Jason Pope
Consumer Duty Policy
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

By email: cp22-26@fca.org.uk

9 January 2023

Dear Mr Pope

Re: Clarificatory amendments to the Consumer Duty in Quarterly Consultation Paper No. 38 (CP22/26)

The BVCA is the industry body and public policy advocate for the private equity and venture capital (PE/VC) industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based PE/VC 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 PE/VC currently employ over two million 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 the FCA's consultation proposals for clarificatory amendments to the Consumer Duty and have responded to consultation questions on which our members have specific views.

In summary:

- We advocate not introducing the proposed change to the £50,000 exemption, for the reasons set out in our answer to question 8.5 below
- If the change is introduced, firms need to be given at least a year to prepare, prior to introduction of the change. This is necessary because we understand many private equity firms have been working on the basis that their business is substantially outside the scope of the Consumer Duty rules. This change would bring many of those firms within scope. Unless there is a delay, those firms will have only a few months to prepare for implementation of the rules.
- If the change is introduced, we would like clarification that it does not apply to distribution chains where the sole retail investors are located outside the UK.
- If the change is introduced, we would like to clarify a number of points of application of the rules to our industry. This will be important to ensure a proportionate application of the rules to funds which are designed for and marketed to global institutional investors.
- The proposals relating to financial promotions relating to unregulated collective investment schemes appear to conflict in part with the forthcoming amendments to COBS. A clarification should be added to the effect that the Consumer Duty does not apply to those communications made by FCA regulated firms which fall within an exemption in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (PCIS Order).

Q8.5: Do you have any comments on our proposal to amend the exclusion for activities linked to 'non-retail financial instruments'?

We strongly disagree with the proposed changes in the section titled the 'Application of the Consumer Duty to 'non-retail financial instruments''. Given the statement on the FCA's website that Quarterly

Consultation Papers (QCPs) are used to consult on miscellaneous amendments to the Handbook that "tend to be minor changes", we're surprised this proposal, which will have significant consequences for many firms, has been included in a QCP and is subject to just a five-week consultation over the winter/new year holiday period.

The final rules for the Consumer Duty were published in July 2022. They are clear that there is an exemption for a 'non-retail financial instrument', which is defined as a product in respect of which (a) the marketing materials feature prominent and clear disclosure that the product is being offered and marketed to investors eligible for categorisation as professional clients or eligible counterparties and is not intended for retail customers; or (b) is subject to a minimum investment amount of £50,000 or more.

Since that publication, firms managing and/or marketing investment funds have worked on the basis of the finalised rules. Many firms have concluded that the majority or all their products are 'non-retail financial instruments' for the purposes of the Consumer Duty and are therefore outside of the scope of the requirements, in part through the exemption for a £50,000 minimum investment. Firms have engaged with and prepared for the Consumer Duty on this basis. Many firms have followed the FCA's request to report progress to senior management and have already reported they anticipate that their firm will be out of scope from summer 2023.

For the following reasons, and to avoid imposing further costs and disruption on affected firms, at a time when we feel this should be a primary concern of the regulator for the reasons outlined below, we ask the FCA not to widen the scope of the Consumer Duty at this late stage and instead retain the definition of a 'non-retail financial instrument' as it was confirmed in Policy Statement (PS) 22/9.

The case for maintaining the current position

The Chancellor's recent letter with recommendations to the FCA states that the FCA should support the Government's objective of medium to long-term economic growth in the interests of consumers and businesses and to promote the international competitiveness of the UK. Our industry is a key contributor to delivering on the Government's ambition to encourage economic growth, primarily by facilitating investment in productive assets.

We are concerned that changing the position set out in the FCA's consultation paper will act as a disincentive for firms to maintain marketing staff in the UK for their global private equity funds. Many private equity firms raise institutional funds with no UK-based retail clients or where the only UK based retail clients are staff at the UK firm. We are particularly concerned about the impact of the rules on these firms.

The UK is a significant global hub for private equity. Private equity firms will typically establish their funds in a small number of jurisdictions in order to be marketed to a global institutional investor base. Often these funds are established in jurisdictions other than the UK (e.g. the United States and/or Luxembourg).

Marketing will take place from those offices where private equity firms maintain their marketing teams. Many firms currently locate members of their global marketing team in their UK office where, over the years, a great deal of expertise has been developed. Firms must market to global investors in compliance with the laws of the jurisdiction where the investor is based, marketing laws relating to the jurisdiction of the fund and (where different) marketing laws relating to the jurisdiction of the marketing team. The UK's strength in private equity provides a good reason to locate members of a professional marketing team here even where this may not be the jurisdiction of the fund or investor. However, if the UK introduces complex additional regulation which applies to the marketing of institutional investor funds, this will be a significant burden for firms. As these funds are designed for global institutional investors, most firms will have no investors or a very small number of investors globally who would be classified as "retail" under

UK standards. Needing to run a Consumer Duty overlay across the marketing of those funds will be a particularly disproportionate burden for those firms. This will act as a disincentive for firms to locate those key marketing staff in the UK.

We are concerned that the Consumer Duty rules fall firmly into this category. The £50,000 exemption has acted as a straightforward route for firms to identify whether they are within or out of scope of the rules. We also think that this is a sensible level at which to distinguish between retail and professional investors as it is unlikely that many retail investors would be in a position to invest £50,000 or more into a single fund.

If this is removed, firms will need to carry out a complex analysis as to how to apply the rules to their business. For many firms this is particularly complex because potentially many of those investors which might be categorised as "retail" will be (a) third party investors based outside the UK and/or (b) a small number of UK staff working for the PE/VC firm. The scoping provisions to apply the FCA rules to these investors are complex.

