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Dear Retail Investment & Disclosure Policy team

RE: CP22/2 Strengthening the financial promotion rules for high-risk investments, including cryptoassets

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based private equity and venture capital firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over 1.1m people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

We welcome the opportunity to feedback on proposals to strengthen the financial promotion rules for high-risk investments in consultation paper CP22/2.

BVCA responses to consultation questions

We have only responded to consultation questions that are relevant to the venture capital industry, and on which our members have specific views.

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

We are generally supportive of proposals to simplify and consolidate the FCA's Handbook. We accept that Non-Mainstream Pooled Investments ("NMPI") and Speculative Illiquid Securities ("SIS") investment products are subject to similar marketing restrictions and can be 'rationalised' under a new heading for Non-Mass Market Investments ("NMMI"). These products are generally higher-risk and, we agree, many are not suitable for retail investors who are not high net worth or sophisticated.

However, we are concerned by the breadth of the proposed new product classification for Restricted Mass Market Investments ("RMMI"), which proposes to treat everything from units in professionally managed venture capital funds, such as Enterprise Investment Schemes ("EIS") funds, to crowdfunding and cryptocurrencies in the same way and subject them to a package of new marketing restrictions (as described in Chapter 4 of CP22/2).

EIS and Seed Enterprise Investment Schemes ("SEIS") are two of the Government's venture capital schemes, designed to help small and medium sized companies and social enterprises grow by attracting investment. These schemes provide tax incentives to investors and have played a vital role in helping Britain's start-ups – with EIS alone raising over £24bn and helping 33,000 UK companies since its introduction in 1994.

When venture capital funds are managed by authorised and regulated investment managers or are internally managed small registered AIFMs, we strongly believe that the existing marketing restrictions

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on Non-Readily Realisable Securities ("NRRS"), which include client categorisation and appropriateness tests, are working well and should be preserved.

We are very concerned that the package of changes proposed to the consumer journey will deter appropriate investors, incur large and unnecessary costs for firms operating venture capital funds, and:

1. restrict an important source of capital for early-stage UK companies and venture capital funds focussed on investing in UK SMEs (there is no obvious replacement for that capital); and
2. damage the growth of early-stage innovative businesses and UK competitiveness as a location for founders to establish and scale-up businesses, which is contrary to the aims of the Government's Productive Finance Working Group and similar initiatives.

We strongly believe that any residual harm in NRRS, that hasn't already been addressed by the introduction of the Speculative Illiquid Security ("SIS") rules, is best identified, and addressed by the FCA at the authorisation gateway, where "1 in 5" applications are refused, and through supervisory and enforcement action (as described in paragraphs 2.25 to 2.32). Significant additional obligations in the rules aren't necessary.

The proposed inclusion of qualifying cryptoassets in the new RMMI product classification should not be used to justify changes to the NRRS rules, which are well understood and working well for the vast majority of investors and businesses.

We are also concerned that the rules remain extremely complex and so will contain "bear traps" for firms targeting primarily professional clients. We regret that the FCA has not taken the opportunity to significantly simplify its rules and definitions on financial promotions. The level of complexity of this part of the rules and accompanying legislation poses significant risk.

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'?

We agree that the existing risk warnings, such as 'capital at risk', are now too easily ignored by consumers and may have lost their impact and meaning. However, we are concerned by the proposal to use a new standardised risk warning across both RMMI and NMMI product classifications. The proposed classifications will encompass a wide range of investment products that have different risk profiles, with various involvements of an authorised person and the regulatory protections which that entails. A standardised risk warning will, at face value, give prospective investors the impression they are equally high-risk. Therefore, we recommend that the FCA consider a separate risk warning for RMMIs, which should be easily distinguished from that required for higher-risk NMMIs.

We are also concerned about misleading wording in the proposed risk warning. Certain firms may participate in the Financial Services Compensation Scheme ("FSCS"), which means investors may be eligible to claim compensation from the FSCS when "something goes wrong", and firms may fall within the jurisdiction of the Financial Ombudsman Service ("FOS"). A statement displayed prominently in the financial promotion that such protection is "unlikely" in these circumstances could be misleading and potentially confusing for prospective investors, depending on the facts. Therefore, we recommend that the proposed language on protection is amended to represent circumstances where consumer protection is available to investors. For example, "You could lose all the money you invest [and might not be protected if something goes wrong.]" Or, alternatively, the square bracketed text on consumer protection could be removed by authorised persons when promoting investment products under the protection and jurisdiction of the FSCS and/or FOS. It is also worth noting that, where applicable, distributors are required to provide details on what happens if things go wrong and how consumers can complain in the

Key Information Document for Packaged Retail Investment and Insurance Products (the "PRIIPs KID"). It will be confusing where these disclosures are contradicted by the standardised risk warning.

