

# Perimeter report 2018/19

June 2019



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## Foreword by Andrew Bailey

The question of what and who the FCA regulates is important for users and providers of financial services, and for society as a whole. This boundary is also referred to as 'the FCA perimeter'. The FCA perimeter determines which firms require our authorisation. It also affects the level of protection consumers can expect for the financial services and products they purchase.

A number of factors test the perimeter and it must be kept under constant review. It is tested by the actions of particular firms and how those actions can harm consumers, for instance by firms innovating and creating new product offerings and services and by firms deliberately trying to avoid our perimeter.

This is the first FCA annual perimeter report. It focuses on areas where perimeter issues are most likely to cause harm to UK consumers and markets. We set out how we are responding to this potential harm, either independently or working closely with the Treasury.

The question of the FCA perimeter is particularly important in 2019, for 3 reasons. Firstly, firms operating on the edges of the perimeter have recently caused serious harm to consumers. These firms are damaging public trust in the regulated financial services sector.

Secondly, technology and the use of data are increasing the speed of change in financial services markets. New products can be launched and sold to large numbers of consumers very quickly. Innovative assets and products, such as cryptoassets, may become more common in future, and the perimeter is likely to be tested more often.

Finally, the FCA perimeter is not a single piece of legislation but a patchwork, set at UK and EU level, which creates multi-tiered complex regimes. We may have an opportunity to create a simpler approach post-Brexit. This year we have started to consider the future of regulation to help determine the UK financial services framework after Brexit. The perimeter is a critical part of that work and I hope this report informs the important discussions ahead.



**Andrew Bailey,**  
CEO, Financial Conduct Authority

# 1 The perimeter - what we do and don't regulate

- 1.1** The FCA has a strategic objective to ensure financial markets function well. As a public body our aim is to serve the public interest by improving the way financial markets work and how firms conduct their business. By doing this, we provide benefit to individuals, business, the economy, and so the wider public interest.
- 1.2** The UK financial services industry is broad, carrying out a wide range of activities for UK and international clients. Some of this activity requires FCA regulation, some of it remains outside our perimeter. The definition of the FCA perimeter – what is and isn't inside it - is ultimately a matter for Government and Parliament to define.
- 1.3** This is the first FCA Annual Perimeter Report. It aims to provide clarity about our role and respond to particular issues that have arisen in the last year. The 2019 report sets out an overview of the perimeter and explains how we manage issues on the edge of it. It also highlights the particular difficulties facing consumers in the retail investment sector. It ends by summarising the specific steps we plan to take and the questions we'll be considering as part of the future of regulation debate.

## What we regulate

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- 1.4** The activities we regulate are primarily set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order (the RAO).<sup>1</sup> The RAO contains the financial services activities, known as 'regulated activities', that require our authorisation<sup>2</sup> before firms or individuals can carry them out. The RAO also sets out some regulated activities, such as arranging, advising and dealing, which require authorisation if they relate to particular types of financial products (such as shares, debt instruments, fund units and derivatives). The boundary set by the RAO, and other relevant legislation which sets out activities we regulate, is commonly referred to as the 'FCA perimeter'. The RAO is also key to determining the perimeter of the Prudential Regulation Authority, which we do not address in this report. Firms authorised by us will also carry out activities that do not need authorisation, and we have more limited powers over these activities.
- 1.5** But the RAO regime governing 'regulated activity' is not the only basis for our regulatory responsibilities. Other UK and EU legislation also has a say in defining our perimeter, including, but not limited to, the following:
- We act as the UK's listing authority. The listing regime applies to firms whether they are authorised under the Financial Services and Markets Act (FSMA) to conduct regulated activities or not. The vast majority of listed companies are not FCA authorised firms.

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1 There are some other regimes which set out activities that we regulate which are set out in other pieces of legislation, such as the Payment Services Regulations for payment services, and the E-money regulation for e-money services

2 In addition, there are some activities which require a person to obtain a recognition or registration by the FCA before they can carry them out, rather than authorisation.

