# Warnings for Investment Scheme Operators and their Banks Following Supreme Court Decision on Collective Investment Schemes

## Summary

The Supreme Court[1] decision in *Asset Land Investment Plc and another (Appellants) v The Financial Conduct Authority* [2016] UKSC 17[2] is important for those operating schemes that could be classified as collective investment schemes ("**CIS**") and their bankers. The Financial Conduct Authority ("**FCA**"), which brought the proceedings against Asset Land Investment plc and associated parties ("**Asset Land**"),[3] alleged that Asset Land had operated a CIS without authorisation, contrary to section 19 of the Financial Services and Markets Act 2000 ("**FSMA**").

The Supreme Court unanimously dismissed the appeal by Asset Land finding that Asset Land was performing the "regulated activity" of operating a CIS under section 235 FSMA and in doing so stressed the importance of examining the substance of CIS arrangements and not their legal form. This is the first Supreme Court case that examines CIS arrangements, providing insight into how the relevant FSMA provisions should be interpreted and confirming that the FCA's understanding of the law is correct in this area. It also serves as a reminder of the consequences of operating a CIS without authorisation and has implications for financial institutions that support such schemes e.g. by providing banking facilities.

1 The Justices sitting were: Lord Mance, Lord Clarke, Lord Sumption, Lord Carnwath and Lord Hodge.

2 Andrew Smith J, delivering his 8 February 2013 judgment in the court of first instance in the *Financial Services Authority and Asset L. I. Inc (trading as Asset Land Investment Inc) and ors* [2013] EWHC 178 (Ch) decided that Asset Land's activities amount to a CIS in breach of FSMA. His decision on liability was upheld by the Gloster LJ's judgment in the Court of Appeal in *Asset Land Investment Plc & Anor v The Financial Conduct Authority* [2014] EWCA 435.

3 The appeal to the Supreme Court was brought by Asset Land and its principal owner and director Mr Banner-Eve.

The CIS provisions in FSMA were intended to strike a balance between protecting consumers and regulatory overkill. The sale of assets as investments (for example land, wine, stamps, ostriches) is not directly regulated. However if day-to-day control over the management of investors' property is handled by the scheme promoter, then, subject to the detailed provisions of section 235 FSMA, the scheme is regarded as a CIS. The consequence of this is that the scheme must be managed by an authorised person and promotion of the scheme is subject to strict rules on how and to whom the investments can be marketed.

For many years, operators of such schemes have sought to avoid regulation, using legal agreements that purportedly provide investors with control of their assets but in reality, the management is controlled centrally by the promoter of the scheme, or someone on their behalf. The Supreme Court has now confirmed that it will look behind the strict wording of agreements with investors and instead focus on how investors understand the scheme is to operate in practice.

Arrangements that could constitute a CIS, particularly so-called land banking schemes like Asset Land's where investors are offered the opportunity to participate in land development projects, have been a long-standing issue for the FCA as it seeks to protect consumers. Asset Land's activities related to sales of individual plots at trade exhibitions, by telephone and through offshore brokers at six possible development sites in England. Individual plots were sold for between £7,500 and £24,000. Participants were told that Asset Land would progress planning applications and enhance the site's value by making it more attractive for housing development. Asset Land would then procure a sale of the site and the increase in price

of the land once sold would be shared by participants. However, the sites were all found by the court to have "little prospect of development".[4] For instance, the sites were never allocated for development, nor sold to a developer and there was little evidence indicating how Asset Land had tried to rezone the sites or attract the interest of developers, ultimately causing the participants to lose their investments.

Section 235 of FSMA defines what is meant by a CIS. Deliberately widely-drafted, section 235 states:

> "(1) In this Part, "*collective investment scheme*" means any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.
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> (2) The arrangements must be such that the persons who are to participate ("participants") do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions.
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> (3) The arrangements must also have either or both of the following characteristics–
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> (a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled;
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> (b) the property is managed as a whole by or on behalf of the operator of the scheme…".

Section 19 of FSMA provides that no person can carry on a "regulated activity" unless that person is authorised or exempt. A "regulated activity" is "an activity of a specified kind" that "relates to an investment of a specified kind". Under article 51ZE of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001/544 (the "**RAO**"), establishing, operating or winding up a CIS is "an activity of a specified kind" and under article 81 of the RAO, units in a CIS are considered to be an "investment of a specified kind".

