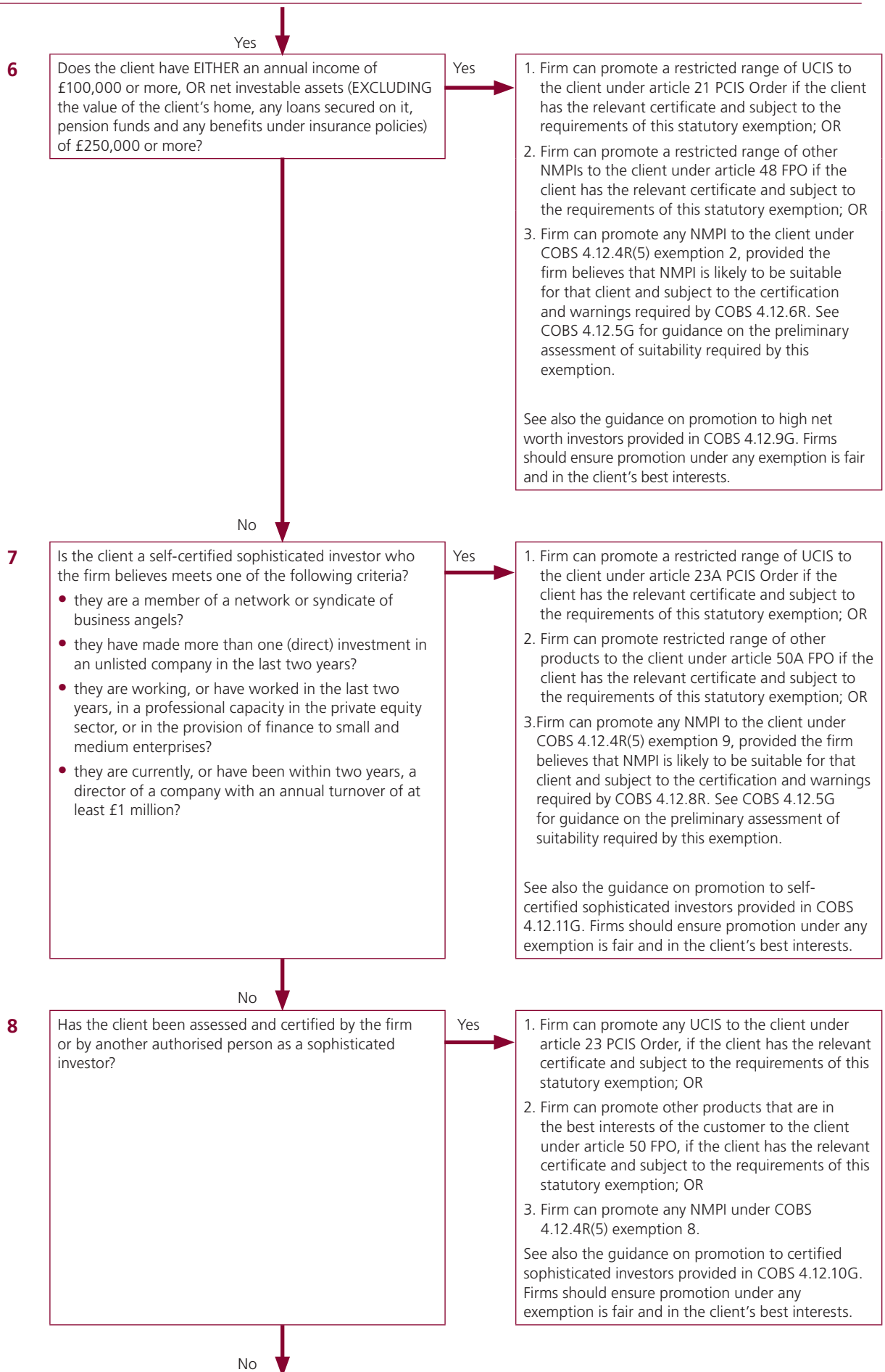
- Consistent: our approach applies in a consistent manner to all firms promoting direct retail sales of NMPIs. We have also sought to address the possibility of regulatory arbitrage to create a level playing field.
  - Targeted only at cases in which action is needed: we consider there is significant need for the introduction of these measures. Standards in this market have been and remain poor.
- 19.** We have also had regard to the Regulators' Compliance Code for the parts of the proposals that consist of general policies, principles or guidance. We consider that the approach we have adopted will be effective in helping firms understand and meet regulatory requirements more easily, in a manner that leads to improved outcomes for consumers and addresses the significant risks in this market. We have sought to adopt an approach that avoids unnecessary burdens on enterprise and stifling economic progress.