- The market abuse regime applies to the behaviour of any person, irrespective of whether they are authorised by us.
- We are also responsible for regulating some entities or conduct under standalone legislation outside the FSMA framework. The Payment Services Regulations, for example, set out a separate regime for registering or authorising payment service providers and give us a different set of responsibilities and powers. Similarly, the Money Laundering Regulations 2017 give us specific responsibilities beyond those we have for authorised firms conducting regulated activities.
- We have a specific objective to promote competition in the interests of consumers and have 'concurrent competition' powers shared by the Competition and Markets Authority (CMA) and other regulators. All these regulators can use these powers to address 'financial services activity' rather than being limited to the regulated activities in the RAO.
- The Financial Promotions Regime requires that most financial promotions should be checked by an FCA-authorised firm for compliance with certain standards set in our rules, in particular that the promotion is clear, fair, and not misleading. But communicating or approving financial promotions is not a regulated activity itself. As a result, our oversight of such activity is limited – there is no requirement to report to us or seek our approval to communicate or approve financial promotions.
- We are able, using injunctive powers, to enforce certain provisions of the Consumer Credit Act 1974, even against unauthorised persons. For example, provisions giving the courts powers for unfair credit relationships, which can also apply to non-regulated credit agreements.

**1.6** This description is necessarily a simplified version of the perimeter, and there are a wide range of exclusions and exemptions we do not cover here. But it is clear that the boundary between what we do and do not regulate is complex. It is not set out in a single piece of legislation, but is an amalgamation of UK and EU legislation that has developed over time. We regulate different activities for different purposes, with different powers and tools.

**1.7** Where activity lies outside the scope of financial conduct regulation, our rules will generally not regulate the conduct between those parties. Depending on the nature of the parties and circumstances, there may be other consumer protection legislation or other legal duties, such as fiduciary duties, which apply to the relationships between the parties.

**1.8** But in respect of the contractual relationship between the parties themselves, there is no general principle in English contract law that parties must act in good faith towards each other. As a result, depending on other legal protections or standards which may apply, firms interacting with consumers outside our perimeter may not be restricted from putting their own commercial interests ahead of their consumers.

## **Challenges to the perimeter**

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**1.9** The perimeter is a highly complex and multi-tiered regime. This gives rise to 3 broad challenges, which we cover in more detail in Chapter 2:

- consumer confusion over how they are protected
- firm activity outside the perimeter affecting our public interest objectives
- swiftly evolving markets and business models

## 2 Challenges to the perimeter

**2.1** The question of what we should regulate – of where to draw the line between services where users will benefit from our regulation – is inevitably complex. This boundary can be difficult for consumers to understand. Some firms will try to act on the edge of the perimeter, to avoid regulation while conducting activities that are similar to, or affect, regulated activities. Markets also change and adapt, so new products and services are launched that do not easily fit within legislative categories.

**2.2** Our response to these challenges is threefold:

- We aim to clarify our role and improve consumers' understanding of the protections they have, and firms' understanding of their obligations.
- We aim to monitor activity that is at the edge of the perimeter, take action - including enforcement action - when we can and make recommendations to the Treasury to change or adapt relevant legislation setting the perimeter. However, where the perimeter is currently set by EU legislation, the UK currently has limited flexibility to make changes unilaterally.
- We horizon-scan future market developments and work with the Treasury and the Bank of England to ensure healthy innovation can occur while maintaining safeguards.

### Consumer confusion about how the perimeter works

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**2.3** The complexity of the perimeter can create uncertainty and ambiguity for consumers and firms. This uncertainty relates both to our role, where we aim to stop harm from happening, and also to the safety net of redress, which ensures consumers are protected when things do go wrong. See Chapter 3 for more information on how redress relates to the perimeter.

#### Our role

**2.4** We have some powers over FCA authorised firms when they conduct unregulated activities, but they are generally more limited than our powers with respect to firms' regulated activities. For example, our principles can be applied to unregulated activities in certain circumstances. Similarly, we may be able to take action under the Senior Managers & Certification Regime (SM&CR) against individuals for activities outside the perimeter.

**2.5** However, we do not actively supervise or intervene in activity or markets outside the perimeter to the same extent as we do inside it. Doing so would ignore the clear choice expressed in legislation, by successive parliaments and governments, about the degree of regulatory scrutiny expected, and would be an inappropriate use of our resources.

