

**CONDUCT OF BUSINESS (SPECULATIVE ILLIQUID SECURITIES)
INSTRUMENT 2020**

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 137R (Financial promotion rules);
 - (4) section 137T (General supplementary powers);
 - (5) section 139A (Power of the FCA to give guidance); and
 - (6) section 238(5) (Restrictions on Promotion).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. Annex A to this instrument comes into force on 11 December 2020.
- D. Annexes B and C to this instrument come into force on 1 January 2021.

Amendments to the Handbook

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

Notes

- G. In Annexes A and C to this instrument, the “notes” (indicated by “*Editor’s note:*”) are included for the convenience of readers but do not form part of the legislative text.

Citation

- H. This instrument may be cited as the Conduct of Business (Speculative Illiquid Securities) Instrument 2020.

By order of the Board
7 December 2020

Annex A

Instrument coversheet

[*Editor's note:* Following consultation in CP20/8 *High-risk investments: Marketing speculative illiquid securities (including speculative mini-bonds) to retail investors*, the change below is being made to make clear the time of day at which the rules made by the Conduct of Business (Speculative Illiquid Securities) Instrument 2019 (FCA 2019/99) expire.]

Amend the commencement date of the following instrument as shown. Underlining indicates new text.

Conduct of Business (Speculative Illiquid Securities) Instrument 2019 (FCA 2019/99)

Commencement

- D. Part 2 of Annex A and Part 2 of Annex B to this instrument come into force at the end of the day on 31 December 2020.

Annex B

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

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

- | | |
|-----------------------------------|--|
| <i>income generating property</i> | <p>a single property or multiple properties within a single development which:</p> <ol style="list-style-type: none"> (1) is actually used, or is available for use, for residential or commercial purposes; (2) is located in the <i>United Kingdom</i>; (3) is available for occupancy or occupied by one or more <i>persons</i> who have no relationship with the <i>directors</i> of the relevant <i>property holding vehicle</i> and who pay rent at a commercial rate or a rate reflecting regulated market practice for social and affordable housing; and (4) has been valued by an independent valuer: <ol style="list-style-type: none"> (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). |
| <i>property holding vehicle</i> | <p>a single <i>body corporate</i> which:</p> <ol style="list-style-type: none"> (1) is the sole legal or beneficial owner of a single <i>income generating property</i>; (2) issues <i>debentures</i> which have a fixed maturity date or <i>preference shares</i>; (3) issues <i>debentures</i> or <i>preference shares</i> in a sum which does not exceed the value of the <i>income generating property</i> owned; (4) issues only one tranche of <i>debentures</i> or <i>preference shares</i>; (5) does not and will not carry on any activities other than the holding of the <i>income generating property</i> referred to in (1) and associated activities, which may include the collection of rent or other income from the <i>income generating property</i> and |

appointing a manager to maintain the *income generating property*, but must not include the development of the *income generating property* that goes beyond maintaining it in a suitable condition; and

- (6) does not enter into any loan agreement whether as the borrower or lender.

single-company holding vehicle

a *single body corporate* which:

- (1) is only able to carry on the following activities:
- (a) issuing *debentures* or *preference shares* for the purpose of investing the proceeds in *shares* or *debentures* issued by a *single company* (without prejudice to the *single-company holding vehicle's* ability to constitute itself);
 - (b) investing the total proceeds of the *debentures* or *preference shares* it issues in *shares* or *debentures* issued by a *single company* and no other *company* and having no discretion in relation to the proceeds of the issue;
 - (c) paying returns to holders of the *debentures* or *preference shares* in sums equal to any income it receives from the *shares* or *debentures* it owns (issued by the *single company*), including income from any sale of the *shares* or *debentures*, on a pro rata basis, less any reasonable fees (without prejudice to relevant legislation governing companies and taxation); and
- (2) has adequate arrangements in place to ensure that:
- (a) the proceeds of the issue are protected and not used for any purpose outside of (1)(b) above; and
 - (b) either:
 - (i) income from the *single company* is held by the *single-company holding vehicle* on trust for holders of the *debentures* or *preference shares* on terms that ensure that those investors receive the full amount they are entitled to according to (1)(c) above; or
 - (ii) the holders of the *debentures* or *preference shares* have security over the income from the *single company* on terms that ensure that those investors receive the full amount they are entitled to according to (1)(c) above; and

