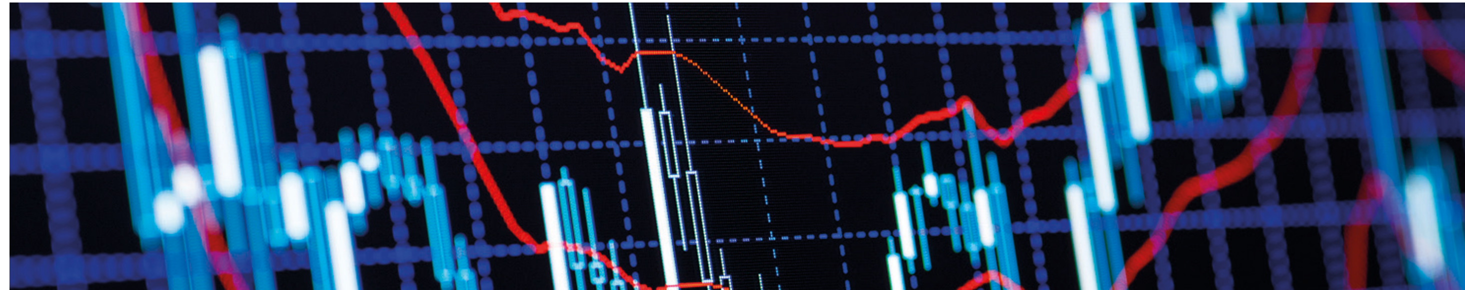
Linklaters

FCA strengthens financial promotions rules for high-risk investments and firms approving financial promotions



The FCA has finalised changes to the financial promotions regime (see Policy Statement 22/10) to enhance the requirements that apply when promoting high-risk investments to retail clients, including better checks to ensure consumers and their investments are well matched, more prominent risk warnings, and a ban on certain incentives to invest. The changes also enhance the requirements for firms that approve financial promotions, requiring them (amongst other things) to have appropriate competence and expertise, and to monitor compliance of financial promotions throughout the life of the promotion rather than just as a "one off" at the time of approval. These enhancements will require significant changes to systems and controls for firms making and approving financial promotions, and it is acknowledged by the FCA that it may reduce the amount of high-risk investments acquired by retail clients, and increase the fees for the approval of financial promotions more generally.

Importantly, while the revised financial promotions regime sets "minimum standards" for compliance, PS22/10 indicates that, in several areas (including, but not limited to, monitoring and record keeping), firms should consider whether compliance with the new Consumer Duty may mean that they should take steps above and beyond those minimum standards. Firms making and approving relevant financial promotions to retail clients should carefully reflect on this FCA commentary when implementing the changes from PS22/10 and the Consumer Duty.

Background

The FCA has been concerned that many investors in high-risk products do not properly understand the risks involved. As part of its Consumer Investments Strategy, the FCA wants to reduce the number of people who are investing in high-risk products that do not reflect their risk appetite. Over the last year, we have also seen more regular intervention by the FCA in financial promotions of high-risk products, and the FCA will continue to intervene going forward.

The enhanced rules published in PS22/10 build on these FCA aims and activities. The FCA flags that work in this area is even more important in the current climate of inflation and a rising cost of living as investors may be looking for higher returns while, at the same time, being less able to absorb potential losses.

Interestingly, the FCA says it hopes that, by 2025, there will be a 50% reduction in the number of consumers with low risk tolerance or vulnerability characteristics investing in high-risk investments. This indicates that the new measures will have a big impact on retail investment markets over the coming years.

Enhanced financial promotion requirements for high-risk investments

Classification of high-risk investments: The FCA is going ahead with the proposal in the consultation to rationalise its rules in COBS 4 under the terms "Restricted Mass Market Investments" (RMMI), promotions of which to retail investors are subject to certain restrictions), and "Non-Mass Market Investments" (NMMI), the marketing of which to retail investors is banned).

RMMIs is a broad category of investments including non-readily realisable securities (NRRS) and peer-to-peer agreements (P2P). The consultation also envisaged qualifying cryptoassets falling into this category, but final rules on this will follow at a later stage (see below).

