



CHARITY INVESTORS' GROUP

THE FORUM FOR INVESTMENT DEBATE

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Jeremy Sherwood
Personal Tax Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

20th October 2009

Dear Mr Sherwood,

Charity Pooled Funds Consultation paper- July 2009

The Charity Investors' Group

The Charity Investors' Group is an independent body comprising the major investing charities and the leading charity fund managers. Our response below highlights the key issues identified by our members at the meeting that you attended on 9th October, and also in written responses.

General Comments on the Consultation paper

We welcome the move to bring Common Investment Fund's into a Charity Authorised Investment Fund ("Charity AIF") regime regulated and authorised by the Financial Services Authority ("FSA").

This would benefit investing charities enabling fund managers to bring new funds to market as fresh opportunities for investment arise and investment legislation (including that in the EU) changes.

To avoid investing charities being financially disadvantaged by the proposals, we consider it vital that the existing CIF exemptions (e.g. SDRT and the flexibility in income payment) and pre-COLL investment and borrowing powers are retained.

We believe that the importance which charities, in particular those with relatively small sums to invest, place upon CIFs being charities in their own right, is greatly underestimated. The involvement of the Charity Commission, a Corporate Trustee and in many cases an Advisory Board, promotes a very high degree of confidence. This does not absolve trustees from the responsibility for ensuring the appropriateness of CIFs as an investment for their charities

We believe therefore that Charity AIFs should continue to have charitable status, even though this entails the Charity Commission continuing to have a role in their future regulation.

This may be accommodated through Charity AIFs being designated 'exempt charities', or even through their regulation being 'outsourced' by the Charity Commission to the FSA, through a service level agreement.

We welcome the removal of VAT on management fees, which we have long considered an anomaly that has disadvantaged investing charities.

Our detailed comments on the consultation paper questions are shown below.

Chapter 4

4(i) The proposal is that existing CIFs and CDFs would become charity AIFs.

- Agreed, on the proviso that Charity AIFs retain charitable status.
- This will allow fund managers to bring new Funds to market more quickly and ease future changes, providing the FSA will apply current COLL service levels to new products.

Are there any adverse consequences of this proposal, and how might they best be mitigated?

- The loss of charitable status. Addressed by ensuring that Charity AIFs retain charitable status akin to CIFs. We recommend a structure in which the FSA is responsible for regulatory approval, and the Charity Commission for oversight of the charitable aspects.
- If the proposal to move to COLL means that Charity AIFs would need to follow Undertaking for Collective Investment in Transferable Securities (“UCITS”), Non UCITS (“NURS”) or Qualified Investor Scheme (“QIS”) structure, this could impede the current investment and borrowing powers enjoyed by most CIFs whose establishment pre-dates COLL. The solution needs to encompass pre and post COLL established CIFs so that existing pre-COLL CIFs are able to continue to hold their investments in collectives that do not necessarily fall within the NURS investment restrictions on second scheme holdings.
- Scheme documents will need to be updated to meet the requirements of COLL. The associated costs have not been addressed, and unless they are relatively modest investing charities will have to bear the cost..

4(ii) Are there any funds for which the OEIC category would be more favourable than the AUT category, and if so, why?

- It would be advantageous to retain flexibility to choose either an OEIC or AUT structure. Managers may have preference based on existing products to ease administration and reduce cost.

4(iii) When church exempt funds cease to be exempt from registration as charities, should they be brought within the charity AIF regime, and if not, how best should they be regulated?

- Once these funds cease to be exempt from registration, the FSA would appear to be the most appropriate body to supervise the schemes.

4(iv) Charity AIFs would not be charities themselves. Would this have any adverse impacts, and if so, how might they be minimised?

- We strongly believe that Charity AIFs should remain as charities. This will continue to provide the high degree of assurance to investing charities; in particular smaller charities who hold all their investments in CIFs. It also ensures that all the existing tax benefits of charitable status are maintained (including SDRT exemption)
- It is important that the form of the Charity AIF tax exemption does not undermine its access to the benefit of the UK's tax treaties. Broadly, CIFs are currently entitled to similar treaty access to a taxable UK AIF.
- Advisory Boards that monitor the performance of the Manager (and the Trustee) and compliance with the Scheme provide investing charities with a further degree of assurance.

Chapter 5

5(i) How would the current governance structures of charity pooled funds need to change, given the possible AUT or OEIC structures?

- Charity AIFs adopting an AUT structure will require restated Scheme documentation to meet COLL requirements.
- Many CIFs are organised in a Scheme arrangement incorporating the Corporate Trustee, the Fund Manager, an Advisory Board and the Charity Commission.