- (3) ensures that neither the *single company*, nor members of its *group*, will use any of the monies received from the *single-company holding vehicle* directly or indirectly for one or more of the purposes in COBS 4.14.20R(2) as modified by limb (b) of the *single company Glossary* definition.

single company

a *single company* that is not part of the same *group* as the *single-company holding vehicle* investing in it and which:

- (a) uses the funds received from the *single-company holding vehicle* solely for the purpose of its own commercial operations or those of its *subsidiaries* carrying out the same commercial operations as the *single company*; and
- (b) does not undertake any of the activities in COBS 4.14.20R(2)(a) to (e) subject to COBS 4.14.22R and COBS 4.14.24R(1) (for these purposes, COBS 4.14.20R(2)(a) to (e), COBS 4.14.22R and COBS 4.14.24R(1) must be read as though references to the *issuer* are to the *single company*).

speculative illiquid security has the meaning in COBS 4.14.20R.

Amend the following definitions as shown.

investment trust

...

- (a) ...
- (b) (for the purposes of COBS 4.14 and the definitions of *non-mainstream pooled investment* and *packaged product* only) is resident in an *EEA state* and would qualify for such approval if resident in the *United Kingdom*.

non-readily realisable security

a *security* which is not any of the following:

...

- (e) a deferred share issued by a *credit union*; ~~or~~
- (f) *credit union subordinated debt*; ~~or~~
- (g) a *speculative illiquid security*.

readily realisable security

(except in COBS 4.14, *COLL* and for the purposes of the definition of *non-readily realisable security*):

- (a) ...

- (b) ...
 - (i) ...

...

(in COBS 4.14, *COLL* and for the purposes of the definition of *non-readily realisable security*):

...

...

...

Annex C

Amendments to the Conduct of Business sourcebook (COBS)

[*Editor's note:* All provisions in the Handbook marked “[deleted]” as a result of Conduct of Business (Speculative Illiquid Securities) Instrument 2019 (FCA 2019/99) are replaced by the content in this instrument and the words “[deleted]” are to be deleted.]

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

2 Conduct of business obligations

...

2.2 Information disclosure before providing services (other than MiFID and insurance distribution)

Application

2.2.-1

R ...

(2) ...

- (a) in relation to a *derivative*, a *warrant*, a *non-readily realisable security*, ~~a *speculative illiquid security*~~, a *P2P agreement*, or *stock lending activity*, but as regards the matters in COBS 2.2.1R(1)(b) only; and

...

(3) Where a *rule* in this section applies to a *firm* carrying on *designated investment business* in relation to a *speculative illiquid security* the *rule* also applies to:

- (a) 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
- (b) a Gibraltar-based firm (having the same meaning as in the *Gibraltar Order*) to the extent that the *rule* does not already apply to such a Gibraltar-based firm as a result of GEN 2.3.1R).

...

4 Communicating with clients, including financial promotions

...

4.7 Direct offer financial promotions

...

4.7.11 G ...

4.7.11A G COBS 4.7.7R does not apply to speculative illiquid securities. Firms, TP firms and Gibraltar-based firms (having the same meaning as in the Gibraltar Order) are reminded of the restrictions on financial promotions in relation to speculative illiquid securities in COBS 4.14.

...

4.12 Restrictions on the promotion of non-mainstream pooled investments

Restrictions on the promotion of non-mainstream pooled investments

4.12.3 R ...

(3) References to a firm in this section include a TP firm to the extent that this section does not already apply to those TP firms as a result of GEN 2.2.26R.