The FCA has said that it will conduct a further review of its categorisation of high-risk investments in 2023, with a view to preventing inconsistencies in the treatment of products with similar features and to reduce opportunities for arbitrage. It is possible that the FCA will, for example, consider the categorisation of different P2P lending models and how these should impact categorisation, acknowledging feedback that not all P2P agreements should necessarily be treated the same (either in the categorisation or in the application of the enhanced requirements below).

The consumer journey into high-risk investments: Where these high-risk investments are **marketed to retail investors**, the FCA is going ahead with certain enhanced requirements for the consumer journey. These enhancements are based on behavioural research undertaken by the FCA and involve strengthening risk warnings, banning inducements to invest, introducing positive frictions to counter social and emotional pressures to invest, improving client categorisation and stronger appropriateness tests.

- Risk warnings: The FCA is going ahead with requiring the risk warnings for all high-risk investments (other than chapter 15 listed shares) to state that **investors could lose all of their money invested**. But in response to feedback, the FCA is providing for **variations on some other aspects of the risk warning** (e.g. as to the level of protection available) for P2P agreements and portfolios, or where there could be recourse to the Financial Services Compensation Scheme. Firms making use of these alternative risk warnings will need to keep a record of their rationale for using these (e.g. any underlying legal advice).
- Risk summaries: There are **prescribed risk summaries**, which should take about two minutes to read. The FCA's final rules allow firms to **diverge from these "if they have a valid reason for doing so"**, e.g. where text would be irrelevant/misleading, or where firms would like to disclose additional risks. Again, the FCA is requiring firms to retain their rationale for any changes to prescribed risk summaries. The FCA envisages that changes may need to be made to risk summaries where there are material changes to entities' business model, and the FCA may ask firms about their risk summaries when firms notify the regulator of the business model change. There are shorter versions of risk summaries to address concerns about character limits, and special rules where relevant technology (e.g. on social media) does not allow a risk summary to be hyperlinked, as well as prominence requirements.
- Banning incentives to invest: The FCA is largely going ahead with its proposal to ban financial promotions for high-risk investments from containing any **monetary or non-monetary benefits (such as "refer a friend" or new joiner bonuses)** to incentivise investment. One **exemption from this ban** (which is now expressly spelt out in the Handbook text) **is in respect of shareholder incentives** that are "real economy" goods or services (such as discounts on acquiring products or services which are being produced or offered by an issuer or its group).
- Cooling off period: The FCA is going ahead with its proposals to introduce **a (minimum) 24 hour cooling off period for first time retail investors with a firm**, meaning that consumers cannot receive a financial promotion for a NMMI, or a direct offer financial promotion (DOFP) for a RMMI, unless they reconfirm their request after waiting (at least) 24 hours. These measures aim to remove elements of "gamification" from the investment process. The final Handbook text incorporates certain clarifications in response to feedback. For example, it confirms that firms can continue to engage with relevant investors during the cooling off period to complete other aspects of the customer journey, such as AML/KYC checks. Although the FCA recognises that the cooling off period may impact time sensitive investments, the regulator thinks that this is justified, particularly as the delay only impacts a retail investor's first investment with a firm. This is an area where PS22/10 contains some commentary indicating that the **FCA thinks that firms could go above and beyond the minimum standards imposed**. By way of example, the FCA encourages firms to voluntarily collect data on how many consumers do not go ahead with an investment after a cooling off period, and to share that data with the FCA who may use it to monitor the effectiveness of this measure, both initially and as it beds down and consumers get more used to cooling off periods over time.
- Personalised risk warnings: For first time investors with a firm, the FCA is also introducing a requirement for firms to show a personalised risk warning (**with the retail client's name**) which (as the general risk warning above) should link through to a two-minute risk summary. This needs to happen before the client categorisation and appropriateness assessment stages for RMMIs.
- Client categorisation: Retail clients are required to self-certify that they fulfil the criteria for receiving financial promotions for high-risk investments. The FCA is enhancing this process by requiring retail clients to include **"evidence" for their self-certification/categorisation** by requiring them to **state why they believe they meet the relevant criteria**. This could be a statement of their income/net assets (to the nearest £10,000/100,000) where the client self-certifies him/herself as a HNW investor, or details of a directorship for a self-certification as a sophisticated investor. The FCA says that firms do not need to "necessarily" verify this by asking consumers to provide supporting documentation, but also notes that firms may request underlying evidence for other purposes, such as compliance with the FCA Principles or the client's best interest rule, particularly when marketing NMMIs.

