



HM TREASURY



Consultation on introducing a protected cell regime for OEICs

July 2009



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1

Feedback on better regulation consultation

1.1 In May 2007 HM Treasury published a Consultation on Better Regulation Measures for the Asset Management Sector¹, in line with its better regulation agenda. The consultation sought views on three proposals to reform aspects of the legislation with the aim of reducing regulatory costs for UK asset managers and promoting international competitiveness:

- facilitating paperless settlements;
- reforming notification requirements for non-UK Undertakings for Collective Investment in Transferable Securities (UCITS); and
- introducing a protected cell regime for Open-Ended Investment Companies (OEICs).

1.2 The overall response to the proposals was good, with responses from 22 stakeholders. The feedback indicated that stakeholders were in principle unanimously behind all three proposals, although differing arguments were offered for some of the detail. Summary of the feedback is in Annex C.

1.3 The protected cell regime is covered in the next chapters.

Facilitating paperless settlements

1.4 OEICs and authorised unit trusts (AUTs) are open-ended collective investment funds authorised by the Financial Services Authority (FSA). Because they are open-ended, investors can and generally do redeem their investments by selling their shares (in the OEIC) or units (in the AUT) back to the fund's management company. The Law of Property Act 1925 (LPA) required these redemptions or transfers to be made in writing, even if the initial instruction could be made electronically.

1.5 The requirement for paper settlement and transfer of title costs fund managers, stockbrokers, financial advisers and other intermediaries money. The Government believed that provision could be made to facilitate purely electronic settlement of trades in OEIC shares and AUT units without compromising investor protection.

1.6 Stakeholder responses were positive and in March 2009 the legislation acquired Royal Assent².

1.7 Although it is still too soon to evaluate the full impact of the legislation, the Government would appreciate any comments on the legislation, its benefits or unintended consequences.

- 1 Do you have any comments on the impact of allowing paperless settlements, be it the legislation, its benefits, or unintended consequences?

¹ <http://www.hm-treasury.gov.uk>

² http://www.opsi.gov.uk/si/si2009/uksi_20090553_en_1

Reforming notification requirements for non-UK UCITS

1.8 The Government proposed amending the Financial Services and Markets Act 2000 (FSMA) so that a fund may begin marketing either where the two-month period has expired and the FSA has raised no objections or as soon as soon as the FSA is satisfied that its requirements have been met, whichever is sooner. This would remove unnecessary delays in the large majority of new notifications which the FSA can approve quickly.

1.9 Stakeholder responses were again in favour and the Government now intends to proceed with amendment of FSMA.

2

Legislating for a protected cell regime for OEICs

2.1 OEICs are investment funds structured as bodies corporate. Large fund managers generally operate a small number of OEIC umbrella companies with a large number of sub-funds within each umbrella, allowing them to operate a large range of funds more efficiently. The sub-funds do not have a separate legal personality, but are separately managed, charged, accounted for and assessed for tax. Under current law there is no segregation of liabilities between different sub-funds. For example, if an umbrella fund contained one cautious UK bond fund and one high-risk Far-east equity fund and the Far-East equity fund collapsed with liabilities exceeding its assets, creditors could have a claim on the assets of the UK bond fund. Investors in the cautious fund therefore bear some of the risk of the riskier fund.

2.2 In practice the probability of an OEIC collapse is small, as OEICs must comply with borrowing limits imposed by the FSA, but not zero. Current FSA rules require disclosure of the contagion risk in the fund prospectus and periodic reports, although there is a danger that some OEIC investors do not fully understand it. Thus, provided adequate protection of existing creditors can also be achieved, segregating liabilities so that the liabilities of any one sub-fund could only be met out of the assets of that sub-fund appeared desirable.

2.3 In the Better Regulation consultation HM Treasury proposed developing a protected cell regime for UK OEIC to provide greater investor protection. The consultation assessed the degree of support for a protected cell regime and explored issues around the fund categories to which such a regime might apply, the transition process to a new regime and how to safeguard stakeholders' interests, for example in the event of insolvency or fraud. See Annex C for a detailed analysis of the responses to the consultation.

Increased risk-aversion of investors

2.4 Recent events highlight the importance of investors understanding the risks they are subject to. Investors in a very low-risk fund should not be subject to the risks in a separate sub-fund holding riskier assets. Furthermore, many investors have become risk-averse and see any possible risk of contagion as a reason not to invest, or at least to invest elsewhere. Feedback from stakeholders indicates this has become a contributing factor to investors' decisions not to invest in UK funds, instead favouring investment in funds in jurisdictions such as Jersey, Ireland or Luxembourg, which already operate protected cell regimes.

Stakeholder input

2.5 The response to the consultation was unanimously in favour of developing a protected cell regime, and the Government decided to take it forward. On some of the details, however, the opinions of stakeholders differed. The Government set up an expert group with membership consisting of fund managers, fund lawyers, insolvency lawyers and a depositary¹, making it possible to utilise the expertise and experience of the industry and gain direct stakeholder input. As Treasury legislation on this matter requires the FSA to amend its rules and to ensure smooth

¹ Firms/organisations that provided assistance and expertise: Investment Management Association, The Insolvency Service, M&G, Insight, Schroders, State Street Trustees, Norton Rose, Herbert Smith, Macfarlanes, Linklaters, KPMG

implementation, the Government and FSA have collaborated to develop the protected cell regime proposed in this document. The FSA's proposals are set out in Chapter 3.

Features of the proposals for a protected cell regime

2.6 Annex A contains the draft Statutory Instrument (SI) with which HM Treasury proposes introducing a protected cell regime into UK legislation. The aim is to introduce clear and unambiguous legislation into the Open-Ended Investment Companies Regulations 2001 ("the OEIC Regulations"), providing the UK with a strong protected cell regime with segregated liability of sub-funds of OEICs, and without unwanted or unforeseen consequences. The insertion of regulation 11A supplies the main features of the protected cell regime.

Segregated liability

2.7 Regulation 11A(1) provides that, where an OEIC is established as an umbrella company, the assets of each sub-fund belong exclusively to that sub-fund, so that they are effectively ring-fenced from the other sub-funds in the umbrella company and the umbrella company itself. This ensures that each sub-fund has segregated liability and the assets of one sub-fund cannot be used to satisfy the liabilities of another sub-fund within the umbrella company or the umbrella company itself, and thus that the insolvency of one sub-fund should not lead to the insolvency of the umbrella company or another sub-fund.

2.8 Regulation 11A(2) clarifies that each sub-fund's liabilities can only be met by its own assets, while regulation 11A(4) ensures that assets received or liabilities incurred by the umbrella company on behalf of its sub-funds and which are not attributable to any particular sub-fund, may be allocated between the sub-funds. While most charges such as management fees are likely to be charged directly to the individual sub-funds, others may be charged to the umbrella. Regulation 11A(4) ensures that such costs, required for the operation of the umbrella company and its sub-funds, are not "orphaned" and can be distributed across the sub-funds. The SI sets out that this distribution must be fair to the shareholders of the sub-funds, similar to references found in COLL.

2.9 Regulation 11A(5) sets out that although sub-funds are not separate companies, they should be treated as though they are separate legal persons by the courts.

- 2 Do you agree that the provisions in Regulation 11A into the OEIC Regulations successfully create a protected cell regime for umbrella funds, with segregated liability for sub-funds?

Winding up

2.10 The insertion of regulation 33A into the OEIC Regulations makes modifications to Part V of the Insolvency Act 1986, so that a sub-fund may be wound up, as if it were an unregistered company and in accordance with regulations 31 to 33 of the OEIC Regulations.