- 2.6** Currently, the perimeter determines the amount and type of information that firms must send us. Unauthorised firms are not generally required to provide us with information about their activities or finances. Firms we authorise are inside the perimeter for their regulated activities, but do not generally have to provide us with the same level of information about their unregulated activities. So, if we do choose to take action in respect of unregulated activity, it is likely to be on a reactive basis after we find a specific problem. In that regard, intelligence that stakeholders proactively pass to us is important.
- 2.7** Our Mission explains that we are more likely to act if we become aware that the unregulated activity is illegal or fraudulent, has the potential to undermine confidence in the UK financial system, or is closely linked to, or may affect, a regulated activity.
- 2.8** We give an example of how this operates in practice below.

#### **Box A: XYZ Vet**

XYZ are vets, but are also authorised by us because they arrange pet insurance. For the insurance distribution activity, we authorise the firm, approve its senior managers, set minimum standards and rules it must follow and receive regular reporting from it. Consumers may refer complaints about the insurance to the Financial Ombudsman Service and, if the firm fails, may also be able to refer claims to the Financial Services Compensation Scheme (FSCS).

But being a vet in itself is not a regulated activity. If we find out there is fraudulent activity in a veterinary practice, we may decide that the firm is not fit and proper to conduct the regulated insurance distribution services. In this scenario, we would consider removing their authorisation and prohibiting senior management. However, we would not pre-emptively monitor this unregulated activity. And consumers would not be able to access the Financial Ombudsman Service or the FSCS in relation to the veterinary service itself.

#### **Action we are taking**

We are taking 5 broad actions to clarify understanding around the perimeter:

- Our Handbook includes guidance on the perimeter, in the [perimeter guidance manual](#). We will continue to update this guidance on a regular basis, in response to particular perimeter issues.
- We will publish an annual perimeter report.
- Through our supervisory interactions with firms, we are discussing their activities and how they sit in relation to the perimeter.
- Where appropriate, we are taking enforcement action regarding breaches of the perimeter and publish details of these cases to foster understanding and act as a deterrent.
- We are also working with the Financial Ombudsman Service, the FSCS, industry and consumer groups to develop an online disclosure system to help consumers understand what protections are in place. The system will take account of digital distribution channels and behavioural science.

## Impact of firm activity outside the perimeter

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- 2.9** Firms do not have to be authorised to carry out activity related to financial services that is not classified as a regulated activity under the RAO or other relevant UK or EU legislation. Authorised firms can also carry out unregulated activity, and this may be confusing to consumers, particularly if our name and logo are displayed by the firm. Even if these activities are legal, with firms trying to offer a fair service, they can harm consumers and damage firms inside the perimeter. And if firms are acting fraudulently, or using an exemption to exploit customers, this can cause severe and widespread harm. We discuss some examples below:

### Pre-paid funeral plans

- 2.10** Pre-paid funeral plans allow people to pay in advance for the cost of their funeral. The main benefit is that the customer's estate is then protected from inflationary price increases in the time between the customer buying the plan and their death. However, we are concerned that the conduct of some of the firms providing these plans may harm consumers. If firms in this sector fail, there will also be significant consumer impact. But no firms providing such plans are currently authorised, because of an exclusion in the RAO.

#### Action we are taking

We believe the perimeter should be extended because of the negative impact these firms can have on consumers. The Treasury is already acting on this issue and has published proposals to remove this exclusion from the RAO so that funeral plans will fall within our remit.

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### Unregulated Introducers

- 2.11** These firms contact consumers with offers of free pension reviews. This is not regulated advice, but we have evidence these reviews can be instrumental in consumers deciding to transfer out of defined benefit pensions, potentially losing major benefits in the process, such as in the British Steel case.

#### Action we are taking

If an unauthorised introducer is offering investment advice, then it is likely to be carrying out regulated activities in contravention of FSMA. If we suspect serious misconduct has occurred, we investigate it.