  The FCA comments that it believes that "*self-certification is fundamentally not the right approach*", expressing support for HM Treasury's proposals (in its CP on reforming the exemptions in the Financial Promotions Order) to require firms to come to a reasonable belief that investors meet the condition of exemptions. The FCA will await the final HM Treasury position and **may then revisit self-certification in the financial promotion rules**, the implication being that firms may, in due course, be required to take more active steps to ascertain whether relevant criteria are actually met.
- Appropriateness test: The FCA is going ahead with a package of measures to beef up the appropriateness assessment for retail investors seeking to invest in RMMIs (unless the investor is receiving advice). These are designed to **make these assessments more robust, prevent firms from coaching investors to pass them, and making them less easy to "game"**. This includes guidance on the types of questions firms should use (such as discouraging binary yes/no answers, and the use of different questions where the assessment is failed and retaken), banning firms from encouraging clients to retake the assessment, and lock out periods before a failed assessment can be retaken (which allow retail clients to retake the assessment once in the first 24 hours period, but require a 24 hour gap between any subsequent re-assessments). The FCA acknowledges feedback that some of these enhancements could be tricky to implement but comments that, for example, firms could write different sets of questions by varying the formulation of answers or the number of answers investors can choose from. The FCA leaves several important decisions up to firms, such as how many retakes of the assessment a firm will allow before concluding that the high-risk investment is not appropriate for an investor. This is one area where PS22/10 makes it clear that the enhanced requirements represent minimum standards, but that firms should consider whether or not to enhance some of these requirements, e.g. as part of their compliance with the new Consumer Duty (see below).

Record keeping requirements: The FCA is requiring firms to collect several new metrics of the customer journey to help the FCA monitor the effectiveness of the new rules, both initially and over time.

> Metrics on client categorisation and appropriateness assessment: Although the FCA had proposed a whole raft of additional record keeping requirements, the final rules only ask firms to collect additional data on:

  > client categorisation (namely the number of consumers not categorised, and the number of consumers categorised as HNW, sophisticated or restricted investors, and the reasons why they believed to meet the criteria); and

  > the appropriateness assessment (namely data on ultimate outcomes of these assessments, as well as about the number of assessments taken by each investor etc).

> One reason given by the FCA for the more limited changes to the record keeping requirements than were originally proposed was the fact that there would otherwise be overlap with data to be collated to fulfil the monitoring obligations under the new Consumer Duty (see below).

What about the new Consumer Duty?

The FCA has recently published final rules and guidance on its new Consumer Duty, which requires regulated firms to focus on achieving good outcomes for consumers (note that a Linklaters client note on the Consumer Duty will follow shortly). As part of the 'consumer understanding' element of the Consumer Duty, firms will need to assess the impact of all communications (including financial promotions) employed throughout the consumer journey.

In the front end of CP22/10, the FCA flags that the enhanced financial promotions rules set a minimum baseline for compliance in the context of promoting high-risk investments. But the new rules also encourage firms to consider whether they should go beyond these minimum standards, considering the needs of consumers and the new requirement to act to deliver good outcomes for retail customers.

Most notably, the FCA "encourages" firms to consider collating data that goes significantly beyond what is prescribed in the new financial promotions rules. For example, the FCA suggests that firms may wish to monitor the effectiveness of risks warnings as part of their monitoring obligations under the Consumer Duty. It indicates that firms should consider various other metrics (measuring the impact of risk warnings and summaries, cooling off periods etc.) which the FCA had wanted to include in the financial promotions rules but has decided to drop to avoid both overlap with the Consumer Duty and the need for firms to revise their consumer journey metrics more than once (when implementing PS22/10 and then again when implementing the Consumer Duty, which applies from 31 July 2023).

