

Financial Advisers



FSA[®]

Financial Services Authority

Unregulated collective investment schemes

This factsheet is for you if:

- you are a regulated firm that promotes and/or advises on unregulated collective investment schemes (UCIS)

This guide explains what a UCIS is and the key things you need to consider if you are promoting and/or advising on a UCIS.

This guide does not constitute formal FSA guidance and is not an exhaustive account of the various complex areas you must consider when promoting and/or advising on a UCIS. It does not amend or qualify any rules and guidance in our Handbook, and is not a substitute for reading the relevant provisions of the Financial Services and Markets Act 2000 (FSMA), relevant statutory instruments and the FSA Handbook, or taking professional advice where appropriate.

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What is an unregulated collective investment scheme?

Many Collective Investment Schemes (CIS) are sold to investors in the UK. Regulated CIS are those that we authorise or are non-UK CIS that we recognise. Our recognition enables overseas CIS to be marketed to the public in the UK and we will only recognise an overseas scheme if certain specified criteria are met.

If we do not authorise or recognise a CIS in this way, it is a UCIS. UCIS may be established, operated and/or managed in the UK or in a jurisdiction outside the UK.

You can check whether the scheme is authorised or recognised by us using the **CIS search** facility on our online Register.

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If it is unregulated, what powers does the FSA have?

UCIS are described as unregulated because they are not subject to the same restrictions as a regulated CIS (e.g., in terms of their investment powers and how they are run). Although the schemes themselves are not authorised or recognised, persons carrying on regulated activities in the UK in relation to UCIS (including providing personal recommendations, arranging deals and establishing, operating and managing schemes) will be subject to FSA regulation, including Handbook requirements (e.g. the Conduct Of Business Sourcebook (COBS)).

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What do we mean by promoting UCIS?

Promoting a UCIS involves the communication, in the course of business, of an invitation or inducement to engage in investment activity in relation to UCIS.

'Promoting' a UCIS is a broad concept and does not only mean communicating through a written financial promotion, such as

marketing literature. It includes face to face discussion, phone calls, emails, advertisements, websites, presentations etc. Whenever you are communicating with a client or a potential client about investment opportunities that relate to or include a particular UCIS, you should consider carefully whether you are promoting this investment to the client.

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What type of clients can I promote UCIS to?

UCIS cannot be promoted to the general public. **Section 21 of FSMA** prevents promoting UCIS by unauthorised persons, unless the financial promotion is approved by an authorised person or benefits from an exemption in the Financial Promotion Order. **Section 238 of FSMA** then precludes promoting UCIS by authorised persons except where:

- there is a statutory exemption in an order made by the Treasury (see the FSMA (Promotion of Collective Investment Schemes (Exemptions) Order 2001 (SI 2001/1060) (as amended)) (we refer to this order below as the "PCIS Order"); or
- the financial promotion is permitted under FSA rules exempting the promotion of UCIS under certain circumstances (**COBS 4.12**).

You will need to ensure, before you promote a UCIS, that a relevant exemption is available. For example, the exemptions permit promotions to the following (this list is not exhaustive):

- certified high net worth individuals (see article 21 of the PCIS Order);
- certified sophisticated investors (see article 23 of the PCIS Order);
- self-certified sophisticated investors (see article 23A of the PCIS Order); or
- individuals that fall in one of eight categories detailed in COBS 4.12.

For a full list of exemptions please refer to PCIS Order and COBS 4.12. For a fuller commentary on the restrictions and exemptions please refer to The Perimeter Guidance Manual (PERG), **Chapter 8.20** ('Additional restriction on the promotion of collective investment schemes').

When relying on exemptions, you should check carefully that you comply with all the conditions of the relevant exemption: for example, there are several conditions regarding the individual wording of statements concerning certified high net worth investors, certified sophisticated investors and self-certified sophisticated investors and related warnings to investors. There may be other conditions to consider: for example, in the case of the statutory exemptions for high net worth investors and self-certified sophisticated investors, this is restricted to promotions relating to UCIS that are limited in the types of investments they can make (broadly, UCIS that invest wholly or predominantly in shares and debentures of unlisted companies).

To demonstrate that your firm has adequate procedures in place, you will need to ensure that you document the exemption/s on which you are relying when promoting a UCIS, and the reasons why the exemption/s apply. For example, if you use exemptions in articles 21-23 of the PCIS Order, you must show you have complied with the certification requirements. Alternatively, if you use exemptions under COBS 4.12 you must show you have taken reasonable steps to establish that the recipients fall within a relevant category of person.