In order to further protect consumers, the Government has recently introduced a pensions cold calling ban, which came into force on 9 January 2019. The ban prohibits all cold-calling in relation to pensions, except where: i) the caller is authorised by us, or the trustee or manager of an occupational or personal pension scheme, and ii) the recipient of the call consents to calls, or has an existing relationship with the caller. In terms of the protection offered by the pensions cold calling ban, there is a broad definition of 'direct marketing in relation to pensions' in the regulation. This captures the marketing of any investment product, not only conventional pension products, to



be acquired using pensions funds. The Information Commissioner's Office (ICO) is the enforcement body of the ban, and we are working closely with the ICO where breaches of the rules by FCA-authorized firms are identified.

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### **Unregulated mortgage book purchasers**

**2.12** These are firms that are not authorised for lending which have purchased books of mortgages from lenders. These firms are still required to have an FCA authorised administrator. However, depending on how the sale is structured, this may still not be sufficient for us to deliver the same level of protection as for consumers that have mortgages with regulated firms. In addition, mortgage book purchasers who do not have lending permissions are not able to offer new products to their customers, some of whom may be unable to switch mortgage.

#### **Action we are taking**

We are now consulting on changes to our rules to ensure that they do not stop consumers switching to a more affordable mortgage. These changes will enable active regulated mortgage lenders to make more proportionate affordability assessments for consumers whose payments are up-to-date and want to borrow the same amount or less. This could allow customers whose current mortgage is with an unregulated lender to access a more affordable external remortgage option that was previously unavailable.

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### **Investment consultants and proxy advisors**

**2.13** These firms provide unregulated services that can significantly influence the investment strategies of asset owners and asset managers. Investment consultants advise pension fund trustees on issues such as asset manager selection, while proxy advisors issue voting advice and recommendations.

#### **Action we are taking**

In our Asset Management Market Study, we identified serious competition concerns with investment consultancy and fiduciary management. We referred these sectors to the CMA for a detailed investigation. The CMA recommended that investment consultancy services should be brought within the FCA supervisory remit, and the Treasury plans to consult to bring these services into our perimeter.

Issuer companies and investor firms have raised concerns with us about proxy advisors' conduct and conflicts of interest. The revised EU Shareholder Rights Directive aims to address these by imposing new disclosure requirements on these advisers. In the regulations that implement the Directive provisions in the UK, the Treasury has given us the role of enforcing these disclosures.

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## Swiftly evolving markets and business models

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- 2.14** Technology is dramatically changing the markets we regulate, and having a major impact on the perimeter. New challenges are created as financial services are increasingly delivered online and we have had to adapt our Handbook and regulatory approach to keep pace.
- 2.15** This constant evolution can deliver significant consumer benefits, as new products meet genuine consumer needs or improve customer service. However, they may not easily fit into the specific categories set out in legislation. In response, we engage with innovative firms through our Innovation Division and aim to anticipate and shape future developments. We discuss 4 priority areas below.

### Delivering financial services digitally

- 2.16** Digital channels enable firms to create, market and sell financial services products very quickly. This means that the speed at which harm can be caused by a misleading or unfair financial promotion has greatly increased. Internet or social media adverts reach millions of people in an instant, challenging our ability to detect and act against misleading adverts. Historically, we asked traditional media to voluntarily remove adverts we believed to be fraudulent. This is harder to achieve with internet service providers. We address this with warnings on our own website, but this is clearly not as effective as taking down promotions.

#### Action we are taking

We are considering how the Financial Promotions Regime can become more effective in a digital age. This may include consideration of additional powers for us in respect of internet service providers.

We are also developing and deploying automated tools for detecting online market developments, such as new products or practices that pose potential risks to our objectives.

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### Cross-border challenges

- 2.17** These challenges are exacerbated when firms conduct financial activity both online and cross-border. This makes it easier for firms to choose between different regulatory regimes to avoid regulation and operate under the least stringent rules (known as 'regulatory arbitrage').
- 2.18** An example of this is selling binary options to retail consumers. In April 2019, we brought in rules to immediately stop selling, marketing or distributing all binary options to UK retail consumers. However, these consumers can still buy binary options if they request them from a third country firm (so-called 'reverse solicitation'), rather than the firm approaching the consumer.

