



A joint submission from ShareSoc and UKSA

Consumer & Retail Policy
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

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By Email to : xxxx@fca.org.uk [you have to use their online form]

Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions Discussion Paper DP21/1

ShareSoc and UKSA represent the views of individual investors (aka retail investors). We have combined over 8,000 members. This is an important discussion paper and we welcome the chance to submit our views. We would be happy to meet to give further background.

We think there should be an effective duty of care to the consumer, so that financial firms should not be able to prey on the less sophisticated consumer. Consumers should expect that financial firms will provide a good quality level of service and that they will not seek to extract high fees for inappropriate products.

We would prefer a principles rather than a rules based approach.

In such an environment, financial firms would not seek to arbitrage regulations. The onus would be on them to provide sensible advice and guide less sophisticated investors away from high risk products.

This would also require an enforcement regime where malfeasance was dealt with promptly and transparently, and examples were made so as to warn industry employees/directors to not to pursue bad/risky practices: it would also give reassurance to knowledgeable, financially educated consumers about the advice they were being given.

Questions in this discussion paper and our responses

Q1: Please provide any data related to:

- 1. the number of consumers who currently hold high-risk investments, the amount they hold and the type of high-risk investments they hold**
- 2. the number of issuers of high-risk investments, the amount they issue and the type of high-risk investments they issue**

no comment.

Q2: a. Are there any investments which are not currently subject to marketing restrictions which should be?

b. If yes, what is the investment and what level of investments which are not currently subject to marketing restriction should apply?

c. Please explain your answer, including providing evidence of harm.

We do not agree with the approach of itemising a list of investments subject to marketing restrictions. That merely encourages financial firms to arbitrage the regulations.

That is why we have not listed any investments.

We think a different approach is required. There should be an effective duty of care to the consumer, so that financial firms should not be able to prey on the less sophisticated consumer. Consumers should expect that financial firms will provide a good quality level of service and that they will not seek to extract high fees for inappropriate products.

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Q3: a. Should there be changes to how certain types of investments are currently classified for the purposes of our financial promotion rules to prevent arbitrage in the context of our SIS rules?

b. If yes, what changes are needed?

c. Please explain your answer, addressing the issues we identify in paragraphs 3.20 to 3.25 where appropriate.

See answer to q2.

Q4: a. Are there any other features of an investment which means they are generally inappropriate for retail investors and should be subject to a mass-marketing ban?

b. If yes, what are the features?

c. Please explain your answer, addressing the issues we identify in paragraphs 3.26 to 3.28.

No. Sophisticated retail investors should be allowed to make their own decisions.

Please note that in our answer to question 7, we explain how we think sophisticated investors should be defined.

Q5: a. Should we change the scope of securities covered by our RRS definition for the purposes of the financial promotion rules?

b. If yes, how should the scope be changed?

c. Please explain your answer, addressing the issues we identify in paragraphs 3.29 to 3.36.

The Woodford case has highlighted either (i) the problems in the current regulations or (ii) the way the regulations are implemented. The FCA needs to speed up its investigation and publish its findings and recommendations for resolving the problems of liquidity.

Until this is done, the retail market, and the Press/media, will not have confidence in whatever regime the FCA proposes.

Q6: Please provide any data you have about the potential impact of any changes discussed in chapter 3. For example: the number of consumers, issuers, firms and investments which might be impacted; the potential costs and benefits of any changes.

No comment.

Q7: a. Do you think more requirements should be placed on firms to ensure the accurate categorisation of retail clients?

b. If yes, what requirements should be introduced?

c. Please explain your answer., addressing the issues we identify in paragraphs 4.12 to 4.18.

We do not subscribe to the concept of a nanny state in respect of retail investors.

It should be the individual investor's responsibility to decide on their level of financial knowledge and to educate themselves accordingly.

Combined with this, as we have noted above, there should be an effective duty of care for advisers and platforms to provide appropriate products with clear transparent information and for individuals to choose based on their knowledge.

UKSA responded to the FCA Consultation on Consumer Investments and the definition proposed in that consultation response is reproduced below.

Extracts about Sophisticated Investor from UKSA response to FCA on Consumer Investments

Q23: What do you think about how the current high net worth and self-certified sophisticated investor exemptions are working in practice and the level they are set at?

We consider it essential for regulators to think separately about high-net-worth investors and sophisticated investors.

Overall, we consider the high-net-worth exemption to be fundamentally misconceived. See Q19 above.

An individual does not become more competent at assessing non-standard investment promotions simply because they have more money. Even if they have £100 million, it may have been acquired in a walk of life that did not require financial competence in order to be successful.

We recommend that the entire policy of enabling financial promotions that would otherwise be prohibited for the general public to be sent to individuals who have a particular level of wealth should be abolished.

The sophisticated investor exemption is conceptually different. The approach here is that if an investor has a sufficient level of knowledge/skills, they are able to evaluate financial promotions that would otherwise be prohibited for the general public.

At present the FCA has two distinct definitions, “*certified sophisticated investor*” defined in COBS 4.12.7 and “*self-certified sophisticated investor*” defined in COBS 4.12.8.

As previously, we have reproduced below those definitions for the benefits of other readers of this submission.

