Chapter 2

Arch cru Consumer Redress Scheme

Risks and features of Arch cru funds

1 The Arch cru funds consist of two open-ended investment companies, the CF Arch cru Diversified Funds and the CF Arch cru Investment Funds, and their respective sub-funds, sold to consumers during the following periods:

Investment funds

Investment Portfolio: July 2006 to March 2009

Specialist Portfolio July 2006 to March 2009

Diversified funds

Balanced Fund September 2007 to March 2009

Global Growth Fund: September 2007 to March 2009

Income Fund: September 2007 to March 2009

Finance Fund: October 2008 to March 2009

2 Dealings in the Arch cru funds were suspended by the authorised corporate director, Capita Financial Managers Ltd ("Capita"), on 13 March 2009.

3 The Arch cru funds aimed to achieve their objectives by investing in a broad range of main-stream and non-mainstream assets.

4 The Arch cru funds, through transferable securities, ultimately invested in the following asset classes, in various combinations:

(a) unlisted equity;

(b) unlisted debt instruments;

(c) non-UK investments;

(d) venture capital or project finance investments;

(e) private markets, private equity, private finance;

(f) private and structured finance;

(g) asset-backed lending;

(h) investments in developing countries;

(i) collateralised debt and collateralised cash flow financings;

(j) life settlements; and

(k) commodities.

5 Information about each Arch cru fund and its sub-funds is set out below.

CF Arch cru Diversified Fund

6 The Diversified Fund was incorporated in June 2002 and originally named "Insinger de Beaufort Manager Selection ICVC".

7 The Diversified Fund was re-named the CF Arch cru Diversified Funds in mid-2007. The firms involved in the diversified fund were:

Authorised corporate director (ACD): Capita

Investment manager: Arch

Depository: HSBC Bank PLC

Marketing and distribution: Cru Investment Management Limited, Arch Financial Products LLP

Income fund

Promotions

8 The Income Fund was promoted to advisers as an investment in the IMA "Cautious Managed" sector and "a strong alternative to cash based investments and bond based investments".

Features

9 The features of the Income Fund as described to advisers are:

(a) its objective is long-term capital and income growth.

(b) it offers both net income and net accumulation shares. For income shareholders, net income was to be distributed half-yearly. For net accumulation shareholders, net income was retained and accumulated for the benefit of shareholders and reflected in the price of the shares;

(c) from October 2007, its aims were to provide returns of cash + 3% per annum from a diversified pool of assets;

(d) it can invest in a range of assets including:

(i) *collective investment schemes* (which invest principally in equities), *transferable securities*, cash, deposits and money market instruments; and

(ii) non-mainstream assets including: private equity; private finance; structured finance and commodities;

(e) from October 2007, the investment classes are described as bonds, equities and other assets to demonstrate low volatility and correlation with equities and bonds to improve diversity;

(f) Transactions in *derivatives* will only be used for the purposes of hedging and will not affect the risk profile of the fund.

Risks

10 It is the *FCA*'s view that an investment in the income fund is likely to be high risk and, as such, investors must understand and be willing to accept the following investment risks:

(a) risk to invested capital and return, in general - the risk that the investment may fall in value;

(b) exchange rate risk - some of the assets are located overseas and would, therefore, be affected by exchange rate movements;

(c) credit risk - the risk of failure of an entity or counterparty to an underlying investment. For some of the assets, this risk was greater than for more mainstream listed assets;

(d) governance risk - where equity or debt instruments are not listed on an exchange, then there may be a higher associated corporate governance risk than with listed assets. Similarly, where assets are located in developing countries, the same increased risk may apply;

(e) liquidity risk - the risk associated with the fund manager being unable to realise assets quickly without significantly affecting the position of investors; and

(f) valuation risk - assets not traded on a recognised market can be difficult to value accurately.

Balanced fund

Promotions

11 The balanced fund was promoted to advisers as investment in the IMA "Balanced Managed" sector and:

(a) may be suitable for investors with a low-level risk appetite;

(b) may be a strong alternative to cash based investments and bond based investments.

