

Email: UCISdata@fsa.gov.uk



20 June 2012

Dear Compliance Officer

This letter requires your immediate attention. Please respond to the FSA by Wednesday 27 June 2012.

Unregulated Collective Investment Schemes (UCIS)

The unlawful promotion and mis-selling of UCIS is a key risk we have identified in the retail investment market. We have identified significant failings by certain distributor firms in relation to their UCIS activities and are concerned there may be similar issues with other firms. The inappropriate marketing of UCIS to retail clients is a priority for us and will continue to be until we are satisfied that the risk is mitigated.

Our intelligence to date suggests that your firm is either currently advising/arranging UCIS for retail clients, or has carried out these regulated activities in the past.

An information request template accompanies this letter requesting information in relation to your firm's UCIS activities since 1 January 2008.

Background to our request

Our direct engagement with you is part of the FSA's wider supervisory focus on firms undertaking UCIS activities that are directed towards retail clients. We are sending similar letters to other relevant retail intermediaries and have also written to UCIS providers that are or have been involved in the supply chain of UCIS to retail clients.

Template copies of both letters have been published on a new UCIS webpage: http://www.fsa.gov.uk/smallfirms/your_firm_type/financial/investment/ucis.shtml

This webpage can be used to access previous FSA publications that set out some examples of the poor behaviours we have seen to date in relation to UCIS. It also provides examples of the numerous Enforcement cases that we have taken against firms in relation to inappropriate promotions of UCIS.

We intend to consult on new rules for unregulated collective investment schemes (UCIS) later this year which will give effect to our view that UCIS are niche products and generally unsuitable for those investors of ordinary means and experience who make up the vast majority of the retail market in the UK.

Key areas of concern

The FSA's Retail Conduct Risk Outlooks published in February 2011 and March 2012¹ highlighted our key risks of UCIS being mis-sold. These included:

- Intermediaries failing to understand the marketing restrictions on UCIS and promoting them to retail clients in breach of statutory restrictions;
- Intermediaries lacking sufficient understanding of the UCIS they are promoting; and
- Consumers receiving unsuitable advice to invest in UCIS even when they are eligible to receive promotions for these products.

The issues underlying our key concerns are summarised below, and broadly fall into three categories: promotion; suitability; and systems and controls. They reflect what we have found in our supervisory work and feature regularly in the 24 enforcement and decision notices against individuals and firms regarding their UCIS activities that the FSA has published since mid-2010.

(The statutory restriction for promoting UCIS is contained in section 238 of the Financial Services and Markets Act 2000. For further details on the FSA's regulatory requirements, please refer to the Appendix to this letter which contains a list of some of the current relevant Handbook obligations.)

Promoting UCIS to Retail Clients

The majority of the firms we saw in our supervisory work could not demonstrate that they took reasonable (or, in some cases, any) steps to ensure their retail clients were eligible to receive UCIS promotions. We saw firms:

- failing to understand that recommending an investment in a UCIS in the context of advice is a form of financial promotion, so eligibility to receive UCIS promotions must be considered before any advice is provided;

¹ <http://www.fsa.gov.uk/library/corporate/rcro>

- promoting UCIS to their customers (i.e. introducing customers to UCIS and/or inducing or inviting them to invest in UCIS) where this was prohibited as their customers were not eligible for this type of investment, putting customers at significant risk of unsuitable advice; and
- failing to evidence steps they had taken to ensure an appropriate exemption to the statutory promotional restrictions applied to the customers to whom they promoted UCIS.

Suitability of advice

The majority of firms we saw failed to demonstrate that they took reasonable steps to ensure that UCIS recommendations were suitable for their clients. This is of particular concern given that these products are unsuitable for the vast majority of retail investors. We saw firms:

- recommending investments which did not match the client's attitude to risk, needs and objectives, and their overall personal circumstances;
- over-estimating the knowledge and experience of a retail client; and
- failing to act in their client's best interests by not taking reasonable steps to ensure the UCIS (and underlying asset allocation) was suitable.

Systems and controls/due diligence

The majority of firms we saw firms did not have adequate systems and controls to support their UCIS activities. We saw firms:

- failing to undertake adequate due diligence to understand the UCIS they were recommending their clients invest in;
- failing to ensure those selling UCIS attained adequate training and competence levels;
- with inadequate compliance oversight of their UCIS activities, having particular regard to the statutory and regulatory restrictions on promotion of UCIS;
- failing to identify and manage conflicts of interest, where they arose; and
- failing to take reasonable steps to identify, manage, monitor and report UCIS risks which they were (or may potentially have been) exposed to, for example inadequate collection and monitoring of management information.

Retail Distribution Review

The Retail Distribution Review is due to be implemented on 31 December 2012. It requires that, in order for firms to hold themselves out as offering independent advice, they must make personal recommendations that are based on a comprehensive and fair analysis of the relevant market and that are unbiased and unrestricted. Some firms appear to think that they must actually recommend all types of retail investment product (including UCIS) as a matter of course in order to demonstrate that they offer independent advice. This is incorrect. Our

recently published Finalised Guidance has addressed this issue and clearly states that *‘It may be possible for a firm to conclude for many clients, early on in the advice process, that certain product types are not going to be suitable, and therefore not consider these product types further for those clients. A firm’s independent status will not be affected if it never recommends these products because it deems them to be unsuitable for its clients’*.

