

Telephone: 020 7066 9346

Email: enquiries@fs-cp.org.uk

25 March 2022

Submitted online

Dear Sir / Madam,

Financial Services Consumer Panel response to FCA consultation on Strengthening our financial promotion rules for high risk investments, including cryptoassets – CP22/2

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of financial services policy and regulation in the UK.

We welcome the opportunity to respond to this consultation on how to improve the regulation of financial promotion rules for high risk investments. The Panel supports the FCA's proposals to create a more consistent approach to the regulation of financial promotions across products, and to strengthen the requirements for section 21 approvers (whereby FCA regulated firms undertake an assessment of financial promotions proposed by unregulated firms, in order to certify that they meet the relevant standards). The Panel considers that the FCA's proposed approach will better match the rules to the needs of consumers, rather than focusing on what works for products.

The Panel also supports the introduction of stronger risk warnings and positive frictions. However, the Panel considers that there would be benefits to extending these rules to cover existing customers, not just those investing with a firm for the first time.

The Panel recognises that HM Treasury, not the FCA, is responsible for the financial promotions exemption regime, which limits how much the FCA can do. As set out in the Panel's recent response to HM Treasury's consultation on financial promotion exemptions, the Panel considers that the current definitions used to define a high net worth individual and the use of self-certification to determine if an investor is sophisticated will not provide adequate protection. The Panel therefore welcomes the FCA's stated position in this consultation on high net worth and self-certification, namely that the definitions for high net worth are not stringent enough, and that self-certification is not the right approach.

There is considerable evidence that too many investors are self-certifying as meeting the criteria, when they do not. Consumers see self-certification as just another box-ticking exercise and do not understand the increased risk they are taking. This means that the current rules are likely to result in investment by consumers who either do not understand the risks, or cannot afford to undertake the risks. The Panel therefore welcomes the FCA's decision not to apply the "self-certified sophisticated investor" exemption to the sale of crypto assets. However, the Panel would like to see the FCA limiting the use of self-certification in other areas as well.

In general the Panel considers it important that the overarching regulatory regime governing retail investments, including financial promotion rules, provides a coherent approach to setting regulation that meets consumers' needs. Our response should be considered in the context of our vision for how the market should function, which is set out in our [response to the FCA's call for input on consumer investments](#). The foundation of this vision is a correctly implemented and supervised Consumer Duty¹. This would make the firm responsible for the appropriate distribution of high-risk investments including the marketing, labelling and comparability of different investment options, as well as consumers' overall suitability for and understanding of the products which they invest in. This would create a market where:

- more of the population with investible assets, and where the decision is right for them, make an active and informed choice to invest, so maximising their own returns and supporting the real economy;
- the information disclosed to potential investors is designed in a way that will allow them to make effective decisions, and to compare the risks and rewards not only of different options for a given product type, but also of different products;
- it is not possible to use regulatory arbitrage to circumvent rules designed to protect consumers;
- there is a common industry-wide definition of consumer segments (such as 'high net worth', 'novice' or 'able to sustain losses'), which is used to inform product design, set purchasing channels, target marketing and ongoing engagement;
- the use of client self-certification is removed;
- information, education, guidance and advice is readily available and tailored to the consumer to ensure they are supported in taking decisions both pre-investment and on an ongoing basis. This will require the re-engineering of current thinking to better integrate these aspects together and blend them throughout the customer's investment life-cycle. Only in this way will trust be established and consumers supported through what is an inherently complex set of decisions;
- the use of guidance or advice should be the gateway to anything other than a range of default-based, simple, tax-efficient investments;
- products must be better designed, labelled and described to enable consumers to better understand fully the opportunities, risks and costs involved and easily compare these across options; and
- when harm does occur, there must be easily accessible and efficient redress and compensation solutions.

Our responses to the questions posed in the consultation are included at Annex A below.

Yours sincerely,

Wanda Goldwag
Chair, Financial Services Consumer Panel

¹ For our full comments on the FCA's proposed new Consumer Duty, please see here: https://www.fs-cp.org.uk/sites/default/files/final_fscp_response_cp21-36_a_new_consumer_duty_20220214.pdf

Annex A – responses to questions

Q1: Should we rationalise our financial promotion rules in COBS 4 by introducing the concepts of 'Restricted Mass Market Investments' and 'Non-Mass Market Investments'?

Yes. The Panel supports rationalising the rules for Financial Promotions to change from rules that are designed around individual product types, where financial promotion rules can vary on a product-by-product basis, to rules that instead define different categories of financial promotions. This switch will ensure that there will be a more consistent approach to the regulation of financial promotions across products. It will also better match consumer needs by ensuring that the regulations are focused on what works for consumers and the level of protection they need, rather than what works for products.

