

**CONDUCT OF BUSINESS (SPECULATIVE ILLIQUID SECURITIES)
INSTRUMENT 2019**

Powers exercised

- A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137D (FCA general rules: product intervention);
 - (3) section 137T (General supplementary powers);
 - (4) section 138M (Consultation: exemptions for temporary product intervention rules); and
 - (5) section 139A (1) and (5) (Power of the FCA to give guidance).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. Part 1 of Annex A and Part 1 of Annex B to this instrument come into force on 1 January 2020.
- D. Part 2 of Annex A and Part 2 of Annex B to this instrument come into force on 31 December 2020.

Amendments to the Handbook

- E. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- F. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

- G. This instrument may be cited as the Conduct of Business (Speculative Illiquid Securities) Instrument 2019.

By order of the Board
21 November 2019

Annex A

Amendments to the Glossary of definitions

Part 1: Comes into force on 1 January 2020

Insert the following new definitions into the appropriate alphabetical positions. The text is not underlined.

- income generating property* a single property or multiple properties within a single development which:
- (1) is actually used, or is intended to be used, for residential or commercial purposes;
 - (2) is located in the *United Kingdom*;
 - (3) is available for occupancy or occupied by *persons* who have no relationship with the *directors* of the *property holding vehicle* and who pay rent at a commercial rate; and
 - (4) has been valued by an independent valuer:
 - (a) who is a member of the Royal Institute for Chartered Surveyors; and/or
 - (b) in accordance with the RICS Valuation Standards (The Red Book).
- property holding vehicle* a *body corporate* which:
- (1) is the legal or beneficial owner of an *income generating property*;
 - (2) issues *debentures* which have a fixed maturity date;
 - (3) issues *debentures* in a sum which does not exceed the value of the *income generating property* owned;
 - (4) issues only one tranche of *debentures*;
 - (5) is only engaged with the holding of *income generating property* and associated activities including the collection of rent or other income from the *income generating property* and appointing a manager to maintain the *income generating property*; and
 - (6) does not enter into any loan agreement whether as the borrower or lender.

speculative illiquid security a *debenture* or *preference share* which meets the requirements in *COBS* 4.14.17R.

Part 2: Comes into force on 31 December 2020

Delete the following definitions. The text is not shown struck through.

income generating property a single property or multiple properties within a single development which meet the following conditions:

- (1) is actually used, or is intended to be used, for residential or commercial purposes;
- (2) is located in the *United Kingdom*;
- (3) is available for occupancy or occupied by *persons* who have no relationship with the *directors* of the *property holding vehicle* and who pay rent at a commercial rate; and
- (4) has been valued by an independent valuer:
 - (a) who is a member of the Royal Institute for Chartered Surveyors; and/or
 - (b) in accordance with the RICS Valuation Standards (The Red Book).

property holding vehicle a *body corporate* which:

- (1) is the legal or beneficial owner of an *income generating property*;
- (2) issues *debentures* which have a fixed maturity date;
- (3) issues *debentures* in a sum which does not exceed the value of the *income generating property* owned;
- (4) issues only one tranche of *debentures*;
- (5) is only engaged with the holding of *income generating property* and associated activities including the collection of rent or other income from the *income generating property* and appointing a manager to maintain the *income generating property*; and
- (6) does not enter into any loan agreement whether as the borrower or lender.

speculative illiquid security a *debenture* or *preference share* which meets the requirements in *COBS* 4.14.17R.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

Part 1: Comes into force on 1 January 2020

In this Annex, underlining indicates new text, unless otherwise stated.

- 4** **Communicating with clients, including financial promotions**
 - ...
 - 4.7** **Direct offer financial promotions**
 - ...
 - 4.7.11 G ...
 - 4.7.11A G Firms are reminded of the restrictions on financial promotions in relation to speculative illiquid securities in COBS 4.14.
 - ...
 - 9** **Suitability (including basic advice) (other than MiFID and insurance-based investment products)**
 - ...
 - 9.3** **Guidance on assessing suitability**
 - ...
 - 9.3.5 G (1) ...
 - (g) speculative illiquid securities are subject to a restriction on financial promotions (see COBS 4.14).
 - ...
 - 9A** **Suitability (MiFID and insurance-based investment products provisions)**
 - ...
 - 9A.2** **Assessing suitability: the obligations**
 - ...
- Investments subject to restrictions on retail distribution: MiFID business and insurance-based investment products

- 9A.2.22 G (1) ...
- (d) *contingent convertible instruments* and *CoCo funds* are subject to a restriction on sales and promotions (see *COBS 22.3*);
- (e) *speculative illiquid securities* are subject to a restriction on *financial promotions* (see *COBS 4.14*).