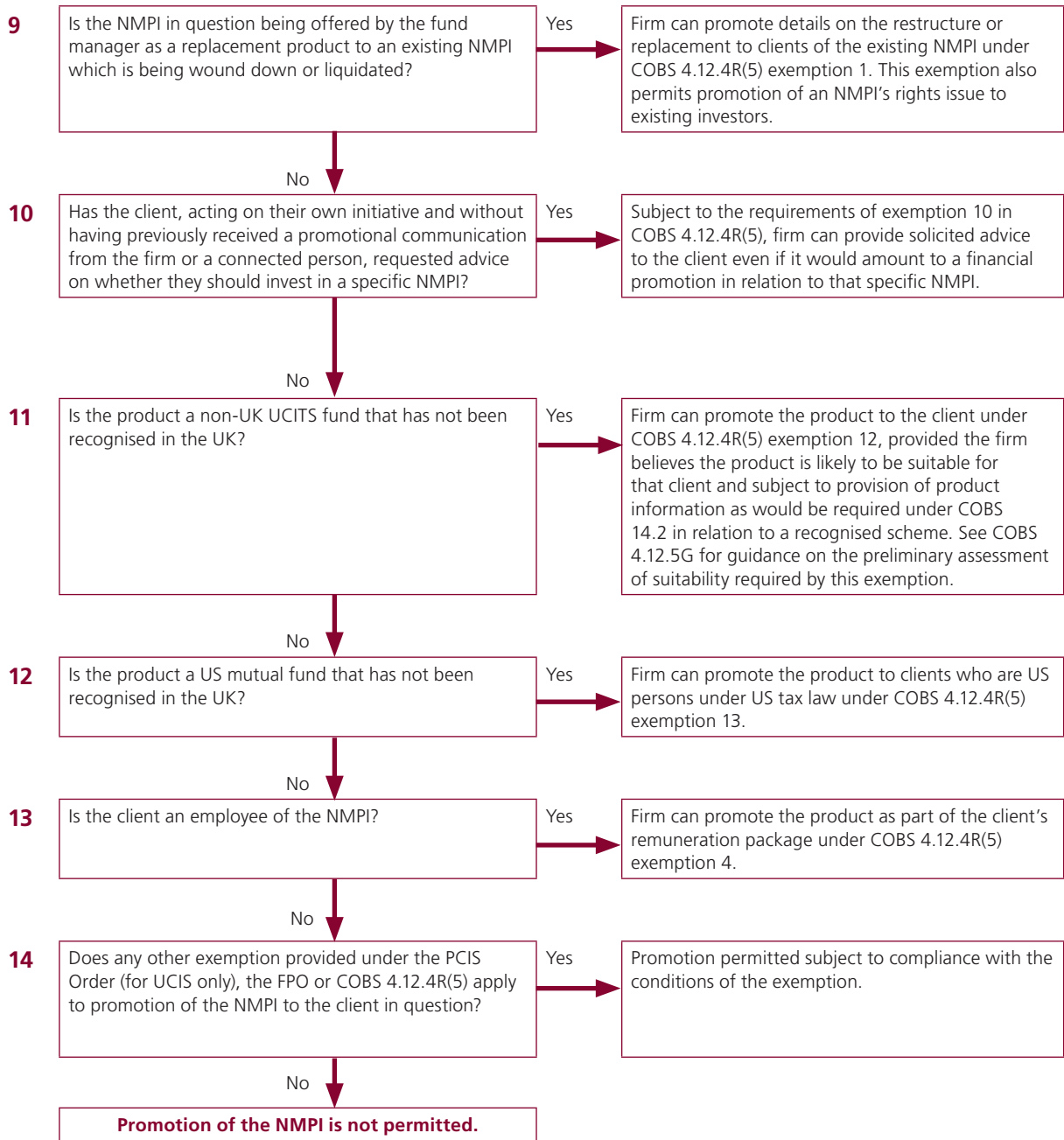
# Annex 4

## Application of the NMPI marketing restrictions to retail customers

This flow diagram shows whether a NMPI marketing restriction applies to a promotion.







# Appendix 1

## Made rules (legal instrument)

## UNREGULATED COLLECTIVE INVESTMENT SCHEMES AND CLOSE SUBSTITUTES INSTRUMENT 2013

### Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (General rule-making power);
  - (2) section 137D (Product intervention rules);
  - (3) section 137R (Financial promotion rules);
  - (4) section 137T (General supplementary powers);
  - (5) section 139A (Guidance);
  - (6) section 238(5) (Restrictions on promotion); and
  - (7) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

### Commencement

- C. This instrument comes into force on 1 January 2014.

### Amendments to the Handbook

- D. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Conduct of Business sourcebook (COBS)	Annex B
Collective Investment Scheme sourcebook (COLL)	Annex C

### Amendments to material outside the Handbook

- E. The Perimeter Guidance manual (PERG) is amended in accordance with Annex D to this instrument.

### Notes

- F. In Annex A to this instrument, the “note” (indicated by “**Note:**”) is included for the convenience of readers but does not form part of the legislative text.

**Citation**

- G. This instrument may be cited as the Unregulated Collective Investments Schemes and Close Substitutes Instrument 2013.