It is also worth noting that, in the case of venture capital funds, distributors are required to provide details on what happens if things go wrong (i.e. consumers are directed to FSCS) and how consumers can complain (i.e. FOS) in the Key Information Document for Packaged Retail Investment and Insurance Products (the "PRIIPs KID"). Again, it will be confusing where these disclosures are contradicted by the standardised risk warning.

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

No. Referral and discount schemes are widely used across financial services markets and beyond. They are used by some of our members to provide, for example, discounted fees to "early-bird" investors or to those coming through certain intermediaries. These practices are a part of normal commercial activity, and, in our view, rare cases involving "bad actors" do not justify a ban that could have significant commercial implications for legitimate businesses. The FCA should note that referral schemes operated by authorised firms are subject to rules and regulatory principles on Treating Customers Fairly ("TCF"), conflicts of interest (in SYSC 10) and the inducement rules (in COBS 2.3 and COBS 2.3A), so are already well-regulated.

We also believe that practices incentivising investors to recommend products (often for little personal benefit) have no consequences on the regulatory requirements that are in place to ensure the appropriateness/suitability of the investment product. Referral is simply a method for product discovery and those prospective investors must still be given the same risk warnings and pass the same client categorisation process and, for RMMIs, appropriateness requirements (in COBS 10 and 10A) before making an investment decision, in the same way as any other investor.

If the FCA decides nonetheless to intervene in these commercial practices, we recommend that the financial promotion regime should instead require authorised firms, when approving promotions for unauthorised persons, to ensure the rules and regulatory principles on TCF, conflicts of interest and inducements are complied with. Alternatively, the ban should be limited to investment products originated by unauthorised persons (i.e. for all promotions that require approval by an authorised firm before being communicated).

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

No. Paragraph 4.37 of the consultation paper says that pop-ups containing a personalised risk warning for RMMIs must appear before a Direct Offer Financial Promotion (DOFP) can be communicated. Pop-up personalisation will only be possible at a later stage in the consumer journey, as promoters are unlikely to have had an opportunity to collect personal details such as the client's name at that time. This can only work for online sales in any case so should be restricted to that sales channel.

We are also concerned about the cost and technical difficultly of implementing this proposal, which will be particularly acute for small firms with limited resources (see response to Q9. on implementation period).

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

No. We believe that any changes should be evidence-led, proportionate and balance (a) promoter obligations and consumer protection, and (b) the cost of compliance to promoters (both intermediary firms and company issuers) with the negative externalities of excluding a wider range of persons, from

both the investor perspective (loss of access for UK-based investors to certain investments and the reduction in their investible universe of asset classes) and the issuer perspective (reduction of a finite range of capital sources with no obvious replacements).

The consultation paper acknowledges that there is little evidence to suggest that a cooling-off period will help consumers to reflect on their investment decision-making. The FCA should not be experimenting on the UK's investment ecosystem, particularly at a time when the UK wants to be world-leading destination to set up and grow new and innovative businesses.

We are also concerned that this proposal may incentivise investors to remain with their existing providers. A restriction on the consumer's ability to engage with new platforms and product providers is unlikely to be in the consumer's best interests and is anti-competitive in nature.

As with the personalised risk warning, there is a timing issue in this proposal. A consumer will not be able to reflect meaningfully on their decision-making at a time when they have not received all the information on which to make an informed investment decision. Under the current proposal, consumers will be asked to reflect and reconfirm their decision to proceed before they've received the financial promotion, or DOFP. If there must be a 24-hour cooling-off period, we recommend it should be after the point at which the investor has received all the information needed to make an informed decision and then confirmed their intention to proceed. This will give consumers time to reflect before their investment order is processed.

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?

We support the proposal to simplify the language in the 'restricted', 'high net worth' and 'sophisticated' investor declarations.

We are not opposed to the proposal to include a 'None of the above' option in investor declarations.

We do not support the proposal for an 'evidence declaration' and caution against any move toward a certification regime. We think it is important that promoters should be entitled to rely on the investor declarations they receive and presume them to be truthful, unless they hold or are aware of information to the contrary or there are circumstances indicating that further due diligence is required. As was stated by HM Treasury in their recent consultation on the Financial Promotion Order ("FPO") exemptions, certification was scrapped for FPO exemption purposes in 2005 because levels of certification were low, and it was found to be expensive and inappropriate for investors.