- 3 Do you agree that the provisions in regulation 33A provide for a suitable wind up mechanism for OEIC sub-funds?

Disclosure

2.11 The insertion of paragraph 2(ba) into Schedule 2 of the OEIC Regulations requires umbrella companies to insert a statement into their instrument of incorporation that discloses the protected cell status of its sub-funds. Chapter 3 covers further disclosure requirements in FSA Rules.

4 Do you agree with this disclosure requirement?

Compulsion and a one-year transitional period

Compulsion for new OEICs

2.12 Regulation 11A makes the protected cell status of OEIC sub-funds compulsory. This is the simplest and most effective solution. It removes investor confusion as to whether funds are protected by segregated liability or not. Removal of the contagion risk is beneficial to investors, but also to UK OEICs, as it will increase their competitiveness with OEICs based in other jurisdictions. The responses to the previous consultation indicated funds would adopt the regime even if it were not compulsory.

One-year transition for existing OEICs

2.13 Although stakeholder responses to the consultation were in favour of compulsion for new OEICs, the view was not as clear for existing OEICs. For the same reasons of investor protection and clarity, but also because the consultation responses indicated that with a voluntary regime most if not all firms would want to convert, the SI has been drafted to also make protected cell status compulsory for existing OEICs, with a one year transitional period, during which all non-compliant existing agreements must expire or be renegotiated.

2.14 On the basis of stakeholder responses to the consultation and feedback from the expert group, it appears that a transitional period of one year gives sufficient advance warning of the changes in the law and a reasonable amount of time for any necessary renegotiation. This period will also keep possible investor confusion to a minimum. As explained, feedback has suggested that most agreements are short-term or already on a segregated liability basis. Furthermore, none of the responses to the consultation indicated that the renegotiation of agreements would be an issue for OEICs. It was, however, pointed out that umbrella funds may have open-ended International Swaps and Derivatives Association (ISDA) agreements covering multiple positions which could be problematic to renegotiate. In light of this and in order to provide further evidence, we would be grateful for answers to Question 7 below.

Converting to protected cell status

2.15 Regulation 4(1) provides that specific paragraphs of regulation 11A (setting out segregated liability of sub-funds) will apply to all new agreements. Of course, protected cell status can only be effective if regulation 11A applies to all of an umbrella's sub-funds and agreements. New OEICs can operate on a protected cell basis, as all their agreements will be new agreements to which regulation 11A applies. Greater detail is provided in regulation 4 in respect of existing OEICs. Regulation 4(3) states that an existing OEIC must notify the FSA of its proposals to amend its instrument of incorporation within one year of these regulations coming into force. Regulation 4(6) requires this notification to include certification that all the OEIC's agreements are on a segregated liability basis. In effect, an existing OEIC has one year to ensure that all its agreements are on a segregated liability basis and notify the FSA accordingly. OEICs can opt to

be covered by regulation 11A earlier, as long as their agreements comply and they have obtained FSA approval, as described above.

2.16 The FSA would be able to take enforcement action against an existing OEIC which at the end of the one-year transitional period has not yet converted, if for example it still had existing agreements that were not on a segregated liability basis or it had not yet notified the FSA that it proposes to amend its instrument of incorporation.

- 5 Do you agree that a compulsory regime for all OEICs, with a transitional period for existing OEICs, is the right approach?
- 6 Is self-certification adequate to ensure that all OEIC umbrella agreements are compliant with the transitional provisions in the SI?
- 7 Do you agree that one year is long enough for the transitional period? Are OEICs likely to have to renegotiate many agreements because they are not already on a segregated liability basis? If so, will an OEIC's agreements have expired or will it be able to renegotiate within the year?

3

Updating FSA rules for protected cell companies

3.1 This chapter outlines the consequences for the FSA COLL sourcebook resulting from the introduction of a Protected Cell Regime as proposed in Chapter 2. The proposed changes to COLL are in Annex B.

Documentation

3.2 Currently our Rules require that the potential cross sub-fund risk for umbrella sub-funds is disclosed in the Prospectus document and the Authorised Fund Manager Reports.

3.3 The proposed amended COLL rules provide that the Prospectus wording should refer to the segregated nature of the sub-funds rather than risk of contagion, as will be the case under the amended OEIC regulations.

3.4 HM Treasury has endeavoured to ensure that the new regime is robust as possible. However, it is impossible to guarantee all jurisdictions will share the UK interpretation of a protected cell regime or that their courts would uphold contract terms to this effect. It is for this reason that the FSA proposes that the revised disclosures should explicitly outline the potential limitations in this regard with respect to foreign law contracts. This will ensure that accurate information is available to investors.

3.5 The FSA proposes to remove the required disclosure of potential cross sub-fund liability in the Authorised Fund Manager Reports as under the new regime the risk is greatly diminished and therefore the warning would be disproportionate.

3.6 The FSA is proposing to include a new explicit requirement in its rules, in-line with the OEIC Regulations Schedule 2, for the segregated nature of Investment Company with Variable Capital (ICVC) umbrella sub-funds to be disclosed in the instrument of incorporation of an umbrella ICVC. It is the FSA's intention that this should inform potential creditors of their rights when contracting with a UK OEIC with protected cell status.

8 Do you agree with the proposed disclosure requirements?

Notification of Unitholders

3.7 Under our rules¹ the authorised fund manager is subject to approval and notification requirements which will be triggered by these proposals. It is for managers to determine the level of scheme change but the FSA envisages that many will comply via a 'notifiable change' category and as such unit-holders can be notified after the event.

9 Is this sufficient notification for unitholders?

¹ COLL 4.3

Notification of FSA

3.8 Under the OEIC regulations (21) any change to the instrument of incorporation or a significant change to the prospectus requires FSA approval which can be deemed to apply after one month has passed.

3.9 It is important for the FSA as Registrar for ICVC companies that it holds accurate and the most recent instrument of incorporation for a scheme, but as for many schemes updating documentation will merely be a formality, the FSA does not wish to impose unnecessary costs. Therefore the OEIC regulations have been amended so that any change to scheme documentation resulting purely from the conversion to a protected cell company for an umbrella OEIC need not be accompanied by a solicitor's letter. Firms will however be required to certify to the FSA when updating their documentation that all their agreements or contacts with third parties are on a segregated liability basis.

- 10 Do you agree that the FSA transitionals as drafted help provide that updating documentation and FSA approval costs are kept to a minimum?

Wind-up provisions

3.10 Chapter 7.3 of COLL provides for winding up a solvent ICVC and terminating a sub-fund of an ICVC. The FSA has made a number of consequential changes to that chapter which clarify the same options and requirements apply for a solvent sub-fund termination as for a solvent ICVC wind-up.

- 11 Do you agree all the proposed rule changes to COLL 7.3 are merely consequential or clarification and therefore do not represent an increased burden to firms? If not, please detail?
- 12 Do you agree that our proposed changes to 7.3 award the same options for solvent wind-up to a sub-fund as for an ICVC? If not why?

Cross sub-fund investment

3.11 The FSA has previously prohibited an umbrella sub-fund investing in other sub-funds of the same umbrella due to the increased contagion risk, circularity of investment, potential for double charging and price manipulation. As the intention of the protected cell regime is to remove the risk of contagion this should no longer be an issue and the FSA therefore proposes that this type of investment will be permissible going forward subject to the necessary safeguards regarding maximum holdings and charges. The FSA believes that its approach is consistent with Ireland which has a protected cell regime already in place. The proposed rules mirror to a large extent those in place for investment in associated schemes.

