

**CONFIDENTIAL**

**FINAL REPORT AND FINDINGS**

**1. Introduction**

1.1 This is the report of an investigation by the Complaints Commissioner of a complaint made by Mr X against the Financial Services Authority (FSA). The relevant procedures and rules are set out in the publication entitled "Complaints against the FSA" (COAF) and which procedures and rules were made pursuant to paragraph 7 of Schedule 1 of the Financial Services and Markets Act 2000. The complaint falls to be considered under the Transitional Scheme. It should be noted that the Commissioner is not able to make a recommendation for financial compensation under the Transitional Scheme.

1.2 The Commissioner has analysed the complaint as being:

"That IMRO was negligent in not ensuring that the firms it regulated updated their sales documentation in line with the guidance contained within Update 85."

**2. Background**

2.1 On 9 May 2001 the complainant, Mr X, decided to make an investment into a Split Capital Investment Trust (splits) run by Company Y. He relied on the marketing material produced by Company Y and did not receive any advice. He has informed the Commissioner that he was influenced in making his decision to invest by the performance graphs and by the risk comparisons which were produced in the investment brochure. The specific statement was made in the brochure that the plan had "*produced an overall level of risk to investors' capital less than that of the FTSE All-Share, whilst maintaining a high level of income and capital growth as well.*" In the following months, the complainant invested more money into the Plan.

2.2 During March 2001 the Personal Investment Authority (PIA) issued a Regulatory Update, Number 85, to its members. This stated that the PIA had concerns about the marketing literature in respect of splits and issued guidance to advisers wishing to market these products.

2.3 The Investment Managers Regulatory Organisation (IMRO) initially had concerns involving the splits sector and had implemented an investigatory project in February 2001. The results of the project were reported in April 2001 and it was noted that although there were risks they did not indicate a problem for the sector as a whole. It was decided that the exercise would be

repeated periodically. RU 85 was issued by the PIA as a result of the initial IMRO concerns.

- 2.4 In July 2001 the Split Capital Investment Trust in which Mr X had invested cut its dividend leading to a fall in market price. This prompted IMRO to conduct a further exercise and examine a larger number of splits. The conclusion from this exercise was that there was a risk and a discussion paper was issued in December 2001.
- 2.5 In July 2002 the FSA confirmed that enforcement investigations were being undertaken.
- 2.6 Mr X waited for the outcome of the FSA's investigation into the sector but was disappointed with the result. On 17 January 2005, he complained to the FSA.
- 2.7 In the view of the FSA the complaint did not fall within the Complaints Scheme because it came under the exclusions in COAF. On 11 February 2005 the FSA wrote to the complainant informing him that the complaint relating to the inaction of IMRO was excluded under COAF 2.3.2 (3) as a complaint relating to IMRO's functions of making rules or issuing guidance.
- 2.8 The complainant then complained to the Complaints Commissioner.
- 2.9 His complaint was in two parts. The first (see section 1.2) related to negligence on the part of IMRO in not implementing RU 85. In the view of the Commissioner this part of the complaint should have been included within the Transitional Complaints Scheme and not excluded. His reasoning was that Mr X was not questioning IMRO's function of making rules or issuing guidance but was complaining that it was negligent in not implementing the guidance.
- 2.10 The second part of the complaint concerned the settlement reached by the FSA with the fund managers in the sector. In the view of the Commissioner this part of the complaint did not fall within the Scheme and was, therefore, not within his jurisdiction.

### **3. Findings**

- 3.1 In order to reach a decision in this matter the Commissioner has initially looked at the regulatory background during the period in question.

#### **Regulatory Background:**

- 3.2 The FSA has explained to the Commissioner that Split Capital Investment Trusts were not, and still are not, regulated products. There were three ways in which the investment trusts might have been purchased:

- a) From the prospectus issued by the Company;

- b) On the advice of an adviser; or
- c) By relying on marketing material.