(4) References to a firm in this section include a Gibraltar-based firm (having the same meaning as in the Gibraltar Order) to the extent that the rule does not already apply to such a Gibraltar-based firm as a result of GEN 2.3.1R.

Exemptions from the restrictions on the promotion of non-mainstream pooled investments

4.12.4 R (1) The restriction in COBS 4.12.3R does not apply if the promotion falls within an exemption in the table in (5) below in accordance with (3).

(2) A ~~firm~~ firm may communicate an invitation or inducement to participate in an *unregulated collective investment scheme* without breaching the restriction on promotion in *section 238 of the Act* if the promotion falls within an exemption in the table in (5) below in accordance with (3).

(3) ~~Where the middle column in the table in (5) refers to promotion to a category of person, this means that the invitation or inducement~~ A promotion falls within an exemption in the table in (5) below if:

(a) ~~is made only to recipients who the firm has taken reasonable steps to establish are persons in that category~~ it is made to or directed at only those recipients whom the firm has taken reasonable steps to establish are persons in the middle

column of the table; ~~or~~ and

- (b) ~~is directed at recipients in a way that may reasonably be regarded as designed to reduce, so far as possible, the risk of participation in, acquisition or underwriting of the *non-mainstream pooled investment by persons who are not in that category* where the third column of the table refers to the need for a preliminary assessment of suitability, that assessment is undertaken before the promotion is made to or directed at the recipient.~~

...

...

Advice and preliminary assessment of suitability

4.12.5 G (1) ...

- (2) (a) ~~The effect of COBS 4.12.4R(3)(b) is that where~~ A a firm which wishes to rely on exemptions 2 (certified high net worth investors) or 9 (self-certified sophisticated investors), as provided ~~under by~~ COBS 4.12.4R(5), should note that these exemptions require a the preliminary assessment of suitability must be undertaken before promotion of the *non-mainstream pooled investment* is made to or directed at clients (in addition to other requirements).

...

...

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 R This section applies to:

- (1) *firms*;
- (2) *TP firms*; and
- (3) Gibraltar-based firms,

when approving or communicating financial promotions in relation to speculative illiquid securities.

- 4.14.2 G In addition to the *persons* listed in COBS 4.14.1R, *persons* (including *unauthorised persons*) who benefit from a temporary exemption or exclusion from the *general prohibition* under:
- (1) Part 7 of the *EU Exit Passport Regulations*; or
 - (2) Part 4 of the Electronic Commerce and Solvency 2 (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/1361)
- are required to comply with the *rules* in this section as a consequence of:
- (3) regulation 59 of the *EU Exit Passport Regulations*; or
 - (4) regulation 19 of the Electronic Commerce and Solvency 2 (Amendment etc.) (EU Exit) Regulations 2019.
- 4.14.3 R Throughout this section:
- (1) References to *firm* include references to a Gibraltar-based firm.
 - (2) Gibraltar-based firm has the same meaning as in the *Gibraltar Order*.
- 4.14.4 G
- (1) The *rules* in this section are 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* and *TP 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 4.14.20R.

Restriction on the promotion of speculative illiquid securities to retail clients

- 4.14.5 R
- (1) A *firm* or a *TP 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 4.14.6R.

Exemptions from the restriction on the promotion of speculative illiquid securities

- 4.14.6 R (1) The restriction in *COBS* 4.14.5R(1) does not apply if the *financial promotion*:
- (a) falls within an exemption in the first column in the table in (3) below; and
 - (b) is made to or directed at only those recipients whom the *firm* or *TP firm* has taken reasonable steps to establish are *persons* in the middle column of the table; and
 - (c) where the third column of the table refers to the need for a preliminary assessment of suitability, that assessment is undertaken before the *financial promotion* is made to or directed at the recipient.
- (2) A *firm* or a *TP firm* may rely on more than one exemption in relation to the same *financial promotion*.
- (3)