Insert the following new section, COBS 4.14, after COBS 4.13 (UCITS). The text is not underlined.

4.14 Restrictions on the promotion of speculative illiquid securities to retail clients

Application and purpose

- 4.14.1 G (1) This section contains *temporary product intervention rules* and is intended to ensure that *financial promotions* relating to *speculative illiquid securities* are not *communicated* to ordinary retail investors.
- (2) The *rules* in this section therefore restrict *firms approving or communicating financial promotions* in relation to *speculative illiquid securities* which are addressed to or disseminated in such a way that they are likely to be received by a *retail client*, subject to certain exemptions.
- (3) The *rules* also ensure *financial promotions* contain prominent information on key risks, costs and charges related to the *speculative illiquid security*.
- (4) The *rules* reflect the often complex and high-risk nature of *speculative illiquid securities*.
- (5) The definition of *speculative illiquid security* can be found in *COBS 4.14.17R*.
- (6) The *temporary product intervention rules* in this section will cease to have effect on 31 December 2020.

Restriction on the promotion of speculative illiquid securities to retail clients

- 4.14.2 R (1) A *firm* must not *communicate* or *approve a financial promotion* in relation to a *speculative illiquid security* where that *financial promotion* is addressed to or disseminated in such a way that it is likely to be received by a *retail client*.

- (2) The restriction in (1) is subject to *COBS* 4.14.3R.

Exemptions from the restrictions on the promotion of speculative illiquid securities

- 4.14.3 R (1) The restriction in *COBS* 4.14.2R does not apply if the *financial promotion* falls within an exemption in the table in (4) below.
- (2) Where the middle column in the table in (4) refers to promotion to a category of *person*, this means that the *financial promotion*:
- (a) is made only to recipients who the *firm* has taken reasonable steps to establish are *persons* in that category; or
- (b) is directed at recipients in a way that may reasonably be regarded as designed to reduce, so far as possible, the risk of acquisition of a *speculative illiquid security* by *persons* who are not in that category.
- (3) A *firm* may rely on more than one exemption in relation to the same *financial promotion*.

(4)

Title of exemption	Promotion to:	Promotion of speculative illiquid security which is:
1. Certified high net worth investor	An individual who meets the requirements set out in <i>COBS</i> 4.14.14R or a <i>person</i> (or <i>persons</i>) legally empowered to make investment decisions on behalf of such an individual.	Any <i>speculative illiquid security</i> the <i>firm</i> considers is likely to be suitable for that individual, based on a preliminary assessment of the <i>client's</i> profile and objectives. [See <i>COBS</i> 4.14.4G]
2. Certified sophisticated investor	An individual who meets the requirements set out in <i>COBS</i> 4.14.15R, including an individual who is legally empowered (solely or jointly with others) to make investment decisions on behalf of another <i>person</i> who is the <i>firm's</i> <i>client</i> .	Any <i>speculative illiquid security</i> .

3. Self-certified sophisticated investor	An individual who meets the requirements set out in <i>COBS</i> 4.14.16R including an individual who is legally empowered (solely or jointly with others) to make investment decisions on behalf of another <i>person</i> who is the <i>firm's client</i> .	Any <i>speculative illiquid security</i> the <i>firm</i> considers is likely to be suitable for that individual, based on a preliminary assessment of the <i>client's</i> profile and objectives. [See <i>COBS</i> 14.14.4G].
4. <i>Excluded communications</i>	Any <i>person</i> .	Any <i>speculative illiquid security</i> , provided the <i>financial promotion</i> is an <i>excluded communication</i> .

Preliminary assessment of suitability

- 4.14.4 G (1) A *firm* which wishes to rely on exemptions 1 (certified high net worth investor) or 3 (self-certified sophisticated investor) as provided under *COBS* 4.14.3R(4), should note that these exemptions require a preliminary assessment of suitability before promotion of the *speculative illiquid security* to *clients* (in addition to other requirements).
- (2) There is no duty to communicate the preliminary assessment of suitability 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 or 9A (as applicable) on suitability.
- (3) The requirement for a preliminary assessment of suitability does not extend to a full suitability assessment, unless advice is being offered in relation to the *speculative illiquid security* being promoted, in which case the requirements in *COBS* 9 or 9A apply (as applicable). However, it requires that the *firm* takes reasonable steps to acquaint itself with the *client's* profile and objectives to ascertain whether the *speculative illiquid security* under contemplation is likely to be suitable for that *client*. The *firm* should not promote the *speculative illiquid security* to the *client* if it does not consider it likely to be suitable for that *client* following such preliminary assessment.

