



What is a collective investment scheme and what are the practical regulatory issues?

Summary and implications

A collective investment scheme ("CIS") is an arrangement that enables a number of investors (called 'participants' in the legislation) to pool their assets with a view to the investors sharing in the profits or income from the purchase, holding, management or disposal of the assets or sums paid out of such profits or income. To be a CIS, participants in the arrangement must not have day to day control over the management of the assets.

The consequences of a fund being a CIS include:

- the need to appoint an operator, authorised by the Financial Services Authority ("FSA") to perform certain regulated functions in respect of the fund;
- being subject to certain restrictions on the promotion of the fund to the public;
- depending on the nature of the assets, and whether or not a group exemption applies, the need to appoint an FSA authorised manager.

Which exemptions may help, and how?

The two most relevant exemptions that prevent arrangements from being a CIS are the 'group' exemption and the 'existing business'/ Article 9 exemption.

1. the 'group' exemption

This can apply where the operator is in the same corporate group as the investors. If it applies, the scheme is not a CIS and does not need the operator to be authorised.

2. the 'existing business' (Article 9) exemption

This exemption typically applies to joint venture structures, as funds with multiple participants who are not all "permitted participants" cannot benefit from it.

Ask a question

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Existing and new vehicles can elect not to be a CIS. This can be done if all of the participants in the joint venture (or their immediate holding entities) are carrying on an existing business which is not a regulated activity under the Financial Services and Markets Act 2000 ("FSMA"). You can look through any special purpose vehicle which participates in the joint venture in the structure to its owner to determine if a permitted business is being carried on by its parent – but you cannot look through multiple SPVs. If the exception applies, the scheme is not a CIS and does not need to appoint an operator or comply with the various UK regulatory requirements.

Why, in some cases, being a CIS is important

For some structures, it is important for marketing and tax reasons that the fund constitutes a CIS (e.g. a Jersey unit trust). The tax legislation takes the definition of unit trust from the FSMA definition. Therefore, if a JUT is constituted as a CIS, the tax position in relation to income, capital gains and SDLT is clear cut.

Operation - what it means

Establishing, operating and winding-up a CIS is a regulated activity and has to be carried out by an FSA-authorized operator. In our view, operating a CIS means looking after relations with investors, rather than managing the assets of the CIS (for which, see below). Examples of operation include:

- appointing auditors and valuers;
- dealing with subscriptions and any equity raising or re-organisation; and
- operating accounts.

Any decisions on these matters that are discretionary should be carried out by the operator.

Management - what it means

The FSA also regulates anyone seeking to act as the advisor to, or third party discretionary manager of the assets of, a CIS where those assets include regulated instruments (such as shares or units in other CISs). Direct property investments are not regulated for these purposes.

Examples of regulated management	Examples of property management
Advising on the buying or selling of assets (shares, units etc.)	Appointing a property manager and any consultants
Arranging deals	Lease management work
Taking discretionary investment decisions	Building maintenance
Dealing as agent	Repairs

Marketing in the UK and Europe

In the UK

Marketing funds is subject to the rules contained in the Financial Promotion Orders. These rules require a fund manager's marketing to be:

- approved by an authorised person; or
- made only to exempt persons. These include investment professionals, sophisticated investors and high net worth companies who typically need less protection than an ordinary member of the public.

To rely on these exemptions, precise disclosure wording must often be included in marketing materials.

How these exemptions apply will depend on whether the marketing is:

- real-time or non-real time (for example, a conversation or a brochure);
- solicited or unsolicited (i.e. whether the client has requested the contact); and
- "directed" or "made" (i.e. whether the marketing is to an unknown group of people or to specific individuals).

A fund that is a CIS cannot be marketed to non-exempt persons even if by an authorised person, or even when the document is approved by an authorised person.

In Europe

As in the UK, most EEA jurisdictions have their own regulatory restrictions on the promotion and marketing of unregulated investment schemes. There are two possible ways to address this: Passporting and Exemptions.

Passporting

Passporting relates to permissions to undertake regulated activities (as opposed to promotion). If a firm is permitted to undertake a regulated activity in the UK and it has a passport to do so in another country it simply means it can promote and undertake that "activity" in the other country. The views of the EEA member states are not always consistent on whether the passport can be used for all aspects of fund marketing.

Exemptions

Many European jurisdictions have exemptions similar to the UK which would allow the fund to be marketed to sophisticated investors.

The future

Important proposals have been put forward by the EU that may change the position set out in this note. Our advice to clients now needs to cover the potential impact of the Directive on Alternative Investment Fund Management, which may come into force in 2011.

As a basic starting point, fund managers have to make sure that their marketing is fair, clear and not misleading

A significant benefit of being an authorised fund manager is that, if you obtain the MiFID passport enabling you to carry out MiFID business through EEA countries, you will usually also be able to market your fund and activities throughout Europe

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