



CUMMINGS

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Collective
Investment
Schemes



Collective Investment Schemes

Introduction

A collective investment scheme (“CIS”) is defined by law. According to section 235(1) of The Financial Services and Markets Act 2000 (“FSMA”), a collective investment scheme is any arrangement with respect to property of any description, including money, 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.

Essentially, this means that a CIS is a vehicle in which profits or income are shared through collective investment, and the participants of the scheme do not have any day-to-day control over the management of the property. Thus, if the investors do have day-to-day control, then the investment is likely to not be a CIS.

Establishing or operating a CIS is a regulated activity requiring authorisation from the Financial Conduct Authority (“FCA”). Subject to certain exemptions, a CIS cannot be promoted to the general public by an authorised person unless it is authorised or recognised under FSMA.

What is a CIS?

The s.235 FSMA definition can be broken down as follows:

- there are no limits on the structure, and the arrangement may involve a contract, a partnership (including an LLP), a trust or a company which is an open-ended investment company (an “OEIC”);
- the property (which need not be investments regulated by the FCA, but can be any type of property) must be managed as a whole by, or on behalf of, the operator of the scheme;

- the operator must be FCA-authorised;
- the participants’ contributions and the income or profits paid out of such contributions must be pooled (which covers blending or co-mingling of assets or collective beneficial ownership of assets); and
- the CIS may be regulated or unregulated

Exclusions from the definition of a CIS

The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (the “CIS Order”) contains a number of exclusions, including the following:

- (i) paragraph 1 of the Schedule to the CIS Order excludes arrangements where investors retain ownership in their portfolios but all use the services of the same investment manager, subject to the following conditions:

- the investor must be able to withdraw their property at any time;
- there must be no pooling of contributions, profits or income;
- the management function must be limited to the buying and selling of investments in bulk on behalf of the various investors;
- the investments to which the exclusion applies are:
 - shares;
 - debentures;
 - government and public securities;
 - warrants;
 - certificates representing securities;
 - units in an authorised unit trust or recognised CIS; and
 - rights under long-term insurance contracts



This means that arrangements for the discretionary management of options and futures may constitute a CIS if they have all the other necessary characteristics set out in section 235 FSMA.

(ii) other exclusions in the CIS Order include:

- individual investment management arrangements (essentially PEPs and ISAs);
- enterprise initiative schemes;
- bank deposits;
- schemes not operated by way of business;
- debt issues;
- common accounts (essentially client accounts);
- certain funds relating to leasehold property;
- certain employee share schemes;
- schemes entered into for commercial purposes;
- arrangements where participants are bodies corporate in the same group;
- franchise arrangements;
- trading schemes;
- timeshare arrangements;
- schemes for personal enjoyment of property;
- certificates representing securities;
- clearing services;
- contracts of insurance;
- funeral plan contracts;
- individual pension accounts;
- occupational and personal pension schemes; and
- bodies corporate (other than OEICs and LLPs).

Regulated or Unregulated CIS?

A CIS may be either regulated or unregulated, the distinction lying with whether or not regulated status has been given to the scheme by the FCA (or, outside the UK, either by an equivalent regulator or specifically recognised by the FCA, under s.272 FSMA, as described below).

It is important to note that this is distinct from regulation of those who establish or operate a CIS or whether or not the regulated activity of establishing, operating or winding up a CIS is being carried on. For a CIS to be regulated in the UK, application must be made to the FCA and specific requirements must be satisfied.

Regulated CIS

A regulated CIS is any of the following:

- (i) a UK authorised unit trust;
- (ii) a UK authorised investment company with variable capital (ICVC);
- (iii) a CIS recognised under s.264 FSMA (i.e. a scheme constituted in another EEA state); or
- (iv) a CIS recognised under s.272 FSMA (i.e. an overseas scheme individually recognised by the FCA as giving “adequate protection” when compared to a UK regulated CIS).

Unregulated CIS

For UK purposes, an unregulated CIS is any CIS which does not fall within the list set out above under ‘Regulated CIS’. It may be either a UK-based scheme or an offshore scheme, such as unauthorised unit trusts, LLPs which are structured to be CISs, limited partnerships or certain other pooling arrangements.

Promotion of CISs

Any person wishing to promote units in a CIS must comply with the financial promotion rules, which create exemptions from the general prohibition set out in s.21 FSMA, and, where authorised under FSMA, with the scheme promotion restriction under s.238 FSMA, which severely restricts the ability of persons authorised under FSMA to promote unregulated CISs. The following sets out a brief summary of the rules relating to the promotion of regulated and unregulated CISs:

Promotion of regulated CISs

The rules vary depending upon whether the promoter is authorised or unauthorised by the FCA:



Promotion by authorised persons:

Authorised persons wishing to promote units in regulated CISs must comply with the financial promotion rules in COBS 4 of the FCA's Handbook unless they are able to take advantage of any of the exemptions in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO"). It must be noted, however, that the FPO exemptions are not applicable to MiFID firms carrying on MiFID business.

