The Money Charity Response – Financial Promotion Exemptions for High-Net-Worth Individuals and Sophisticated Investors (March 2022)

The Money Charity is a Financial Wellbeing charity whose vision is to empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.[1]

We welcome the opportunity to respond to HM Treasury's consultation on financial promotion exemptions for high net worth individuals and sophisticated investors.

In this response, we set out our Key Points, make some overall comments on the issue then answer the questions posed in the Consultation Paper.

[1] See box on back page.

Key Points

1. We accept that the exemptions on promotions of financial products to high net worth individuals and sophisticated investors will be retained. However, we have ethical concerns about allowing the promotion of risky financial products to certain individuals on the basis of their financial status. We also have concerns that "sophisticated investors" do not exist as a real and distinct group. We think it would be sensible to continue to scrutinise the function of the exemptions.
2. We would like to see a fourth objective for reform, which explicitly states that firms should be unable to bypass rules meant to protect ordinary investors.
3. We do not agree that an individual's income is a good indicator of their status as high net worth.
4. We think that the scope for who can be considered a sophisticated investor should not be widened any further, to do so would increase the number of people being exposed to risky financial products.
5. By putting the burden of proof (of proving whether a prospective investor meets the criteria of being high net worth or sophisticated) on to firms, firms will be unable to knowingly circumnavigate rules which are meant to protect individuals from being exposed to risky financial products.
6. Similarly, we suggest that firms should have a responsibility to establish whether prospective investors might be vulnerable, and whether it is appropriate to market to them as a result. As a charity that works closely with vulnerable people, we understand that there are lots of different ways in which someone can be vulnerable, even if they are classified as high net worth or sophisticated.

Overall Comments

In our previous response to the FCA's consultation on Consumer Investment Promotions, we questioned the idea that individuals who are deemed by various measures to have more money, can afford to lose money on their investments. Whilst this statement may be factually true, we have serious ethical concerns about the use (or abuse) of this fact to justify the promotion of potentially, and often demonstrably, risky financial products to high net worth individuals. We do not think it is right that high net worth individuals should be exposed to risky financial products simply because of their financial status.

We have also previously questioned the existence of "sophisticated investors". We have yet to see any evidence from our workshops, or in studies of investment markets, that this group exists and whether there is any real distinction from retail investors in general. When we have discussed the idea of sophisticated investors with regulated financial advisers, we have been told that retail investors generally have "zero knowledge" of financial markets. This applies to wealthy investors as well as modest investors because most wealthy people have made their money outside the financial markets. They are familiar with their own domains (e.g., professional football) but know little about financial markets in a sophisticated sense.

In the past, we have argued that the exemptions should not be in place at all, meaning that nobody should be exposed to high-risk financial products. However, we now appreciate that there is a place for the exemptions in providing relief for small and medium sized firms. We also recognise that the small number of people who genuinely meet the criteria for being high net worth should be able to make a free choice about how to invest their money. Having said that, we would like to stress our belief that the scope of people who do genuinely meet these criteria is very limited and should be kept this way in order to restrict the number of people who are exposed to high-risk financial products. The end of supporting small and medium sized firms by removing the cost of having a financial promotion approved is a worthy one, but the means used to achieve this open up avenues for exploitation. We accept that the exemptions will be retained and that with reform these avenues can be narrowed, but feel it is important to continue to question whether the exemptions are doing more harm than good.

Answers to consultation questions

Question 1: Do you agree that the exemptions should be retained?

As set out in the overall comments section, we have concerns about the criteria for defining high net worth individuals and sophisticated investors. Therefore, we are not completely convinced by the exemptions to restrictions that allow for unauthorised firms to promote financial products to them. In our view, high net worth individuals and sophisticated investors should have similar protections in relation to promotion of financial products as lower net worth individuals and ordinary, ‘non-sophisticated’ retail investors. For the former group, this is because we believe that their financial status does not negate a moral responsibility that should be upheld towards protecting individuals of any net worth. For the latter, this is because we do not believe there is any real distinction between sophisticated investors and ordinary retail investors. Despite this, and in light of the reforms to the exemptions laid out in the consultation paper (which we view as making good progress towards fuller protections for retail investors), we understand that the exemptions do serve an important purpose. The end of supporting small and medium sized firms by removing the cost of having a financial promotion approved is a worthy one, but the means used to achieve this open up avenues for exploitation. We accept that the exemptions will be retained and that with reform these avenues can be narrowed, but feel it is important to continue to question whether the exemptions are doing more harm than good.

