IA response to FCA consultation paper (CP) 22/2

Strengthening financial promotion rules for high-risk investments, including cryptoassets

23 March 2022

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 270 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.4 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 44% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Introduction

As with Discussion Paper 21/1, the proposals in CP22/2 are focused mainly on areas outside the core focus of the investment management industry, which we represent, and which delivers highly regulated investment fund products to the UK retail market. For that reason, we are not responding in detail to the specific questions posed in the CP but provide some high-level views on key issues per chapter.

A core focus for the IA is on the implications of any proposed changes to the marketing of the Long-Term Asset Fund (LTAF), which has already been categorised as a Non-Mainstream Pooled Investment (NMPI). However, we note from paragraph 1.8 of the CP that the FCA has generally excluded LTAFs from the scope of the proposals in this CP due to the forthcoming consultation on the distribution rules for the LTAF. We recognise that the appropriate place for the debate on LTAF retail distribution will be the forthcoming consultation, with which we look forward to engaging with.

Clarity on the extent to which a QIS would be caught by the proposed requirements where it is only promoted to professional clients (since it remains a NMPI) would be welcomed. From our reading, it would appear the policy intention is that the requirements in the CP would not apply to QIS given they are not distributed to retail investors. However, confirmation of this in the resulting policy statement would be helpful.

We would also note the important differentiation between high risk investments and scams. While some scams do make use of high risk investments, many do not. And many high risk investments do have a place in a well-diversified portfolio.

We are pleased that the Government's Online Safety Bill (OSB) has been amended to include paid-for advertising, as well as user-generated/search content. We are also pleased that the case for content relating to fraud offences to be designated as 'priority' illegal content seems to have been successful.

Finally, we would like to highlight concerns about the FCA's proposed implementation timetable. The consultation states that, after publication of the final Policy Statement, firms will be given a 3 month period to implement the new rules. This would imply an implementation deadline of September/October 2022. Our members are of the view that, given the breadth of the new rules and the pressure firms are currently under to implement other major regulatory initiatives (e.g. the Consumer Duty), a 3 month period is insufficient. We would urge the FCA to consider a longer implementation period to give firms sufficient time to implement these changes correctly.

1. The FCA's classification of high-risk investments (chapter 3)

It is our understanding from the CP that there are no proposals to change the rules applying varying levels of restrictions to the marketing of investments. The proposed rationalisation, i.e. having three new financial promotions marketing restrictions product categories, will still lead to the same level of restrictions as applied before to non-readily realisable securities (NRRS), Peer-to-Peer (P2P) agreements, Non-Mainstreamed Pooled Investments (NMPI) and Speculative Illiquid Securities (SIS).

We do feel there is a missed opportunity and a need to rethink the future framework for categorising high-risk investments, or at least collective investment schemes within that high-risk framework (and the associated rules around distribution). As noted in our response to DP21/1, as currently framed, there is little distinction between individual instruments with very different risk characteristics (e.g. P2P loans and unlisted companies); regulated and unregulated products; and between individual instruments and diversified portfolios of such instruments. Relative liquidity remains a defining feature of how risky a product is considered, and we do not agree with this approach.

While liquidity is clearly an important issue, we suggest the central focus as to whether a product is liquid or 'readily realisable' should not be conflated with the overall riskiness of a product when considering whether it should be marketed to retail investors. Instead, the framework should be modified to include a distinction that recognises the importance of other factors, including the level of rigour and oversight applied to the investment process, for example, governance structures (e.g. being subject to the value assessment process plus additional requirements to assess the due diligence and liquidity management) , segregation of assets and that of the nature of the product itself (e.g. how diversified it may be).

According to the current proposals, the LTAF will have more marketing restrictions placed on it than qualifying cryptoassets (when the relevant primary legislation is passed by HMT). Classifying a highly regulated product such as the LTAF in a higher risk category than speculative high-risk investments such as cryptocurrencies is absurd - a tighter restriction on the marketing of LTAFs relative to such speculative investments is unjustified.

Our position is that the LTAF is a highly regulated vehicle with strong customer protections in the form of governance, disclosure, and due diligence of the underlying assets. It has been specifically designed to allow for safe access to the underlying assets by certain retail investors. In our view its current designation as a NMPI is not reflective of this high standard of customer protection. We do not see how the illiquid nature of the LTAF alone makes it more risky than speculative unregulated investments such as cryptocurrencies. Treating it as such does not help the coherence of the financial promotion regime for high-risk investments. When the FCA consults on broader retail distribution of the LTAF we would like to see the highly regulated nature of the product reflected in the distribution rules and positioned appropriately in relation to unregulated high-risk investments. However, we recognise that the appropriate place for the debate on LTAF retail distribution will be the forthcoming FCA consultation on this matter.

Overall, we think it is worth considering whether the primary legislation needs to be reconsidered regarding the promotion of collective investment schemes. The Financial Services Act 1986 provided the template that basically outlines if a fund is authorised or recognised, then it can be promoted to the general public, otherwise the fund is an unregulated scheme and so has to follow the promotion of unregulated scheme rules and the general promotion regime. However, the regulatory landscape has moved on in that time, particularly with the introduction of the Alternative Investment Funds Mangers Directive (AIFMD) which means most funds are now not 'unregulated' as per the Financial Service Act 1986 (and the Financial Services and Markets Act 2000, its replacement, which rolled over the regime) since the operator must now comply with the AIFM requirements such as having a separate depositary and independent valuation. So we think at the very least there is a need to differentiate between pure unregulated funds and those subject to AIFM requirements in the definition of non-mass market investments and restricted mass market investments.