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> 4.14.17R 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> or <i>TP 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> 4.14.7G]
2. Certified sophisticated investor	An individual who meets the requirements set out in <i>COBS</i> 4.14.18R, 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> or the <i>TP firm's client</i> .	Any <i>speculative illiquid security</i> .
3. Self-certified sophisticated	An individual who meets the requirements set out in <i>COBS</i> 4.14.19R including an individual	Any <i>speculative illiquid security</i> the <i>firm</i> or <i>TP firm</i>

investor	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> or <i>TP firm's client</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> 4.14.7G].
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

- 4.14.7 G (1) The effect of *COBS* 4.14.6R(1)(c) is that where a *firm* or *TP firm* wishes to rely on exemptions 1 (certified high net worth investors) or 3 (self-certified sophisticated investors), the preliminary assessment of suitability must be undertaken before the *financial promotion* of the *speculative illiquid security* is made to or directed at *clients* (in addition to other requirements).
- (2) There is no duty to communicate the preliminary assessment of suitability to the *client*. If the *firm* or the *TP 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* or *TP 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* or *TP 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

- 4.14.8 R Subject to *COBS* 4.14.5R and *COBS* 4.14.6R, a *firm* or *TP 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* 4.14.9R;
- (2) if applicable, the date on which the *financial promotion* was approved; and
- (3) statements that comply with *COBS* 4.14.12R disclosing all costs, charges and commission.
- 4.14.9 R (1) For the purposes of *COBS* 4.14.8R(1), and subject to *COBS* 4.14.9R(2) and *COBS* 4.14.9R(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*.
- 4.14.10 R The relevant risk warning in *COBS* 4.14.9R must be:
- (1) prominent;
- (2) contained within its own border and with bold and underlined 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.
- 4.14.11 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.
- 4.14.12 R For the purposes of *COBS* 4.14.8R(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.
- 4.14.13 G (1) There is an illustration of how a *firm* or *TP firm* should comply with *COBS* 4.14.12R(2) in (2) below.
- (2) Where a *firm* or *TP 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."
- 4.14.14 R The statements providing the percentage figure in *COBS* 4.14.12R(1) and the cash sum in *COBS* 4.14.12R(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.
- 4.14.15 G The statement providing the breakdown of expenditure in *COBS* 4.14.12R(3) should be included in the *financial promotion* in a clear and prominent way.
- 4.14.16 G The purpose of the statements required by *COBS* 4.14.12R 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, other income or otherwise to repay the investor's capital at maturity.

Definitions of certified high net worth and sophisticated investors

- 4.14.17 R A certified 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:

- 4.14.18 R A certified sophisticated investor is an individual who:

- (1) has a written certificate signed within the last 36 *months* by a *firm* or *TP firm* confirming they have been assessed by that *firm* or *TP 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: ”

- 4.14.19 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 to seek advice from someone who specialises in advising on speculative illiquid securities.

Signature:

Date: ”

Definition of speculative illiquid security

- 4.14.20 R For the purposes of this section, and subject to *COBS* 4.14.22R to *COBS* 4.14.24R, a *speculative illiquid security* is a *debenture* or *preference share* which:
- (1) has a denomination or minimum investment of less than £100,000 (or an equivalent amount as defined in *COBS* 4.14.21R); 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 *specified investments* (whether they are to be held directly or indirectly);
 - (c) *buying* or acquiring *investments* other than *specified investments* (whether they are to be held directly or indirectly);
 - (d) *buying* real property or an interest in real property (whether it is to be held directly or indirectly);
 - (e) paying for or funding the construction of real property.
- 4.14.21 R For the purposes of *COBS* 4.14.20R(1):
- (1) an equivalent amount in relation to an amount denominated in any currency other than sterling is an amount of equal value denominated wholly or partly in another currency; and
 - (2) the equivalent amount is to be calculated at the latest practicable date before (but in any event not more than three *business days* before) the date of the issue of *debentures* or *preference shares*.