One of Asset Land's key grounds of appeal was that the court had erred in treating the "property" for the purpose of section 235(1) as each of the whole sites acquired by the company rather than the aggregate of all plots sold to individual investors. It is, by virtue of the individual ownerships, the appellants argued, that the investors had full control over whether or not they were included in the scheme, for instance they could withdraw from the arrangements at any point. This right in itself equated to day-to-day control over the management of all relevant property. If the court could find that the investors had day-to-day control, then the arrangements would not be regarded as a CIS.

The related question was one of control. FCA Guidance in PERG 11.2 provides that "if the substance is that each investor is investing in a property whose management will be under his control, the arrangements should not be regarded as a collective investment scheme. On the other hand, if the substance is that each investor is getting rights under a scheme that provides for someone else to manage the property, the arrangements would be regarded as a collective investment scheme". Following the judgment in *Sky Land*,[5] the judge in the Court of Appeal had found that the relevant management of the property as a whole comprised the steps necessary to obtain planning permission and secure a sale to the developer: arrangements that the investors should not have a part in, or control over. Their ability to determine whether they should participate in a sale could therefore not be equated with control of the property's management. Furthermore, the ownership of units was not linked to exercise of management control – the plots were not even separately identifiable on the ground.

4 Lord Carnwath, *Asset Land Investment Plc and another (Appellants) v The Financial Conduct Authority (Respondent)* [2016] UKSC 17, paragraph 23.

5 *Re Sky Land Consultants plc* [2010] EWHC 399 (Ch).

In his judgment, Lord Carnwarth found that the relevant "property" was each of the company's sites taken as a whole, not the individual plots because it was the property as a whole that was to provide profits to participants, not the sale of the individual plots. Furthermore, on the question of control, Asset Land was not just managing agent for the owners but acted as operator of the scheme, giving Asset Land day-to-day control over the management of the property.

In his concurring judgment, Lord Sumption stressed that when analysing arrangements to see if they constitute a CIS, it is important to look at their substance, not their form – what the arrangements were at the time they were made and not what was done thereafter (although he says that what was done after can indicate what was originally understood). Sumption states "it must be possible to determine whether arrangements amount to a collective investment scheme as soon as those arrangements have been made. Whether the scheme is a collective investment scheme depends on what was objectively intended at that time, and not on what later happened, if different".[6]

Reacting to the decision, Mark Steward, Director of Enforcement and Market Oversight at the FCA said that it: "should sound a clear warning to those selling dubious investments".[7] The decision in the Asset Land case now means that the stay has been lifted on the High Court's March 2013 order against Asset Land to make a payment of £21 million as part repayment for investors. However the FCA has said it considers it "unlikely" that Asset Land and others will have the funds to pay the money ordered by the High Court.[8]

Operating a CIS without authorisation breaches the general prohibition in section 19 of FSMA and amounts to a criminal offence, carrying an unlimited fine and up to two years imprisonment. Any contract made in the course of carrying on its operation of the CIS is unenforceable and the investors can be subject to compensation and restitution. Further, monies obtained from investors can properly be regarded as the proceeds of crime. Not only does this judgment provide further guidance for operators of potential schemes into the type of schemes that may be caught by the definition of CIS, it also serves to warn those companies that may be operating similar schemes to seek professional advice. Given that operating a CIS in contravention of FSMA may lead to a criminal offence, those providing banking facilities to such schemes may fall foul of anti-money laundering legislation if the operation of a scheme does not comply with the relevant provisions of FSMA. Banks considering providing facilities to unregulated firms selling assets as investments should therefore satisfy themselves that the scheme does not require authorisation.

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6 Lord Sumption, *Asset Land Investment Plc and another (Appellants) v The Financial Conduct Authority (Respondent)* [2016] UKSC 17, paragraph 91.

7 FCA Press Release, "FCA wins case in the Supreme Court", 20 April 2016 https://www.fca.org.uk/news/fca-wins-supreme-court-case.

8 Ibid.

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