#### Action we are taking

We are closely involved with initiatives to better align international approaches to common policy and regulatory issues, including those

that may affect the perimeter. By sharing experiences and lessons learned, we are better able to assess whether the perimeter is fit for purpose, and sufficiently future-proofed to deal with these new delivery channels.

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## **Cryptoassets**

- 2.19** Cryptoassets have developed over the past decade due to major technological advancement. Although this market in the UK is still relatively small, the intangible nature of many cryptoassets presents challenges to the regulatory perimeter. Cryptoassets can display different characteristics through their life and be used for different functions, which can create uncertainty as to which cryptoassets already fall within the perimeter.
- 2.20** There are also challenges in identifying whether the existing perimeter is fit for purpose to manage the potential harm cryptoassets pose. The Treasury will consult this year on cryptoassets currently outside the perimeter.

### **Action we are taking**

We consulted in January 2019 on draft perimeter guidance and will publish finalised guidance in summer 2019. We also announced that we will consult later in 2019 on a potential ban on the sale to retail consumers of products (for example, derivatives) referencing some cryptoassets that are outside the regulatory perimeter.

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## **Technology companies entering the financial services sphere**

- 2.21** While FinTechs are financial services firms aiming to use technology to deliver products in a more efficient and consumer friendly way, technology companies themselves are increasingly pushing into financial services.
- 2.22** Large technology companies, such as social media platforms and online retailers, are considering or have already made steps towards providing financial services in various ways. Some of these have never previously engaged in financial services activities. The market power of these companies could create a significant impact on financial services consumers. This impact could be both from providing regulated activities, such as payment or banking services, and from other activities outside the regulatory perimeter.
- 2.23** The boundary between providing mostly unregulated technical infrastructure to deliver financial services and providing regulated activities is increasingly narrowing. This also raises questions around whether financial regulators have the necessary tools and techniques to effectively oversee those organisations.

### **Action we are taking**

This is an area we are heavily engaged with and one that we continue to monitor very closely. As part of this we will be publishing a call for input on Open Finance later this year which will look at how the principles of Open Banking, such as those relating to data sharing, can be applied across financial services.

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## 3 What this means for consumers

- 3.1** In Chapters 1 and 2, we set out the legal definitions of the perimeter and our role. In practice, consumers can find it difficult to understand the perimeter. It is particularly difficult in respect of the retail investment market, especially when an authorised firm offers both regulated and unregulated services. It can also be particularly hard for a consumer to know which is which, even when firms meet all their disclosure requirements and are clear about the relevant consumer protections. When firms break our rules, or carry out fraud, it becomes virtually impossible for consumers to make the distinction.
- 3.2** We do not operate a zero-failure regime. Consumers will sometimes suffer loss because of the way the market performs. However, if they suffer loss because they have been treated unfairly, then they may in some cases be able to get compensation.
- 3.3** In this chapter, we explain what consumers should expect from us and what protection may be available to them if something goes wrong. We then provide examples of how this applies to a particular activity, a particular firm and a particular product.

### Giving consumers confidence

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- 3.4** When dealing with an FCA-authorised firm in respect of a regulated activity, consumers can take confidence that we have undertaken a variety of regulatory actions. These include:
- authorising the firm for those activities
  - approving the individuals running the firm
  - setting standards and rules these firms and individuals must follow
  - receiving regular reports about these activities
  - acting on intelligence about problems
  - proactively supervising larger firms
  - taking enforcement action with respect to breaches
- 3.5** These activities are not designed to create a zero-failure regime. Problems do occur and consumers may be able to complain to the Financial Ombudsman Service or access compensation through the FSCS.
- 3.6** Consumers get less protection from us in respect of unregulated activities. We do significantly less proactive work to prevent things from going wrong. As stated in Chapter 2, we apply a higher test before responding to information about unregulated activities compared to regulated activities.

### Redress

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- 3.7** The Financial Ombudsman Service's compulsory jurisdiction generally covers complaints against respondents (including firms) about regulated activities, and also

other activities which are listed at [DISP 2.3.1R](#) – for example lending money secured by a charge on land and activities ancillary to regulated activities.

