

Starting and Running an Investment Club

Expert knowledge means success



Contents

1. Introduction
2. Starting an Investment Club
4. Running an Investment Club
5. Taxation
6. Useful Links
7. Further Information

Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

Investment clubs are groups of people – often friends, neighbours or work colleagues - who meet together on a regular basis, to invest, primarily on the Stock Exchange. They use both their combined capital and knowledge to purchase investment products while enjoying the social benefits that come from being a member of a club. Most groups operate with between three and 20 members, although there is no upper limit on size, and larger worldwide groups that communicate over the web do exist.

Investment clubs started in America and have been gaining in popularity in the UK since the mid nineties. There are now more than 12,000 registered clubs in the UK whose club members are paying £100 million a year in subscriptions.

Members pay a regular subscription fee and in return receive a share of income from the investments and make gains or losses on the shares' disposal in accordance with the proportion of the club's investments that they own. A member's share of income and gains is included as part of their personal income and gains and qualifies in the same way for any available personal allowances and reliefs to which they may be entitled.

Why invest in the Stock Market?

Investing money in the stock market is not without risk but the rewards can be great. Timing and informed judgement are needed to succeed. The stock market rises and falls and in the short-term investments can show a loss. However, investments made for the medium and long term generally provide a greater return than simply leaving your money in a traditional savings account. In fact, over any 10 year period, investment in company shares has proven to be a very lucrative form of investment when exercised with care and knowledge.

There is a range of funds available on the Stock Market to suit the level of risk and security you require. Generally speaking, the greater the risk, the greater the potential rewards.

Stock market investment should form part of a diverse financial plan allowing you to spread both your wealth and your risk across a range of assets including savings, property, your business and other financial products. Clubs, like individuals, should aim for a varied and balanced portfolio to protect against fluctuations in particular sectors.

ProShare

ProShare Investment Clubs is part of ProShare (UK) Ltd which is an independent, not-for-profit organisation funded by the London Stock Exchange and industry which exists to promote the benefits of owning shares.

ProShare provides a number of useful services and products, including:

- **ProShare Investment Clubs Manual**

The ProShare Investment Clubs Manual provides all the key up to date information on a range of important topics. It is an essential reference for all clubs – new and established – to ensure that they are run correctly and efficiently. The manual includes:

- Top tips for running your club;
- Taxation issues;
- Managing club finances;
- Banks and brokers; and
- Details of free services.

- **ProShare Toolkit**

A unique system that allows private investors and clubs, however inexperienced, to use their own skills to accurately assess the track record of a company and its management and decide whether its share price today represents value for money. The Toolkit includes:

- a Guide to Analysing Shares;
- Share Appraisal Forms; and
- The **Investor's Guide to Information Sources**; and
- unique company data.

- **ProShare Seminars**

ProShare offers free seminars with stock market experts.

- **ProShare Online Services**

ProShare provides a range of useful free services to its registered members including:

- online portfolio tracking;
- investment research; and
- an information library.

- **Website:**

Visit www.proshareclubs.co.uk to register your club's details and join the National Register of Investment Clubs. Registration is entirely free, and provides access to all of the products, services and events that ProShare Investment Clubs has on offer.

Why use an Investment Club?

There are many advantages to investing as a member of an investment club rather than as an individual investor. For a small regular investment, you can gain hands-on experience of how the stock market works and share in the decision-making, financial knowledge and responsibility – and social life – that comes with being a member. The vast majority of club members had never traded a share before joining a club, but statistics show that 18% of members start their own share portfolio after joining a club.

Because of the commission charges, it can be uneconomical to make a small capital investment as an individual. However, in a club, many small investments are accumulated and invested on behalf of the club and spread across multiple investments thereby limiting each individual's exposure and spreading the commission charges across members.

Using a club rather than acting as an individual investor will allow you to capitalise on;

- the combined knowledge and experience of investing;
- experience of different market sectors;
- the sharing out of the research workload across the club;
- decision making based on discussion and democratic choice;
- utilisation of the skills within the club to handle the necessary book-keeping, tax forms and administration;
- the accumulated investment capital of the club;
- the spreading of financial risk across multiple investments; and
- the sharing of commission charges.

There are no tax benefits given to members of an investment club as members are taxed individually and everyone in the club is liable to pay tax on their share of the club's profits, both income tax on dividends and capital gains tax on any increase in price of shares sold. However, if tax is not your forte, you may benefit from the tax expertise of other members in your club.

