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


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)

<table>
<thead>
<tr>
<th>Title of exemption</th>
<th>Promotion to:</th>
<th>Promotion of speculative illiquid security which is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Certified high net worth investor</td>
<td>An individual who meets the requirements set out in COBS 4.14.14R or a person (or persons) legally empowered to make investment decisions on behalf of such an individual.</td>
<td>Any speculative illiquid security the firm considers is likely to be suitable for that individual, based on a preliminary assessment of the client’s profile and objectives. [See COBS 4.14.4G]</td>
</tr>
<tr>
<td>2. Certified sophisticated investor</td>
<td>An individual who meets the requirements set out in COBS 4.14.15R, including an individual who is legally empowered (solely or jointly with others) to make investment decisions on behalf of another person who is the firm’s client.</td>
<td>Any speculative illiquid security.</td>
</tr>
</tbody>
</table>
3. Self-certified sophisticated investor
An individual who meets the requirements set out in COBS 4.14.16R including an individual who is legally empowered (solely or jointly with others) to make investment decisions on behalf of another person who is the firm’s client.

Any speculative illiquid security the firm considers is likely to be suitable for that individual, based on a preliminary assessment of the client’s profile and objectives.
[See COBS 14.14.4G].

4. Excluded communications
Any person.
Any speculative illiquid security, provided the financial promotion is an excluded communication.

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 14.4.2R and COBS 14.4.3R, 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:
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: ”

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 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]