- Advisory Boards are independent of the Fund Managers, and are made up of knowledgeable individuals representing the interests of the investing charities.
- The role of the Advisory Board is integral to steering the charitable objectives of CIFs. However, these boards are not FSA approved. If a Charity AIF Advisory Board were established, would the FSA expect board members to be brought under the 'approved persons' regime?
- Because the current CIF structure has worked well to the benefit of investing charities, we consider it vital that the Charity Commission and lay individuals solely representing the interests of the investing charities continue to be involved into the future.
- We believe that investing charities would view the removal/dilution of these roles as detrimental. Because CIFs are currently established and registered with the Charity Commission and are charities in their own right, investing charities see this as reassurance in considering this type of pooled investment. As many CIFs also have Advisory Boards that monitor the performance of the Managers and their compliance with the Schemes, a further degree of assurance exists for investing charities. This must not be underestimated.

5(ii) Would it be preferable to specify that charity AIFS must take the format of NURS (rather than UCITS schemes or QISs)?

- We believe that flexibility is required for individual fund managers.
- Many follow the NURS structure, because UCITS is too restrictive.
- However NURS imposes the "15% rule" on collectives, whilst the QIS structure presents eligibility issues.

- The QIS structure provides wider investment and borrowing powers but it does not address the “15% rule” which would inhibit the current investment and borrowing powers of some funds. In addition, the QIS eligibility requirements would potentially exclude some charities from investing and force Managers to reassess current investors and even force redemption of those who either do not meet the eligibility criteria or consent to be treated as “professional investors”.
- The establishment of Charity AIFs provides the opportunity to simplify the current rules for charity investments, e.g. provide exemption from the 15% rule, to prevent waiver applications being submitted.

5(iii) Which requirements of COLL would be unduly burdensome for charity AIFs?

Please explain why and provide details of compliance costs, where possible.

- Restatement of the various Scheme documents. COLL requirements are quite particular on constitutional documents. There would need to be a framework for transition that could be achievable within a given timeframe and require only notification to investors (similar to the move from CIS to COLL).
- If Charity AIFs fall into the “Packaged Product” regime, they may require Risk Management Reports, Key Features Documents, and Past Performance disclosures, which may well change the basis for performance measurement on some Funds. Charity AIFs would become regulated bringing them into the scope of the financial Promotion Rules (currently treated as unregulated funds).
- Forcing choice between UCITS, NURS or QIS – each presents restructuring issues, as mentioned above.

- Requirement to distribute all income at end of relevant accounting period (COLL 6.8.3). CIF' can smooth income over accounting periods. As income is a key consideration for many charity investors, this ability to smooth income is a popular and key feature for many investing charities. The majority of investing charities would regard losing this flexibility as detrimental.

5(iv) Which requirements of the FSA Handbook outside COLL would be unduly burdensome for charity AIFs? Please explain why and provide details of compliance costs, where possible.

- The approved persons regime could be burdensome, if this is imposed on Advisory Boards.
- The authorised status would bring Charity AIFs within the current 'packaged products' regime which would introduce the requirement to prepare key features documents in the prescribed form if marketing to retail investors.
- If the NURS structure was adopted, managers would be required to provide a short report as well as a long report, thus increasing production time and costs.

5(v) What, if any, transitional arrangements should be made for charity pooled funds converting to charity AIFs? Please explain why and provide details of compliance costs, where possible.

- Subject to structural considerations in 5(ii) above.

Chapter 6

6(i) Would the proposal to tax charity AIF income at 20 per cent if the income is not applied for charitable causes have any adverse consequences in practice, and if so, why?

- We cannot see any problem with this.

6(ii) Are there any circumstances where the requirement that the charity AIF does not withhold tax from distributions work to the detriment of the charity investors?

- We cannot see any problem with this.

6(iii) Are there any other adverse tax consequences arising from the charity AIF proposal?

- Both charities and fund managers believe it vital that the existing SDRT / stamp duty exemption for CIFs is maintained under the new Charity AIF regime.
- The paper does not indicate whether Charity AIFs would be required to prepare and submit tax returns. Assuming they are required to file returns, this places an increased compliance / administration burden on the fund and increased costs.
- CIFs are currently subject to VAT on their management fees. We welcome the proposal to remove this anomaly. However we recognise that investment managers would no longer be able to recover input VAT suffered on the supply of services to the fund.
- The consultation document states that a Charity AIF is able to make either interest or dividend distributions to investors, however it is not clear as to whether the "bond fund" rules that apply to UK Authorised Unit Trusts currently will also apply to Charity AIFs under the new proposals.

Yours sincerely,



Noel Muddiman
Consultation Committee Chairman