Chapter 10

Appropriateness (for non-advised services) (non-MiFID and non-insurance-based investment products provisions)

10.1 Application

10.1.1 R [deleted]

10.1.2 R (1) This chapter applies to a firm which:

(a) arranges or deals in relation to a:

(i) *non-readily realisable security*;

(ii) *speculative illiquid security*;

(iii) *derivative*;

(iv) *warrant*; or

(v) *unit* in a *long-term asset fund*,

with or for a *retail client*, other than in the course of *MiFID or equivalent third country business*;

(b) facilitates a *retail client* becoming a lender under a *P2P agreement*;

(c) *issues* a *unit* in a *long-term asset fund* to a *retail client*; or

(d) transacts in a *qualifying cryptoasset* with or for a *retail client*,

and the *firm* is aware, or ought reasonably to be aware, that the application or order is in response to a *direct offer financial promotion*.

(2) The *rules* in this chapter also apply to:

a *TP firm* (to the extent that the *rule* does not already apply to such a *TP firm* as a result of ■ GEN 2.2.26R); and

a *Gibraltar-based firm* to the extent that the *rule* does not already apply to such a *Gibraltar-based firm* as a result of ■ GEN 2.3.1R).

(3) (a) This chapter also applies to a *registered person* which transacts in *qualifying cryptoassets* with or for a *retail client* where the *registered person* is aware, or ought reasonably to be aware, that the application or order is in response to a *direct offer financial promotion*, as it applies to an *authorised person*.

(b) For the purpose of (3)(a), in this chapter, relevant references to a *firm* include reference to a *registered person*.

10.1.3 R [deleted]

Related rules

10.1.4 G A *firm* that is carrying on a *regulated activity* on a non-advised basis, whether or not the *rules* in this chapter apply to its activities, should also consider whether other *rules* in *COBS* apply.

10.2 Assessing appropriateness: the obligations

10.2.1 R

(1) When providing a service to which this chapter applies, a *firm* must ask the *client* to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the *firm* to assess whether the service or product envisaged is appropriate for the *client*.

(2) When assessing appropriateness, a *firm* must determine whether the *client* has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service offered or demanded.

10.2.2 R

The information regarding a *client's* knowledge and experience in the investment field includes, to the extent appropriate to the nature of the *client*, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved, information on:

(1) the types of service, transaction and *designated investment* with which the *client* is familiar;

(2) the nature, volume, frequency of the *client's* transactions in *designated investments* and the period over which they have been carried out;

(3) the level of education, profession or relevant former profession of the *client*.

10.2.3 R

A *firm* must not encourage a *client* not to provide information required for the purposes of its assessment of appropriateness.

Reliance on information

10.2.4 R

A *firm* is entitled to rely on the information provided by a *client* unless it is aware that the information is manifestly out of date, inaccurate or incomplete.

Use of existing information

10.2.5 G

When assessing appropriateness, a *firm* may use information it already has in its possession.

Knowledge and experience

10.2.6 G Depending on the circumstances, a *firm* may be satisfied that the *client's* knowledge alone is sufficient for him to understand the risks involved in a product or service. Where reasonable, a *firm* may infer knowledge from experience.

Increasing the client's understanding

10.2.7 G If, before assessing appropriateness, a *firm* seeks to increase the *client's* level of understanding of a service or product by providing information to him, relevant considerations are likely to include the nature and complexity of the information and the *client's* existing level of understanding.

No duty to communicate firm's assessment of knowledge and experience

10.2.8 G If a *firm* is satisfied that the *client* has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service, there is no duty to communicate this to the *client*. If the *firm* does so, it must not do so in a way that amounts to making a *personal recommendation* unless it complies with the *rules* in ■ COBS 9 (Suitability (including basic advice) (non-MiFID provisions)).

Restricted mass market investments

10.2.9 G (1) When determining whether a *client* has the necessary knowledge to understand the risks involved in relation to a *restricted mass market investment*, a *firm* should consider asking the *client* questions that cover, at least, the matters in:

(a) ■ COBS 10 Annex 1G in relation to *non-readily realisable securities*;

(b) ■ COBS 10 Annex 2G in relation to *P2P agreements* or *P2P portfolios*;

(c) [deleted]

(d) [deleted]

(e) [deleted]

(f) [deleted]

(g) [deleted]

(h) [deleted]

(i) [deleted]

(j) [deleted]

(k) [deleted]

(l) [deleted]

(m) ■ COBS 10 Annex 3G in relation to *units* in a *long-term asset fund*; or

(n) ■ COBS 10 Annex 4G in relation to *qualifying cryptoassets*.