**3.3 a) The prospectus:**

On 1 May 2000 the responsibility for the Listing Rules was transferred from the London Stock Exchange (LSE) to the FSA. IMRO had responsibility for regulating the conduct of the investment managers. The investment managers may have advised the Splits Company on matters relating to its set-up and listing aspects may have come into this advice. The listing rules in force at the time required that a sponsor should be responsible for advising on the listing particulars; and sponsor regulation was not a responsibility of IMRO. IMRO would have been the regulator in relation to the investment manager's work on marketing materials in relation to a splits issue but not the actual Listing Particulars (LPs) themselves. PIA regulated Independent Financial Advisors may have used the marketing materials in advising on the Split, other investors may have used the materials without seeking advice.

Prospectuses would have been one of two types: either non-listing prospectuses under the Public Offer of Securities Regulations or prospectuses that were LPs under the listing rules. Under section 87 of the Financial Services and Markets Act 2000, the FSA was made the authority for the approval of prospectuses where no application for listing was to be made.

**3.4 b) Advised:**

Where an investor purchased the split capital investment trust using an adviser, he would have been subject to PIA regulation and would have been required to follow the guidance in Regulatory Update 85. Failure to do so would have meant that the investor could have sought compensation by complaining to the firm and then, if he was still dissatisfied, by taking the complaint to the Financial Ombudsman Service (FOS), or its predecessor the PIA Ombudsman Bureau.

**3.5 c) Marketing Material:**

The Commissioner understands that where an investor purchased the investment using marketing material to make his decision the situation is more complex. If the split was marketed as part of a packaged product such as within an ISA, then the marketing material was regulated in respect of the Authorised Person either by IMRO or by PIA depending on which regulator took the lead for regulating a particular firm's marketing of packaged products. Where a firm's marketing of packaged products was regulated by IMRO it had to comply with the relevant IMRO rules. Where the investment was a pure investment trust it was not regulated under the financial services regime and, therefore, there is no method apart from taking legal action to obtain compensation.

**Mr X's Complaint:**

- 3.6 Mr X purchased his investment relying on the information contained in the marketing material produced by Company Y. From the above it can be seen that the marketing of splits was not regulated by PIA. Responsibility under the listing rules would fall with the remit of IMRO.
- 3.7 The PIA was a separate regulator from IMRO. It therefore follows that IMRO did not have a duty to issue a similar warning to the one issued by the PIA neither was IMRO required to follow the guidance issued by RU 85. The FSA has explained that it did issue a warning concerning exotic ISA's in March 2001 but in the Commissioner's view this would not necessarily have alerted investors in pure investment trusts as to the possible dangers of the investment.
- 3.8 IMRO did start investigating the sector as early as February 2001 and from its initial investigations did not believe as a matter of judgement that further action was necessary at that time but it did decide that it would continue to watch the situation. The FSA has explained to the Commissioner that there was only a problem in relation to a small section of the sector involving heavy gearing and cross investment. The FSA has explained that the majority of the sector did not give cause for alarm.
- 3.9 In the Commissioner's view where the marketing of investment trusts was regulated by IMRO (because those trusts were marketed as part of a packaged product), there was no requirement on IMRO to issue guidance if it did not consider the situation warranted it to do so. The decision on whether to issue rules or guidance was one for IMRO to make. In addition there was no requirement to implement a warning issued by another regulator (PIA). The complainant purchased an investment which was not regulated by the PIA. The Commissioner, therefore, finds that the case has not been made out.

**4. Recommendations**

- 4.1 The Commissioner has not upheld this complaint and therefore he has no formal recommendations to offer.
- 4.2 He has noted that IMRO was slow to act over the issue but questions whether there was a duty to do so as the sector was not regulated. He has also noted that there are suggestions that the sector should be regulated but this is not something which can be decided by the FSA or by the Commissioner.
- 4.3 The Commissioner is of the opinion that the agreement reached between the industry and the FSA remains the best option for most investors to obtain some compensation for their losses. Regretfully, there will still be investors who will not be able to benefit from the agreement but the option of legal action always remains open to those investors.
- 4.4 The Commissioner has decided to publish this report.