Requirements governing the form and content of financial promotions for speculative illiquid securities

- 4.14.5 R Subject to *COBS* 4.14.2R and *COBS* 4.14.3R, a *firm* must not *communicate* or *approve* a *financial promotion* which relates to a *speculative illiquid security* unless it contains:
- (1) a risk warning that complies with *COBS* 4.14.6R;
 - (2) if applicable, the date on which the *financial promotion* was *approved*; and
 - (3) statements that comply with *COBS* 4.14.9R disclosing all costs, charges and commission.
- 4.14.6 R (1) For the purposes of *COBS* 4.14.5R(1), and subject to *COBS* 4.14.6R(2) and *COBS* 4.14.6R(3), the *financial promotion* must contain the following risk warning:
- You could lose all of your money invested in this product.
This is a high-risk investment and is much riskier than a savings account**
- (2) Where the *financial promotion* contains a reference to an *innovative finance ISA*, the risk warning is as follows:
- You could lose all of your money invested in this product
This is a high-risk investment and is much riskier than a savings account
ISA eligibility does not guarantee returns or protect you from losses**
- (3) Where the number of characters contained in the risk warnings in this *rule* exceeds the character limit permitted by a third-party marketing provider, the following risk warning must be used:
- You could lose all of your money invested in this product**
- (4) Where the *financial promotion* does not appear on a website or mobile application, the risk warning must be provided in a *durable medium*.
- 4.14.7 R The relevant risk warning in *COBS* 4.14.6R must be:
- (1) prominent;
 - (2) contained within its own border and with bold text as indicated;
 - (3) if provided on a website or via a mobile application, statically fixed and visible at the top of the screen even when the *retail client* scrolls up or down the webpage; and

- (4) if provided on a website, included on each linked webpage on the website.
- 4.14.8 G The relevant risk warning, including the font size, should be:
- (1) proportionate to the *financial promotion*, taking into account the content, size and orientation of the *financial promotion* as a whole; and
 - (2) published so that it is clearly legible against a neutral background.
- 4.14.9 R For the purposes of *COBS* 4.14.5R(3) the *financial promotion* must contain:
- (1) a statement which expresses as a percentage the total amount of the capital raised by the issue of the *speculative illiquid security* which will be paid out in costs, fees, charges and commissions and other expenses to any third party;
 - (2) a statement which expresses as a cash sum the percentage referred to in (1) above; and
 - (3) in addition to the statements in (1) and (2) above, a statement which provides a breakdown of the actual or potential expenditure to be paid out of an investor's capital and details of the third party (or parties) who will receive it.
- 4.14.10 G
- (1) There is an illustration of how a *firm* should comply with *COBS* 4.14.9R(2) in (2) below.
 - (2) Where a firm pays 30% of the total amount of capital raised by the issue of *speculative illiquid securities* towards costs, fees, charges and commissions and other expenses to any third party, the statement should say: "For every £100 you invest, £30 will be paid to third parties to meet costs, fees, charges and commissions."
- 4.14.11 R The statements providing the percentage figure in *COBS* 4.14.9R(1) and the cash sum in *COBS* 4.14.9R(2) must be:
- (1) prominent;
 - (2) contained together within their own border and with bold text;
 - (3) immediately follow the most prominent reference to the expected return on the *speculative illiquid security*; and
 - (4) published so that they are clearly legible against a neutral background.
- 4.14.12 G The statement providing the breakdown of expenditure in *COBS* 4.14.9R(3) should be included in the *financial promotion* in a clear and prominent way.

- 4.14.13 G The purpose of the statements required by *COBS* 4.14.9R is to enable an investor to consider the proportion of capital raised by an issue of *speculative illiquid securities* that will not be invested. This information should help the investor to assess the risk that the *issuer* will be unable to pay any advertised interest payments or otherwise to repay the investor's capital at maturity.

Definitions of certified high net worth and sophisticated investors

- 4.14.14 R A high net worth investor is an individual who has signed, within the period of twelve *months* ending on the day on which the communication is made, a statement in the following terms:

“HIGH NET WORTH INVESTOR STATEMENT

I make this statement so that I can receive promotional communications which are exempt from the restriction on promotion of speculative illiquid securities. The exemption relates to high net worth investors and I declare that I qualify as such because at least one of the following applies to me:

I had, throughout the financial year immediately preceding the date below, an annual **income** to the value of **£100,000 or more**. Annual income for these purposes does not include money withdrawn from my pension savings (except where the withdrawals are used directly for income in retirement).