By order of the Board  
3 June 2013

## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

<i>certified high net worth investor</i>	a <i>person</i> who meets the requirements set out in article 21 of the <i>Promotion of Collective Investment Schemes Order</i> , in article 48 of the <i>Financial Promotions Order</i> or in <i>COBS 4.12.6R</i> .
<i>certified sophisticated investor</i>	a <i>person</i> who meets the requirements set out in article 23 of the <i>Promotion of Collective Investment Schemes Order</i> , in article 50 of the <i>Financial Promotions Order</i> or in <i>COBS 4.12.7R</i> .
<i>excluded security</i>	any of the following <i>investments</i> : <ul style="list-style-type: none"> <li>(a) a <i>security</i> whereby the issuer's payment obligations to the investor are wholly or predominantly linked to, contingent on, highly sensitive to or dependent on, the performance of or changes in the value of <i>shares</i>, <i>debentures</i> or <i>government and public securities</i>, whether or not such performance or changes in value are measured directly or via a market index or indices, and provided the relevant <i>shares</i> and <i>debentures</i> are not themselves issued by <i>special purpose vehicles</i>;</li> <li>(b) a <i>covered bond</i>;</li> <li>(c) a <i>share</i> in an <i>investment trust</i>;</li> <li>(d) a <i>share</i> in a <i>company</i> resident outside the <i>EEA</i>, where that <i>company</i> would qualify for approval as an <i>investment trust</i> by the Commissioners for HM Revenue and Customs under sections 1158 and 1159 of the Corporation Tax Act 2010 if resident and <i>listed</i> in the <i>United Kingdom</i>;</li> <li>(e) a <i>share</i> in a <i>venture capital trust</i>;</li> <li>(f) a <i>share</i> in a <i>company</i> to which Part 12 of the Corporation Tax Act 2010 (Real Estate Investment Trusts) applies or a member of a group to which that Part applies;</li> <li>(g) an <i>exchange traded product</i>.</li> </ul>
<i>exchange traded product</i>	any of the following <i>investments</i> :



- (a) a *unit* or *share* in an *exchange traded fund*, a *debt security* or a *contract for differences* which meets all of the following criteria:
- (i) it is traded on a *regulated market* or *designated investment exchange*;
  - (ii) it is created and redeemed in response to demand from investors or arbitrage opportunities arising from the difference in price from the *unit*, *share*, *debt security* or *contract for differences* and the price of the underlying asset(s) it seeks to track;
  - (iii) it aims to closely simulate the performance of a specified index or other benchmark (relating to any assets such as *shares*, *debentures*, *commodities* or *currencies*), whether or not the simulated performance is delta 1, inverse, leveraged, achieved by physical replication or synthetically through *derivatives*.
- (b) a senior, unsubordinated *debt security* traded on a *regulated market* or *designated investment exchange* featuring no periodic coupon payments and whose return tracks the performance of a specific index or other benchmark (relating to any assets such as *shares*, *debentures*, *commodities* or *currencies*), minus applicable fees, whether or not featuring delta 1, inverse or leveraged exposure to the index or other benchmark being tracked.

*non-mainstream  
pooled investment*

any of the following *investments*:

- (a) a *unit* in an *unregulated collective investment scheme*;
- (b) a *unit* in a *qualified investor scheme*;
- (c) a *security* issued by a *special purpose vehicle*, other than an *excluded security*;
- (d) a *traded life policy investment*;
- (e) *rights to or interests in investments* that are any of (a) to (d).

*one-off promotion*

a communication meeting the requirements set out in articles 15 or 15A of the *Promotion of Collective Investment Schemes Order* or in articles 28 or 28A of the *Financial Promotions Order*.

*Promotion of  
Collective Investment  
Schemes Order*

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

*self-certified sophisticated investor* a person who meets the requirements set out in article 23A of the *Promotion of Collective Investment Schemes Order*, in article 50A of the *Financial Promotions Order* or in *COBS 4.12.8R*.

*traded life policy investment* an *investment* in relation to which one of the following conditions applies:

- (a) it is a *traded life policy* other than an *endowment assurance policy*;
- (b) its underlying assets are wholly or predominately *traded life policies* other than *endowment assurance policies*;
- (c) its investment returns, or the issuer's payment obligations, are linked to, contingent on, or highly sensitive to, the performance of *traded life policies* other than *endowment assurance policies*.

Amend the following as shown.

*investment trust* a company listed in the *United Kingdom* or another *EEA State* which:

- (a) is approved by the Commissioners for HM Revenue and Customs under ~~section 842 of the Income and Corporation Taxes Act 1988~~ sections 1158 and 1159 of the Corporation Tax Act 2010 (or, in the case of a newly formed *company*, has declared its intention to conduct its affairs so as to obtain such approval); or
- (b) is resident in an *EEA State* other than the *United Kingdom* and would qualify for such approval if resident and listed in the *United Kingdom*.

*retail investment product* ...  
 whether or not any of (a) to (h) are held within an *ISA* or a *CTF*.  
[Note: Section 238 of the Act and COBS 4.12.3R set out restrictions on the promotion of non-mainstream pooled investments to retail clients. See also COBS 9.3.5G (Non-mainstream pooled investments).]

## Annex B

### Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless stated otherwise.

#### 4.1 Application

...