- 4.14.22 R A *debenture* or *preference share* that does not otherwise fall within *COBS* 4.14.20R is not a *speculative illiquid security* by virtue only of the fact that the proceeds of the issue are used to *buy* or acquire *specified investments* as part of the ordinary cash management activities or treasury functions of an *issuer* (or its *group*) carrying on a general commercial or industrial purpose as defined in *COBS* 4.14.24R(1).
- 4.14.23 R For the purposes of *COBS* 4.14.20R, and notwithstanding the exemption for *readily realisable securities* in *COBS* 4.14.24R(3)(d), a *debenture* is also a *speculative illiquid security* if:
- (1) it meets the conditions set out in *COBS* 4.14.20R; and
 - (2) it:
 - (a) is admitted to official listing on an exchange in the *United Kingdom* or an *EEA State*; and
 - (b) is not regularly traded on or under the rules of such an exchange; or
 - (3) it:
 - (a) is a newly issued *debenture* which can be reasonably expected to be admitted to official listing on an exchange in the *United Kingdom* or an *EEA State*; and
 - (b) cannot reasonably be expected to be regularly traded on or under the rules of such an exchange when it begins to be traded.
- 4.14.24 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 the proceeds of the issue for the purpose of the activities in *COBS* 4.14.20R(2)(c) (*buying* or acquiring *investments* other than *specified investments*), (d) (*buying* real property or an interest in real property) or (e) (paying for or funding the construction of real property); and
 - (b) the relevant property or *investment* 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 in respect of a *debenture* or *preference share* within *COBS* 4.14.20R(2) (d) or (e) 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, highly sensitive to or dependent on a return generated as a result of the matters referred to in *COBS* 4.14.20R(2)(d) or (e).

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

- (a) issued, or to be issued, by a *credit institution*;
- (b) issued, or to be issued by an *investment trust*;
- (c) a *non-mainstream pooled investment*;
- (d) a *readily realisable security* except for a *debenture* within *COBS* 4.14.23R; or
- (e) a *P2P agreement*.

(4) This exemption applies where:

- (a) the *issuer* is:
 - (i) a *property holding vehicle*; or
 - (ii) a *single-company holding vehicle*;
- (b) any *financial promotions* made relating to the investment comply with *COBS* 4.7.7R to *COBS* 4.7.12G as appropriate; and
- (c) any *financial promotion* made relating to a *single-company holding vehicle* clearly and prominently states which *single company* the investment relates to.

4.14.25 R (1) For the purposes of *COBS* 4.14.24R(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; or
- (b) an industrial activity involving the production of goods; or
- (c) a combination of (a) and (b).

(2) For the purposes of *COBS* 4.14.24R(1)(b), a general commercial or industrial purpose does not include:

- (a) investment to generate a pooled return;

- (b) property development or construction services;
- (c) hiring, leasing or rental services.

Guidance on general commercial or industrial purpose

- 4.14.26 G (1) *COBS 4.14.20R* 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 *buying* or acquiring *investments* (other than *specified investments*) or the *buying* or construction of real property.
- (2) However, *COBS 4.14.24R(1)* provides an exemption in cases where the *investments* (other than *specified investments*) that are bought or acquired, or the property which is bought or constructed are 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 4.14.25R*.
- (4) The effect of the exemption in *COBS 4.14.24R(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 acquire *investments* (other than *specified investments*), or to buy or construct real property, and the relevant *investments* or property are or will be used by the *issuer* or *group* member for the purposes of its own commercial or industrial activities. This is illustrated in the examples in (5) and (6) below.
- (5) In relation to *COBS 4.14.20R(2)(c)* (*buying* or acquiring *investments* other than *specified investments*):
- (a) where a *company* issues a *debenture* or *preference share* and uses the proceeds to purchase IT equipment for use in its business, to the extent that the IT equipment might be considered an *investment*, the *debenture* or *preference share* will benefit from the exemption because the IT equipment is used by the *company* for its own commercial activities (in this case, for use by its staff to provide services to customers);
 - (b) where a supermarket chain issues a *debenture* or *preference share* and uses the proceeds to purchase stock (for example wine) for sale as part of its retail business, to the extent that the wine might be considered an *investment*, the *debenture* or *preference share* will benefit from the exemption because the wine is used by the supermarket for its own commercial activities (in this case, to sell it on to its retail