The Panel also considers that it will be important to ensure that products are allocated to the appropriate financial promotions bucket, and that these allocations are reviewed on an ongoing basis. Regular review will, for example, help to limit the opportunities for regulatory arbitrage, as markets develop and new products emerge.

Q2: Should we introduce stronger risk warnings, as outlined in paragraphs 4.20 – 4.27, for all 'Restricted Mass Market Investments' and 'Non-Mass Market Investments'?

Yes. The Panel strongly supports the introduction of prominent risk warnings in simple language that warn about the risk of losing money. Behavioural economics teaches us that most people tend to place a much higher weight on potential losses than potential gains, meaning potential gains need to be significantly larger than any potential losses, in order to ensure people are comfortable with the risks they are taking. Therefore, ensuring that people are aware of the potential for loss will help improve decision making. This insight has been confirmed by the consumer testing that the FCA undertook. The Panel is pleased to see that these proposals are based on the results of behavioural testing, and would encourage the FCA to apply this approach more widely.

However, amongst the investment products covered by these two financial promotion categories, some products will have either a higher likelihood of losses occurring, or the potential for larger losses to occur. Therefore, in addition to the FCA's proposal, which would flag the possibility of loss occurring, the Panel considers that it might be helpful to supplement this (possibly at a later stage in the process), with some form of pictorial risk indicator that conveys the level of relative risk associated with each product. Having all providers using the same pictorial risk indicator can significantly improve the ability of consumers to make effective choices and to match products with their risk appetite. It will be important that the methodology used to underpin such pictorial depictions of risk is consistent across products and providers, which allows consumers to make comparisons. The risk indicators must also be designed in a way that will ensure risk rankings remain stable over time, reflecting a product's long run characteristics, rather than simply short run data outturns

Q3: Should we ban inducements to invest e.g. refer a friend bonuses, for all 'Restricted Mass Market Investments' and 'Non-Mass Market Investments'?

Yes, the Panel supports the FCA's proposal to ban inducements to invest. Banning inducements that are linked to persuading others to invest as well, such as refer a friend bonuses, is particularly important. Consumers are much more likely to trust friends and family members, yet those friends and family members are also unlikely to be experts. Given the risks of investing in these types of product, it is therefore important that such inducements are not used.

Q4: Should we introduce a personalised risk warning pop up for first time investors in 'Restricted Mass Market Investments' and 'Non-Mass Market Investments'?

Yes, the Panel supports adding an additional personalised risk message, and considers that asking how you would feel if you lost the money that you are about to invest is the right question to focus on.

Q5: Should we introduce a 24 hour cooling off period for first time investors in 'Restricted Mass Market Investments' and 'Non-Mass Market Investments'?

Yes. The Panel does not see why there should be any urgency in the purchase of these types of higher risk investments. We would therefore support the implementation of a dual step investment journey, especially for a consumer's first investment.

However, the Panel considers that the definition of "first time" should be extended so that all 'new' investments – new to firm, new to product and a new account - should have a cooling off period. This would cover situations where a single firm offers different types of investment opportunity, and would avoid the risk that consumers might start their investment journey with a firm in lower risk products, but because of this it is then assumed that they have sufficient knowledge not to need the additional protections, even though the new investment option they have been presented with might have very different policy features and risk profiles. Indeed, given some risks only manifest occasionally, it could be argued that any large increases in a client's investments should also have a cooling off period, as simply holding a product will not mean they necessarily fully understand the risks.

Although the Panel supports the introduction of a cooling off period, thought also needs to be given to how firms might use the information that they have X customers who will be due to invest (or who might invest) once their 24 hour cooling off period has ended. For example, would prices be allowed to change over that 24 hour period, or would investors be able to invest at the price they were offered 24 hours earlier? These alternatives would potentially have very different implications for both consumers and firms. Therefore, the Panel considers that more consultation is needed on this issue, to better understand how it would work and what the implications would be for consumers.

In addition to the 24 hour cooling off period, the Panel considers that it might be helpful to make use of other positive frictions. For example, auto enrolment into pensions using an opt-out approach (rather than opt-in), has hugely increased the take up of pensions. Using the reverse logic, ensuring that consumers need to actively opt-in to start the 24 hour cooling off period would also help improve the protections provided by positive frictions.

Q6: Should we change the investor declaration form for 'restricted', 'high net worth' and 'sophisticated' investors to introduce an 'evidence declaration' and simplify the declaration?

The Panel agrees with the FCA's position on self-certification set out in paragraph 4.47 of CP22/2, namely that "We still believe that self-certification is fundamentally not the right approach". The Panel's position on self-certification is that it must cease.