10.3 Warning the client

10.3.1 R

(1) If a *firm* considers, on the basis of the information received to enable it to assess appropriateness, that the product or service is not appropriate to the *client*, the *firm* must warn the *client*.

(2) This warning may be provided in a standardised format.

10.3.2 R

(1) If the *client* elects not to provide the information to enable the *firm* to assess appropriateness, or if he provides insufficient information regarding his knowledge and experience, the *firm* must warn the *client* that such a decision will not allow the *firm* to determine whether the service or product envisaged is appropriate for him.

(2) This warning may be provided in a standardised format.

10.3.3 G

If a *client* asks a *firm* to go ahead with a transaction, despite being given a warning by the *firm*, it is for the *firm* to consider whether to do so having regard to the circumstances.

10.4 Assessing appropriateness: when it need not be done

10.4.1 R

(1) A *firm* is not required to ask its *client* to provide information or assess appropriateness if:

(a) the service only consists of execution and/or the reception and transmission of *client* orders, with or without *ancillary services*, it relates to particular *financial instruments* and is provided at the initiative of the *client*;

(b) the *client* has been clearly informed (whether the warning is given in a standardised format or not) that in the provision of this service the *firm* is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the protection of the *rules* on assessing suitability; and

(c) the *firm* complies with its obligations in relation to conflicts of interest.

(2) The *financial instruments* referred to in (1)(a) are:

(a) [deleted]

(b) money market instruments, bonds or other forms of securitised debt (excluding those bonds or securitised debt that embed a *derivative*); or

(c) [deleted]

(d) other non-complex *financial instruments*.

(3) A *financial instrument* is non-complex if it satisfies the following criteria:

(a) it is not a *derivative* or other security giving the right to acquire or sell a *transferable security* or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;

(b) there are frequent opportunities to dispose of, redeem, or otherwise realise the instrument at prices that are publicly available to the market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer;

(c) it does not involve any actual or potential liability for the *client* that exceeds the cost of acquiring the instrument; and

(d) adequately comprehensive information on its characteristics is publicly available and is likely to be readily understood so as to

enable the average *retail client* to make an informed judgment as to whether to enter into a transaction in that instrument.

10.4.2 R If a *client* engages in a course of dealings involving a specific type of product or service through the services of a *firm*, the *firm* is not required to make a new assessment on the occasion of each separate transaction. A *firm* complies with the *rules* in this chapter provided that it makes the necessary appropriateness assessment before beginning that service.

10.4.3 G As explained in ■ COBS 4.12A.33G, ■ COBS 10.4 is not relevant for the purpose of complying with the *rules* requiring an appropriateness assessment under ■ COBS 4.12A in relation to *restricted mass market investments*.

10.4.3 R [deleted]

10.5 Assessing appropriateness: guidance

The initiative of the client

10.5.1 G A service should be considered to be provided at the initiative of a *client* (see ■ COBS 10.4.1 R (1)(a)) unless the *client* demands it in response to a personalised communication from or on behalf of the *firm* to that particular *client* which contains an invitation or is intended to influence the *client* in respect of a specific *financial instrument* or specific transaction.

10.5.2 G A service can be considered to be provided at the initiative of a *client* notwithstanding that the *client* demands it on the basis of any communication containing a promotion or offer of *investments* made by any means that by its very nature is general and addressed to the public or a larger group or category of *clients*.

Personalised communications

10.5.3 G

(1) Communications to the world at large, such as those in newspapers or on billboards, are likely to be by their very nature general and therefore not personalised communications.

(2) Communications addressed to a *client* (such as, for example, an email, telephone call or letter), may or may not be personalised depending on the content.

(3) A communication is not personalised solely because it contains the name and address of the *client* or because a mailing list has been filtered.

(4) If a *firm* is satisfied that a communication does not contain any personalised content, it may wish to make clear that it does not intend the communication to be personalised and that the personal circumstances of the recipient have not been taken into account.

10.5.4 G [deleted]

Independent valuation systems

10.5.5 G The circumstances in which valuation systems will be independent of the issuer (see ■ COBS 10.4.1 R (3)(b)) include where they are overseen by a depositary that is regulated as a provider of depositary services in a the *United Kingdom*.

10.6 When a firm need not assess appropriateness

10.6.1 G A *firm* need not assess appropriateness if it is receiving or transmitting an order in relation to which it has assessed suitability under ■ COBS 9 (Suitability (including basic advice)).

10.6.2 G [deleted]

10.7 Record keeping and retention periods for appropriateness records

10.7.1 G A *firm* is required to keep orderly records of its business and internal organisation, including all services and transactions undertaken by it. The records may be expected to include the *client* information a *firm* obtains to assess appropriateness and should be adequate to indicate what the assessment was.