##### 4.1.9 G ...

- (3) The *financial promotion rules* do not apply to incoming communications in relation to the *MiFID business* of an *investment firm* from another *EEA State* that are, in its *home member state*, regulated under *MiFID in another EEA State* other than to the extent *COBS 4.12 (Restrictions on the promotion of non-mainstream pooled investments)* applies. ~~For the purpose of article 36 of the *Financial Promotion Order* the *FSA* does not make any rules in relation to such incoming communications.~~

...

#### 4.11 Record keeping: financial promotion

##### 4.11.1 R ...

- (2A) If a *firm* communicates or approves an invitation or inducement to participate in, acquire, or underwrite a *non-mainstream pooled investment* which is addressed to or disseminated in such a way that it is likely to be received by a *retail client*:
- (a) the *person* allocated the *compliance oversight function* in the *firm* must make a record certifying that the *financial promotion* complies with the restrictions set out in section 238 of the *Act* and in *COBS 4.12.3R*, as applicable;
- (b) the making of the record required in (a) may be delegated to one or more *employees* of the *firm* who report to and are supervised by the *person* allocated the *compliance oversight function*, provided the process for certification of compliance has been reviewed and approved by the *person* allocated the *compliance oversight function* no more than 12 months before the date of the *financial promotion*;
- (c) the *firm* must make a record of which exemption was relied on for the purposes of the invitation or inducement, together with the reason why the *firm* is satisfied that that exemption

applies:

- (d) where the *firm* relies on an exemption that requires investor certification and warnings to investors, it must make a record of any certificate or investor statement (as signed by the investor) and of any warnings or indications required by the exemption;
- (e) if the exemption relied on is that for an *excluded communication* under COBS 4.12.4R(5), the *firm* must identify in the record which type of *financial promotion* defined as an *excluded communication* corresponds to the promotion being made, including, where applicable, which article in the *Financial Promotion Order* or in the *Promotion of Collective Investment Schemes Order* was relied on for the purposes of the promotion, together with the reason why the *firm* is satisfied that the exemption applies;

...

#### **4.12 ~~Unregulated collective investment schemes~~ Restrictions on the promotion of Non-mainstream pooled investments**

COBS 4.12.1R and COBS 4.12.2G are deleted in their entirety. The deleted text is not shown.

COBS 4.12.3R to COBS 4.12.13G should be inserted after the deleted COBS 4.12.2G, all these provisions are new and the text is not underlined.

##### Restrictions on the promotion of non-mainstream pooled investments

- 4.12.3 R (1) *A firm must not communicate or approve an invitation or inducement to participate in, acquire, or underwrite a non-mainstream pooled investment where that invitation or inducement is addressed to or disseminated in such a way that it is likely to be received by a retail client.*
- (2) *The restriction in (1) is subject to COBS 4.12.4R and does not apply to units in unregulated collective investment schemes, which are subject to a statutory restriction on promotion in section 238 of the Act.*

##### Exemptions from the restrictions on the promotion of non-mainstream pooled investments

- 4.12.4 R (1) *The restriction in COBS 4.12.3R does not apply if the promotion falls within an exemption in the table in (5) below.*
- (2) *A firm may communicate an invitation or inducement to participate in an unregulated collective investment scheme without breaching the restriction on promotion in section 238 of the Act if the promotion falls within an exemption in the table in (5) below.*

- (3) Where the middle column in the table in (5) refers to promotion to a category of *person*, this means that the invitation or inducement:
- (a) is made only to recipients who the *firm* has taken reasonable steps to establish are *persons* in that category; or
  - (b) is directed at recipients in a way that may reasonably be regarded as designed to reduce, so far as possible, the risk of participation in, acquisition or underwriting of the *non-mainstream pooled investment* by *persons* who are not in that category.
- (4) A *firm* may rely on more than one exemption in relation to the same invitation or inducement.

(5)

<b>Title of Exemption</b>	<b>Promotion to:</b>	<b>Promotion of a non-mainstream pooled investment which is:</b>
1. Replacement products and rights issues	A <i>person</i> who already participates in, owns, holds rights to or interests in, a <i>non-mainstream pooled investment</i> that is being liquidated or wound down or which is undergoing a rights issue. [See Note 1.]	1. A <i>non-mainstream pooled investment</i> which is intended by the operator or manager to absorb or take over the assets of that <i>non-mainstream pooled investment</i> , or which is being offered by the operator or manager of that <i>non-mainstream pooled investment</i> as an alternative to cash on its liquidation; or 2. <i>Securities</i> offered by the existing <i>non-mainstream pooled investment</i> as part of a rights issue.
2. Certified high net worth investors	A <i>person</i> who meets the requirements set out in <i>COBS</i> 4.12.6R.	Any <i>non-mainstream pooled investment</i> the <i>firm</i> considers is likely to be suitable for that <i>client</i> , based on a preliminary assessment of the <i>client's</i> profile and objectives. [See <i>COBS</i> 4.12.5G(2).]