- customers for a profit);
- (c) where a *company* issues a *debenture* or *preference share* and uses the proceeds to buy or acquire art or fine wine as an investment, it will not benefit from the exemption because the art or fine wine will not be used by the *company* itself for its own commercial activities; if the art or fine wine is used to generate a pooled return, then the exemption would also not apply as a result of *COBS* 4.14.25R(2)(a);
 - (d) where a *company* issues a *debenture* or *preference share* and uses the proceeds to purchase IT equipment for the purpose of hiring or leasing those out to another *company*, it will not benefit from the exemption because it is not using the IT equipment for its own commercial activities and hiring and leasing services are excluded from the definition of general commercial or industrial purpose as a result of *COBS* 4.14.25R(2)(c).
- (6) In relation to *COBS* 4.14.20R(2)(d) or (e) (*buying* or constructing real property):
- (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 or rented out for commercial purposes or as residential dwellings, 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 (see *COBS* 4.14.25R(2)(b));
 - (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* 4.14.24R(2) applies). That is because it will use the property for its own commercial or industrial activities (generating electricity). However, *firms* and *TP firms* should also consider *COBS* 4.14.24R(2) and the guidance in (7) below.
- (7) *COBS* 4.14.24R(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, highly sensitive to or dependent on a return generated as a result of the matters referred to in COBS 4.14.20R(2)(d) or (e) (*buying* or construction of real property).

- (8) The effect of the above is that where a *company* issues a *debenture* or *preference share* for the purpose of buying real property, an interest in real property or 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 purchase or project, the exemption in COBS 4.14.24R(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 4.14.24R applies.

Amend the following as shown.

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

...

9.3 Guidance on assessing suitability

...

Investments subject to restrictions on retail distribution

9.3.5 G (1) ...

(f) *credit union subordinated debt* is subject to a restriction on *direct offer financial promotions* (see CREDS 3A.5);

(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*).

...

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

10.1 Application

...

10.1.2 R (1) This chapter applies to a *firm* which *arranges or deals* in relation to a *non-readily realisable security*, *speculative illiquid security*, *derivative* or a *warrant* with or for a *retail client*, other than in the course of *MiFID* or *equivalent third country business*, or facilitates a *retail client* becoming a lender under a *P2P agreement* 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) Where a *rule* in this chapter applies to a *firm* which *arranges or deals* in relation to a *speculative illiquid security*, the *rule* also applies to:

(a) 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

(b) a Gibraltar-based firm (having the same meaning as in the *Gibraltar Order*) to the extent that the *rule* does not already apply to such a Gibraltar-based firm as a result of *GEN 2.3.1R*).

14 Providing product information to clients

...

14.3 Information about designated investments (non-MiFID provisions)

14.3.1 R ...

...

(2) ...

- (c) *arranging* (bringing about) or *executing a deal* in a *warrant*, *non-readily realisable security*, *speculative illiquid security*, or *derivative*; or

...

(3) Where a *rule* in this chapter applies to a *firm* which is *arranging* (bringing about) or *executing a deal* in a *speculative illiquid security*, the *rule* also applies to:

- (a) 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
- (b) a Gibraltar-based firm (having the same meaning as in the *Gibraltar Order*) to the extent that the *rule* does not already apply to such a Gibraltar-based firm as a result of *GEN 2.3.1R*).