Features

12 The features of the Balanced Fund, as described to advisers, are:

(a) its objective is long-term capital growth;

(b) it offers net accumulation shares;

(c) from May 2008, its aims were to provide returns of cash + 4% per annum particularly over the medium term;

(d) it can invest in a range of assets including:

(i) *collective investment schemes* (which invest principally in equities), *transferable securities*, cash, deposits and money market instruments; and

(ii) non-mainstream assets including: private equity; private finance; structured finance and commodities;

(e) it will have a UK overweight portfolio;

(f) transactions in *derivatives* will only be used for the purposes of hedging and will not affect the risk profile of the fund.

Risks

13 It is the *FCA*'s view that an investment in the balanced fund is likely to be high risk and investors must understand and be willing to accept the following investment risks:

(a) risk to invested capital and return, in general - the risk that the investment may fall in value;

(b) exchange rate risk - some of the assets are located overseas and would, therefore, be affected by exchange rate movements;

(c) credit risk - the risk of failure of an entity or counterparty to an underlying investment. For some of the assets, this risk was greater than for more mainstream listed assets;

(d) governance risk - where equity or debt instruments are not listed on an exchange, then there may be a higher associated corporate governance risk than with listed assets. Similarly, where assets are located in developing countries, the same increased risk may apply;

(e) liquidity risk - the risk associated with the fund manager being unable to realise assets quickly without significantly affecting the position of investors; and

(f) valuation risk - assets not traded on a recognised market can be difficult to value accurately.

Global Growth fund

Promotions

14 The Global Growth Fund was promoted to advisers as an investment in the IMA "Global Growth" sector and:

(a) may be suitable for investors with a low-level risk appetite;

(b) to deliver decent absolute returns through a broad exposure to the major asset classes;

(c) investing in equity and bond funds and also other assets.

Features

15 The features of the Global Growth Fund, as described to advisers, are:

(a) its objective is long-term capital growth;

(b) it offers net accumulation shares;

(c) from May 2008, its aims were to provide returns of 6% per annum more than cash returns;

(d) it can invest in a range of assets including:

(i) *collective investment schemes* (which invest principally in equities), *transferable securities*, cash, deposits and money market instruments; and

(ii) non-mainstream assets including: private equity; private finance; structured finance and commodities;

(e) from October 2007, the investment classes are described as bonds, equities and other assets to demonstrate low volatility and correlation with equities and bonds to improve diversity;

(f) transactions in *derivatives* will only be used for the purposes of hedging and will not affect the risk profile of the fund.

Risks

16 It is the *FCA*'s view that an investment in the Global Growth Fund is likely to be high risk and investors must understand and be willing to accept the following investment risks:

(a) risk to invested capital and return, in general - the risk that the investment may fall in value;

(b) exchange rate risk - some of the assets are located overseas and would, therefore, be affected by exchange rate movements;

(c) credit risk - the risk of failure of an entity or counterparty to an underlying investment. For some of the assets, this risk was greater than for more mainstream listed assets;

(d) governance risk - where equity or debt instruments are not listed on an exchange, then there may be a higher associated corporate governance risk than with listed assets. Similarly, where assets are located in developing countries, the same increased risk may apply;

(e) liquidity risk - the risk associated with the fund manager being unable to realise assets quickly without significantly affecting the position of investors; and

(f) valuation risk - assets not traded on a recognised market can be difficult to value accurately.

Finance Fund

Promotions

17 The Finance Fund was promoted to advisers as an investment in the IMA "Cautious Managed" sector and:

(a) providing "steady returns, low risk";

(b) aiming to beat both cash and bond returns;

(c) as a superior investment to cash deposits and bonds.

Features

18 The features of the finance fund, as described to advisers, are:

(a) its objective is steady capital appreciation over the medium to long-term through exposure to a diversified portfolio of private finance-related instruments;

(b) it offers net accumulation shares;

(c) from November 2008, its aims were to provide returns of cash + 3% per annum;

(d) from November 2008, the investment category is defined as private finance, including bridging finance and term lending;

(e) it can invest in a range of assets including:

(i) *collective investment schemes* (which invest principally in equities), *transferable securities*, cash, deposits and money market instruments; and

(ii) non-mainstream assets including: private equity; private finance; structured finance and commodities;

(f) transactions in *derivatives* will only be used for the purposes of hedging and will not affect the risk profile of the fund;

(g) it will have a UK overweight portfolio.