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Article 3 MiFID exemption and the promotion and selling of UCIS

Where a UCIS promotion can be made, the COBS rules apply differently in relation to the Markets in Financial Instruments Directive (MiFID) or equivalent third country business and non-MiFID business. If you consider yourself a non-MiFID firm, you must ensure you do not fall foul of the 'Article 3 MiFID exempt firm' requirement. For example, you will fall outside the MiFID exemption if you transmit orders directly to operators of UCIS unless they are fund managers to which MiFID applies.

For more details please refer to **Chapter 4** of the 'MiFID Permissions and Notifications Guide – Update' and PERG 13 'Guidance on the scope of the Markets in Financial Instruments

Directive and the recast Capital Adequacy Directive', in particular, PERG 13.5 "Exemptions from MiFID" Q49 and Q50.

Should you breach any of the qualifying conditions (PERG 13, Q51), you are required to notify us of the breach (**SUP 15.3.11 R** 'Breaches of rules and other requirements in or under the Act'). We will then consider whether you should continue to benefit from the exemption and what, if any, supervisory or enforcement action will be taken.

For more details please refer to '**Promoting unregulated CIS – Communicating with clients, including financial promotions.**'

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Can I recommend a UCIS?

Under COBS 9, 'Suitability (including basic advice)' rules, before you recommend a UCIS, you will need to gather information about your client to establish whether the UCIS is suitable for that person.

When making a personal recommendation or providing discretionary portfolio management services on a UCIS, you must meet all suitability obligations. This includes obtaining the necessary information regarding your client's knowledge and experience in relation to UCIS, his financial

situation and investment objectives, so you can make a suitable recommendation.

There are other COBS provisions that apply when you provide investment services in relation to UCIS, whether these services are advisory or otherwise. In the case of MiFID, firms providing MiFID investment services other than investment advice or discretionary portfolio management in relation to UCIS, this can include 'appropriateness' requirements (**COBS 10**).

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What are the risks of UCIS?

As with most other investments, a client investing in a UCIS could lose some or all of their money. However this risk is likely to be particularly relevant to UCIS. UCIS frequently invest in assets that are not available to regulated CIS (for example, because they are riskier or less liquid), or are structured in a way that is different from regulated CIS. Unlike regulated CIS, UCIS are not subject to investment and borrowing restrictions aimed at ensuring a prudent spread of risk. As a result they are generally considered to be a high risk investment and you should always ensure that clients understand the risks before investing.

Your clients may not be covered by the **Financial Ombudsman Service (FOS)**, should they have a complaint about the fund or the **Financial Services Compensation Scheme (FSCS)**, should they need to seek compensation. You should make this clear to your clients. The documents from the UCIS should help confirm whether your clients have access to FOS or FSCS.

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I currently promote and advise on UCIS. What should I do now?

You need to ensure you comply with all applicable requirements concerning your promotion of UCIS and, where this is not the case, you should take appropriate action (including remedial). If you have been advising retail customers to invest in UCIS without explicit regard to the statutory restrictions on promoting UCIS to the general public, you should check with your professional indemnity insurer whether your cover remains valid.

You should review your systems and controls especially in relation to financial promotions (including checking whether a client can be promoted to), client risk profiles and conflicts of interest. Remember that when it comes to promoting and advising on investments, you may be doing both in the course of the same communication (whether oral or written) and the effectiveness of your systems and controls will be essential in ensuring compliance with your regulatory obligations. You should seek professional advice if you are unsure about your obligations.

Understanding individual UCIS and what they invest in is essential to ensuring compliance with your regulatory obligations. We expect to see that you have carried out adequate due diligence on any UCIS you recommend and that this is sufficiently documented.

We are aware that some firms are recommending UCIS without having any regard to the statutory restrictions on the promotion of UCIS to the general public. If you recommend UCIS to your clients and you are not aware of the restrictions on promotion, you may be acting in breach of the scheme promotion restriction and putting your clients at a significant risk of receiving unsuitable advice. As such, you risk tough disciplinary action and FSMA s150 actions for damages.

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Establishing, operating and/or managing your own UCIS

If you establish, operate and/or manage your own UCIS then you must have permission to do so.

If this is not the case then you must stop these activities until you have permission in place. We also expect you to notify us of this breach of your regulatory obligations.

Should a firm fail to obtain permission and we find out, we will consider the relevant action to be taken.

More generally, you should ensure that you have permission which correspond to all your regulated activities and comply with these.

Please also be advised that the exemption from promoting UCIS to a certified sophisticated investor (article 23 PCIS Order) will not apply to a promotion by you of a scheme, which you operate, to an investor you have certified as a 'sophisticated investor'.

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Further information available

UCIS Good and Poor Practice

Regulatory Guide: **'The Responsibilities of Providers and Distributors for the Fair Treatment of Customers'**

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