3. Enterprise and charitable funds	<p>A <i>person</i> who is eligible to participate or invest in an arrangement constituted under:</p> <p>(1) the Church Funds Investment Measure 1958;</p> <p>(2) section 96 of the Charities Act 2011;</p> <p>(3) section 25 of the Charities Act (Northern Ireland) 1964;</p> <p>(4) the Regulation on European Venture Capital Funds ('EuVECA's'); or</p> <p>(5) the Regulation on European Social Entrepreneurship Funds ('EuSEFs').</p>	Any <i>non-mainstream pooled investment</i> which is such an arrangement.
4. Eligible employees	<p>An eligible <i>employee</i>, that is, a <i>person</i> who is:</p> <p>(1) an officer;</p> <p>(2) an <i>employee</i>;</p> <p>(3) a former officer or <i>employee</i>; or</p> <p>(4) a member of the immediate family of any of (1) - (3), of an employer which is (or is in the same <i>group</i> as) the <i>firm</i>, or which has accepted responsibility for the activities of the <i>firm</i> in carrying out the <i>designated investment business</i> in question.</p>	<p>1. A <i>non-mainstream pooled investment</i>, the instrument constituting which:</p> <p>A. restricts the property of the <i>non-mainstream pooled investment</i>, apart from cash and near cash, to:</p> <p>(1) (where the employer is a company) <i>shares</i> in and <i>debentures</i> of the <i>company</i> or any other connected <i>company</i>; [See Note 2.]</p> <p>(2) (in any case), any property, provided that the <i>non-mainstream pooled investment</i></p>

		<p>takes the form of:</p> <p>(i) a limited <i>partnership</i>, under the terms of which the employer (or connected <i>company</i>) will be the unlimited partner and the eligible employees will be some or all of the limited partners; or</p> <p>(ii) a trust which the <i>firm</i> reasonably believes not to contain any risk that any eligible employee may be liable to make any further payments (other than <i>charges</i>) for <i>investment</i> transactions earlier entered into, which the eligible <i>employee</i> was not aware of at the time he entered into them; and</p> <p>B. (in a case falling within A(1) above) restricts participation in the <i>non-mainstream pooled investment</i> to eligible <i>employees</i>, the employer and any connected <i>company</i>.</p> <p>2. Any <i>non-mainstream pooled investment</i>, provided that the participation of eligible employees is to facilitate their co-investment:</p> <p>(i) with one or more <i>companies</i> in the same <i>group</i> as their employer</p>
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		(which may include the employer); or  (ii) with one or more <i>clients</i> of such a <i>company</i> .
5. Members of the Society of Lloyd's	A <i>person</i> admitted to membership of the Society of Lloyd's or any <i>person</i> by law entitled or bound to administer his affairs.	A <i>scheme</i> in the form of a limited <i>partnership</i> which is established for the sole purpose of underwriting <i>insurance business</i> at Lloyd's.
6. Exempt persons	An exempt <i>person</i> (other than a <i>person</i> exempted only by section 39 of the <i>Act</i> (Exemption of appointed representatives)) if the <i>financial promotion</i> relates to a <i>regulated activity</i> in respect of which the <i>person</i> is exempt from the <i>general prohibition</i> .	Any <i>non-mainstream pooled investment</i> .
7. Non-retail clients	An <i>eligible counterparty</i> or a <i>professional client</i> .	Any <i>non-mainstream pooled investment</i> in relation to which the <i>client</i> is categorised as a <i>professional client</i> or <i>eligible counterparty</i> . [See Note 4.]
8. Certified sophisticated investors	A <i>person</i> who meets the requirements set out in <i>COBS 4.12.7R</i> .	Any <i>non-mainstream pooled investment</i> .
9. Self-certified sophisticated investors	A <i>person</i> who meets the requirements set out in <i>COBS 4.12.8R</i> .	Any <i>non-mainstream pooled investment</i> the <i>firm</i> considers is likely to be suitable for that <i>client</i> , based on a preliminary assessment of the <i>client's</i> profile and objectives. [See <i>COBS 4.12.5G(2)</i> ]
10. Solicited	Any <i>person</i> .	Any <i>non-mainstream</i>



advice		<p><i>pooled investment</i>, provided the communication meets all of the following requirements:</p> <p>(a) the communication only amounts to a <i>financial promotion</i> because it is a <i>personal recommendation</i> on a <i>non-mainstream pooled investment</i>;</p> <p>(b) the <i>personal recommendation</i> is made following a specific request by that <i>client</i> for advice on the merits of investing in the <i>non-mainstream pooled investment</i>; and</p> <p>(c) the <i>client</i> has not previously received a <i>financial promotion</i> or any other communication from the <i>firm</i> (or from a <i>person</i> connected to the <i>firm</i>) which is intended to influence the <i>client</i> in relation to that <i>non-mainstream pooled investment</i>. [See Note 3.]</p>
11. Excluded communications	Any <i>person</i> .	<p>Any <i>non-mainstream pooled investment</i>, provided the <i>financial promotion</i> is an <i>excluded communication</i>.</p> <p>[See <i>COBS</i> 4.12.12G and <i>COBS</i> 4.12.13G.]</p>
12. Non-recognised UCITS	Any <i>person</i> .	<p>Any <i>EEA UCITS scheme</i> which is not a <i>recognised scheme</i>, provided the following requirements are met:</p> <p>(1) the <i>firm</i> considers it is likely to be suitable for that <i>client</i> based on a</p>

		<p>preliminary assessment of the <i>client's</i> profile and objectives; and</p> <p>(2) the <i>firm</i> provides that <i>client</i> with the same product information as it would be required to provide by <i>COBS 14.2</i> if the scheme were a <i>recognised scheme</i>.</p> <p>[See <i>COBS 4.12.5G(2)</i>.]</p>
13. US persons	A <i>person</i> who is classified as a United States person for tax purposes under United States legislation or who owns a US qualified retirement plan.	Any investment <i>company</i> registered and operated in the United States under the Investment Company Act 1940.