The evidence provided by the FCA reinforces this position, namely that even with the improvements proposed in this consultation, such as the introduction of an evidence declaration form that potential investors must fill out, roughly twice as many investors self-certify as high net worth or sophisticated as would objectively qualify.

The Panel supports the introduction of improvements to the evidence declarations set out in this consultation, as it does lead to some improvement. However, in light of the evidence, while we recognise that it is HM Treasury not the FCA that oversees the

Financial Promotions exemptions regime, we would still prefer the FCA to do more to find ways to limit the use of these financial promotion exemptions. We also consider that the evidence declaration itself should not be sufficient to prevent a consumer from bringing a claim that the product they sold were unsuitable.

In its recent consultation [response to the HM Treasury consultation on Financial Promotion exemptions for high net worth individuals and sophisticated investors](#), the Panel also suggested that (while it preferred the use of self-certification to be removed), if the use of self-certified sophisticated investors is retained, then the label associated with it should be made less aspirational. The Panel recommended using a label such as “highly experienced”, which was likely to be more objective, making it less likely that someone would certify themselves, if they were not. The Panel recommends that the FCA should investigate the possibility and impact of making changes to the labels associated with these exemptions, if it is not possible to ban them.

Q7: Should we make changes to our rules on appropriateness to ensure all investors in ‘Restricted Mass Market Investments’ must pass a robust assessment of their knowledge and experience?

Yes. The Panel supports these changes, including: the move away from binary questions; the need for there to be a delay of at least 24 hours before someone can retake the test; the move to ensure the questions are not the same when the test is retaken; and the ban on allowing coaching. The Panel is particularly pleased to see the proposal to ensure that firms will not be allowed to contact consumers to encourage them to retake their test. [London Economics’ research into the non-transferable debt securities \(mini bond\) market](#), which was conducted to inform HM Treasury’s 2021 consultation on the regulation of this market, illustrates why allowing firms to encourage consumers to retake these tests is problematic, as illustrated by the findings in Section 5.3.2 of the research, which states:

“A few received cold calls from finance company’s [sic] trying to sell a mini bond to them. One spoke of receiving a follow-up call from the provider when the online application form said she wasn’t eligible for the mini bond; the caller told her to complete the form again and answer in such ways [sic] as to ensure it accepted her application. She has since lost £80,000 as the company went into administration.”

In relation to the minimum 24 hour delay before someone can retake their test, the Panel also wonders whether it would be sensible to introduce a longer delay for those who scored very poorly in their tests, or those who need to retake more than once.

Q8: Should we introduce record keeping requirements for firms to monitor the outcome of the consumer journey for ‘Restricted Mass Market Investments’ and ‘Non-Mass Market Investments’?

Yes. The Panel supports these measures and considers that the information required will help the FCA to strengthen consumer protections in future, if needed. The Panel also considers that it would be helpful for the record keeping requirements to include a date stamped record of scores from the tests on knowledge and experience.

Q9: Do you agree with our proposed approach to implementation of our consumer journey proposals for investments already subject to our financial promotion rules?

Yes. The Panel would like to see the changes to protect consumers introduced as quickly as possible.

Q10: Do you have any suggestions for how we can monitor the impact of our consumer journey proposals?

The proposed record keeping set out in paragraphs 4.70-4.72 should help the FCA monitor some of the key proposals in this consultation. However, the Panel notes that the proposed data does not include complaints data, and considers that data of this type might help identify potential problems in the market.

In addition, the FCA could consider using resources such as the Financial Lives Survey to monitor the impact on the take-up of different investment products. Mystery shopping can also be informative, so the FCA should consider using that as a way of finding out how the system is working in practice.

Q11: Do you agree with our proposed approach to implementation of our consumer journey proposals for cryptoassets?

The Panel agrees with the proposals that firms communicating or approving cryptoasset direct offer financial promotions need to ensure that all clients (including existing clients receiving marketing) are categorised correctly and have undertaken an appropriateness test.

The Panel is comfortable with the proposal that the cooling off period should not apply to existing clients investing in cryptoassets.

However, the Panel does not agree with the proposal that all the proposed positive frictions should not apply. There is considerable anecdotal evidence that many people investing in cryptoassets do not fully understand the risks associated with them. (Indeed, there is some suggestion that there may not be a sufficient number of suitably qualified people to act as section 21 approvers for cryptoasset investments, suggesting that those in the industry who are creating and promoting cryptoassets may not fully understand the risks.) Therefore introducing personalised risk warnings for existing clients might encourage some to investigate the risks, and potentially cease to invest in assets that may not be suitable for them.

Q12: Do you agree with our proposed changes to COBS 4.5 to clarify the obligation regarding the name of the s21 approver?