**3.8** The FSCS is the compensation scheme of last resort for customers of UK-authorized financial services firms that can't meet claims against them. FSCS protection applies to protected claims in connection with an activity which is regulated, but it does not apply to all regulated activities. For example, most consumer credit activities are not covered by the FSCS. There are also limits to the FSCS coverage in any particular case.

## Activity example – financial promotions

**3.9** The Financial Promotions Regime limits who can make financial promotions. FCA authorised firms can communicate financial promotions, and can also approve financial promotions for communication by non-regulated firms.

**3.10** Authorised firms are required to ensure that the financial promotions they approve and communicate are fair, clear and not misleading. In addition, authorised firms need to check whether the product or service being promoted is subject to more specific requirements, for example:

Securities	Marketing Restrictions
Non-readily realisable securities	Direct offer promotions (through which the investor can immediately proceed to make the investment if they choose) must only be made to consumers meeting certain criteria.
Non-mainstream pooled investments	Generally only marketable to investors who are sophisticated, high net worth, or non-retail investors.

**3.11** We do not approve financial promotions ourselves; the responsibility is on the authorised firm to check that the promotion is compliant. However, if we become aware of financial promotions which do not in our view meet our standards, we ask firms to withdraw them.

**3.12** Generally speaking consumers are not able to complain to the Financial Ombudsman Service or apply for compensation from the FSCS against an authorised firm which failed to comply with these standards if all they did was approve the financial promotion, that is, if no regulated activity was carried out by that firm for that consumer. However, consumers may be able to use:

- a.** the Financial Ombudsman Service if the approval of the financial promotion was part of – or was ancillary to – a regulated activity (eg arranging the sale of bonds).
- b.** the FSCS if the customer's claim, arising partly from the financial promotion, was ancillary to a protected regulated activity (eg advising on the purchase of shares).

## Firm example - XYZ Advisors

- 3.13** The following example is for a hypothetical firm, XYZ Advisors. XYZ is an authorised firm conducting regulated activities but also offering other services. This example does not imply XYZ has done anything wrong.

### **Box B: XYZ Advisors**

Mr and Mrs Patel engage XYZ Advisors to help them make financial choices.

- As part of their service, XYZ Advisors make a personal recommendation to Mr and Mrs Patel, on the merits of investing in a particular financial product. A personal recommendation is one the firm present as suitable to the customer to whom it is made, or based on a consideration of the circumstances of the customer. For the purposes of this example, this is a regulated activity. The recommendation must be suitable for Mr and Mrs Patel and take into account their personal financial situation and goals. As the advice is a regulated activity, Mr and Mrs Patel will usually be eligible to complain to the Financial Ombudsman Service. If XYZ Advisors is declared in default and Mr and Mrs Patel have a claim against XYZ relating to the personal recommendation, the FSCS may be able to compensate them for that claim.
- Mr and Mrs Patel hold money in a regular savings account. At a later date and separate to the initial advice above, XYZ Advisors also recommend the couple invest by buying a second property as a buy-to-let investment, a suitable recommendation for Mr and Mrs Patel, and arrange for the investment to occur. This does not constitute either regulated investment advice or regulated arranging as the activity does not involve a regulated financial product. The advice is not given as ancillary to any activity under DISP 2.3.1R. No Financial Ombudsman Service or FSCS protection is available.
- 12 months later, XYZ make a specific recommendation that Mr and Mrs Patel buy shares in a property development company. This would constitute regulated investment advice as the information is about a particular regulated financial product. As the advice is a regulated activity, Financial Ombudsman Service or FSCS protection may be available.

- 3.14** So consumers need to take various factors into account to decide whether a service is classified as regulated investment advice, with the associated consumer protections, or not. The answer will depend on the specific nature of the service provided and it will not always be easy for consumers to identify.

- 3.15** We are currently reviewing the Retail Distribution Review and the Financial Advice Market Review (which includes measures to clarify the advice boundary). As part of this evaluation, we will consider how well the current landscape is meeting consumer needs.

## Product example – mini-bonds

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- 3.16** Mini-bonds are high-risk investments. Box C outlines the case of London Capital & Finance (LC&F), which issued such bonds. Many stakeholders have asked how the regulatory perimeter applies in cases like this, as well as why some activities are unregulated. Both we and the Treasury have committed to a series of actions in response to this situation.