10.7.2 R The *firm* must retain its records relating to appropriateness for a minimum of five years.

Assessing appropriateness: non-readily realisable securities

This Annex belongs to ■ COBS 10.2.9G(1)(a) and ■ COBS 10A.2.11G.

When determining whether a *retail client* has the necessary knowledge to understand the risks involved in relation to a *non-readily realisable security*, a *firm* should consider asking the *client* questions that cover, at least, the following matters:

(1) the nature of the *client's* contractual relationship with the *issuer* and any underlying beneficiaries of the investment;

(2) the possibility that the *client* could lose all the money they invest;

(3) the risk of failure of the *issuer* and the associated risk of losing all of the money invested;

(4) the regulated status of the investment activity, including that the issuance of *securities* does not ordinarily involve *regulated activity* and the implications in relation to *FCA* regulation;

(5) the extent to which the protection of the *Financial Ombudsman Service* or *FSCS* apply to the investment activity (including the fact that these services do not protect investors against poor investment performance and that the *Financial Ombudsman Service* cannot ordinarily consider complaints in relation to *unauthorised persons*);

(6) the potential illiquidity of *non-readily realisable securities* (including the unlikelihood or impossibility that the *client* will be able to sell the *security* and the nature of the mechanisms through which the *client* could be paid their money back);

(7) the risk to any management and administration of the *client's* investment in the event of the *issuer* becoming insolvent or otherwise failing;

(8) the role of the *issuer* (including its role in assessing and making underlying investments);

(9) that where a *security* is held in an *innovative finance ISA* (IFISA), this does not reduce the risk of the *security* or otherwise protect the *client* from the risk of losing their money;

(10) the benefits of diversification and that *retail clients* should not generally invest more than 10% of their net assets in *restricted mass market investments*;

(11) where the security is a *share*:

(a) the likelihood of dividend payments;

(b) the risk of dilution from further issues of *shares* and the implications for the value of the *security*; and

(c) the risk of any further issues of *shares* granting preferential rights that negatively impact existing investors and the implications for the value of the *security*;

(12) where the *security* is a *debenture*:

(a) the *client's* exposure to the credit risk of the *issuer*;

(b) that investing in a *debenture* is not comparable to depositing money in a savings account; and

(c) that returns may vary over time; and

(13) where an investment in a *non-readily realisable security* is, or is to be, *arranged* by a *firm*:

(a) the nature of the *client's* contractual relationships with the *firm*;

(b) the role of the *firm* and the scope of the service it provides to *clients* (including the extent of the due diligence that the *firm* undertakes in relation to the *securities* that it distributes); and

(c) the risk to any management and administration of the *client's* investment in the event of the *firm* becoming insolvent or otherwise failing.

Assessing appropriateness: P2P agreements and P2P portfolios

This Annex belongs to ■ COBS 10.2.9G(1)(b).

When determining whether a *retail client* has the necessary knowledge to understand the risks involved in relation to a *P2P agreement* or a *P2P portfolio*, a *firm* should consider asking the *client* questions that cover, at least, the following matters:

(1) the nature of the *client's* contractual relationships with the borrower and the *firm*;

(2) the *client's* exposure to the credit risk of the borrower;

(3) that the *client* can lose all of the money that they invest in a *P2P agreement* or *P2P portfolio*;

(4) that *P2P agreements* or *P2P portfolios* are not covered by *FSCS* and that the *Financial Ombudsman Service* does not protect investors against poor performance of *P2P agreements* or *P2P portfolios*;

(5) that returns may vary over time;

(6) that entering into a *P2P agreement* or investing in a *P2P portfolio* is not comparable to depositing money in a savings account;

(7) the characteristics of any:

(a) security interest, insurance or guarantee taken in relation to the *P2P agreements* or *P2P portfolio*; or

(b) risk diversification facilitated by the *firm*; or

(c) *contingency fund* offered by the *firm*; or

(d) any other risk mitigation measure adopted by the *firm*;

(8) that any of the measures in (7) adopted by the *firm* cannot guarantee that the *client* will not suffer a loss in relation to the money invested;

(9) that where a *firm* has not adopted any risk mitigation measures (such as those in (7)), the extent of any loss of money invested is likely to be greater than if risk mitigation measures were adopted by the *firm*;

(10) illiquidity in the context of a *P2P agreement* or *P2P portfolio*, including the risk that the lender may be unable to exit a *P2P agreement* before maturity even where the *firm* operates a secondary market (including the fact that any advertised access to money invested is not guaranteed);

(11) the role of the *firm* and the scope of its services, including what the *firm* does and does not do on behalf of *clients*;

(12) the risks to the management and administration of a *P2P agreement* or *P2P portfolio* in the event of the *firm's* becoming insolvent or otherwise failing;

(13) that where a *P2P agreement* or *P2P portfolio* is held in an *innovative finance ISA* (IFISA), this does not reduce the risk of the *P2P agreement* or *P2P portfolio* or otherwise protect the *client* from the risk of losing their money; and

(14) the benefits of diversification and that *retail clients* should not generally invest more than 10% of their net assets in *restricted mass market investments*.