- 13 Do you have any comments on the draft rules regarding cross sub-fund investment, specifically are there any unintended consequences or problems that should be addressed?

Authorised Corporate Director (ACD) responsibility

3.12 COLL² already requires that the Authorised Fund Manager must manage the scheme in accordance with the instrument constituting the scheme. As detailed in the disclosure section above there remains uncertainty where a fund enters into foreign law contracts on behalf of an umbrella sub-fund. The FSA therefore proposes to clarify the duties of the ACD via a new rule that details reasonable care is sufficient when a fund enters into foreign law contracts.

3.13 The FSA feels that where the ACD has taken reasonable care they should not be liable for costs to rectify a breach but that if they have failed to exercise the required diligence then costs will fall to them rather than the fund.

14 Do you agree with the proposed approach modifying the obligation of ACDs in the case of negotiation of foreign law contracts? If not please explain.

NI OEIC Regulations

3.14 A number of the FSA draft rule changes in Annex B reflect the planned repeal of the Open-Ended Investment Companies Regulations (Northern Ireland) 2004 with effect from 1 October 2009

² COLL 6.6.3R(1)a

4

Impact and conclusion

Regulatory impact assessment

4.1 The regulatory impact assessment below lays out implementation options for the areas highlighted above and considers qualitative and, where possible, quantitative costs and benefits for the proposals.

4.2 A copy of the impact assessment can be found on HM Treasury's website - www.hm-treasury.gov.uk - or requested through HM Treasury's correspondence and enquiry unit. Contact details can be found at http://www.hm-treasury.gov.uk/contact/contact_index.cfm. The impact assessment can also be found in Annex E.

Industry

Estimated benefits

4.3 As outlined in Chapter 2, the industry is supportive of this regime, as it will improve the competitiveness of UK funds by increasing the attractiveness of UK OEIC investments. It is hard to quantify these benefits, although as explained in Chapter 2 feedback from stakeholders suggests that as investors have become more risk averse following the global downturn, the potential of this benefit has increased. Although it is relatively unlikely that a protected cell regime could be sufficient to sway a decision on fund domicile on its own, it could materialise through increased sales of existing funds, and through cost savings if UK fund managers chose to maintain a consolidated UK fund range rather than adding a Luxembourg or Dublin range.

Estimated costs

4.4 It is unlikely that there would be any ongoing administrative costs from the proposal. The previous consultation estimated that there could be additional costs in terms of higher borrowing costs, as creditors may demand higher risk premia given the lack of access to assets of other sub-funds. However, the industry indications that umbrellas already contract with creditors on a segregated liability basis would mean that these costs are not likely to crystallise.

4.5 The main costs of the proposal will be the conversion costs for existing OEICs. There are two broad scenarios:

- 1 OEICs have no agreements or only agreements that are on a segregated liability basis; or
- 2 OEICs have at least one agreement that specifies cross-liability or at least one agreement that does not specify either way.

4.6 Although feedback suggests that most OEIC umbrellas meet Scenario 1, it is reasonable to estimate that 25 per cent fall under Scenario 2, and will need to let expire or renegotiate at least one agreement during the transitional period.

4.7 There are also two types of one-off costs per OEIC:

- A internal and external legal advice and cost of notifying the FSA of conversion and amending the instrument of incorporation and prospectus; and
- B ongoing legal counsel and internal costs depending on negotiation and complexity of agreements.

4.8 Industry feedback indicates that Cost A is up to £5,000 per OEIC. For OEICs registered in other EU countries, there could be another £10,000 per OEIC to file revised fund documentation with EU regulators, although not many firms currently passport UK funds to the EU. The estimates for Cost B look at industry indications and at what the costs of one of the more complicated and lengthy credit agreement (ISDA Master Agreement) negotiations might be, to establish an upper range. According to the latest ISDA survey¹, negotiations of ISDA Master Agreements are likely to take 30-90 days. Feedback from stakeholders indicates that the global downturn has made negotiation of terms more involved, and will therefore take longer. This is difficult to quantify, but a reasonable estimate is 50 per cent more time or 45-135 days. If we then assume that on average it will take 90 days at an estimated cost of £500 per day, negotiations will, on average, cost £45,000. Compare this with an industry-estimated cost of £10,000 per agreement, and that to satisfy regulations on risk diversifications it is likely firms will operate with a minimum of three agreements per OEIC. These estimates can be used as a range for Cost B of between £30,000 and £45,000.

4.9 There are 362 authorised umbrella OEICs² and their minimum conversion costs are Cost A, and therefore, assuming a cost of £5,000 per OEIC, would be up to £1.81m. Assuming 25 per cent, or 91 OEICs, will need to negotiate an agreement at Cost B of £30,000-£45,000 per OEIC, this adds costs of between £2.73m and £4.10m. This amounts to between £4.54m and £5.91m in one-off costs spread over the transitional period.

4.10 Further one-off costs arise for FSA approval of conversion. At 3.5-6 hours per approval of revised documentation per umbrella at a cost of £25 per hour and with 362 OEIC umbrellas, this is between £31,675 and £54,300 over the transitional period.

- 15 Do you agree with the estimated costs and benefits for the industry? What is the breakdown of your estimated cost of conversion?
- 16 Are there any unintended consequences for industry not covered here or in chapters 2 and 3?

Consumers

Estimated benefits

4.11 The other key benefit would be protecting OEIC investors from having to meet the liabilities of another sub-fund in the event of insolvency. As proposed in Chapter 3, new consumers will be made aware of the status of their investments by the prospectus disclosure and existing customers will be notified in accordance with the requirements in COLL 4.3.

4.12 There is reason to believe that in aggregate risks could be borne more cheaply under a protected cell regime than with unsegregated liability. Under the current rules, assessing the creditworthiness of an OEIC sub-fund requires an assessment of the solvency of the umbrella as a whole. Potential investors would also have to assess the creditworthiness of other sub-funds in

¹ <http://www.isda.org/statistics/pdf/ISDA-Master-Agreement-Negotiation-Survey2006.pdf>

² As of 4 June 2009

an umbrella to gain a complete picture of the risks of a possible investment. With segregated liability, both parties would only require information on the sub-fund and the umbrella (not including other sub-funds) in order to make a complete assessment of risk. Thus it is likely that the net benefit in terms of distribution of risk and payment of risk premia would be positive.

Estimated costs

4.13 There is no material detriment to consumers of this new regime as it improves consumer protection by removing a potential risk to investors in sub-funds of UK OEICs. However as explained above there is the possibility of creditors charging more under the new regime, although assuming OEIC investors have the same risk preferences as creditors, the benefit to investors would be equal to the additional amount creditors charge for bearing the extra risk and those costs and benefits would cancel each other out.

4.14 Finally, although a two-tier system will exist over the transitional period whereby there will be both protected cell companies and non-protected cell companies, investor confusion is mitigated by the disclosure requirements proposed in Chapter 3 and by the intention that, in the interest of simplicity for consumers, all OEIC umbrellas will convert by the end of the transitional period.

17 Do you agree with our assumption that this regime is good for all consumers invested in sub-funds of OEIC umbrellas? Are there any detrimental effects for consumers not identified?

Conclusion

Legislation

4.15 Chapter 2 sets out what the Government is trying to achieve with its proposals for a protected cell regime. The aim is to remove investor confusion and contagion risk, and to provide UK OEICs with a competitive legislative landscape. It is important that the legislation is clear and unambiguous to the courts, firms, investors and creditors, especially in the ever-increasing international context of financial services.