2. Strengthening the consumer journey for high-risk investments (chapter 4)

The CP includes a package of measures which makes changes to the consumer journey in relation to high-risk investments which aim to strengthen risk warnings, banning inducements to invest, introducing positive frictions, improving client categorisation and stronger appropriateness tests. We have no comments on the banning of inducements as our members do not offer retail investors inducements to invest.

Risk warnings

We also have no comment on the proposed updated risk warning given it will not apply to funds and products offered by our members to retail investors. As noted in our DP responses, it may be helpful for regulated products if it was clearer when products are not regulated because this reduces the extent to which there is loss of trust in regulated firms when unregulated firms/products lose money. As per our response to question 7 of the FCA DP21/5 Compensation Framework Review, being clearer as to the scope of FSCS would benefit investors by allowing firms to make better, more helpful disclosures in relation to their products and services. The IA considers that creating a new type of disclosure requirement, such as a "kitemark" where FSCS protection is available, would not serve to reduce levels of consumer harm. Moreover, further work to establish where consumers are receiving their investment information, and whether this includes disclosures regarding FSCS coverage, would be helpful.

Positive frictions

As noted in our response to the DP21/1, adding frictions to the consumer journey should help in ensuring that those investors who have the financial resources to accept higher investment risk can do so. That said, the new 24 hour cooling off period requirement proposed does not consider the movements in daily pricing and market which would need to be factored into the trade lifecycle. Consumers would need to be made aware that the trade date would be 24 hours after the investor's initial enquiry.

We also reiterate from our DP response frictions that could be placed on technology, to the extent the FCA can apply these frictions on regulated firms. For example, frictions placed on trading apps, such as informing the investors if the investment is over a certain percentage of their overall portfolio or that they are to phone a broker for certain investments.

Record keeping

Furthermore, the implementation of the record keeping requirements (paragraphs 4.70-4.72) would need to be assessed alongside other consumer duty requirements. For the collection of such data would likely require the building of monitoring and data protection capabilities which would be onerous and very costly. It is also not clear how firms are expected to comply/translate the record keeping requirements for non-online journeys.

Categorization of retail investor

The IA agrees that retail investor categories need further attention and also agrees with including the LTAF within scope of these proposals, as we agree there should not be duplicative versions of the investor declaration forms in the FCA Handbook. Overall, we support the proposals to make changes to investor declarations to help consumers better categorise themselves as high net worth, sophisticated or restricted investors. In addition, we support proposals in the recent HMT consultation paper on financial promotions exemptions that firms play more of a role in satisfying themselves that consumers meet the criteria of high net worth individuals and sophisticated investors.

As noted in our response to the DP and in the IA response to the Consumer Investment Markets Call for Input, it is not just a question of the current exemption levels but how firms market products and services to those investors. Just because a person has a high net worth does not mean they understand the product or solution they are investing in to and therefore should be afforded less protection. Processes and warnings need to be clear to ensure that investors can judge whether they should be signing such an exemption, and this system should also reflect on whether the investor is receiving regulated advice or their portfolio is being managed by a professional investment manager on a discretionary basis.

3. Strengthening the role of authorised firms communicating and approving financial promotions (chapter 5)

Some IA members have observed that the proposed rules in this section are not distinctively different from existing rules, and they would already expect to meet these standards in the ordinary course of business so would question why supplementary rules are required. We have no further views on this section.

4. Applying financial promotion rules to cryptoassets (chapter 6)

We agree that the financial promotion rules should apply to cryptoassets as RMMIs but note our views above in relation to categorising qualifying cryptoassets with lower marketing restrictions than highly regulated funds, such as the LTAF.

As you have found, the level of engagement by UK consumers in the cryptoasset market is not insignificant, and these consumers are often led into such engagement via financial promotions. We do not necessarily agree that 'investment' in cryptoasset is the correct term for this engagement and are wary of granting a sense of legitimacy to a currently-unregulated market via the use of this term.

However, we do recognise that many consumers do wish to obtain a stake in the market, and while the jury is still out on the long-term prospects for the market, it may be that such stakes may justify a long-term investment as part of a well-diversified global portfolio. In this case, an appropriate way for such investment to take place should be via a regulated investment fund, managed by a professional investment manager with robust risk management and a diversified investment mandate.

We support the FCA's InvestSmart initiative, which seeks to promote the causes of long-term diversified investment, rather than hoarding large amounts of cash in deposit-based savings products. It is important that where consumers have the options of various savings products, these are subject to the same financial promotions rules. The frictions inherent in promoting currently regulated products should be introduced for products that are currently too slick to access, without appropriate risk warnings and suitability assessments.

Bringing cryptoassets into the financial promotions regime will make it clearer to consumers that the asset class they are considering is being marketed in a fair and consistent way with other financial products, and introduce the necessary frictions into the sales process. Ultimately, we would like to see a regulated investment fund option introduced to ensure that consumers considering such investment are ensuring that their exposure to the asset class is made with an appropriate weighting in line with other asset classes suitable to their long-term needs.

End.