The following Notes explain certain words and phrases used in the table above.	
Note 1	Promotion of <i>non-mainstream pooled investments</i> to a category of person includes any nominee company acting for such a person.
Note 2	<p>A <i>company</i> is 'connected' with another <i>company</i> if:</p> <p>(a) they are both in the same <i>group</i>; or</p> <p>(b) one <i>company</i> is entitled, either alone or with another <i>company</i> in the same <i>group</i>, to exercise or control the exercise of a majority of the voting rights attributable to the <i>share</i> capital, which are exercisable in all circumstances at any general meeting of the other <i>company</i> or of its <i>holding company</i>.</p>
Note 3	A <i>person</i> is connected with a <i>firm</i> if it acts as an <i>introducer</i> or <i>appointed representative</i> for that <i>firm</i> or if it is any other <i>person</i> , regardless of <i>authorisation</i> status, who has a relevant business relationship with the <i>firm</i> .
Note 4	In deciding whether a promotion is permitted under the rules of this section or under section 238 of the Act, <i>firms</i> may use the <i>client</i> categorisation regime that applies to

	business other than <i>MiFID</i> or equivalent third country business. (This is the case even if the <i>firm</i> will be carrying on a <i>MiFID</i> activity at the same time as or following the promotion.)
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Advice and preliminary assessment of suitability

- 4.12.5 G (1) Where a *firm* communicates any promotion of a *non-mainstream pooled investment* in the context of advice, it should have regard to and comply with its obligations under *COBS* 9. *Firms* should also be mindful of the appropriateness requirements in *COBS* 10 which apply to a wide range of non-advised services.
- (2) (a) A *firm* which wishes to rely on exemptions 2 (certified high net worth investors), 9 (self-certified sophisticated investors) or 12 (non-recognised UCITS), as provided under *COBS* 4.12.4R(5), should note that these exemptions require a preliminary assessment of suitability before promotion of the *non-mainstream pooled investment* to clients (in addition to other requirements).
- (b) There is no duty to communicate the preliminary assessment of suitability to the *client*. If the *firm* does so, it must not do so in a way that amounts to making a *personal recommendation* unless it complies with the rules in *COBS* 9 on suitability.
- (c) The requirement for a preliminary assessment of suitability does not extend to a full suitability assessment, unless advice is being offered in relation to the *non-mainstream pooled investment* being promoted, in which case the requirements in *COBS* 9 apply. However, it requires that the *firm* take reasonable steps to acquaint itself with the *client's* profile and objectives in order to ascertain whether the *non-mainstream pooled investment* under contemplation is likely to be suitable for that *client*. The *firm* should not promote the *non-mainstream pooled investment* to the *client* if it does not consider it likely to be suitable for that *client* following such preliminary assessment.

Definition of sophisticated and high net worth investors

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

“HIGH NET WORTH INVESTOR STATEMENT

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

- I had, throughout the financial year immediately preceding the date below, an annual **income** to the value of **£100,000 or more**;
- I held, throughout the financial year immediately preceding the date below, **net assets** to the value of **£250,000 or more**. Net assets for these purposes do **not** include:
  - (a) the property which is my primary residence or any money raised through a loan secured on that property;
  - (b) any rights of mine under a qualifying contract of insurance; or
  - (c) any benefits (in the form of pensions or otherwise) which are payable on the termination of my service or on my death or retirement and to which I am (or my dependants are), or may be, entitled.

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

Signature:

Date: ”

4.12.7 R A *certified sophisticated investor* is an individual:

- (1) who has a written certificate signed within the last 36 months by a *firm* confirming he has been assessed by that *firm* as sufficiently knowledgeable to understand the risks associated with engaging in investment activity in *non-mainstream pooled investments*; and
- (2) who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:

“SOPHISTICATED INVESTOR STATEMENT

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

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

Signature:

Date: ”

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

“SELF-CERTIFIED SOPHISTICATED INVESTOR STATEMENT

I declare that I am a self-certified sophisticated investor for the purposes of the restriction on promotion of non-mainstream pooled investments. I understand that this means:

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

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

- (a) I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;
- (b) I have made more than one investment in an unlisted company in the two years prior to the date below;
- (c) I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;
- (d) I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £1 million.