FSA Rules

4.16 Chapter 3 sets out what the FSA, as the Regulator, proposes in relation to documentation, notification, winding-up, cross sub-fund investment and ACD responsibilities.

Impact assessment

4.17 Chapter 4 assesses the costs and benefits to industry and consumers. The two key benefits are removing the contagion risk to OEIC investors and improving the international attractiveness of the UK OEIC vehicle. It is unlikely there are any ongoing net costs. The estimated one-off costs to industry are between £4.54m and £5.91m, while one-off costs to the FSA are estimated at between £31,675 and £54,300. These costs can be put into context with estimated revenue for the sector of £1.13bn³.

³ Figures used from the Investment Management Association's Annual Survey 2008 and assuming a similar ratio of revenue to assets under management

Transitional period

4.18 The protected cell regime is compulsory for all OEIC umbrellas. As explained, stakeholders have suggested that many umbrella funds already contract with creditors on a segregated liability basis. However, the proposals provide those that do not with a transitional period of one year to: a) ensure that, where necessary, their agreements are renegotiated; and b) that their documents are updated.

- 18 Do you agree that the SI and proposed FSA Rule changes achieve what is set out in this consultation document? If not, what improvements would you suggest?
- 19 We would be grateful for any further comments.

5

Responding to the consultation

5.1 The Government would welcome responses on its proposals for introducing a protected cell regime for OEICs and the FSA would welcome responses on its accompanying proposed rule changes.

How to respond

5.2 The Government and FSA would welcome the views of all stakeholders on the issues raised in the document. The consultation begins with the publication of this document and will last for a period of two months. Please respond by 27 September 2009. Responses to the consultation should be sent to:

Matthew Cowie
Savings and Investments
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5890

Email: matthew.cowie@hm-treasury.gov.uk

5.3 This document can be found on HM Treasury's website at www.hm-treasury.gov.uk. When responding please state whether you are responding as an individual or as part of an organisation. If responding on behalf of a larger organisation, please make it clear whom the organisation represents and, where applicable, how the members' views were assembled.

Confidentiality

5.4 All written responses will be made public on HM Treasury's website unless the author specifically requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. If you wish, part, but not all, of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and another confidential version for the team managing the consultation.

5.5 Even where confidentiality is requested, if a request for disclosure of the consultation response is made in accordance with the freedom of information legislation, and the response is not covered by one of the exemptions in the legislation, the Government may have to disclose the response in whole or in part.

Cabinet Office Code of Practice for Written Consultations

5.6 The Cabinet Office has published a Code of Practice for Written Consultations to guide Departments' activities in this area which sets down the following criteria:

- consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy;
- be clear about what the proposals are, who may be affected, what questions are being asked, and the timescale for responses;
- ensure the consultation is clear, concise and widely accessible;
- give feedback regarding the responses received and how the consultation process influenced the policy;
- monitor the Department's effectiveness at consultation, including through the use of a designated consultation coordinator;
- ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

5.7 If you feel that this consultation does not fulfil these criteria please contact:

Angela Carden
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Email: angela.carden@hm-treasury.gov.uk

Confidentiality disclosures

5.8 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, among other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

5.9 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department. The Department will process your personal data in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

Freedom of Information contact

5.10 Any Freedom of Information Act queries should be directed to:

Correspondence and Enquiry Unit
Freedom of Information Section
HM Treasury
1 Horse Guards Road
London
SW1A 1HQ

Tel: 020 7270 4558

Fax: 020 7270 4681

Email: public.enquiries@hm-treasury.gov.uk



Draft Statutory Instruments on Protected Cell Regime

Draft Regulations laid before Parliament under section 429(2) of the Financial Services and Markets Act 2000, for approval by resolution of each House of Parliament.

DRAFT STATUTORY INSTRUMENTS

2009 No.

FINANCIAL SERVICES AND MARKETS

The Open-Ended Investment Companies (Amendment) (No. 2) Regulations 2009

<i>Made</i>	- - - -	<i>2009</i>
<i>Coming into force</i>	- -	<i>2009</i>

A draft of these Regulations has been approved by a resolution of each House of Parliament pursuant to section 429(2) of the Financial Services and Markets Act 2000⁽¹⁾;

The Treasury make the following Regulations in exercise of the powers conferred on them by section 262(1)(a), (2)(e) and (3)(f) and section 428(3) of that Act:

Citation, commencement and interpretation

1. These Regulations may be cited as the Open-Ended Investment Companies (Amendment) (No. 2) Regulations 2009 and come into force on the day after the day on which they are made.

2. In these Regulations “the Principal Regulations” means the Open-Ended Investment Companies Regulations 2001⁽²⁾.

Amendment of the Principal Regulations

3.—(1) The Principal Regulations are amended as follows.

(2) In regulation 2 (interpretation) after the definition of “smaller denomination share” insert—
“sub-fund” means a separate part of the property of an umbrella company that is pooled separately;”

⁽¹⁾ 2000 c. 8.

⁽²⁾ S.I. 2001/1228, to which there are amendments not relevant to these Regulations.

(3) In regulation 6(1) (FSA rules) after “open-ended investment companies” insert “and sub-funds of those companies”.

(4) After regulation 11 (the Tribunal) insert—

“Umbrella companies

Segregated liability of sub-funds

11A.—(1) In the case of an umbrella company, the assets of a sub-fund belong exclusively to that sub-fund and shall not be used to discharge the liabilities of or claims against any other person or body, including the umbrella company, or any other sub-fund, and shall not be available for any such purpose whether such liability or claim was incurred before, on or after the date this regulation commences.

(2) Any liability incurred on behalf of or attributable to any sub-fund of an umbrella company shall be discharged solely out of the assets of that sub-fund.

(3) Any provision, whether contained in an instrument of incorporation, agreement, contract or otherwise, shall be void to the extent that it is inconsistent with paragraphs (1) or (2) and any application of, or agreement to apply, assets in contravention of such paragraphs shall be void.

(4) Notwithstanding paragraphs (1) and (2), an umbrella company may allocate any assets it receives or liabilities it incurs on behalf of its sub-funds or in order to enable the operation of the sub-funds and which are not attributable to any particular sub-fund between its sub-funds in a manner which it considers is fair to shareholders.

(5) Without prejudice to paragraphs (1) and (2), a sub-fund of an umbrella company is not a legal person separate from that umbrella company but the property of a sub-fund is subject to orders of the court as it would have been had the sub-fund been a separate legal person.

(6) Without prejudice to paragraphs (1) and (2) and save as provided in regulation 33A(7), an umbrella company may sue and be sued in respect of a particular sub-fund and may exercise the same rights of set-off in relation to that sub-fund as apply at law in respect of companies.”.

(5) In regulation 21(d) (the Authority’s approval for certain changes in respect of a company) after “company” insert “or a sub-fund of that company”.

(6) After regulation 33 (dissolution in other circumstances) insert—

“Winding up of sub-funds

33A.—(1) Save as provided in paragraphs (2) and (3), a sub-fund may be wound up as if it were an unregistered company in accordance with the provisions of regulations 31 to 33 provided that the appointment of the liquidator or any provisional liquidator and the powers and duties of the liquidator or any provisional liquidator shall be confined to the sub-fund which is being wound up and its affairs, business and property.

(2) Notwithstanding paragraph (1), sections 226 to 228 of the 1986 Act shall not apply where a sub-fund is wound up in accordance with the provisions of this regulation.

