PS13/3: RESTRICTIONS ON THE RETAIL DISTRIBUTION OF UNREGULATED COLLECTIVE INVESTMENT SCHEMES (UCIS) AND CLOSE SUBSTITUTES

Summary

On 4th June the FCA issued its policy paper on UCIS. This policy is based upon the FCA's consultation paper CP12/19, which was released in August 2012. CP12/19 proposed a solution to serious problems identified in the distribution of high risk, complex investments to ordinary retail investors and invited feedback in order to help the regulator formulate a new policy.

PS13/3 is the culmination of that process and, with a few notable exceptions, implements all of CP12/19s proposals.

Some of the most notable exceptions are Enterprise Investment Schemes (EIS) (including Seed Enterprise Investment Schemes) and Venture Capital Trusts (VCTs). Many people felt that as useful tax efficient investments it would be wrong to prohibit the distribution of these. Similarly at a time of low growth and tight credit it would be wrong to deny small and medium sized enterprises this alternative source of funding.

There are also a number of property investment schemes that up until now have claimed that as they are structured as direct purchases of land or property, they are not collective investments and as such they are not UCIS. Expert opinion on this matter has always differed and the new policy does not appear to have addressed this confusion.

We've put together an FAQ to help advisers make sense of the new rules:

Frequently Asked Questions

What have the FCA restricted?

The FCA has prohibited the promotion and sale of the following assets to retail investors: units in qualified investor schemes; traded life policy investments; units in UCIS; and securities issued by special purpose vehicles (SPVs) pooling investment in assets other than listed or unlisted shares or bonds.

What is a UCIS?

Very simply a UCIS is a collective investment scheme that is not authorised by the FCA – usually because the assets held by the scheme do not meet the FCA's criteria on the spread of assets, liquidity, dealing frequency, cash reserves and limitations on borrowings.

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Note that although the scheme itself is not authorised by the FCA, it will be operated by an authorised firm who will issue an investment memorandum. It is also worth noting that although UCIS themselves are not directly authorised by the FCA, persons carrying on regulated activities such as providing personal recommendations or arranging deals are subject to FCA regulation.

Intelligent Partnership
Halford Chambers, 1-3 Halford Rd, Richmond, Surrey TW10 6AW Company Reg. No. 06442114
enquiry@intelligent-partnership.com 0203 375 1700 www.intelligent-partnership.com

Frequently Asked Questions

Who or what is a retail investor?

An ordinary retail investor is anybody who is not either a sophisticated investor or a high net worth individual.

A sophisticated investor is a retail client with extensive investment experience and knowledge of complex instruments who are better able to understand and evaluate the risks and potential rewards of unusual, complex and/or illiquid investments.

A high net worth individual is a retail client with an annual income of more than £100,000 or investable net assets (i.e. not including their home) of more than £250,000.

Everyone else is an ordinary retail investor.

What specified investments have been excluded from the restrictions?

It had originally been suggested that enterprise investment schemes, seed enterprise investment schemes, venture capital trusts, exchange traded products and real estate investment trusts might be captured by the new rules. This is not the case and these types of investment have been excluded from the new restrictions. Note that social impact investments that take the form of a UCIS or SPV will **not** escape the ban.

Why have the FCA done this?

The FCA (and their predecessor organisation, the FCA) felt that UCIS were too complex, too risky and too illiquid for ordinary retail investors to be exposed to. This is based upon consistent evidence of mis-selling and a number of high profile UCIS failures.

Can I still promote UCIS?

If you have the right regulatory permissions, you can promote and sell UCIS to sophisticated investors and high net worth individuals. You must ensure that your promotion is targeted at the relevant market. If you advise a client to invest in a UCIS, you must be certain that the investment is suitable for their financial objectives and you must have carried out your own due diligence on the investment opportunity.

What has not been captured?

This is the grey area. There are a number of schemes in the market that have been structured as direct purchases of property or land. Direct purchase or property or land are not specified investments and are not regulated by the FCA. So these schemes may not be captured by the new restrictions.

Here at Intelligent Partnership, we've seen differing legal and expert opinions: some believe that these types of schemes will not be captured (and indeed, cannot be captured without a change to primary legislation), some believe that "if it walks like a duck and quacks like a duck, it is a duck" i.e. they will be captured. None of this has been tested in court yet.

We've also seen the regulator reverse their previous opinion that a scheme was not a UCIS, based upon a difference between what the scheme had proposed and what they actually did in practice.

What's clear is that anybody involved in investments that are structured in this way is taking a very big risk. If the scheme were to come to the FCA's attention and be deemed a UCIS, and the operators or promoters did not have the appropriate authorisations, they would be conducting a criminal offence.

What next?

The rules come into effect on the 1st January 2014

Conclusion

PS13/3 will mean that authorised advisers can no longer promote or recommend UCIS or anything that looks like UCIS (i.e something that is illiquid, hard to value, has little regulatory oversight and has complex terms and conditions) to retail clients.

This isn't perfect. In the UK, the vast majority of ordinary retail investors' wealth is tied up in illiquid, hard to value, unregulated assets that are complex to hold – their houses. So we can't say that retail investors are not capable of understanding these kind of investments, or that they are automatically poor investments. There are going to be cases where we are now prohibiting retail investors from accessing good investments.

However, many UCIS style investments exploited the lack of regulatory oversight to make overblown claims for the level of returns they would deliver and the level of risk they exposed investors to. Too many failed, or ended up in the portfolios of investors who they were not suitable for, in concentrations that were too high. Much of this was driven by the high commissions UCIS products paid to advisers. Putting an end to this practice is a good thing, even if it does come at the cost of reducing access to genuine opportunities.

The possibility that some investments will look to structure as direct asset purchases and side-step the new rules (and continue to be distributed by unregulated sales people) remains an issue. But any of these scheme operators or promoters that want to be certain that they are not conducting a criminal offence will now have to find an operator, structure themselves as a UCIS and restrict their market to sophisticated and high net worth investors.