Question 2: Do you agree with the objectives for reform? Are there other objectives the government should consider?

We agree with the objectives for reform; however, we suggest that there should be a fourth objective. This objective would explicitly state that firms should be unable to easily circumvent the regime of measures laid out to ensure that the exemptions are not being abused.

Question 3: Do you agree that the financial thresholds for high net worth individuals should be increased? At what value do you think the thresholds should be set? Please justify your answer.

Whilst we would prefer to see a similar level of protection for high net worth individuals that is currently afforded to individuals of lower net worth, we accept that there is a place for the exemptions. We recognise that the higher the financial threshold for high net worth individuals is set, the greater the number of people is that will be protected from the promotion of risky financial products. Therefore, we support an increase in the threshold for who should be regarded as ‘high net worth’. We think it is reasonable that somebody with £900,000 worth of net assets, or the top 1% of asset owners, should be considered as being high net worth. However, we don’t agree that an individual’s income is a good or reliable indicator of them being high net worth. An individual’s reported income does not tell us anything about their outgoings, and whilst it may be true that these individuals have large disposable incomes and are therefore able to afford losses on their investments, it is more often the case that individuals with high incomes lead lifestyles with proportionately high outgoings, and so would be unable to afford this kind of loss. Crucially, it is impossible to discern from a person’s income how much loss they would be able to afford, consequently we argue that income should not used as a threshold to define individuals as high net worth. But if the exemption is to be maintained we agree it should be uplifted.

Question 4: If you are a business (or trade body who represents businesses) who use the exemptions when promoting investments to investors, can you provide information on the investor profile of the investors who are promoted to within the exemptions? How would increasing the high net worth investor thresholds affect your ability to make communications to these investors?

Not applicable.

Question 5: Do you agree that the assets in the scope of net asset calculation should remain the same?

We agree that the scope should remain the same, excluding primary residences, any loan secured on that residence; any rights under a qualifying contract of insurance; and any benefits in the form of pensions or otherwise.

Question 6: Do you agree that the unlisted company criteria of the self-certified sophisticated investor test is no longer a reliable way of demonstrating sophistication, and therefore should be removed?

We agree that due to technological changes in the investment market making it far easier for ordinary retail investors to invest in unlisted companies, having made more than one investment in an unlisted company in the last two years is no longer a reliable measure of an individual's experience in investing, and therefore cannot indicate their status as sophisticated. We agree that the self-certified sophisticated investor test should be removed.

Question 7: Do you have suggestions for other tests that could be included to demonstrate sophistication, and could be incorporated into the definition of a self-certified sophisticated investor?

We believe that the scope for who counts as sophisticated investor is wide enough, and any attempts to broaden it by establishing new tests for sophistication should be reconsidered. As a Financial Wellbeing charity, we would like to keep this scope as narrow as possible. The more stringent the criteria for determining sophistication, the higher level of protection there is for ordinary retail investors, as less of them are likely to be defined as sophisticated and therefore potentially exposed to risky financial products.

Question 8: Do you agree that the fourth criteria of the self-certified sophisticated investor definition should be updated so that the company must have, or have had, a turnover of at least £1.4 million?

We agree that the fourth criteria should be updated so that a company must have or have had a turnover of at least £1.4 million.

Question 9: Do you agree that a greater responsibility should be placed on firms to ensure that prospective investors satisfy the thresholds for categorisation as high net worth individuals or self-certified sophisticated investors?

We absolutely agree that firms should bear a greater, if not total responsibility to guarantee that prospective investors can be genuinely categorised as high net worth or sophisticated. In the past firms have been able to coach ordinary retail investors to answer questions about the exemptions, so they are classified as high net worth or sophisticated, when in reality they don't meet the criteria. By putting the burden of belief on firms, they will be unable to circumnavigate rules which are meant to protect individuals from being categorised as high net worth or sophisticated, but in their current form are easily manipulated to the advantage of firm.