(3) The provisions of Part V of the 1986 Act with respect to staying, sisting or restraining actions and proceedings against a company at any time after the presentation of a petition for winding up and before the making of a winding-up order extend, in the case of a sub-fund, where the application to stay, sist or restrain is presented by a creditor, to actions and proceedings against the umbrella company of that sub-fund, or any of the umbrella company’s other sub-funds, in respect of a liability of that sub-fund.

(4) Notwithstanding regulation 11A(5), a sub-fund shall be treated as it would have been had it been a separate legal person for the purposes of winding up.

(5) For the purposes of paragraph (1), in regulations 31 to 33 —

- (a) a reference to an open-ended investment company is taken to be a reference to a sub-fund;
 - (b) a reference to a company, save in relation to the term “unregistered company”, is taken to be a reference to a sub-fund;
 - (c) a reference to creditors is taken to be a reference to the creditors of a sub-fund;
 - (d) a reference to members is taken to be a reference to the holders of the shares in a sub-fund;
- and

- (e) regulations 31 to 33 are to be read with any other necessary modifications.
- (6) For the purposes of paragraph (1), in the provisions of the 1986 Act to which reference is made in regulations 31 to 33 —
 - (a) references to an unregistered company and to a company are taken to be references to a sub-fund; and
 - (b) the provisions of the Insolvency Act 1986 to which reference is made in regulations 31 to 33 are to be read with any other necessary modifications.
- (7) Subject to paragraph (8), regulation 11A(6) shall not apply after the appointment of a liquidator or a provisional liquidator.
- (8) Where an order has been made for the winding-up of a sub-fund, no action or proceedings shall be commenced or proceeded with against the umbrella company or the sub-fund in respect of any liability of the sub-fund, except by leave of the court and subject to such terms as the court may impose.”.
- (7) In Schedule 2 (instrument of incorporation) after paragraph 2(b) insert—
 - “(ba)in the case of an umbrella company, the assets of a sub-fund belong exclusively to that sub-fund and shall not be used to discharge the liabilities of or claims against any other person or body, including the umbrella company, or any other sub-fund, and shall not be available for any such purpose;”.

Transitional provisions

4.—(1) An umbrella company shall not enter into any agreement or contract after the date these Regulations come into force which is inconsistent with the provisions of paragraphs (1) and (2) of regulation 11A of the Principal Regulations and the provisions of paragraph (3) of regulation 11A shall apply to any such agreement or contract.

- (2) Regulation 11A of the Principal Regulations shall apply to an umbrella company which —
 - (a) has been authorised prior to the date these Regulations come into force; and
 - (b) has given written notice to the Authority that it proposes to alter its instrument of incorporation to effect compliance with paragraph 2(ba) of Schedule 2 to the Principal Regulations

from the date on which effect may be given to the proposal under regulation 21(3) of the Principal Regulations.

- (3) An umbrella company which has been authorised prior to the date these Regulations come into force and to which regulation 11A of the Principal Regulations does not already apply as provided in paragraph (2) shall give written notice to the Authority that it proposes to alter its instrument of incorporation to effect compliance with paragraph 2(ba) of Schedule 2 to the Principal Regulations before the end of the period of one year beginning with the date these Regulations come into force.
- (4) Regulation 11A of the Principal Regulations shall apply to an umbrella company which has given written notice to the Authority of the proposed alteration to its instrument of incorporation under paragraph (3) of this regulation from the date on which effect may be given to the proposal under regulation 21(3) of the Principal Regulations.
- (5) Regulations 21 and 22 of the Principal Regulations apply to any proposed alteration to an instrument of incorporation under paragraph (2) or (3) of this regulation with the exception of paragraph (2) of regulation 21.
- (6) Any notice given under paragraph (2) or (3) shall be accompanied by a notification in such form as the Authority may direct that the umbrella company does not have any agreements or contracts with a third party the provisions of which are inconsistent with paragraph (1) or (2) of regulation 11A of the Principal Regulations.
- (7) Paragraph 5(1) of Schedule 2 to the Principal Regulations shall not apply to any alteration to an instrument of incorporation made in accordance with paragraph (3) or (4) of this regulation.
- (8) An umbrella company which contravenes any provision of this regulation is to be treated as having contravened a provision of the Principal Regulations.

Name

Date

EXPLANATORY NOTE*(This note is not part of the Regulations)*

These Regulations amend the Open-Ended Investment Companies Regulations 2001 (S.I. 2001/1228) (“the Principal Regulations”) to make provision as to the assets of sub-funds of umbrella companies.

Regulation 3(4) inserts a new regulation 11A into the Principal Regulations. Regulation 11A(1) provides that, where an open-ended investment company is established as an umbrella company, the assets of each sub-fund shall belong exclusively to that sub-fund so that they are effectively ring-fenced from the other sub-funds in the umbrella company and the umbrella company itself. This ensures that each sub-fund will have segregated liability and the assets of one sub-fund cannot be used to discharge liabilities incurred by another sub-fund within the umbrella company or the umbrella company itself. New regulation 11A(2) provides that any liability incurred by or attributable to a sub-fund shall be discharged solely out of the assets of that sub-fund. New regulation 11A(4) provides for an exception to the general position set out in paragraphs (1) and (2) of new regulation 11A: assets received or liabilities incurred by an umbrella company on behalf of its sub-funds or in order to enable the operation of those sub-funds and which are not attributable to any particular sub-fund may be allocated between the sub-funds in a manner which the umbrella company considers is fair to shareholders.

New regulation 11A(3) provides that any provision in any document that is inconsistent with paragraphs (1) and (2) of regulation 11A shall be void and that any attempt to assign assets in contravention of the provisions of these paragraphs shall also be void.

New regulations 11A(5) and (6) provide respectively that the property of a sub-fund is subject to orders of the court as if the sub-fund were a separate legal person, despite the sub-fund not being a separate legal person, and that an umbrella company may sue and be sued in respect of a sub-fund and may exercise the same rights of set-off in respect of a sub-fund that apply in respect of companies.

Regulation 3(6) inserts a new regulation 33A into the Principal Regulations. New regulation 33A makes additional modifications to Part V of the Insolvency Act 1986 (c.45) so that a sub-fund may be wound up as if were an unregistered company, in accordance with the provisions of regulations 31 to 33 of the principal Regulations.

Regulation 3(7) inserts a new paragraph into Schedule 2 of the Principal Regulations. New paragraph 2(ba) of Schedule 2 requires that an umbrella company's instrument of incorporation contain a statement that the assets of each sub-fund belong exclusively to that sub-fund and cannot be used to discharge liabilities incurred by another sub-fund within the umbrella company or the umbrella company itself.

Regulation 4 makes transitional provisions. Regulation 4(1) provides that all agreements made after the date these Regulations commence shall be in accordance with the provisions of paragraphs (1) and (2) of regulation 11A of the Principal Regulations and that paragraph (3) of regulation 11A shall apply to them. Regulation 4(2) permits an umbrella company which has been authorised prior to the date of commencement to opt to apply regulation 11A. In order to do so, an umbrella company must give notice to the Financial Services Authority (“the Authority”) that it proposes to alter its instrument of incorporation so as to comply with new paragraph 2(ba) of Schedule 2. Regulation 4(3) provides that an umbrella company must have informed the Authority that it proposes to alter its instrument of incorporation to comply with new paragraph 2(ba) within a year of the commencement of these Regulations. Regulations 4(2) and (4) state that regulation 11A shall apply to an umbrella company from the date that effect may be given to the proposal under regulation 21(3) of the Principal Regulations. Notice of the proposal must be accompanied by a notification, in the form specified by the Authority, that the umbrella company does not have any agreements that are inconsistent with the provisions of paragraphs (1) and (2) of regulation 11A.

