

## **FCA Consultation Paper on financial promotion rules for high-risk investments and cryptoassets**

On 19<sup>th</sup> January 2022, the Financial Conduct Authority (FCA) published a new Consultation Paper (**CP22/2**) entitled “Strengthening our financial promotion rules for high-risk investments, including cryptoassets”, which sets out proposed changes to its financial promotion regime.

In this article, Matthew Hazell and Abdul Motobbir summarise the proposed changes under the Consultation Paper.

### **SUMMARY**

The purpose of the Consultation Paper is to ensure its financial promotion regime remains fit for purpose in light of the changing investment environment with promotions of high-risk instruments distributed to a mass audience at increasing speed via online platforms and through social media.

The Consultation Paper also supplements work carried out by the HM treasury to improve the Financial Promotions regime. This includes proposed new regulatory gateway (s21 Gateway) for authorised firms who approve financial promotions for unregulated firms, extending the regime to Qualifying Cryptoassets and consulting on reforming the high net worth and sophisticated investor exemptions.

### **WHO WILL THIS AFFECT?**

The Consultation Paper will impact firms which issue financial promotions to retail clients. It will also impact firms which approve financial promotions for other unregulated firms more commonly known as “Section 21 Approver”.

## WHAT ARE THE PROPOSED CHANGES?

The FCA are proposing to make changes in the following areas based on responses from its 2021 Discussion Paper (**DP21/1**) entitled “Strengthening our financial promotion rules for high-risk investments and firms approving financial promotions” and the wider evidences collected.

The proposed changes are set out in the following areas:

### Classification of high-risk investments

The FCA seeks to rationalise the way it currently categorises high-risk investments to ensure products with similar characteristics are treated in the same way under the financial promotion rules. Under the proposed changes, the new product categories include:

- I. **Readily realizable securities (RRS)** – Comprises listed and exchange traded securities which is traded on a regulated market or trading venue. There will be no marketing restrictions.
- II. **Restricted mass market investments (RMMI)** – This will be a new term that the FCA is proposing to add to their rules and will include Non-Readily Realisable Securities (NRRS), Peer-to-Peer (P2P) and Qualifying cryptoassets. These can be marketed to retail clients with some restrictions such Direct Offer Financial promotions.
- III. **Non-mass market investment (NMMI)** – This include certain retail banned promotions, which include crypto derivatives, binary options and unregulated collective investment schemes. Mass marketing will be banned to retail investors.

### The consumer journey into high-risk investments

The FCA are concerned that too many consumers are just ‘clicking through’ and accessing high-risk investments without fully comprehending the risks involved. The FCA intends to introduce package of measures designed to strengthen the consumer journey in the following ways:

- **Improving risk warnings** – New risk warnings are to be introduced when marketing RMMIs and NMMIs. These must be prominent and include a link to an expanded, product-specific risk description.
- **Banning inducements to investment** – There will be a blanket ban on offerings such as

refer a friend bonuses and new joiner bonuses.

- **Adding positive friction** – The FCA are proposing two new positive friction to counter social and emotional pressure to invest. First is a personalised pop up for first-time investors investing in RMMI and NMML. The second is that a 24hr cooling off period will apply to first-time investors.
- **Helping consumers better categorise themselves** - The FCA is proposing to simplify the language of the self-certification declaration and add 'none of the above' to it.
- **Strengthening the Appropriateness tests (only applies for RMMI)** - This includes firms that have assessed a client as appropriate for an investment cannot reassess the client within 24hrs and the questions asked must be different each time the consumer takes the test.

## Strengthen the role of firms approving and communicating financial promotions

The FCA intends to strengthen the role of a section 21 (S21) approver (a regulated firm that approves financial promotions for others) as it believes that they play an important role in enabling unauthorised issuers of high-risk investments to reach consumers. The proposal includes:

- the requirement for firms to self-assess whether they have the necessary competence and expertise (C & E) in an investment product or service before approving or communicating a relevant financial promotion.
- S21 approvers to actively monitor financial promotion throughout the life of the promotion after approval for any changes that may no longer apply.
- S21 approvers to collect attestations of no material change from clients with approved promotions every three months, and for the lifetime of the approved promotion.
- When approving promotions with appropriateness test, the s21 approvers will be required to check the compliance of the appropriateness test periodically throughout the lifetime of a promotion.

## Applying the financial promotion rules to qualifying cryptoassets

The Treasury has announced that it intends to bring “qualifying cryptoassets” in scope of the UK’s financial promotion regime. Qualifying cryptoassets are defined broadly as “any cryptographically secured digital representation of value or contractual rights which is fungible and transferable”, but excludes electronic money, certain payment tokens, and central bank money. This definition would include most cryptoassets traded on retail exchanges, such as Bitcoin (BTC) and Ether (ETH).

The FCA are proposing to categorise Qualifying cryptoassets as Restricted Mass Market Investments (RMMI). This means that marketing restrictions that apply to RMMI's will apply as mentioned above.

## HOW SHOULD FIRMS PREPARE FOR THE PROPOSED CHANGES?

While the Consultation is in progress, no action is required in the meantime, however firms should begin to consider how the proposed new rules will affect their financial promotions processes. This could include any combination of the following (but not limited to):

- An initial gap analysis between current processes and the proposed new rules;
- Updating policies and procedures, including controls around marketing processes and record keeping;
- Reviewing the governance, Management Information (MI) and record keeping requirements for the approval of financial promotions; and
- Considering the competence requirements for those involved in the financial promotion's approval process

Firms that market RMMIs and NMMLs to retail investors will be most impacted by these rules with proposed changes likely to have an impact on sales and onboarding processes.

The deadline for response to the consultation questions is 23 March 2022, with final rules due in Summer 2022. Once final rules are published, firms will have three months to comply with the new requirements for the consumer journey and financial promotion approvers. Cryptoasset requirements will apply from the date cryptoassets are brought within the financial promotions' regime by the Treasury.

## HOW CAN NEWGATE ASSIST?

Newgate's experienced team of consultants will be able to advise you on the impact of the proposed changes to the financial promotion's regime. We are reviewing the proposed requirements and will have readiness assessment in due course that will map out in requirements such as record keeping, Risk warnings, Certification templates, appropriateness assessment test, etc.

Newgate operates the Gateway system which sets out an online compliance framework to enable

firms to set up attestations, affirmations, monitoring tasks, record keeping and many more to meet the proposed requirements. Call us for a free demo today.



### **Matthew Hazell**

#### **Managing Director**

E [matthewhazell@newgatecompliance.com](mailto:matthewhazell@newgatecompliance.com)

T +44 (0) 20 3696 8753



### **Abdul Motobbir**

#### **Consultant**

E [abdulmotobbir@newgatecompliance.com](mailto:abdulmotobbir@newgatecompliance.com)

T +44 (0) 20 3696 8745

 +44 (0)20 3696 8750

 [info@newgatecompliance.com](mailto:info@newgatecompliance.com)

 [newgatecompliance.com](https://newgatecompliance.com)

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FEBRUARY 2022

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