It is clear that the FCA envisages that many firms will decide to apply enhanced standards to those outlined in the revised financial promotions rules. PS22/10 could be seen as containing guidance – or at least certain "FCA views" – on how the new Consumer Duty may be complied with by firms promoting (or signing off financial promotions in respect of) high-risk investments to retail customers. These FCA views, and mention of the Consumer Duty, have not been reflected in the Handbook text or non-Handbook guidance in PS22/10, meaning that the policy statement itself presents an additional "source" which firms need to take into account when assessing whether they are delivering good outcomes for retail customers in this area.

Another point to note here is the enhanced focus on outcomes for customers exhibiting vulnerability. Given the FCA's stated aim of halving the number of consumers with low risk tolerance or vulnerability investing in high-risk investments, firms should ensure they have systems in place to ensure they are tracking outcomes for this specific class of customers.

What about cryptoassets?

In January 2022, HM Treasury confirmed that it will legislate to bring certain cryptoassets within scope of the financial promotions regime. Although covered in the consultation, the new final rules will not apply to cryptoasset promotions. However, the FCA makes it clear that cryptoassets are high-risk investments, with the FCA intending to make promotions of qualifying cryptoassets subject to requirements which are consistent with those applicable to high-risk investments, as and when the regulation of those assets is brought under the FCA's remit.

Firms approving and communicating financial promotions

PS22/10 also includes significant additional requirements for firms approving and communicating financial promotions, which will complement the s.21 FSMA gateway and aim to ensure that s.21 approvers adhere to high standards. The enhancements are set out in non-Handbook guidance and include:

> displaying the **name of the approver and date of approval** on the face of a financial promotion (with some modifications allowing the use of a firms FRN where there are character limits or space restrictions);

> requiring approvers to have appropriate levels of **competence and expertise** in the type of investment/service being promoted (or relying on an authorised person who does have the required C&E);

> requiring approvers to take an active role in **ensuring that promotions remain compliant** for as long as they are being used. This will require approvers to consider whether any change has occurred which results in the promotion no longer being clear, fair and not misleading, "*including consideration of the ongoing commercial viability of the proposition being described in the promotion*". For these purposes, the FCA expects approvers to obtain three-monthly attestations of "no material change";

> requiring approvers to take reasonable steps (periodically throughout the life of the promotion) to ensure **compliance with appropriateness rules**;

> enhancements to **conflicts of interest requirements** for approvers; and

> reiterating the requirements for approvers to undertake **preliminary suitability assessments** before NMMIs can be promoted to relevant retail investors.

Clearly, some of these enhancements (particularly the ongoing monitoring requirements) will mean that approvers of financial promotions will need to commit additional resource, and the FCA has acknowledged that fees for the approval of financial promotions may go up as a result.

Timing

The revised requirements on **main risk warnings and risk summaries** for financial promotions of high-risk investments (but not personalised risk warnings) will apply from **1 December 2022**, and all other enhancements (including non-Handbook guidance relevant to firms approving financial promotions) will apply from **1 February 2023**.

This represents an extended implementation schedule, compared to the three-month period the FCA had previously proposed. But it also means that the FCA expects firms to have "*robust implementation plans, including user testing, where appropriate*".

As noted above, the FCA intends to put in place equivalent rules for financial promotions of certain qualifying cryptoassets once these have been brought into scope by relevant primary legislation.

There will also be a second phase of FCA work, in 2023, to consider further the categorisation of certain products (e.g. different types of P2P agreements) as high-risk investments, and whether there is a greater need to diversify specific requirements (e.g. risk warnings) that apply to particular products.

Documents

FCA PS22/10 is here, and the related FCA press release is here.

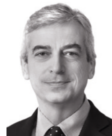
The FCA has also published a consultation (CP22/14) on broadening retail access to the Long-Term Asset Fund (LTAF), which proposes to classify the LTAF as a "restricted mass market investment" for the purposes of the financial promotions regime. Our client note on this is here.

A Linklaters client note on the final rules and guidance on the new Consumer Duty will be published shortly.

Our client note on the Financial Services and Markets Bill is here.

Key contacts

If you wish to discuss any of the enhancements to the financial promotions regime introduced by PS22/10, the final rules and guidance on the new Consumer Duty, or any other aspect of this note, please reach out to any of those listed below or your usual Linklaters contact.



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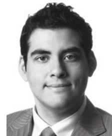

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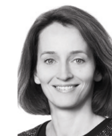

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