A full regulatory impact assessment of the effect that this instrument will have on the costs of business is available on HM Treasury's website (www.hm-treasury.gov.uk) or from Savings and Investment Team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ and is annexed to the Explanatory Memorandum which is available alongside the instrument on the OPSI website (www.opsi.gov.uk).

B

Draft FSA Rules updates

Note: these draft amendments to FSA rules also label annexes A and B.

COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK (ICVC SUB-FUNDS AND OTHER AMENDMENTS) INSTRUMENT 2009

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in or under:
- (1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):
 - (a) section 138 (General rule-making power);
 - (b) section 156 (General supplementary powers);
 - (c) section 157(1) (Guidance);
 - (d) section 247 (Trust scheme rules); and
 - (e) section 248 (Scheme particulars rules);
 - (2) regulation 6(1) (FSA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228); and
 - (3) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. The Annexes to this instrument come into force on [date].

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Collective Investment Schemes sourcebook (COLL) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Collective Investment Schemes Sourcebook (ICVC Sub-funds and Other Amendments) Instrument 2009.

By order of the Board
[Date]

...

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text unless otherwise stated.

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

foreign law contract any contract other than a contract:

- (a) governed by the laws of any part of the *United Kingdom*; and
- (b) whose parties agree to the exclusive jurisdiction of the courts of any part of the *United Kingdom*.

Amend the following as shown.

OEIC Regulations the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228) ~~or for an ICVC established in Northern Ireland, the Open-Ended Investment Companies Regulations (Northern Ireland) 2004 (SR 2004/335).~~

Annex B

Amendments to the Collective Investments Schemes sourcebook (COLL)

In this Annex, underlining indicates new text and striking through indicates deleted text.

Table: contents of the instrument constituting the scheme

3.2.6 R ...

...	
7B	...
	<u>Umbrella schemes</u>
7C	<u>For an ICVC which is an umbrella, a statement that the assets of a sub-fund belong exclusively to that sub-fund and shall not be used to discharge directly or indirectly the liabilities of or claims against any other person or body, including the umbrella and any other sub-fund and shall not be available for any such purpose.</u>
...	
21	A statement that the <i>person</i> designated for the purposes of paragraph 4 of Schedule 4 to the <i>OEIC Regulations</i> (Share transfers) or for an ICVC established in Northern Ireland, paragraph 3 of Schedule 4 to the Open-Ended Investment Companies Regulations (Northern Ireland) 2004 (SR 2004/335) is the <i>person</i> who, for the time being, is the <i>ACD</i> of the <i>ICVC</i> .
...	

...

Table: contents of the prospectus

4.2.5 R ...

...	
Authorised fund	
2	A description of the <i>authorised fund</i> including:
	(a) its name;
	(b) whether it is an <i>ICVC</i> or an <i>AUT</i> ; and that:
	<u>(ba)</u> (i) <u>a statement that unitholders are not liable for the debts of the authorised fund; and</u>
	(ii) <u>for an ICVC, a statement that the sub-funds of a scheme which is an umbrella are not 'ring-fenced' and in the event of the umbrella being unable to meet liabilities</u>

		attributable to any particular <i>sub-fund</i> out of the assets attributable to that <i>sub-fund</i> , that the remaining liabilities may have to be met out of the assets attributable to other <i>sub-funds</i> ;
	(ba) (bb)	whether it is a <i>UCITS</i> scheme or a <i>non-UCITS</i> retail scheme;
...		
2A	For an <i>ICVC</i> which is an <i>umbrella</i> , a statement that:	
	(a)	<u>its <i>sub-funds</i> are segregated portfolios of assets and, accordingly, the assets of a <i>sub-fund</i> belong exclusively to that <i>sub-fund</i> and shall not be used to discharge directly or indirectly the liabilities of or claims against any other <i>person</i> or body, including the <i>umbrella</i> and any other <i>sub-fund</i> and shall not be available for any such purpose; and</u>
	(b)	<u>whilst the provisions of the <i>OEIC Regulations</i> provide for segregated liability between <i>sub-funds</i>, these provisions are subject to the scrutiny of the courts and it is not free from doubt, in the context of claims brought by local creditors in foreign courts or under <i>foreign law contracts</i>, that the assets of a <i>sub-fund</i> will always be 'ring fenced' from the liabilities of other <i>sub-funds</i> of the <i>ICVC</i>.</u>
...		

...

Authorised fund manager's report

4.5.9 R The matters set out in (1) to (13) must be included in any *authorised fund manager's* report, except where otherwise indicated:

...

(11) for a report on an *umbrella* prepared in accordance with *COLL* 4.5.7R(2) or *COLL* 4.5.8R(2):

(a) (for an *ICVC*), a statement that:

(i) its *sub-funds* are segregated portfolios of assets and, accordingly, the assets of a *sub-fund* belong exclusively to that *sub-fund* and shall not be used to discharge directly or indirectly the liabilities of or claims against any other *person* or body, including the *umbrella* and any other *sub-fund* and shall not be available for any such purpose; and

(ii) whilst the provisions of the *OEIC Regulations* provide for segregated liability between *sub-funds*, these provisions are subject to the scrutiny of the courts and it is not free from doubt, in the context of claims brought by local creditors in foreign courts or under *foreign law contracts*, that the assets of a *sub-fund* will always be 'ring fenced' from the liabilities of other *sub-funds* of the *ICVC* to the effect that, as a *sub-*

~~fund is not a legal entity, if the assets attributable to any sub-fund were insufficient to meet the liabilities attributable to it, the shortfall might have to be met out of the assets attributable to one or more other sub-funds of the ICVC; and~~

- (b) information required by (1) to (10) must be given for each *sub-fund*, if it would vary from that given in respect of the *umbrella* as a whole;

....

- (13) for a report on an individual *sub-fund* of a *scheme* which is an *umbrella* prepared in accordance with *COLL 4.5.7R(4)* or *COLL 4.5.8R(3)*;

- (a) (for an ICVC) a statement corresponding to that required by (11)(a) ~~making it clear that if the liability relates to another sub-fund of the umbrella, the shortfall or any part of it might have to be met out of the assets of the sub-fund to which the report relates; and~~
- (b) a statement that the latest long report prepared for the *umbrella* as a whole is available on request.

...

Investment in other group schemes

- 5.2.16 R (1) ...
- (2) When an investment is made, the amount referred to in (1)(a) is either:
 - (a) ...
- (3) When a disposal is made, the amount referred to in (1)(a) is any charge made for the account of the *authorised fund manager* or *operator* of the second *scheme* or an *associate* of any of them in respect of the disposal.

...

...

UCITS schemes that are umbrellas

- 5.2.30 R ...
- (2) ~~A sub-fund must not~~ may invest in or dispose of units of another sub-fund of the same umbrella (the second sub-fund) only if the following conditions are satisfied:
 - (a) the second sub-fund does not itself hold units in any other sub-fund of the same umbrella;
 - (b) in respect of the proportion of the scheme property of the investing sub-fund represented by units of the second sub-fund, no payment over and above that due in relation to services provided to the second sub-fund is taken to remunerate the

authorised fund manager or any other director of the ICVC or an associate of either of them;

(c) the prospectus of the umbrella clearly states that the property of the investing sub-fund may include such units; and

(d) COLL 5.2.30AR is complied with.