Promotion by unauthorised persons:

Unauthorised persons wishing to promote units in regulated CISs may only do so if either:

- the promotion is approved by an authorised person; or
- the unauthorised person can rely on an exemption in the FPO.

Promotion of unregulated CISs

Again, the rules vary depending upon whether the promoter is authorised or unauthorised by the FCA:

Promotion by authorised persons:

The effect of s.238 FSMA is to restrict the promotion of units by authorised persons in unregulated CISs in the UK except in the following circumstances:

- by relying on an exemption set out in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 ("CIS Promotion Order");
- by promoting the scheme only to those persons set out in COBS 4.12

The effect of the above is to restrict the promotion of unregulated schemes to those investors for whom participation is likely to be suitable, such as professional clients, high net worth individuals and sophisticated investors, as traditionally, unregulated schemes have been higher risk than regulated schemes. Unregulated CISs are not allowed to be promoted to the general public.

MiFID firms are able to rely on the exemptions set out in the CIS Promotion Order. This is because the restriction on promoting unregulated schemes falls outside the scope of MiFID. Once a MiFID firm promotes the scheme, however, it must then comply with the MiFiD-based financial promotion rules in COBS 4.

Promotion by unauthorised persons:

Unauthorised persons wishing to promote units in unregulated CISs may only do so if either:

- the promotion is approved by an authorised person; or
- the unauthorised person can rely on an exemption in the FPO.

These rules reflect those for the promotion of regulated CISs by unauthorised persons, as set out above.

FCA recent developments relating to CISs

Further to extensive work on the marketing of unregulated CISs ('UCIS') carried out by its predecessor, the Financial Services Authority, the FCA amended the financial promotion rules in relation to unregulated CISs to retail investors in June 2013. This was due to the fact that the majority of retail promotions and sales of UCIS reviewed were inappropriate and failed to meet the existing FCA Handbook requirements.

The rule changes mean that, in the retail market, UCIS promotions will generally be restricted to sophisticated investors and high net worth individuals for whom these products are more likely to be suitable as they are more likely to be able to protect their own interests. The rule change will not affect the marketing to professional and institutional investors. Providing financial advice generally includes making a financial promotion so, by limiting the promotion of UCIS, the new rules aim to limit the number of retail clients being wrongly advised to invest in UCIS.

The marketing restrictions apply to "non-mainstream pooled investments" (NMPs), which



includes a unit in an unregulated collective investment scheme as well as rights to or interests in investments that are any of the above.

The FCA has also recently published new webpages regarding CISs, including the following:

- *Collective Investment Schemes*, which provides an overview of the regulation of AUTs, ICVCs and authorised contractual schemes (ACSs);
- *Authorisation or Approval*, which explains how to get a CIS authorised in the UK (including FAQs) and approval for an alteration to an authorised CIS;
- *Recognised schemes*, which explains how overseas schemes can be recognised in the UK under sections 264 and 272 of FSMA (including FAQs);
- *Marketing a UK UCITS in the EEA*;
- *Electronic Submissions*;
- *Protected cell legislation applications*;
- *Key messages*, which focuses on model portfolios and portfolio monitoring and stress testing; and
- *Filing Requirements*, which explains how documents should be submitted to the FCA and sets out contact details.

The Alternative Investment Fund Managers Directive (“AIFMD”) and CISs

In broad terms, an alternative investment fund under the AIFMD (“AIF”) is a collective investment undertaking other than a fund authorised under the UCITS Directive. Thus, while the definition of a CIS and AIF do not precisely overlap, generally a CIS which is not a UCITS fund will be an AIF for the purposes of the AIFMD.

A point to note, however, is that an arrangement which does not fall within the definition of a CIS may nevertheless create an AIF. Since the alternative investment fund manager under the AIFMD (“AIFM”) of an AIF, effectively the entity responsible for its portfolio and/or risk management activities, is generally required to be authorised, the AIFMD may apply to such arrangements, or the persons running them, which are legitimately operating outside the scope of FSMA. The arrangements may, however, benefit from an exemption under the AIFMD, notably the de minimis exemption i.e. AIFs whose leveraged assets under management do not exceed €100 million or, if the AIF whose unleveraged assets are under €500 million and do not afford redemption rights within five years of initial investment. It is important to note, however, that even where this exemption is applicable, there are still certain registration and reporting requirements which apply.

Conclusion

This article provides only a brief overview of the definition of a collective investment scheme and the promotion of both regulated and unregulated CISs, as well as the impact of the AIFMD on such schemes. If you require more detailed information on any of the above, please contact us at claire.cummings@cummingslaw.com.

**This document is for general guidance only. It does not constitute advice
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