“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:"

The consultation document does not ask for comments about the “*certified sophisticated investor*” scheme. However we generally support it, as it has the advantage that it is the firm that is required to assess the investor and reach a conclusion regarding whether the investor is sophisticated. The FCA has laid down various requirements, and can sanction the firm if it carries out the assessment negligently or wilfully incorrectly.

The FCA seeks views about the “*self-certified sophisticated investor*” exemption. The definition is reproduced below.

“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:"

As a preliminary point, there is nothing wrong with self-certification as a concept.

For example, an investor may be able to self-certify that he has a degree in mathematics, is a chartered accountant, is a chartered tax adviser, and is also a member of the Association of Corporate Treasurers, and has been investing in quoted shares, warrants and options for over 30 years, and that for these reasons he considers himself as meeting the requirements of a sophisticated investor.

We would regard the giving of such a certificate, and the associated exemption, as appropriate.

The challenge is to come up with acceptable criteria suitable for general use.

We consider the existing criteria in the FCA Handbook as reproduced above to be seriously flawed.

(c) is the only criterion that involves some assessment of competence by a third party, since either the private equity employer or the bank which employ the individual to provide finance to small and medium enterprises must have assessed the competence of the individual.

The other criteria, (a), (b) and (d) involved no requirement for any kind of competence or knowledge. (d) is particularly inadequate since being the HR director of a small company running a grocery warehouse, with a turnover exceeding £1m p.a. could not conceivably be regarded as making the individual into a sophisticated investor.

Since relatively few individuals are likely to have existing formal qualifications that would clearly qualify them as sophisticated investors, we recommend that the FCA along with the industry develops a series of online tests that could be taken by individuals wishing to achieve sophisticated investor status.

A certain level of formality should surround these tests.

For example, the individual could be required to apply for testing, then be sent an access code by paper post, and be timed while sitting the test online. The risk would still remain of impersonation, with the individual seeking someone else to sit the test on their behalf. The FCA could either choose to accept that risk, or could make the test even more rigorous by requiring the test-taker to be video recorded by their laptop webcam while taking the test. This would almost certainly deter impersonation.

What matters is having the will to introduce rigorous standards. The principle of trust but verify should be followed. We also refer to our answer to Q 19 and our suggested requirement to make an additional certification on investment.

Q8: a. Do you think changes should be introduced to help consumers better categorise themselves?

b. If yes, what changes should be introduced?

c. Please explain your answer,

Yes. Three changes (at least) that should be introduced are:

- (i) Better financial education. This should start at school. Some Maths questions should use the concepts of finance and this would familiarise children, e.g. percentage calculations could be phrased around dividends.
- (ii) A free independent shares and investment basics course should be freely available and promoted by the FCA, Government and others. (ShareSoc has identified this gap and will shortly be launching this training course.)
- (iii) Individuals can self-certificate for some aspects. However there should also be a test available online so that individuals can test themselves. The parallel is with driving where a test is required before one is allowed to potentially wreck oneself in a high risk vehicle/product.

Q9: a. Do you think the risk warnings we introduced for SISs should be applied more broadly?

b. . If yes, what investments should they apply to?

c. Please explain your answer, addressing the issues we discuss in paragraphs 4.27 to 4.33.

Probably not. This seems a bit nanny state.

Q10: a. If yes, what visual based risk warnings should be introduced?

b. Do you think visual based risk warnings should be introduced for high-risk investments?

c. Please explain your answer.

Yes, at point of purchase.

Q11: a. Do you think additional 'positive frictions' should be introduced to the consumer journey for high-risk investments?

If yes, what changes should be introduced?

Please explain your answer.

This should be selective. There is no need for friction for sophisticated investors. Gamblers and unsophisticated investors will benefit from friction.

Q12: Please provide any data you have about the potential impact of any changes discussed in chapter 4. For example: the number of consumers, issuers, firms and investments which might be impacted; the potential costs and benefits of any changes and evidence of the potential effectiveness of the changes.

No comment.

Q13: a. Do you think new ongoing monitoring obligations should be introduced for section 21 approvers?

b. If yes, what ongoing monitoring obligations should be introduced?

c. Please explain your answer, addressing the issues we identify in paragraphs 5.9 to 5.11.

no comment.

Q14: a. Do you think changes should be introduced to the role a section 21 approver in the client categorisation, appropriateness and pre-liminary suitability assessment processes?

b. If yes, what changes should be introduced?

c. Please explain your answer, addressing the issues we identify in paragraph 5.20.

no comment.

Q15: Please provide any data you have about the potential impact of any changes discussed in chapter 5. For example: the number of consumers, issuers and investments which might be impacted; the potential costs and benefits of any changes.

no comment.

Q16: Do you have any other comments you would like to make on the topics covered in this Discussion Paper?

We would stress the key themes of our response:

We think there should be an effective duty of care to the consumer, so that financial firms should not be able to prey on the less sophisticated consumer. Consumers should expect that financial firms will provide a good quality level of service and that they will not seek to extract high fees for inappropriate products.

We would prefer a principles rather than a rules based approach.

In such an environment, financial firms would not seek to arbitrage regulations. The onus would be on them to provide sensible advice and guide less sophisticated investors away from high risk products.

This would also require an enforcement regime where malfeasance was dealt with promptly and transparent and examples were set so as to warn industry employees to not to pursue bad/risky practices: it would also give reassurance to knowledgeable financially educated consumers about the advice they were being given.

Yours sincerely

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