5.2.30A R (1) Where:

(a) an investment or disposal is made under COLL 5.2.30R; and

(b) there is a charge in respect of such investment or disposal;

the authorised fund manager of the umbrella must pay the investing sub-fund the amounts referred to in (2) or (3) within four business days following the date of the agreement to invest or dispose.

(2) When an investment is made, the amount referred to in (1) is either:

(a) any amount by which the consideration paid by the investing sub-fund for the units in the second sub-fund exceeds the price that would have been paid for the benefit of the second sub-fund had the units been newly issued or sold by it; or

(b) if such price cannot be ascertained by the authorised fund manager, the maximum amount of any charge permitted to be made by the seller of units in the second sub-fund.

(3) When a disposal is made, the amount referred to in (1)(b) is any charge made for the account of the authorised fund manager or operator of the umbrella or an associate of any of them in respect of the disposal.

(4) In this rule:

(a) any addition to or deduction from the consideration paid on the acquisition or disposal of units in the second sub-fund, which is applied for the benefit of the second sub-fund and is, or is like, a dilution levy made in accordance with COLL 6.3.8R (Dilution) or SDRT provision made in accordance with COLL 6.3.7R (SDRT provision) is to be treated as part of the price of the units and not as part of any charge; and

(b) any charge made in respect of an exchange of units in the second sub-fund for units in another sub-fund of the umbrella is to be included as part of the consideration paid for the units.

...

Non-UCITS retail schemes that are umbrellas

5.6.24 R ...

(2) A sub-fund ~~must not~~ may invest in or dispose of units of another sub-fund of the same umbrella (the second sub-fund) only if the following conditions are satisfied:

- (a) the second sub-fund does not itself hold units in any other sub-fund of the same umbrella;
- (b) in respect of the proportion of the scheme property of the investing sub-fund represented by units of the second sub-fund, no payment over and above that due in relation to services provided to the second sub-fund is taken to remunerate the authorised fund manager or any other director of the ICVC or an associate of either of them;
- (c) the prospectus of the umbrella clearly states that the property of the investing sub-fund may include such units; and
- (d) the conditions in COLL 5.2.30AR are complied with.

...

Table of application

6.6.2 R ...

<i>Rule</i>	<i>ICVC</i>	<i>ACD</i>	<i>Any other directors of an ICVC</i>	<i>Depositary of an ICVC</i>	<i>Manager of an AUT</i>	<i>Trustee of an AUT</i>
...						
<u>6.6.14AR</u>		<u>x</u>				
...						

...

6.6.14 R ...

Duties of the ACD: umbrella schemes

- 6.6.14A R (1) In the case of an ICVC which is an umbrella, the ACD must take reasonable care to ensure that, where the ICVC enters into a foreign law contract in relation to assets or liabilities of the ICVC, that foreign law contract is consistent with the principle of limited recourse in the instrument of incorporation of the ICVC and as provided for in Regulation 11A of the OEIC Regulations.
- (2) The ACD of an ICVC which is an umbrella must:
- (a) promptly upon becoming aware that a foreign law contract falling within (1) above is or has become inconsistent with the principle of limited recourse in the ICVC's instrument of incorporation, except where the inconsistency arises from a breach of (1) above, take reasonable steps to remedy that inconsistency;

(b) promptly upon becoming aware of any breach of (1) above, take action, at its own expense, to rectify that breach, unless it is beyond the control of the ACD to do so.

...

Explanation of COLL 7.3

7.3.1 G (1) ...

(2) The termination of a *sub-fund* may be carried out under this section instead of by the court provided the *sub-fund* is solvent and the steps required under will be subject to the conditions set out in regulation 21 of the *OEIC Regulations* are fulfilled. Termination can only commence once the proposed alterations to the *ICVC's instrument of incorporation* and *prospectus* have been notified to the *FSA* and permitted to take effect. On termination, the assets of the *sub-fund* will normally be realised, and the *unitholders* in the *sub-fund* will receive their respective share of the proceeds net of liabilities and the expenses of the termination.

...

Guidance on winding up or termination

7.3.3 G ...

...			
Step number	Explanation	When	<i>COLL</i> rule (unless stated otherwise)
...			
8	Request <i>FSA</i> to revoke relevant <u>authorisation order or update its records</u>	On completion of W/U or <u>termination</u>	7.3.7(9)

...

When an *ICVC* is to be wound up or a *sub-fund* terminated

7.3.4 R (1) ...

(2) An *ICVC* must not be wound up or a *sub-fund* terminated under this section if there is a vacancy in the position of *ACD*.

...

Umbrella companies

7.3.4A R The assets of a *sub-fund* of an *ICVC* which is an *umbrella* belong exclusively to that *sub-fund* and shall not be used to discharge directly or indirectly the liabilities of or claims against any other *person* or body, including

the umbrella and any other sub-fund and shall not be available for any such purpose.

...

Solvency statement

- 7.3.5 R (1) Before notice is given to the *FSA* under regulation 21 of the *OEIC Regulations* of the proposals referred to in *COLL 7.3.4R(3)*, the *directors* must make a full enquiry into the *ICVCs* or, in the case of termination of a sub-fund, the sub-fund's affairs, business and property to determine whether the *ICVC* or the sub-fund will be able to meet all its liabilities.
- (2) The *ACD* must then, based on the results of this enquiry, prepare a statement either:
- (a) confirming that the *ICVC* or the sub-fund will be able to meet all its liabilities within twelve *months* of the date of the statement; or
- ...
- (3) This solvency statement must:
- (a) relate to the *ICVCs* or the sub-fund's affairs, business and property at a date no more than *28 days* before the date on which notice is given to the *FSA*;

...

...

Consequences of commencement of winding up or termination

- 7.3.6 R ...
- (3) ~~The *ACD* must as soon as practicable after winding up or termination has commenced:~~
- (a) ~~if~~ if the *ACD* has not previously notified *unitholders* of the proposal to wind up the *ICVC* or terminate the *sub-fund*, the *ACD* must as soon as practicable after winding up or termination has commenced give written notice of the commencement of the winding up or termination to the *unitholders*; ~~and~~
- (b) ~~if winding up an *ICVC* that has its head office situated in Northern Ireland, publish notice of the commencement of the winding up in the *Belfast Gazette*.~~

Manner of winding up or termination

- 7.3.7 R (1) Paragraphs (2) to (910) of this rule apply to winding up an *ICVC* and termination of a *sub-fund*; ~~paragraph (10) only applies to the winding up of an *ICVC* and paragraphs (11) to (15) only apply to the termination of a *sub-fund* of an *ICVC*.~~

...