For these reasons, we believe the proposed high net worth investor declaration, requiring the investor to state their income, will feel intrusive and off-putting to those investors who are understandably wary of giving out personal details and financial information. A more palatable option might be to allow prospective investor to select an income bracket, rather than disclosing their exact income to promoters.

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?

Addressing the proposals in the order they appear in the consultation paper:

1. **New guidance on appropriateness test questions:** Yes. We broadly support this new guidance as a helpful clarification of the FCA's expectations.

2. **Removal of the rule that allow investors to proceed with an investment, even if they fail an appropriateness test:** Yes. We support the proposal to remove the rules in COBS 10.3 and COBS 10A.3 that allow consumers to proceed with an investment in circumstances until the authorised

firm considers the investment product is appropriate. This brings the rules into line with what is already standard practice amongst our members.

3. **24-hour ban on retaking appropriateness tests:** We are not opposed to a short time-limited ban on prospective investors retaking appropriateness tests. However, we strongly recommend the rule allows a small margin for error to give prospective investors the opportunity to address minor misunderstandings or typographical errors when completing appropriateness tests. We recommend that up to three retakes should be permitted before the proposed 24-hour ban comes into force.

4. **Requirement to ask different questions each time a prospective investor retakes an appropriateness test:** No. Appropriateness tests are made up of questions on fundamental areas of knowledge. Under new rules, prospective investors must not be told which questions they got wrong, nor are they to be given the correct answers. On that basis, we think that requiring new (but necessarily similar) questions to be asked of prospective investors retaking appropriateness tests creates unnecessary burden on firms to dynamically track which questions have been asked of which individuals. The technical changes needed to implement this proposal are not proportionate with the negligible impact on the effectiveness of the appropriateness test.

5. **New guidance that firms must not encourage retests:** Yes. We broadly support this new guidance, which aligns with standard market practice amongst our members.

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'?

No. As a matter of principle, we believe that firms should only be required by the FCA to collect and monitor data and information to confirm compliance with regulations, and not primarily for monitoring the effectiveness of FCA rules.

While firms will already be monitoring and retaining records relating to appropriateness for a minimum of five years (as required by COBS 10.7.2 R), many will not be tracking where prospective investors drop-off in the consumer journey. Implementing the proposed monitoring and record keeping requirements will incur unreasonably large set-up and ongoing costs for firms marketing RMMI and NMMIs. To mitigate this, we strongly recommend that these recording keeping requirements should be voluntary for firms.

While there is no specific consultation question on debt-based payment options, we broadly support the FCA's statement on (paragraph 4.73) indicators of vulnerability. However, there are several reasons why an investor might choose to use a credit card. For example, credit card purchases are protected under section 75 of the Consumer Credit Act and consumers can take advantage of reward and cashback schemes. When used responsibly, debt-based payment options can be advantageous for investors over potentially riskier alternatives such as bank transfers.

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

No. Having discussed these proposals with our members, we are very concerned about the short three-month implementation period proposed in the consultation paper. Feedback from our members is that the volume and nature of the proposed changes will incur large one-off and ongoing costs for firms, which will be disproportionately challenging and expensive for small firms.

Our members are also concerned about the availability of developers to help realise these changes, which will require a redesign of the consumer journey. As the FCA will know, changing systems and processes is a long, laborious and expensive process, even for large organisations with plentiful resources. The developers that will be needed to help firms will typically already be engaged in other high-priority projects, often with six-to-nine-month lead-in times. On this basis, we believe that three-months will be completely unworkable for most firms. Our members have suggested a range of six months to a year as a more reasonable implementation period for changes to the consumer journey.

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

The FCA should monitor complaints data to identify where there are issues. As we said in response to question 8, regulatory reporting and record keeping requirements should be used to monitor compliance with the rules, not their effectiveness.

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

No comment.

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 new guidance is a helpful clarification of the existing requirement in COBS 4.5.2 R.

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

Yes.

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 clarification in paragraph 5.23 that firms will have competence and expertise where the promotion is related to a regulated activity for which the firm holds a Part 4A permission, e.g. dealing in investments, is helpful.

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.

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

No comment.

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?

No comment.

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

No comment.

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?

No comment.

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

No comment.

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

No comment.

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

No comment.

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

The proposed inclusion of qualifying cryptoassets in the new RMMIs product classification should not be used to justify changes to the NRRS rules, which are well understood and working well for the vast majority of investors and businesses.

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

No comment.

Yours sincerely,

Tim Lewis, Chair, BVCA Regulatory Committee