Risks

19 It is the *FCA*'s view that an investment in the Finance Fund is likely to be high risk, and investors must understand and be willing to accept the following investment risks:

(a) risk to invested capital and return, in general - the risk that the investment may fall in value;

(b) exchange rate risk - some of the assets are located overseas and would, therefore, be affected by exchange rate movements;

(c) credit risk - the risk of failure of an entity or counterparty to an underlying investment. For some of the assets, this risk was greater than for more mainstream listed assets;

(d) governance risk - where equity or debt instruments are not listed on an exchange, then there may be a higher associated corporate governance risk than with listed assets. Similarly, where assets are located in developing countries, the same increased risk may apply;

(e) liquidity risk - the risk associated with the fund manager being unable to realise assets quickly without significantly affecting the position of investors; and

(f) valuation risk - assets not traded on a recognised market can be difficult to value accurately.

CF Arch cru investment fund

20 The investment fund was incorporated on 29 June 2006. It has two sub-funds: the investment portfolio and specialist portfolio.

21 The firms involved in the investment fund were:

Authorised corporate director (ACD): Capita Financial Managers Limited

Investment manager: Arch Financial Products LLP

Depository: Bank of New York Mellon Trust and Depository (UK) Ltd

Marketing and distribution: Cru Investment Management Limited, Arch Financial Products LLP

Investment Portfolio

Promotions

22 The Investment Portfolio was promoted to advisers as an investment in the IMA "Cautious Managed" sector and "an excellent replacement for cash based and bond based investments."

Features

23 The features of the Investment Portfolio as described to advisers are:

(a) its objective is to generate consistent returns to provide wealth preservation and capital appreciation;

(b) it offers net accumulation and net income shares;

(c) in March 2007, its aims were to provide consistent returns of LIBOR + 4% with a significant focus on risk management, this was revised to cash + 4% in August 2007;

(d) from March 2007, investment classes are stated as being public market securities and private investments. In September 2007 it is stated that the premise since inception of the fund was that public markets did not represent sufficient future reward for the fund.

Risks

24 It is the *FCA*'s view that an investment in the Investment Portfolio is likely to be high risk and investors must understand and be willing to accept the following investment risks:

(a) risk to invested capital and return, in general - the risk that the investment may fall in value;

(b) exchange rate risk - some of the assets are located overseas, and would therefore be affected by exchange rate movements;

(c) credit risk - the risk of failure of an entity or counterparty to an underlying investment. For some of the assets, this risk was greater than for more mainstream listed assets;

(d) governance risk - where equity or debt instruments are not listed on an exchange, then there may be a higher associated corporate governance risk than with listed assets. Similarly, where assets are located in developing countries, the same increased risk may apply;

(e) liquidity risk - the risk associated with the fund manager being unable to realise assets quickly without significantly affecting the position of investors; and

(f) valuation risk - assets not traded on a recognised market can be difficult to value accurately.

Specialist Portfolio

Promotions

25 The Specialist Portfolio was promoted to advisers as an investment in the IMA "Active Managed" sector and "an excellent replacement for cash based and bond based investments."

Features

26 The features of the Specialist Portfolio as described to advisers are:

(a) its objective is "to seek capital growth from an aggressively managed portfolio which may take high cash weightings at times when the investment manager lacks confidence in the outlook for equities, bonds and other asset classes. There is a moderate risk to capital";

(b) it offers net accumulation and net income shares;

(c) in March 2007, its aims were to provide consistent returns of LIBOR + 6% with a significant focus on risk management; this was revised to cash + 6% in August 2007;

(d) from March 2007, investment classes are stated as being public market securities and private investments which are leveraged up to 25%. In September 2007, the fund is described as having a low correlation with traditional public investments such as bonds and equities.

Risks

27 It is the *FCA*'s view that an investment in the Specialist Portfolio is likely to be high risk and investors must understand and be willing to accept the following investment risks:

(a) risk to invested capital and return, in general - the risk that the investment may fall in value;

(b) exchange rate risk - some of the assets are located overseas and would, therefore, be affected by exchange rate movements;

(c) credit risk - the risk of failure of an entity or counterparty to an underlying investment. For some of the assets, this risk was greater than for more mainstream listed assets;

(d) governance risk - where equity or debt instruments are not listed on an exchange, then there may be a higher associated corporate governance risk than with listed assets. Similarly, where assets are located in developing countries, the same increased risk may apply;

(e) liquidity risk - the risk associated with the fund manager being unable to realise assets quickly without significantly affecting the position of investors; and

(f) valuation risk - assets not traded on a recognised market can be difficult to value accurately.