Starting an Investment Club

Membership

It can be difficult to join an existing investment club, as the membership usually comprises friends, relatives and colleagues - people who have already known each other for some time. If you do want to join an existing club, ProShare provides a Club Connections section on their website where clubs that are looking for new members can advertise.

The easiest way of becoming involved in an investment club is to start your own with your own circle of contacts. When you have garnered enough interest; arrange a preliminary informative meeting to discuss the nature of the club and the level of commitment required. You then need to decide on a name for the club, agree the constitution and club's rules and decide on the frequency of and venue for meetings. Once the club is off the ground, interest often grows and recruitment becomes easier.

While it is always useful to have some experienced investors on board, it is not mandatory for success. In fact, it can be more beneficial to have members that bring a variety of market sector expertise from their job and other interests.

Ideally the club workload should be shared equally between members: where a particular role – for example the Treasurer – requires a greater time commitment, the role could be divided between multiple members.

ProShare produces an Investment Club Manual – backed up by a helpline - which provides detailed information on how to start and run a club.

Committee

As a minimum, an Investment club must have a Chairperson, Treasurer, and Secretary to perform the book-keeping and administrative duties. All services provided to the club by members must be provided free of charge.

The Chairperson should be someone who can control the meetings in a diplomatic fashion. Some knowledge or experience of the stock market is obviously advantageous.

Ideally, the Treasurer should have some financial administration experience as they will need to set up the club's share-dealing account, do the book-keeping, keep financial records, produce monthly and annual reports and deal with tax issues.

The Secretary will need to arrange meetings, produce agendas, take minutes, and look after membership administration.

Two or three club members should be nominated to have the authority to instruct the club's stockbroker to make a deal.

Constitution and Rules

An investment club needs to have a constitution and rules, to provide an organisational framework and points of contact for correspondence and official notices. Amongst other things, these rules should lay down how the club's investments are proportioned between by individual members.

There is no model constitution, but ProShare publish a draft constitution and rules which your club can adapt as necessary.

The more time you spend on agreeing the rules of your club operations upfront, the more time you will save later in your meetings. This is particularly true when it comes to voting on which shares to buy. The one member, one vote per share method can result in tied votes; where there are multiple shares a member may feel restricted by only being able to vote for one share when there are multiple shares of interest.

One tried and tested method for casting votes is to use a points system, where each member has a number of points that they can allocate between the shares being voted on. They may choose to allocate all the points to one share if they are particularly interested in it or split the points between multiple shares to "weight" them in line with their level of interest. The money invested in each type of share can then be matched with the collective level of interest in each of the shares being voted on.

Subscriptions

Most investment clubs take monthly subscriptions, commonly around £25. The actual amount may be based upon the number of members, and the frequency of investment required - it is not economical to make investments of less than £500 because

of broker's minimum commission charges. Some investment clubs require an initial lump sum from members to enable the club to make investments immediately rather than having to wait until the monthly subscriptions have built up into an economically viable investment sum. In a large club, the investment sums soon build up: in fact, the average size of portfolio for clubs formed more than two years ago is over £50,000.

Subscriptions should always be kept at a level that members can afford; bearing in mind that there may be losses as well as gains. If your club's portfolio is reaping rewards and some of the members want to increase their investment, consider implementing a variable contribution system, where subscriptions are matched with a number of "units" in the club. This can bring the added benefit of encouraging people to join your club who may have limited capital but valuable expertise.

ProShare recommend that where a variable contribution system is implemented that when it comes to voting on buying or selling shares, democracy rules. One member - one vote, no matter how big or small the individual holdings.

Investment Choices

Members should agree upfront a general consensus towards the spread of investments. In particular, the balance between the following should be considered:

- High risk/reward investments;
- Low risk/reward investments;
- Ethical investments;
- UK-based companies;
- Foreign companies;
- Sectors within the club's "circle of competence"; and
- Personal preferences.

Remember that if you have access to confidential information about a company which could affect its share price, it is illegal to use this knowledge to buy or sell shares.

Investment Process

Generally, funds are invested on the London Stock Exchange, but they can also be invested in other assets, including foreign shares and securities, or they can be held on deposit in a bank account.

For share dealing, you will need to set up a nominee account, in which to keep your holdings. This means you don't have to deal with share certificates and it also speeds up the share-dealing process.