We hear from many firms that they find the UK's approach to financial services regulation puzzling. On the one hand, the Government has for some time been advocating "global Britain", with a tailored approach to financial services which will enhance the UK's global competitiveness. On the other hand, the UK continues to introduce new complex rules such as IFPR and the Consumer Duty which in the context of this industry do not appear to benefit UK consumers but do have the effect of layering more "red tape" on the industry. This appears to be directly contrary to stated government policy. Notably, non-UK fund managers marketing their institutional funds into the UK would be outside the scope of the Consumer Duty rules where they have clients who would be categorised as "retail clients". So firms appear to have a choice: (a) locate staff in the UK and comply with the rules even if all retail investors are outside the UK or (b) locate staff outside the UK and none of the rules apply.

By contrast, a number of competing European jurisdictions now have a concept of a 'semi-professional investor', i.e. a retail investor who commits to investing a minimum of €100,000 and who can provide a written statement to the effect that they are aware of the risks associated with the envisaged commitment or investment. These arrangements have proven popular elsewhere and ease costly and burdensome disclosure and other regulatory requirements in such circumstances. The £50,000 minimum investment exemption for the Consumer Duty had been welcomed by industry as a reasonable and proportionate attempt by the FCA at creating a similar threshold in the UK.

For these reasons, we recommend that the FCA withdraw its proposal to amend the exclusion for activities linked to 'non-retail financial instruments'.

<u>If the FCA proceeds with its proposal</u>

Implementation Periods

If the FCA does proceed with the proposed amendment, we ask that it defers the effective date of the amendment to give firms adequate time to consider and implement the Consumer Duty. Absent such an arrangement, by the time the new definition has been confirmed by the FCA in a Policy Statement, affected firms will have just a few months to analyse and make changes to comply with the new obligations. This contrasts with the whole calendar year that firms managing or marketing products squarely in scope of the Consumer Duty will have had to prepare for the new rules coming into force in July 2023.

We therefore recommend that, if the FCA proceeds with these changes, it uses transitional provisions to amend the implementation periods for firms with products brought into scope because of the proposed changes, as follows:

	PS22/9	Recommend
New and existing products and services	31 July 2023	31 July 2024
Closed products and services	31 July 2024	31 July 2025

Non-UK investors

If the FCA does proceed with its proposed amendment, we also suggest that distribution chains relating to institutional investor funds where the only retail investors are outside the UK be excluded from the scope of the Consumer Duty.

Where institutional investor products are marketed to investors based outside of the UK, this must be done in compliance with the relevant marketing regime applicable in that jurisdiction, which includes the consumer protections that the relevant authorities consider appropriate for that type of investor. However, the local marketing regime may not be fully aligned to that of the FCA and, in particular, the criteria to be considered a professional investor (or the local equivalent) may differ. To apply the Consumer Duty to such arrangements would be a significant burden for firms with no corresponding benefit for UK customers.

Therefore, we think that the rules should make it clear that the Consumer Duty does not apply to distribution chains where the sole retail investors in the distribution chain are located outside the UK.

Q8.7: Do you have any comments on our proposal to clarify the application of the Duty where an exemption applies in a sectoral sourcebook?

We do not have any comments on the proposed change to PRIN 3.2.8R itself but we think that there is some potential inconsistency between PRIN 3.2.6R(2) and (3) as currently drafted and the scope of application of the COBS rules as they will apply from February 2023 to unregulated collective investment schemes. We suggest the language of the proposals is updated to clarify the position.

PRIN 3.2.6R(2)(a) and PRIN 3.2.6R(2)(c) appear to suggest that Principle 12 and certain sections of PRIN 2A (as set out in PRIN 3.2.6R(3)) apply to financial promotions communicated by authorised firms to retail customers in reliance on the exemptions in the PCIS Order. We note that the rules do allow firms to exclude those communications which could be communicated by an unauthorised person without breaching section 21(1) of FSMA. However, we think that the rules could be made clearer if PRIN stated that promotions falling within an exemption in the PCIS Order are out of scope.

PRIN 3.2.8R states that "*Principle 12 and PRIN 2A do not apply to activities to the extent that those activities are excluded from a rule which sets out the scope of protections offered to retail customers by COBS, ICOBS, MCOB, BCOBS, CMCOB, FPCOB, PROD or CONC*". There are a number of provisions in COBS 4 which are expressed not to apply to "excluded communications" which include communications made using the exemptions in the PCIS Order, including the forthcoming COBS 4.12B. It would therefore seem that the effect of PRIN 3.2.8R is to exclude financial promotions made using the exemptions in the PCIS Order.

We think that the current language used in PRIN 3.2.6R(2) should be revised to clarify this. In particular, we think it should be made clear that communications made using the exemptions in the PCIS Order should not be considered to be within the scope of the Consumer Duty. This would be consistent both with the fact that such financial promotions are not subject to the high-risk protections in COBS 4.12B and also that the recipients of such communications have already been considered sufficiently sophisticated to receive such types of promotion under the criteria set out in the PCIS Order.

If the FCA proceeds with this amendment in relation to financial promotions, we also think it would be helpful to discuss the scope of application where the COBS 4 rules are disapplied through the application of the table in COBS 4.12B.7R.

Further engagement

Whatever approach the FCA proposes to the potential amendments, we would be grateful for the opportunity to discuss with you how implementation of the Consumer Duty can be clarified and appropriately and proportionately managed in a private capital context, i.e. by PE/VC firms. For example, the application of the Consumer Duty should take into account those firms where the only UK based "retail" clients are UK staff of the FCA regulated firm promoting the fund who co-invest in funds alongside investors.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor ttaylor@bvca.co.uk / Nick Chipperfield nchipperfield@bvca.co.uk).

Yours sincerely,

Tim Lewis

Chair, BVCA regulatory committee