### Issuing securities

- 3.17** Companies often raise finance from the public to grow and support their business. This activity of issuing securities (shares or debt) does not necessarily require authorisation (or else all companies would need to be authorised).
- 3.18** These companies may not be regulated, but it remains important that investors can have confidence in what they are buying and can take action if they are misled. Investors may be able to pursue legal claims if the information the company gave them is incorrect or if it conducts its business in a different way from that originally set out. Investors would typically have to take this kind of action through the courts, including against firms providing professional advice and assurance.

### Disclosure standards

- 3.19** The level of disclosure required when securities issued by companies are traded on a regulated public market, such as the London Stock Exchange's Main Market, is the most extensive of those we regulate. The company must produce a prospectus according to our prospectus rules and FSMA, and the company has to make ongoing disclosures under our disclosure and transparency rules and the Market Abuse Regulation (MAR). We have a role in approving the prospectus, and can take action when a company makes inaccurate initial or ongoing disclosures.
- 3.20** But in other cases, for example, when companies raise relatively small amounts, there are no prescriptive standards and we have no or only a limited role. We do not have a pre-approval role, and the company has a broad amount of discretion in the way it promotes these issues.

## Mini-bonds

- 3.21** The mini-bonds market has changed over recent years, with more complex mini-bonds being issued and marketed to retail investors. Issuers of these more complex products have often been able to rely on the same exclusion as ordinary commercial companies to issue their securities without the need for authorisation. In a low-interest environment, these high-risk investments, offering the potential of higher returns on capital, have increasingly been offered as retail investments.

### **Box C: London Capital & Finance**

Mini-bonds have attracted widespread attention after the collapse of LC&F last year. Following our direction to LC&F to immediately withdraw promotional material about mini-bonds, and the start of investigations by both us and the Serious Fraud Office, LC&F went into administration. This has left approximately 14,000 consumers who had invested in its mini-bonds at risk of losses.

As explained on page 13 above, the FSCS may compensate protected types of claim relating to a regulated activity. Although LC&F was an authorised firm, issuing non-transferable mini-bonds is typically not a regulated activity in itself. However, there may be FSCS protection where customers also received a service which is a regulated activity. For example, if they received regulated advice when they invested in mini-bonds. The FSCS is currently considering whether LC&F has generated any protected types of claim.

Following the failure of LC&F, we requested the Treasury to direct an investigation into our actions, policies and approach in this case, and we have appointed a senior judge to conduct this investigation. The Treasury has also announced a review of the wider policy questions this case raises, including the current regulatory arrangements for the issue of mini-bonds and other non-transferable securities.



## 4 The future

- 4.1** Markets are innovative and evolve, and some firms will always try to avoid regulation. So the boundary between which firms and activities do or don't require FCA regulation is constantly tested.
- 4.2** The current perimeter is complicated. This makes it difficult for consumers to understand which of our protections apply in what circumstances, and what compensation they may be eligible for. The recent behaviour of some firms operating around the perimeter has caused serious consumer harm and reduced trust in regulated financial services markets.
- 4.3** The actions we are taking in response fall into 3 broad categories.
- 4.4** Firstly, we work to make our role clearer and to explain what compensation may be available. We do this by issuing guidance on the perimeter and by producing this annual perimeter report. And as noted above, we are working with the Financial Ombudsman Service, the FSCS, industry and consumer groups to develop an online disclosure system to help consumers understand what protections are in place.
- 4.5** Secondly, we continue to monitor activity outside the perimeter that may cause consumer harm and require the perimeter to be widened. Where appropriate, this includes taking enforcement action. We base our monitoring on intelligence we receive. It will still remain a very small part of our activity, as we must prioritise our resources on the activities specified by legislation. Activity around the perimeter will continue to cause consumer harm. Our aim is to identify this quickly and make recommendations to Government and Parliament.
- 4.6** Thirdly, we are horizon scanning to anticipate future market developments. Most recently, for example, we have carried out significant work on cryptoassets and are considering these issues internationally. Looking ahead, we know that technology companies entering the financial services sphere are likely to have a major impact on both firms and consumers in the UK, even if their activities fall outside the perimeter. We will keep this under constant review.