Assessing appropriateness: units in a long-term asset fund

This Annex belongs to ■ COBS 10.2.9G(1)(m).

When determining whether a *retail client* has the necessary knowledge to understand the risks involved in relation to a *long-term asset fund*, a *firm* should consider asking the *client* questions that cover, at least, the following matters:

(1) the possibility that the *client* could see the value of the amount they invest go down;

(2) the potential illiquidity of *LTAFs* and their underlying assets;

(3) the possibility that it could take the *client* many years to make a profit on the *money* they invest, and (where relevant) that payments of income may be limited or non-existent;

(4) that due to the *dealing* frequency and *notice period* after a *redemption* request has been accepted (see ■ COLL 15.8.12R (Dealing: redemption of units):

  (a) the *client* will not know the value of the proceeds of *redemption* until the end of the *notice period*; and

  (b) it will take at least [period of time] for the *client* to receive the proceeds of *redemption*;

(5) the risk of the *LTAF's investments* failing and the associated risk of the *client* losing all of the *money* invested;

(6) the extent to which the protection of the *Financial Ombudsman Service* or *FSCS* apply to the investment activity (including the fact that these services do not protect investors against poor investment performance);

(7) the nature of the *client's* contractual relationships with the *authorised fund manager* (including its role in assessing and making underlying *investments*);

(8) the benefits of diversification and that *retail clients* should not generally invest more than 10% of their net assets in *restricted mass market investments*;

(9) where the *units* in the *LTAF* are, or are to be, *dealt* or *arranged* by another *firm* (AF):

  (a) the nature of the *client's* contractual relationships with (AF);

  (b) the role of AF and the scope of the service it provides to *clients* (including the extent of the due diligence that AF undertakes in relation to *units* in *LTAFs* that it *deals* in or *arranges*); and

  (c) the risk to any management and administration of the *client's* investment in the event of AF becoming insolvent or otherwise failing.

Assessing appropriateness: qualifying cryptoassets

This Annex belongs to ■ COBS 10.2.9G(1)(n).

When determining whether a *retail client* has the necessary knowledge to understand the risks involved in relation to a *qualifying cryptoasset*, a *firm* should consider asking the *client* questions that cover, at least, the matters in (1) to (12).

Firms may need to ask additional or alternative questions to ensure that the *retail client* has the necessary knowledge to understand the risks involved in relation to the specific type of *qualifying cryptoasset* offered.

The matters are:

(1) the role of the business offering or marketing the *qualifying cryptoasset* (the business) and the scope of its services, including what the business does and does not do on behalf of *clients*, such as what due diligence is and is not undertaken by the business on any underlying investments;

(2) the nature of the *client's* rights and obligations with the business, in particular the nature of the legal and beneficial ownership of the *qualifying cryptoasset* and the risks associated with those rights;

(3) that the *client* can lose all of the money that they invest in a *qualifying cryptoasset*;

(4) the potential complexity of investments in *qualifying cryptoassets* and the associated difficulty of understanding the risks of the investment;

(5) that the performance of many *qualifying cryptoassets* can be highly volatile and that the value of an investment in a *qualifying cryptoasset* can fall as quickly as it can rise;

(6) the risk of losing money or any *qualifying cryptoassets* purchased as a result of operational risks (such as through cyber-attacks, loss of private keys, comingling of funds) or financial crime;

(7) the risk to any management and administration of the *client's* investment in the event of the business becoming insolvent or otherwise failing;

(8) that the *client* may not be able to readily sell their *qualifying cryptoasset* investment, including as a result of market illiquidity or operational outages;

(9) the regulated status of the business offering or marketing the *qualifying cryptoasset* and the investment activity and the implications of this in relation to *FCA* regulation;

(10) the extent to which the protection of the *Financial Ombudsman Service* or *FSCS* apply to the investment activity (including the fact that these services do not protect investors against poor investment performance and that the *Financial Ombudsman Service* cannot ordinarily consider complaints in relation to *unauthorised persons*);

(11) that investing in, and holding, *qualifying cryptoassets* is not comparable to investing in mainstream *investments* such as listed or exchange-traded securities; and

(12) the benefits of diversification and that *retail clients* should not generally invest more than 10% of their net assets in *restricted mass market investments*.