

COLLECTIVE INVESTMENT SCHEMES

John Virgo, Guildhall Chambers

Big Business

In 2011 the FSA reported that the total of retail UCIS funds under management were in the low billions:

- £20m invested by sophisticated retail customers;
- £280m by high net worth individuals and £2bn by retail customers (i.e. neither sophisticated nor HNWIs)
- £10bn was invested in qualified investor schemes (of which £420m was estimated to be held by retail investors)
- Investments in SPV structures were put at £27bn (£1bn held by retail investors) and £25bn in TLPs (£1bn with retail investors)

Basic Terminology

Collective Investment Schemes ('CIS') are of two kinds:

- regulated schemes
- unregulated schemes

A regulated CIS is defined as:

- An investment company with variable capital ('ICVC')
- An authorised unit trust scheme ('AUT')
- A recognised scheme

An unregulated scheme is any scheme that is not regulated

What constitutes a CIS?

Section 235(1) to the **Financial Services and Markets Act 2000** ('the **2000 Act**') defines a “collective investment scheme” as meaning “any arrangements with respect to property of any description ... the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income”

Very wide definitional scope

FSA v Fradley [2004] EWHC 3008

Sums deposited by investors in a horse-betting scheme managed by Top Bet Placement Services were property the subject of a CIS although the money belonged to the contributors when invested and no contributor ‘owned’ another’s contribution – the character of an arrangement may change from time to time and so fall in and out of the definition of a CIS – the fact each was entitled to a defined return was did not prevent pooling

Purpose or effect

The Russell-Cooke Trust Company v Elliott Ch D 16
July 2001

Sums deposited with Elliotts – solicitors – and loaned on a pooled basis to borrowers gave rise to a CIS.

Per Laddie J: ‘...the fact that an investor's funds may rest in client account pending putting in place a particular loan, does not stop it being in a CIS. If the money was placed there for the purpose of such an arrangement, it is from that time in a CIS...’

Two further requirements

First, under s235(2) of the **2000 Act**: ‘the arrangements must be such that the persons who are to participate (‘participants’) do not have day to day control over the management of the property, whether or not they have the right to be consulted or to give directions’

Note: To avoid the arrangements amounting to a CIS all the participants must retain day-to-day control – it is not enough some do: **The Russell-Cooke Trust Company**

Further...

Secondly, s235(3) requires that: 'the arrangements must also have either or both of the following characteristics (a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled; (b) the property is managed as a whole by or on behalf of the operator of the scheme'

These provisions have been examined in three important recent cases:

Brown v InnovatorOne plc [2012] EWHC 1321

FSA v Asset Land Investment Inc [2013] EWHC 178; [2014] EWCA Civ 435

FCA v Capital Alternatives Ltd [2015] EWCA Civ 284

Brown v InnovatorOne plc

This was a tax-avoidance film investment scheme in which the participants became partners in an LLP. Each advanced highly geared loans to the company with the intention of gaining tax relief on these liabilities. The scheme was successfully challenged by the Revenue. The investors brought claims for their losses, alleging inter alia the scheme was an unregulated CIS.

Hamblen J concluded it was a CIS and the day-to-day control test required more than a right to exert control; it required evidence of actual control on the part of the investors. Again, a broad view was taken of the 'purpose and effect' of the arrangements – whatever the documents creating the scheme provided.

FSA v Asset Land Investment Inc

This was a typical land-banking scheme in which investors bought small parcels of a green-field site on the understanding their plot would increase in value if PP was later obtained. They were told the vendors were to seek PP but signed contracts giving them dominion over their parcel and acknowledging that vendors had no obligation or intention to seek PP.

Andrew Smith J concluded this was a CIS. He held: (1) it did not matter the investors had a different understanding as to how the scheme might be taken forward ('...there can be an arrangement without both or all parties sharing an intention or expectation' and (2) the contractual disclaimers did not prevent the arrangement as orally described creating a CIS: the purpose and effect of the scheme was broadly understood by the investors

FCA v Capital Alternatives

Investment in rice fields in Sierra Leone

Key conclusions:

- Pooling of profits is not undermined by cross-subsidisation of scheme running costs
- Scheme property refers to the property involved in the scheme as a whole and not the individual investor's property
- Management as a whole requires an overall objective assessment and is not dependent on identifying and apportioning responsibility for particular management activities to investors and those performing acts of management

Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001

Arrangements of the kind specified by the Schedule to this Order do not amount to a collective investment scheme.

There are 21 exclusions – including

- ‘Debt issues’ Regulation 5: ‘(1) arrangements do not amount to a collective investment scheme if they are arrangements under which the rights or interests of participants are... represented by investments of one, and only one, of the following descriptions: (a) investments of the kind specified by article 77 of the Regulated Activities Order (instruments creating or acknowledging indebtedness) which are — (i) issued by a single body corporate other than an open-ended investment company... and which are not convertible into or exchangeable for investments of any other description’ – and –
- Bodies corporate – other than OEIC

Promotion of CIS

Section 238 prohibits even an authorised firm promoting such an investment unless the CIS is regulated or the promotion is exempted under the **FSMA (Promotion of Collective Investment Schemes (Exemption) Order 2001 (SI 2001 No, 1060)** ('the PICS Order') or otherwise permitted by **COBS 4.12**

PICS Order

Introductions to UCIS providers where no advice or recommendation has been given by the introducer

Generic promotions not relating to any particular UCIS

Investment professionals to whom a UCIS is promoted (subject to complying with particular prescribed caveat wording)

One off non-real time or solicited real time promotions not part of a marketing campaign

Certified HNWIs where the UCIS invests wholly or predominantly in the shares in or debentures of an unlisted company

Certified HNW companies and unincorporated associations (in which case the limitation to shares/ debentures of unlisted companies does not apply)

Sophisticated investors (in which case the limitation to shares/ debentures of unlisted companies does not apply).

COBS 4.12

COBS 4.12 specified 8 categories of persons to whom an UCIS investment may be promoted, which include:

- Category 1: existing UCIS investors or where they have been so within the last 30 months
- Category 2: new or established clients where the firm has taken reasonable care to ensure the investment is suitable
- Category 8: a person reasonably assessed as able to understand the risks and making his own investment decision

FSA Consultation Paper CP 12/19 (August 2012)

This proposed to remove Categories 2 and 8 and remove reference in Category 1 to investors who have invested in a CIS within the last 30 months

Policy Statement PS13/3

In the result, the proposals went further so that in addition to removing Categories 2 and 8, Category 1 was restricted to any NMPI 'which is intended by the operator or manager to absorb or take over the assets of that non-mainstream pooled investment or which is being offered by the operator or manager of that non-mainstream pooled investment as an alternative to cash on its liquidation ...or ...securities offered by the non-mainstream pooled investment as part of a rights issue'

Wrappers and units in CIS

Where the investment wrapper is issued by the CIS as a tax efficient means of the policyholder acquiring units in the fund it is clear that the investor is the participant in the CIS e.g. Investments in the AIG EVRF

Where a wrapper bond is sold by a provider other than the operator of the CIS and the investment is made by the bond issuer – and not in the investor's name – it is difficult to see how the investor can be properly said to be a participant in the CIS. This is reinforced by s237(2) which defines “units” as meaning ‘the rights or interests (however described) of the participants in a collective investment scheme’. Where the investment has been made by a third party wrapper provider, the investor's rights are against the bond issuer and not the CIS itself e.g. Keydata type investments

END

Thank you....