### The future of regulation

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- 4.7** As we stated in Chapter 1, the perimeter is a matter for Government and Parliament. This report highlights how we are responding to the tactical challenges posed by the current perimeter, both in terms of FCA action and how we work with the Treasury on specific issues such as funeral plans or cryptocurrencies.
- 4.8** The challenges posed by the current perimeter, particularly in respect of consumer understanding, raise a set of broader questions that we will work on during 2019 and discuss with the Treasury, Financial Ombudsman Service, FSCS and wider stakeholders. We will provide an update in the 2020 perimeter report with a particular focus on three key areas:

1. The extent to which the FCA can exercise its functions in relation to all financial services related activities undertaken by an authorised firm, particularly if things go wrong;
2. The alignment between our perimeter and the coverage of the Financial Ombudsman Service and the FSCS;
3. How clear the distinction is between what is covered by the perimeter and what is not. This may create a tier of activities covered by the FCA, Financial Ombudsman Service and FSCS and a tier that is not

**4.9** In Annex A we set out a long-list of issues and activities we have undertaken involving the perimeter in 2018/19. In the Perimeter Report 2020, we will provide an update on these strategic questions and an updated longlist of issues.

## Annex A

### Other perimeter issues

1. We have taken a number of other actions to deal with perimeter issues in areas that are not covered in detail in this report. These are:

#### The insurance perimeter

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2. The RAO does not provide a complete and exhaustive definition of insurance. This means court decisions about whether particular contracts amount to insurance are relevant in determining where our remit applies. But the court decisions themselves do not provide absolute clarity. This has sometimes led to uncertainty as to whether certain contracts should be classed as insurance. As a result, there have been situations where firms have believed that the products they sell fall outside our remit, but where we consider those products should properly be regarded as insurance. We have identified concerns in 2 areas:
  - Insurance requires an undertaking to pay money or provide a corresponding benefit to a recipient. In some contracts, the provider claims to have absolute discretion not to pay out. But this may be in circumstances where we consider the discretion to have no real content or to be an unfair term. In these cases, our view is that the contracts should properly be categorised as insurance.
  - We have also seen firms claim that their warranties are mainly service contracts providing repair services, with a minor indemnity element that pays benefits if the product is lost or damaged. We believe many of these contracts artificially describe the repair services and, on more detailed analysis, are really contracts of insurance.

#### Action we are taking

We intervene, including through enforcement action, where we identify such contracts. We are also considering whether we need to take any further steps. For example, we could issue further guidance to reduce the scope for consumer harm.

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#### Senior Managers & Certification Regime, Fair and Effective Markets Review and Fixed Income, Currencies and Commodities Markets Standards Board

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3. Senior Managers, Certified Individuals and other individuals of authorised firms under the SM&CR must meet the 5 conduct rules, including one that states, 'you must observe proper standards of market conduct.' These rules apply to all activities the individual carries out during their duties, whether or not those are activities are regulated.

### Action we are taking

To further support and encourage the development and use of best practice industry codes of conduct, we have established a framework to formally recognise industry codes that cover certain unregulated activities. Recognition of Industry Codes provides us with another means of setting standards across the perimeter and influence best practice in unregulated parts of the financial sector. These codes offer a flexible and responsive way of dealing with issues such as conduct and market practices in areas that are significant to regulated firms and markets, such as in spot FX and in wholesale money markets.

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## Claims Management Companies (CMCs)

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4. Some eligible CMCs may apply to be regulated by the Solicitors Regulation Authority (SRA), instead of by us.

### Action we are taking

We are working with the SRA to keep a level playing field and prevent CMCs arbitraging regulatory requirements. We have also agreed a specific Memorandum of Understanding with the SRA governing how we cooperate on supervising CMCs.

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## Social housing landlords and credit broking

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5. New legislation allows landlords to direct tenants to lower cost alternatives to high-cost credit. We do not believe these landlords need our authorisation.

### Action we are taking

We are working with the Treasury in scoping the legislation.

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