Yes. The Panel agrees that it is helpful to ensure that the details of those acting as s21 approvers is clear to consumers.

Q13: Do you agree with our proposal for s21 approvers to ensure that approved promotions include the date of approval in the financial promotion?

The Panel agrees that the inclusion of information on the date when a financial promotion was approved is helpful, as it will help the FCA in its monitoring.

However, the Panel notes that there is a potential risk that the date might be misinterpreted by consumers. It is possible that, if it has been a long time since a financial promotion was approved, consumers will interpret this as a financial promotion that has stood the test of time, rather than one that is out of date.

One way to try and reduce this risk, might be to refer to when the promotion was last reviewed (rather than when it was approved), as this would give a better sense that it might be out of date. The Panel notes that the FCA does not appear to have tested the inclusion of a date with consumers and considers that it would be helpful to do so.

In addition, the Panel also considers that it might be helpful for the FCA to look introducing a 'best before date' so that promotions must be reassessed after a certain period of time.

Q14: Do you agree with the introduction of a competence and expertise rule to apply to all authorised firms when approving or communicating financial promotions?

Yes. The Panel considers that it is important for those approving financial promotions to have the necessary expertise to assess them.

Q15: Do you agree with the proposed approach to firms assessing competence and expertise?

Yes.

Q16: Do you agree with our guidance to firms on the competence and expertise requirement?

Yes.

In addition the Panel also considers that it would be helpful to review the Senior Managers & Certification Regime to assess whether to add a Prescribed Responsibility in relation to financial promotions, as suggested in paragraph 5.28 of this consultation.

Q17: Do you agree with our proposal for a new ongoing monitoring requirement for s21 approvers?

Yes. The Panel considers that it is important to move away from a "once and done" approach to approving financial promotions by s21 approvers. The Panel supports the requirement for s21 approvers to have a continuing relationship over the lifetime of a promotion with those for whom they have approved promotions; and for s21 approvers to have to actively monitor for any changes that might mean that a promotion they have approved no longer complies. If a s21 approver ceases to monitor a financial promotion (for example, if it terminates its relationship with the firm seeking approval), then the promotional material should no longer be usable.

Q18: Do you agree with our guidance on ongoing monitoring for s21 approvers?

No comment.

Q19: Do you agree with our proposal to require s21 approvers to obtain attestations of no material change from clients?

Yes. The Panel supports proposals for s21 approvers to need to obtain attestations of "no material change" every three months during the lifetime of a promotion.

However, the Panel considers that this should only form part of the active monitoring required by s21 approvers, to reduce the risk of fraud whereby the organisation running the promotion falsely attests to no material change.

Q20: Do you agree with our proposal to extend conflicts of interest requirements to s21 approvers?

Yes.

Q21: Do you agree that s21 approvers of 'Restricted Mass Market Investments' should take reasonable steps to ensure that the relevant processes for appropriateness tests comply with our rules on an ongoing basis?

Yes. Where firms choose to use a section 21 approver, they are doing so because they themselves are not authorised by the FCA. This means they may not fully understand the rules themselves, or that FCA rules themselves may have changed. This makes it important to ensure that a section 21 approver will have a role in certifying their processes, and that any such certification is carried out on an ongoing basis.

Q22: Do you agree with our expectations on what reasonable steps may look like when complying with the appropriateness test?

Yes.

Q23: Do you agree with our proposed guidance to firms on conducting appropriateness tests?

Yes.

Q24: Do you agree with our proposed guidance for firms approving financial promotions for 'Non-Mass Market Investments'?

The Panel supports the need for firms approving financial promotions for "non-mass market investments" to undertake a preliminary assessment of suitability before a firm can make a promotion to high-net worth or sophisticated investors.

Q25: Do you agree with our proposal to apply the financial promotion regime to cryptoassets and classify them as 'Restricted Mass Market Investments'?

Yes. The Panel considers that applying the financial promotions regime to cryptoassets in this way (for example by including risk warnings and banning inducements) has the potential to help mitigate some of the risks in this sector.

However, as the FCA has identified, this is an emerging sector and therefore it will be important to monitor how it is functioning, in order to assess whether more stringent measures are needed.

Q26: Do you agree with our proposed approach to exemptions for cryptoassets?

The Panel is pleased to see that the FCA is proposing not to apply the "self-certified sophisticated investor" exemption to the sale of crypto assets. The Panel considers that the use of self-certification should cease, and would like to see the FCA limiting its use in other areas as well.

As set out in its [response to HM Treasury's consultation on "Financial Promotion exemptions for high net worth individuals and sophisticated investors"](#), the Panel also considers that the thresholds for high net worth investors are too low.