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

Signature:

Date: ”

Sophisticated and high net worth investors: guidance on certification by authorised person and reliance on self-certification

- 4.12.9 G (1) A *firm* which wishes to rely on any of the *certified high net worth investor* exemptions (see Part I of the Schedule to the *Promotion of Collective Investment Schemes Order*, Part I of Schedule 5 to the *Financial Promotions Order* and *COBS 4.12.6R*) should have regard to its duties under the *Principles* and the *client’s best interests rule*. In particular, the *firm* should take reasonable steps to ascertain that the *retail client* does, in fact, meet the income and net assets criteria set out in the relevant statement for *certified high net worth investors*.
- (2) In addition, the *firm* should consider whether the promotion of the *non-mainstream pooled investment* is in the interests of the *retail client* and whether it is fair to make the promotion to that *client* on the basis that the *client* is a *certified high net worth investor*, having

regard to the generally complex nature of *non-mainstream pooled investments*. A *retail client* who meets the criteria for a *certified high net worth investor* but not for a *certified sophisticated investor* may be unable to properly understand and evaluate the risks of the *non-mainstream pooled investment* in question.

- 4.12.10 G (1) A *firm* which is asked to or proposes to assess and certify a *retail client* as a *certified sophisticated investor* (see article 23 of the *Promotion of Collective Investment Schemes Order*, article 50 of the *Financial Promotions Order* and *COBS 4.12.7R*) should have regard to its duties under the *Principles* and the *client's best interests rule*. In particular, the *firm* should carry out that assessment with due skill, care and diligence, having regard to the generally complex nature of *non-mainstream pooled investments* and the level of experience, knowledge and expertise the *retail client* being assessed must possess in order to be fairly and reasonably assessed and certified as a sophisticated investor.
- (2) (a) For example, a *retail client* whose *investment* experience is limited to mainstream *investments* such as *securities* issued by *listed companies*, *life policies* or *units in regulated collective investment schemes* (other than *qualified investor schemes*) is generally unlikely to possess the requisite knowledge to adequately understand the risks associated with investing in *non-mainstream pooled investments*.
- (b) In exceptional circumstances, however, the *retail client* may have acquired the requisite knowledge through means other than his own investment experience, for example, if the *retail client* is a professional of several years' experience with the design, operation or marketing of complex investments such as *options*, *futures*, *contracts for differences* or *non-mainstream pooled investments*.
- 4.12.11 G (1) A *firm* which wishes to rely on any of the *self-certified sophisticated investor* exemptions (see Part II of the Schedule to the *Promotion of Collective Investment Schemes Order*, Part II of Schedule 5 to the *Financial Promotions Order* and *COBS 4.12.8R*) should have regard to its duties under the *Principles* and the *client's best interests rule*. In particular, the *firm* should consider whether the promotion of the *non-mainstream pooled investment* is in the interests of the *client* and whether it is fair to make the promotion to that *client* on the basis of self-certification.
- (2) For example, it is unlikely to be appropriate for a *firm* to make a promotion under any of the *self-certified sophisticated investor* exemption without first taking reasonable steps to satisfy itself that the investor does in fact have the requisite experience, knowledge or expertise to understand the risks of the *non-mainstream pooled investment* in question. A *retail client* who meets the criteria for a *self-certified sophisticated investor* but not for a *certified sophisticated*

*investor* may be unable to properly understand and evaluate the risks of a *non-mainstream pooled investment* which invests wholly or predominantly in assets other than *shares* in or *debentures* of unlisted *companies*.

#### One-off promotions

- 4.12.12 G (1) A firm which wishes to rely on one of the *one-off promotion* exemptions provided by the *Promotion of Collective Investment Schemes* or the *Financial Promotion Order* to promote a *non-mainstream pooled investment* to a *retail client* should have regard to its duties under the *Principles* and the *client's best interests rule*. In particular, the *firm* should consider whether the promotion of the *non-mainstream pooled investment* is in the interests of the *client* and whether it is fair to make the promotion to that *client* on the basis of a *one-off promotion* exemption.
- (2) The *one-off promotion* exemptions permit the promotion of investments to clients under certain conditions (see *PERG* 8.14.3G to 8.14.13G for guidance on the scope of the one-off exemptions in the *Financial Promotion Order*). *Firms* should note that, in the *FCA's* view, promotion of a *non-mainstream pooled investment* to a *retail client* who is not a *certified high net worth investor*, a *certified sophisticated investor* or a *self-certified sophisticated investor* is unlikely to be appropriate or in that *client's* best interests.

#### Qualified investor schemes

- 4.12.13 G (1) A *firm* which wishes to rely on the *excluded communications* exemption in *COBS* 4.12.4R(5) to promote *units* in a *qualified investor scheme* to a *retail client* should have regard to its duties under the *Principles* and the *client's best interests rule*.
- (2) As explained in *COLL* 8.1, *qualified investor schemes* are intended only for *professional clients* and *retail clients* who are sophisticated investors. *Firms* should note that, in the *FCA's* view, promotion of *units* in a *qualified investor scheme* to a *retail client* who is not a *certified sophisticated investor* or a *self-certified sophisticated investor* is unlikely to be appropriate or in that *client's* best interests.

...

### 9.3 Guidance on assessing suitability

...