Question 10: If so, do you agree that the emphasis of the "reasonable belief" be shifted so that the firm communicating the financial promotion must have a reasonable belief that an individual meets the criteria? Is there a better alternative?

Yes, as set out above, we agree that the responsibility to determine whether individuals meet the criteria should lie with the firm. We think that this shift is entirely appropriate and from a consumer perspective, that there is no better alternative.

Question 11: Do you think there is a better alternative than placing greater responsibility on firms to ensure that prospective investors satisfy the thresholds for categorisation as high net worth individuals or self-certified sophisticated investors?

As set out above, we don't believe there is a better alternative from a consumer perspective.

Question 12: If you are a firm who uses the exemptions, how would you establish a reasonable belief that a particular individual satisfied the relevant net worth or sophistication criteria? How would this compare to what you do now? If you envisage problems in establishing whether a consumer meets these criteria, please explain why?

Not applicable.

Question 13: Do you agree that firms should be required to provide details about themselves in any communications made using the exemptions?

Yes, we agree that firms should be required to provide details about themselves in any communications. This is to make it as easy as possible for a consumer to do due diligence and/or seek further information.

Question 14: Do you agree that the investor statement should be updated to achieve greater engagement from investors and awareness of the regulatory protections they are losing in receiving financial promotions under the exemptions?

We agree with that the investor statement should be updated to make it more engaging, in turn achieving greater awareness amongst about the risks they are facing. We suggest that more research could be carried out, perhaps through the use of focus groups, to establish the best methods of communicating this information in an engaging way.

Question 15: Do you agree with the proposed changes to the investor statements?

We agree with the proposed changes, please see the previous question.

Question 16: Do you have any other suggestions for how the investor statement could be updated to ensure greater investor engagement, for example, to work more effectively as part of a digital journey?

As part of a broader approach to engagement, the investor statement should be an integrated part of the customer’s digital journey. Research should be carried out to understand how customers are engaging with the statement, and measures should then be taken to ensure that prospective investors are genuinely reading and understanding the statement.

Question 17: If you are a firm that uses the exemptions, do you envisage any issues with the proposed changes, particularly to require individuals to set out how they meet the exemption criteria? Please justify your answer.

Not applicable.

Question 18: Do you agree that the title of the ‘certified high net worth individual’ exemption should be updated to ‘high net worth individual’?

Yes, we agree with the change to this title.

Question 19: Are there any other ideas that you feel would deliver on the three objectives of these proposals, outlined in paragraph 4.7?

We don’t have any suggestions for this question.

Question 20: The financial promotions regime plays an important role in protecting vulnerable consumers when investing. The government would welcome views from groups that represent vulnerable groups regarding any of the information presented in this consultation, and in particular on the proposals outlined in the preceding chapter.

As a charity that works closely with vulnerable adults, we know that there lots of different ways that someone can be considered as being vulnerable. People suffering from mental health problems, people being affected by bereavement or going through a divorce are amongst those who could traditionally be described as vulnerable. Yet, it is entirely possible that these people (including, but not limited to) could also equally meet the criteria of being high net worth, or sophisticated. There exists a multitude of other reasons that are separate from the established criteria (of not meeting financial/sophistication thresholds) for why it might not be appropriate to market financial products to an individual, which relate to the prospective investor being vulnerable. Any approach to vulnerability needs to be multi-layered; the duty of care towards customers should be widened so that prospective investors are not able to tick a box confirming that they meet a certain threshold if the firm has any other reason to believe that the individual might not be suitable to invest. It should be the firm's responsibility to establish whether or not a prospective investor is vulnerable.

Question 21: If you are a firm or individual who relies on the OPE to provide or receive financial services from foreign jurisdictions, what effect would the proposed changes have?

Not applicable.

The Money Charity is the UK's Financial Wellbeing charity providing education, information, advice and guidance to all.

We believe that everyone achieves Financial Wellbeing by managing money well. We empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.

We do this by developing and delivering products and services which provide education, information and advice on money matters for those in the workplace, in our communities, and in education, as well as through influencing and supporting others to promote Financial Capability and Financial Wellbeing through consultancy, policy, research and media work.

We have a 'can-do' attitude, finding solutions to meet the needs of our clients, partners, funders and stakeholders.

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