Our information request

We are asking a number of firms we believe have recently carried on UCIS business to provide us with information about their UCIS activities and related systems and controls. This will assist the FSA in considering its supervisory approach to tackling the risks identified in this market. We have identified a significant increase in UCIS transactions in the retail market over the last four years. We have therefore set 1 January 2008 as a start date for this information-gathering exercise.

What you need to do next

Step 1: Please respond to UCISdata@fsa.gov.uk by **Wednesday 27 June 2012** acknowledging receipt of this letter and informing us of the name and job title of the person who has responsibility for the compliance oversight function of the UCIS activities in your firm.

Step 2: Please complete the unique [information request template](#) link which was issued to your firm in the email instructions accompanying this letter by no later than **Wednesday 18 July 2012**.

As noted above, the information request you are asked to complete asks you to answer a number of questions in relation to your UCIS activities and your systems and controls in relation to the period since 1 January 2008.

Attestation of current compliance required by CF10: The information request also poses a key question for the person who currently has responsibility for the compliance oversight function of the UCIS activities in your firm (CF10), asking them **whether they are satisfied that the firm has adequate policies and procedures which are sufficient to ensure compliance with its obligations under the regulatory system in relation to its UCIS activities (see further SYSC 6.1.1R and Appendix to this letter).**

Instructions for completion

- Please submit your response in relation to Step 1 to UCISdata@fsa.gov.uk, copying in the Firm Contact Centre or your FSA Conduct Supervisor (as appropriate). Please state your Firm Registration Number (FRN) in the subject box.
- Your response to Step 2 of our request (including the attestation of compliance) should be submitted using the [unique information request template link](#) which was issued to your

firm in the email instructions accompanying this letter. Please also email us at UCISdata@fsa.gov.uk to provide confirmation that this has been done, providing your FRN in the subject box.

- The information request template should be completed and submitted by (or on behalf of) the person who currently has responsibility for the compliance oversight function of the UCIS activities in the firm.
- A number of our questions are designed to capture information about activities that your firm has carried out since 1 January 2008. Please ensure that your response adequately covers these matters where appropriate.
- When preparing your response, you may also wish to consider Principle 11 of the FSA's Principles for Businesses which states that: *'A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.'*
- You may also want to consider sampling a meaningful number of retail client files to assess whether they have relevant, meaningful, accurate and up-to-date information, in particular in relation to the promotion and suitability of UCIS.
- More generally, we would also like to remind you that when considering your UCIS activities you should take into account the guidance in DISP 1.3.6G which states:

'Where a firm identifies (from its complaints or otherwise) recurring or systemic problems in its provision of, or failure to provide, a financial service, it should (in accordance with Principle 6 (Customers' interests) and to the extent that it applies) consider whether it ought to act with regard to the position of customers who may have suffered detriment from, or been potentially disadvantaged by, such problems but who have not complained and, if so, take appropriate and proportionate measures to ensure that those customers are given appropriate redress or a proper opportunity to obtain it. In particular, the firm should:

(1) ascertain the scope and severity of the consumer detriment that might have arisen; and

(2) consider whether it is fair and reasonable for the firm to undertake proactively a redress or remediation exercise, which may include contacting customers who have not complained.'

Please note that the contents of this letter do not prevent, or in any other way limit, the FSA from investigating and taking any action in respect of any matter against any firm either before 20 June 2012 or after in relation to the subject matter in this letter, where we consider it appropriate in the light of any particular facts.

If you have any queries regarding the letter please email these to UCISdata@fsa.gov.uk.

Yours sincerely

A handwritten signature in grey ink that reads "L. Woodall". The signature is written in a cursive style with a large initial 'L'.

Linda Woodall
Head of Investment Intermediaries Department
Financial Services Authority

Appendix: Key Principles and Rules

Area of focus	Relevant regulatory provisions
Promotion of UCIS to retail customers	S.238 Financial Services and Markets Act 2000 COBS 4.12R ¹
Suitability of advice	COBS 2.1.1R COBS 9.2.1R COBS 9.2.2R COBS 9.2.3R COBS 9.2.6R
<u>Systems and controls</u>	SYSC 4.1.1R SYSC 4.1.10R SYSC 5.1.1R SYSC 6.1.1R SYSC 6.1.2R SYSC 9.1.1R SYSC 10.1.1R
Key principles relevant to UCIS activities	FSA Principles for Businesses 1, 2, 3, 6, 7, 8, 9 and 11

¹ For a full list of exemptions please refer to the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 and COBS 4.12. For further commentary on the promotion of UCIS please refer to The Perimeter Guidance Manual (PERG), Chapter 8.20 ('Additional restriction on the promotion of collective investment schemes').