

## Statement

### **ESMA highlights the risks arising from the provision of unregulated products and/or services by investment firms<sup>1</sup>**

National Competent Authorities (NCAs) and ESMA have observed investment firms offering products and/or services which are outside the scope of financial services regulation in the European Union<sup>2</sup> but that are offered to investors as investment alternatives to financial instruments (which are defined and regulated under MiFID II<sup>3</sup>). Examples of such products and services that, in some jurisdictions, fall outside the scope of financial services regulation, include crypto assets<sup>4</sup>, real estate, gold, raw materials, certain non-transferable securities (for example non-transferable loan notes).

Specifically on crypto assets, while the Markets in Crypto-Assets Regulation (MiCA) is close to adoption, crypto assets offered by investment firms will continue to be unregulated in most jurisdictions until MiCA applies. Some Member States have domestic legislation and specialist regimes in place which can provide protections for investors in relation to investment firms selling unregulated products and/or services. However, specialist regimes may not exist in all Member States and may also not address all unregulated products encountered.

ESMA is concerned that the practice of investment firms also offering products and services that are not regulated gives rise to both investor protection and prudential risks. The purpose of this Statement is to set out some of the risks that may arise and the issues that investment firms should pay particular attention to when providing such unregulated products and/or services. This Statement does not consider detailed risks arising from specific products and services.<sup>5</sup>

This Statement is addressed to investment firms offering unregulated products having a purpose similar to financial instruments regulated under MiFID II, namely unregulated products in which the client is investing for return or hedging purposes.

---

<sup>1</sup> The reference to investment firms includes credit institutions providing investment services and activities.

<sup>2</sup> Some may, however, be regulated at national level.

<sup>3</sup> Directive 2014/65/EU of the European Parliament and of the Council.

<sup>4</sup> Until the Markets in Crypto-Assets regulation (MiCA) comes into force, likely at end of 2024

<sup>5</sup> For example the risks associated with crypto assets, which the ESAs have set out in their consumer warning of 17 March 2022 (<https://www.esma.europa.eu/press-news/esma-news/eu-financial-regulators-warn-consumers-risks-crypto-assets>).

## **Risks faced by investors in unregulated products and services offered by investment firms**

Where investment firms engage in providing both regulated and unregulated products and/or services, there is a significant risk that investors may misunderstand the protections they are afforded when investing in those unregulated products and/or services. In particular, there is a risk that investors may not be aware that the protections afforded by investment services regulation do not apply to unregulated products and/or services and that, if an adverse event arises, they are unlikely to have the same levels of recourse (for instance, when investing in an unregulated product, clients may not have access to the national ombudsman or investor compensation scheme). Where an investor transacts with an investment firm, the investment firm's reputation, or 'halo effect', may often serve to provide potentially misguided reassurance in relation to the unregulated products and/or services offered by that investment firm, although such products may present heightened risks relating to complexity, illiquidity or even fraud.

ESMA has observed that the following risks may apply to unregulated products and/or services:

- Potential for investors to be misled as to the level of protection they get, especially if the unregulated products and/or services are provided on the same webpage as regulated ones (where the investment firm's website is unclear and confusing for investors as to the regulatory status of the products/services being sold);
- Potential for investors to not be fully aware of the nature of the product and/or service, and their risks;
- Potential for investors to be confused or mis-sold products (investors may rely on a recommendation from the investment firm, even though MiFID requirements such as suitability and appropriateness assessments only apply to investment services, in relation to financial instruments); and
- Some investment firms may encourage the confusion between regulated and unregulated products and services.

Investment firms should be particularly vigilant about additional risks relating to products and/or services outside the scope of financial regulation.

## **Risks to the investment firm**

Investment firms engaging in unregulated products and/or services such as the ones mentioned above may also face reputational risks. Unregulated products such as crypto-assets or non-transferable securities may present a higher level of risk for clients. Where clients lose their initial investment and find out that they do not benefit from the protections afforded to them under financial regulation, they may complain to the investment firm for not having provided clear information about the products they were investing in.

In addition, investment firms' activities related to unregulated products may pose a higher risk to the sound and prudent management of the investment firm as a whole and may jeopardise the investment firm's compliance with its obligations relating to their regulated business.

### **How to mitigate such risks**

ESMA is of the view that, by virtue of their regulated status, investment firms offering unregulated products and/or services that may be considered as alternatives to investing in financial instruments should act in the best interests of their clients.

When providing investment services, investment firms must act in accordance with the requirements of Article 24(1) of MiFID II<sup>6</sup> and ensure that they are acting fairly, professionally and in accordance with the best interests of their clients. In addition, they must comply with their obligations under Article 24(3) of MiFID II and ensure that all information, including marketing communications, addressed to clients or potential clients is fair, clear and not misleading.

Therefore, ESMA recommends that investment firms:

- take all necessary measures to ensure that clients are fully aware of the regulatory status of the product/service they are receiving; and
- clearly disclose to clients when regulatory protections do not apply to the product or service provided.

In particular, without prejudice to national law, ESMA considers the following behaviours are expected when investment firms are providing, together with investment services, unregulated products/and or services to investors, in order to ensure that no confusion exist with their regulated offering:

- The regulatory status of the product and/or service is clearly and effectively communicated in all dealings with clients, and at every stage of the sales process. For example, all marketing communications should indicate clearly if a product and/or service offered by an investment firm is regulated or not.
- The information about the regulatory status of the product and/or service is fair, clear and not misleading.
- The terminology used does not imply that the product and/or service is regulated or protected in any way where this is not the case.
- The information provided explicitly states what investor protections are lost/not applicable when investing in a product and/or service deemed to be out of scope of financial regulation, including: compensation schemes, client assets protections,

---

<sup>6</sup> Directive 2014/65/EU of the European Parliament and of the Council.

supervision by the national competent authority and recourse to any national regulatory authorities.

- The investment firm's regulatory status is not used as a promotional tool. When engaging in unregulated activities, information provided to the client or potential client, including marketing materials and other documentation, does not include a reference to the investment firm being authorised/regulated by an NCA.
- Any information on an investment firm's website related to unregulated activities is clearly distinguished from regulated activities. Investment firms have separate sections on any website they operate for regulated activities and any other activities which they carry out. Client documentation is distinguished accordingly in order to ensure that clients are sufficiently aware of the differences in protection.

In addition, ESMA recommends investment firms take into consideration the impact that their unregulated activities may have on their business activity as a whole as part of their risk management systems and policies.

Finally, ESMA reminds investment firms that they should have a full understanding and comprehensive view of the risks connected with both their regulated and unregulated activities, including the risks to clients, to markets and the risk to the investment firm itself. Investment firms should be particularly careful in all those cases where the scale of unregulated activity might have material impact on their overall risk profile.

Investment firms should be able to demonstrate the measures taken to ensure that unregulated activities do not affect their ability to fully comply with requirements applicable to the provision of investment services. For example, investment firms should ensure that sufficient financial and human resources are dedicated to the compliance function and should identify and manage any potential conflict of interest arising from the provision of both regulated and unregulated activities.