

FSA CP12/19: Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes

Memorandum from the Financial Ombudsman Service

14 November 2012

The Financial Ombudsman Service welcomes the opportunity to respond to the consultation.

About us

The Financial Ombudsman Service was established by law to resolve individual disputes between consumers and financial businesses - fairly, reasonably, quickly and informally. We can look at complaints about a wide range of financial matters - from insurance and mortgages to investments and credit.

If we decide that a business has treated a consumer fairly, we will explain why - but if we decide that the business has acted wrongly and the consumer has lost out - we can order matters to be put right. We are completely independent and impartial and decide each case by reference to what is fair and reasonable in all the circumstances.

We can look at a wide range of investment complaints - from mortgage endowments and whole-of-life policies to personal pension plans and unit-linked bonds. Although unregulated collective investment schemes ('UCIS') are by their very nature unregulated - advice to invest in them usually is. So if advice has been given then we can generally consider the complaint.

The nature of our work, in very broad terms, is to "put wrongs right". And as we deal with disputes across the whole of financial services, we can see where things are going wrong - and we can share the insight we get from these disputes to help prevent future problems. So we have welcomed the dialogue we have had with the FSA in the preparation of these proposals.

Our experience

The rates of return on more traditional forms of investment have been volatile and often disappointingly low for many investors. And it is against this backdrop that we have seen an increase in the number of complaints we receive about UCIS - with investors increasingly seeking alternative forms of investment in the hope of stronger returns and greater security.

But whilst these products often appear to offer more competitive returns and are often marketed as being lower risk, UCIS can often include assets such as overseas property and investments such as fine wines, crops and timber. So these are often high risk and speculative investments that should not be marketed to ordinary retail investors.

During the year there was an overall decline in the number of complaints referred to us about stockbroking and portfolio-management issues. But we saw more complaints about UCIS and we continued to see complaints where these often complex products have been marketed to ordinary retail investors.

The complaints that we receive about UCIS generally involve substantial amounts of money and frequently relate to highly illiquid funds that have either been suspended or have already

failed. So the potential for consumer detriment can be high and the losses incurred by consumers can be significant.

Although the promotion of UCIS is already restricted by legislation and FSA rules - we agree with the consultation that the current exemptions are widely misinterpreted, poorly understood and sometimes even ignored by businesses. So there is certainly a strong case for reform in this area.

In the complaints that we see, businesses often appear to have little understanding of the fact that these funds should only be marketed to restricted classes of individuals and not to consumers in general. The information provided to us by businesses often reveals unsatisfactory record keeping and poor evidence about the classification of funds.

We have also continued to see many cases where consumers, eager to take advantage of what seems to be an exciting investment opportunity, fail to take the time to reflect on the risks involved. So there appears to be a fundamental lack of understanding about UCIS - from both businesses and consumers.

We have also seen many cases where consumers have been advised to invest in an UCIS by an appointed representative purporting to be carrying out a regulated activity on behalf of an authorised firm. But the contract under which the authorised firm accepts responsibility for the regulated activities carried on by its appointed representative prevents it from doing so.

In such cases it may appear to the consumer that the appointed representative is acting on behalf of the authorised firm - but this is not the case. This can cause further confusion - particularly if the consumer later makes a complaint about the advice received from the appointed representative.

In our experience we consider that authorised firms could benefit from further guidance on this issue – particularly on the steps that could be taken to help prevent this from happening. Also authorised firms need to be aware that they may be held responsible for advice provided in their name - even though the appointed representative may not have had permission to do so.

Conclusion

The consultation confirms that the majority of retail promotions and sales of UCIS that have been reviewed by the FSA failed to meet its requirements, exposing ordinary investors to significant potential for detriment. And it is upon this basis that the FSA is proposing to intervene in the market.

Although we can only comment on our own experience – the complaints that we receive certainly suggest that there is potential for high levels of consumer detriment in this area. We therefore welcome the fact that the consultation recognises this and we are in broad agreement with the FSA proposals in this area.