Buying and selling shares is fairly straightforward: most stockbrokers will guide you through the process and many major brokers have special departments and dealing services for investment clubs. You can choose between an execution-only service where the stockbroker simply carries out buying and selling instructions and a private client service where the stockbroker will provide advice on investment opportunities for an increased fee.

ProShare provide a range of information aimed at the inexperienced investor to guide them through the investment process.

The National Register of Clubs

You can join the National Register of Investment Clubs by registering free with ProShare at www.proshareclubs.co.uk

Membership benefits include keeping you up to date with changes in tax and FSA guidelines, providing ongoing help and education to start and run a club, free monthly e-mail newsletters, and a free website for club members (as above) that features community, portfolio and research facilities.

HMRC Registration

The Treasurer, Secretary or other official of the club will need to notify the local tax office of the club's existence and of the official correspondence address.

Running an Investment Club

Researching and Monitoring

Research into particular shares (or market sectors) can be shared out amongst appropriate members – “champions”. Champions monitor the movement of their allocated shares and any company news that may affect the shares and report on their research at the next meeting.

Meetings

Meetings should be held regularly; once a month is common. The success of your meetings may depend on your choice of club chairperson. They play a vital role in ensuring that the meetings run smoothly and to the agreed agenda. They need to ensure that all members voice their opinion and that any disagreements are dealt with in a diplomatic way.

One typical area of disagreement is the balance struck between investing in a wide spread of shares to reduce risk and containing investments within a club's “circle of competence”. ProShare make the following suggestions on this issue:

- match the number of shares to the number of members so that each person can act as 'champion' of a single share;
- create a 'waiting list' of would-be replacements that are compared at the monthly meeting to those in the club's current portfolio; and
- where there are areas of interest outside your “circle of competence”, consider specialised unit trusts or investment trusts.

For effective meetings, consider the following suggestions:

- Before any meeting, your members should be sent the minutes from the previous meeting and the agreed agenda (both usually prepared by the club secretary), along with the treasurer's initial report;
- Move through the formal agenda items, e.g. the last meeting's minutes, members reports, absences etc. quickly and efficiently so you can get down to the real purpose of the meeting – investment.

- Don't waste time in meetings talking about matters that do not impact the discussing and selection of investments;
- Deal with the existing portfolio first, listening to the "champion's" report on each investment in turn with any associated recommendations. Vote on whether to hold, sell or buy;
- Allow most time for discussion on new investments. All proposed investments should conform to the club's investment criteria and all members should be provided with information that ensures that they understand exactly what the company does and what they are being asked to vote on.

Buying and Selling

The authorised club members should make any purchases or disposals of investments as soon as possible following the meeting in which the relevant commercial decision was taken.

The club may agree to empower an authorised club member to make further purchases or disposals between meetings where market conditions meet agreed criteria.

Taxation¹

Club members are taxed individually and everyone in the club is liable to pay both income tax on dividends and capital gains tax on any increase in price of shares sold, for their share of the club's profits. Non resident members need to check the tax situation in their local country as rules in the overseas country where the investor is resident may not be the same as in the UK.

Club members will be liable for tax on gains whether such gains are retained by the Club for re-investment or distributed to Club members.

Tax Apportionment

An appointed club officer, normally the Treasurer, will be responsible for keeping a record of the club's dealings in stocks and shares. They will apportion any income, gains and losses between the members in accordance with the rules of the club, and should provide each member with a written statement of their share of gains for the year (form 185(New)) which indicates, for each investment sold, the time(s) on which it was acquired, and, for each member, the date the member joined the club.

Accurate calculation of each member's gains (or losses) for a year can be very complicated as the members' proportionate entitlement changes every time capital is invested in or withdrawn from the club. Consequently, HM Revenue & Customs (HMRC) asks clubs to enter into a form of agreement for the return of members' gains (or losses) which aims to produce approximately the right results without the need for lengthy computations. This arrangement is described in detail at CG20620- 20625 and is available at HMRC website: www.hmrc.gov.uk.

Tax Declaration

Every club member should declare their apportioned share of income or gains received from investments made by the club on his/her Self Assessment Tax Return.

However, a member does not have to declare their share of investment club gains to HMRC if:

- those gains, together with any other chargeable gains of the year are less than the Annual Exempt Amount; and
- his or her share of the proceeds from the sale of shares by the club in the tax year, together with any other proceeds from the disposal of other assets, is less than twice the Annual Exempt Amount.