I held throughout the financial year immediately preceding the date below, **net assets** to the value of **£250,000 or more**. Net assets for these purposes do **not** include:

- (a) the property which is my primary residence or any money raised through a loan secured on that property; or
- (b) any rights of mine under a qualifying contract of insurance; or
- (c) any benefits (in the form of pensions or otherwise) which are payable on the termination of my service or on my death or retirement and to which I am (or my dependants are), or may be, entitled; or
- (d) any withdrawals from my pension savings (except where the withdrawals are used directly for income in retirement).

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on speculative illiquid securities.

Signature:

Date:

4.14.15 R A certified sophisticated investor is an individual who:

(1) has a written certificate signed within the last 36 *months* by a *firm* confirming he has been assessed by that *firm* as sufficiently knowledgeable to understand the risks associated with engaging in investment activity in *speculative illiquid securities*; and

(2) has signed, within the period of twelve *months* ending with the day on which the communication is made, a statement in the following terms:

“SOPHISTICATED INVESTOR STATEMENT

I make this statement so that I can receive promotional communications which are exempt from the restriction on promotion of speculative illiquid securities. The exemption relates to certified sophisticated investors and I declare that I qualify as such.

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on speculative illiquid securities.

Signature:

Date: ”

4.14.16 R A self-certified sophisticated investor is an individual who has signed, within the period of twelve *months* ending with the day on which the communication is made, a statement in the following terms:

“I declare that I am a self-certified sophisticated investor for the purposes of the restriction on promotion of speculative illiquid securities. I understand that this means:

- (i) I can receive promotional communications made by a person who is authorised by the Financial Conduct Authority which relate to investment activity in speculative illiquid securities;
- (ii) the investments to which the promotions will relate may expose me to a significant risk of losing all of the property invested.

I am a self-certified sophisticated investor because at least one of the following applies:

- (a) I am a member of a network or syndicate of business angels and have been so for at least the last six months prior to the date below;

(b) I have made more than one investment in an unlisted company in the two years prior to the date below;

(c) I am working, or have worked in the two years prior to the date below, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;

(d) I am currently, or have been in the two years prior to the date below, a director of a company with an annual turnover of at least £1 million.

I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me seek advice from someone who specialises in advising on speculative illiquid securities.

Signature:

Date: ”

Definition of speculative illiquid security

- 4.14.17 R For the purposes of this section, and subject to *COBS* 4.14.18R, a *speculative illiquid security* is a *debenture* or *preference share* which:
- (1) has a denomination or minimum investment of £100,000 or less; and
 - (2) has been issued, or is to be issued, in circumstances where the *issuer* or a member of the *issuer's group* uses, will use or purports to use some or all of the proceeds of the issue directly or indirectly for one or more of the following:
 - (a) the provision of loans or finance to any *person* other than a member of the *issuer's group*;
 - (b) *buying* or acquiring *investments* (whether they are to be held directly or indirectly);
 - (c) *buying* property or an interest in property (whether it is to be held directly or indirectly);
 - (d) paying for or funding the construction of property.
- 4.14.18 R A *debenture* or *preference share* is not a *speculative illiquid security* where one or more of the exemptions in (1), (3) or (4) below applies.
- (1) This exemption applies where:
 - (a) the *issuer* or a member of the *issuer's group* uses or purports to use the proceeds of the issue for the purpose of the

activities in *COBS* 4.14.17R(2)(c) or (d) (*buying* or *constructing* property); and

- (b) the relevant property is or will be used by the *issuer* or a member of the *issuer's group* for a general commercial or industrial purpose which it carries on.

- (2) The exemption in (1) will not apply if the ability of the *issuer* to pay in relation to the *debenture* or *preference share*:

- (a) any *coupon* or other income; and/or
- (b) capital at maturity

is wholly or predominantly linked to, contingent on, sensitive to or dependent on a return generated as a result of the matters referred to in *COBS* 4.14.17R(2)(c) or (d).

- (3) This exemption applies where the *debenture* or *preference share* is:

- (a) issued, or to be issued, by a *credit institution*;
- (b) a *non-mainstream pooled investment*;
- (c) a *readily realisable security*; or
- (d) a *P2P agreement*.

- (4) This exemption applies where the *issuer* is a *property holding vehicle*.