#### Non-mainstream pooled investments

- 9.3.5 G (1) *Firms* should note that section 238 of the *Act* and *COBS* 4.12.3R set out restrictions on the promotion of *non-mainstream pooled investments* to *retail clients*.

- (2) (a) Firms should bear in mind that the provision of advice or information may involve the communication of a *financial promotion* (see *PERG 8*). In particular, making a *personal recommendation* that a client should enter into a *non-mainstream pooled investment* will generally amount to a *financial promotion* of that investment because a *personal recommendation* typically includes an invitation or inducement to engage in investment activity.
- (b) Due to the restrictions in section 238 of the *Act* and *COBS 4.12.3R*, the promotion of a *non-mainstream pooled investment* to a *retail client* is not permitted except where a valid exemption is available and relied on by the *firm* communicating the promotion. *Firms* should therefore first satisfy themselves that an exemption is available in relation to the promotion of the *non-mainstream pooled investment* before recommending the investment to a *retail client*.
- (3) (a) In addition to assessing whether the promotion is permitted, a *firm* giving advice on a *non-mainstream pooled investment* should comply with their obligations in *COBS 9* and ensure any *personal recommendation* is suitable for its client.
- (b) In considering its obligations under *COBS 9*, a *firm* purchasing a *non-mainstream pooled investment* on behalf of a *client* as part of a discretionary management agreement should have regard to whether that *client* is a *person* to whom promotion of that *non-mainstream pooled investment* is permissible under *COBS 4.12.4R(5)*. Whilst the restriction in *COBS 4.12.3R* does not affect transactions where there is no prior communication with the *client* in connection with the transaction, a *discretionary investment manager* should exercise particular care to satisfy himself that the transaction is suitable for the *client* and that it is in that *client's* best interests, if promotion of the investment would not have been permitted.

...

**Sch 1 Record keeping requirements**

...

Sch 1.3 G	Handbook reference	Subject of record	Contents of record	When record must be made
	...			
	<i>COBS</i>	...		



4.11.1R(2)			
<p><u>COBS</u> <u>4.11.1R(2A)</u></p>	<p><u>Non-mainstream pooled investments: certification of compliance</u></p>	<p>(1) <u>Certification by the person allocated the compliance oversight function or employees of the firm reporting to and supervised by that person confirming that the financial promotion is compliant with the restrictions in section 238 of the Act and COBS 4.12.3R, as applicable.</u></p> <p>(2) <u>Which exemption applies and the reason why that exemption applies. Where the exemption requires a certificate, investor statement, warning or indication, a copy of that certificate, investment statement, warning or indication.</u></p>	<p>(1) <u>Date of certification</u></p> <p>(2) <u>Date the promotion is made to the client</u></p>
...			

## Annex C

## Amendments to the Collective Investment Schemes sourcebook (COLL)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

## 8.1 Introduction

...

Qualified investor schemes: eligible investors

8.1.3 R (1) The *authorised fund manager* of a *qualified investor scheme* must take reasonable care to ensure that ownership of *units* in that *scheme* is ~~only~~ recorded in the *register* only for a *person* ~~that falls into one or more of the categories set out in COLL 8 Annex 1R (Qualified Investor Scheme: eligible investors)~~ to whom such *units* may be promoted under COBS 4.12.4R.

(2) ...

Qualified investor schemes - explanation

8.1.4 G (1) *Qualified investor schemes* are *authorised funds* which ~~may only be sold to~~ are intended only for *professional clients* and for *retail clients* who are sophisticated investors. For this reason, *qualified investor schemes* are subject to a restriction on promotion under COBS 4.12.3R. See also COBS 4.12.13G. ~~Therefore, the *authorised fund manager* must take reasonable care to ensure that subscription in relation to the *units* of this type of *scheme* should only be in relation to the *client* types set out in COLL 8 Annex 1R.~~

...

...

COLL 8 Annex 1 is deleted in its entirety. The deleted text is not shown.

## Annex D

### Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text and striking through indicates deleted text.

#### 8.20 Additional restriction on the promotion of collective investment schemes

...

- 8.20.4 G The *FCA* has made rules under section 238(5) which allow *authorised firms* to *communicate* or *approve a financial promotion* for an *unregulated collective investment scheme* in certain specified circumstances. These circumstances are set out in *COBS* ~~4.12.1R~~ 4.12.4R. To date, the Treasury has not made an order exempting single property schemes under section 239.

...

#### 9.10 Significance of being an open-ended investment company

Marketing of securities issued by a body corporate

...

- 9.10.6 G The *FCA* has also made rules under section 238(5) which allow *authorised persons* to *communicate* or *approve a financial promotion* for an *open-ended investment company* that is an *unregulated collective investment scheme* (that is, one that does not fall within *PERG* 9.10.4G). The circumstances in which such a *communication* or *approval* is allowed are explained in *COBS* ~~4.12.1R~~ 4.12.4R.

Financial Conduct Authority



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© Financial Conduct Authority 2013  
25 The North Colonnade Canary Wharf  
London E14 5HS  
Telephone: +44 (0)20 7066 1000  
Website: [www.fca.org.uk](http://www.fca.org.uk)  
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