Further information on the calculation of Capital Gains Tax, can be found at:

www.hmrc.gov.uk/cgt/forms.htm and www.hmrc.gov.uk/cgt/intro/basics.htm

Transferring shares into a club

If you start a club and transfer shares that you already own into the club you could incur an immediate tax liability if the value of the shares has gone up since you originally acquired them. This is because the transfer to the club is treated as a disposal of an interest in the shares to the other club members, because you would no longer own the shares absolutely, but would own them jointly with the other club members. The shares would have to be valued at the transfer date to establish the amount of your gain or loss for tax purposes.

Leaving a club

When you leave, the club will pay you the value of your share of the club's investments. And the occasion of your departure represents a disposal of your share of those investments for capital gains tax purposes. To calculate the chargeable gain on this occasion, you will need to deduct from the

Reform of Capital Gains Tax

From 6 April 2008, taper relief and indexation allowance was withdrawn and replaced by a single rate of capital gains tax of 18 per cent for disposals on or after that date. The annual exempt amount remains in place.

But this may not be good news for those who hold shares classified as business assets, including those:

- with shares in unquoted companies;
- with shares in quoted trading companies if the individual is employed (full or part-time) by the company concerned;
- with shares in quoted trading companies where the shareholding represents at least 5% of the voting rights;
- with shares listed on AIM.

Higher rate taxpayers investing in shares classified as non-business assets (typically shares in quoted trading companies) will benefit under the new system as they will pay 18% tax instead of the minimum effective rate of tax of 24% after 10 years taper relief due under the old system.

amount you receive from the club the total of

- the sums you have paid into the club from time to time (together with any indexation allowance up to 5 April 1998 relating to those payments; and
- the amounts of income (net of tax or tax credit) and gains allocated to you for each year you were a member, adjusted for any losses allocated to you each year, and any sums paid out to you by the club in the past.

A section specifically for investment clubs is available on the HMRC website at: www.hmrc.gov.uk/cgt/investment_clubsfaqs.htm

Form 185(new) is the form that Investment Clubs must fill out every tax year: http://search2.hmrc.gov.uk/kb5/hmrc/forms/view.page?record=F2ttumE6b_1&formId=3231

Useful Links

Software for Investment Clubs

The following software packages facilitate the running of an investment club and the identification of potential investment candidates.

Investor Ease

This is an all-round package that offers charting, portfolios and daily data services as part of the all-in price. Investor Ease offers significant subscription discounts to multiple users who are members of the same investment club.

www.investorease.com

Meridian Software

Three software products for private investors are provided – they range from a simple portfolio manager which will draw price charts and has manual data entry to a very comprehensive program with a wide variety of analytical tools and automatic data entry. Each will let you follow any number of portfolios of shares. www.meridian-software.co.uk

Udata PLC

This is a range of software products for the more active investor and more experienced investment club, specialising in technical analysis.

www.udata.co.uk

ShareScope PLC

ShareScope provide investment and trading software for private investors. It offers complete stock market data and analysis allowing you to track your portfolios easily and analyse market trends with great speed, accuracy and reliability. In 2005, ShareScope was voted “Best Investment Software” by ProShare Investment Club members.

www.sharescope.co.uk

Brokers

The following webpage provides a list of stockbrokers that offer services especially for investment clubs:

www.proshareclubs.co.uk/cgi-bin/proshareclubs/runningclub/pagewiz.cgi?pg=/services_stockbrokers.htm

Banks

The following webpage provides a list of banks that provide services geared towards investment clubs:

www.proshareclubs.co.uk/cgi-bin/proshareclubs/runningclub/pagewiz.cgi?pg=/services_bank.htm

Regulatory Bodies

Financial Services Authority (FSA)

The FSA is the regulator for the financial services industry in the UK.

www.fsa.gov.uk

APCIMS (The Association of Private Client Investment Managers and Stockbrokers)

APCIMS is the trade association of more than 250 firms who, on more than 400 sites across the UK and Ireland, deal in stocks and shares for private investors.

www.apcims.co.uk/

IMA (The Investment Management Association)

The IMA is the trade body for the UK Investment Industry, comprising Fund Managers, Unit Trust Managers and Investment Fund Managers. The IMA's members manage over £2,000 billion worth of assets.

www.investmentfunds.org.uk

Further Information

This guide is for the general interest of our clients. It is therefore essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

Acknowledgement

¹ Taxation information has been provided by HM Revenue & Customs and Crown Copyright therein is duly acknowledged. Other information has been sourced from ProShare literature.

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