- 4.14.19 R (1) For the purposes of *COBS* 4.14.18R(1)(b), a general commercial or industrial purpose includes the following:

- (a) a commercial activity, involving the purchase, sale and/or exchange of goods or commodities and/or the supply of services (other than property development or construction services); or
- (b) an industrial activity involving the production of goods; or
- (c) a combination of (a) and (b).

- (2) For the purposes of *COBS* 4.14.18R(1)(b), a general commercial or industrial purpose does not include investment to generate a pooled return.

Guidance on general commercial or industrial purpose

- 4.14.20 G (1) *COBS* 4.14.17R provides that a *debenture* or *preference share* will fall within the definition of a *speculative illiquid security* where the proceeds of the issue are to be used by the *issuer* or a member of the

issuer's group to fund various activities including the *buying* or construction of property.

- (2) However, *COBS* 4.14.18R(1) provides an exemption in cases where the property which is bought or constructed is or will be used by the *issuer* or a member of the *issuer's group* for a general commercial or industrial purpose which it carries on.
- (3) General commercial or industrial purpose is defined in *COBS* 4.14.19R.
- (4) The effect of the exemption in *COBS* 4.14.18R(1) is that a *debenture* or *preference share* will not be a *speculative illiquid security* where the proceeds of the issue are used by the *issuer* or a member of the *issuer's group* to buy or construct a property which is used by the *issuer* or *group* member for the purposes of its own commercial or industrial activities.
- (5) For instance:
 - (a) where a retailer issues a *debenture* or *preference share* and uses the proceeds to build a shop, the *debenture* or *preference share* will benefit from the exemption because the property is used by the retailer for its own commercial activities (in this case, the sale of goods);
 - (b) where a property developer issues a *debenture* or *preference share* and uses the proceeds to fund the costs of a property development or construction of property, which is intended to be sold, it will not benefit from the exemption because the development will not be used by the developer itself, and property development and construction services are excluded from the definition of general commercial or industrial purpose.
 - (c) where a company issues a *debenture* or *preference share* to fund the costs of constructing a power station which the company intends to operate itself with a view to selling the electricity it produces, the *debenture* or *preference share* will benefit from the exemption (unless *COBS* 4.14.18R(2) applies). That is because it will use the property for its own commercial or industrial activities (generating electricity). However, *firms* should also consider *COBS* 4.14.18R(2) and the guidance in (6) below.
- (6) *COBS* 4.14.18R(2) provides that the general commercial or industrial purposes exemption does not apply where the ability of the issuer to pay the *coupon* or other income or to repay capital on maturity in relation to the *debenture* or *preference share* is wholly or predominantly linked to, contingent on, sensitive to or dependent on

the return generated as a result of the matters referred to in *COBS* 4.14.17R(2)(c) or (d) (*buying* or constructing property).

- (7) The effect of the above is that where a company issues a *debenture* or *preference share* for the purpose of funding the construction of a particular project and the company's ability to pay interest on the *debenture* or *preference share* or repay capital depends on the success of that project, the exemption in *COBS* 4.14.18R(1) will not apply. In those circumstances, the *debenture* or *preference share* will be a *speculative illiquid security* unless one of the other exemptions in *COBS* 4.14.18R applies.

Part 2: Comes into force on 31 December 2020

4 Communicating with clients, including financial promotions

...

4.7 Direct offer financial promotions

...

4.7.11 G ...

4.7.11A G ~~*Firms are reminded of the restrictions on financial promotions in relation to speculative illiquid securities in COBS 4.14. [deleted]*~~

...

COBS 4.14 is deleted in its entirety. The deleted text is not shown but the section is marked deleted, as shown below.

4.14 Restrictions on the promotion of speculative illiquid securities to retail clients [deleted]

Amend the following as shown.

9 Suitability (including basic advice) (other than MiFID and insurance-based investment products)

...

9.3 Guidance on assessing suitability

...

9.3.5 G (1) ...

- (g) ~~speculative illiquid securities are subject to a restriction on financial promotions (see COBS 4.14). [deleted]~~

...

9A Suitability (MiFID and insurance-based investment products provisions)

...

9A.2 Assessing suitability: the obligations

...

Investments subject to restrictions on retail distribution: MiFID business and insurance-based investment products

9A.2.22 G (1) ...

- (d) *contingent convertible instruments* and *CoCo funds* are subject to a restriction on sales and promotions (see *COBS 22.3*);
- (e) ~~speculative illiquid securities are subject to a restriction on financial promotions (see COBS 4.14). [deleted]~~