- (9) The *depository* must notify the *FSA* once the winding up of the *ICVC* or the termination of a *sub-fund* (including compliance with COLL 7.3.8R) is complete and at the same time the *ACD* or the *depository* must request the *FSA* to revoke the relevant *authorisation order* (on the winding up of an *ICVC*) or to update its records (on the termination of a *sub-fund* of an *ICVC*).
- (10) Where any sum of *money* stands to the account of the *ICVC* at the date of its dissolution or a *sub-fund* at the date of its termination, the *ACD* must arrange for the *depository* to pay or lodge that sum within one *month* after that date in accordance with regulation 33(4) or (5) of the *OEIC Regulations* (Dissolution in other circumstances).
- (11) ~~Where any sums (including unclaimed distributions) remain standing to the account of the *scheme property* following tender of payment (whether to a creditor or a *unitholder*), the *ACD* must instruct the *depository* to retain the sums ('tendered sums') in an account ('unclaimed payments account') separate from any other part of the *scheme property*. [deleted]~~
- (12) ~~The *depository* must, if instructed by the *ACD*, make a payment out of the unclaimed payments account for the purpose of settling a claim for a tendered sum. [deleted]~~
- (13) ~~Any costs and reasonable expenses of the *ACD* for investigating a claim and any costs and expenses incurred by the *depository* in making a payment out of the unclaimed payments account may be reimbursed from the payment. [deleted]~~
- (14) ~~The *person* entitled to any tendered sum is not entitled to any interest in respect of the unclaimed payments account and any interest arising in respect of the unclaimed payments account must be allocated between the continuing *sub-funds* of the *ICVC* in a manner which is fair to the *unitholders* of the *ICVC* generally. [deleted]~~
- (15) ~~Amounts standing to the credit of an unclaimed payments account must be excluded from the value of the *scheme property* and must not be subject to any distribution under this *rule*, but upon a dissolution of the *ICVC* under regulation 33 of the *OEIC Regulations*, the *depository* must cease to hold those amounts as part of that account and they will become subject to the provisions of (10). [deleted]~~

...

Duty to ascertain liabilities

- 7.3.9 R
- (1) The *ACD* must use all reasonable endeavours to ensure that all the liabilities of the *ICVC* or the *sub-fund* are discharged before the completion of the winding up or termination.
- ...
- (3) If the *ACD* rejects any claim against the *ICVC* or the *sub-fund* in whole or part or against the *ICVC* or the *sub-fund* in respect of a liability in whole

or part, the ACD must immediately send to the claimant written notice of its reasons for doing so.

...

Additional provisions applicable to umbrella companies

- 7.3.12 R (1) ~~Liabilities of an ICVC which is an umbrella attributable, or allocated, to a particular sub-fund must be met first out of the scheme property attributable or allocated to such sub-fund. [deleted]~~
- (2) ~~If the liabilities to be met out of a particular sub-fund of an umbrella ICVC are greater than the proceeds of the realisation of the scheme property attributable or allocated to that sub-fund, the deficit must be met out of the scheme property attributable or allocated to the solvent sub-funds of that umbrella ICVC in which the proceeds of realisation exceed liabilities and divided between those sub-funds in a manner that is fair to the unitholders in those solvent sub-funds. [deleted]~~
- (3) ~~Paragraph (2) applies in respect of any deficit arising as a result of additional liabilities accruing to a sub-fund through the operation of (2). [deleted]~~
- (4) ~~In calculating the amount of liabilities for the purpose of (2), account must be taken of any payments received or to be received from the ACD under COLL 7.3.11R (Liabilities of the ACD). [deleted]~~

Miscellaneous

- 7.3.13 R (1) If:
- (a) ...
- (b) after winding up or termination has commenced, the ACD becomes of the opinion that the ICVC or the sub-fund will be unable to meet all its liabilities within twelve months of the date of the statement provided under (a) of COLL 7.3.5R(2);
- the directors must immediately present a petition or cause the ICVC or sub-fund to present a petition for the winding up of the ICVC as, or (in the case of a sub-fund) of the sub-fund as if it were, an unregistered ICVC under Part V of the Insolvency Act 1986.
- (2) If, after the commencement of a winding up or termination under this chapter and before notice of completion of the winding up or termination has been sent to the FSA, there is a vacancy in the position of ACD, the directors of the ICVC must immediately present or cause the ICVC or sub-fund to present or, if there are no directors, the depositary must immediately present, a petition for the winding up of the ICVC as, or (in the case of a sub-fund) of the sub-fund as if it were, an unregistered ICVC under Part V of the Insolvency Act 1986.

...

Table: contents of the instrument constituting the scheme

8.2.6 R ...

1	Description of the authorised fund	
	Information detailing:	
	...	
	(3)	in the case of an <i>ICVC</i> , whether the head office of the <i>company</i> is situated in England and Wales or Wales or Scotland or Northern Ireland .
	...	
2	Constitution	
	...	
	(4)	...
	(4A)	<u>For an <i>ICVC</i> which is an <i>umbrella</i>, a statement that the assets of a <i>sub-fund</i> belong exclusively to that <i>sub-fund</i> and shall not be used to discharge directly or indirectly the liabilities of or claims against any other <i>person</i> or <i>body</i>, including the <i>umbrella</i> and any other <i>sub-fund</i> and shall not be available for any such purpose;</u>
	...	

...

Table: contents of qualified investor scheme prospectus

8.3.4 R ...

...		
17	Information on the umbrella	
	
	(5)	for an <i>ICVC</i> , that:
	(a)	the <i>sub-funds</i> are not “ring fenced” and in the event of an <i>umbrella</i> being unable to meet liabilities attributable to any particular <i>sub-fund</i> out of the assets attributable to that <i>sub-fund</i>, the remaining liabilities may have to be met out of the assets attributable to other <i>sub-funds</i>; <u>segregated portfolios of assets and, accordingly, the assets of a <i>sub-fund</i> belong exclusively to that <i>sub-fund</i> and shall not be used to discharge directly or indirectly the liabilities of or claims against any other <i>person</i> or <i>body</i>, including the <i>umbrella</i> and any other <i>sub-fund</i> and shall not be available for any such purpose; and</u>
	(b)	<u>whilst the provisions of the <i>OEIC Regulations</i> provide for segregated liability between <i>sub-funds</i>, these provisions are subject to the scrutiny of the courts and it is not free from doubt, in the context of claims brought by local creditors in or under <i>foreign law contracts</i>, that the</u>

			<u>assets of a <i>sub-fund</i> will always be 'ring fenced' from the liabilities of other <i>sub-funds</i> of the <i>ICVC</i>.</u>
...			

...

8.5.3 R ...

Duties of the ACD: umbrella schemes

- 8.5.3A R (1) In the case of an *ICVC* which is an *umbrella*, the *ACD* must take reasonable care to ensure that, where the *ICVC* enters into a *foreign law contract* in relation to assets or liabilities of the *ICVC*, that *foreign law contract* is consistent with the principle of limited recourse in the *instrument of incorporation* of the *ICVC* and as provided for in Regulation 11A of the *OEIC Regulations*.
- (2) The *ACD* of an *ICVC* which is an *umbrella* must:
- (a) promptly upon becoming aware that a *foreign law contract* falling within (1) above is or has become inconsistent with the principle of limited recourse in the *ICVC's instrument of incorporation*, except where the inconsistency arises from a breach of (1) above, take reasonable steps to remedy that inconsistency;
- (b) promptly upon becoming aware of any breach of (1) above, take action, at its own expense, to rectify that breach, unless it is beyond the control of the *ACD* to do so.

...

COLL TP 1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
15	<u>COLL 3 to COLL 8</u>	R	(1) <u>This transitional provision applies to an <i>ICVC</i> which is an <i>umbrella</i> and in respect of whom an <i>authorisation order</i> was made before [date].</u> (2) <u>The following chapters and provisions of <i>COLL</i> shall apply as if the amendments made to those chapters and provisions by the <i>Collective Investment Schemes Sourcebook (ICVC Sub-funds and Other Amendments) Instrument 2009</i> had not been made in respect</u>	<u>From [date] indefinitely</u>	<u>[date]</u>

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
			<p>of an <i>ICVC</i> in the circumstances specified under <i>COLL TP 1.1(15)(3)</i> below:</p> <p>(a) <i>COLL 3</i>; (b) <i>COLL 4</i>; (c) <i>COLL 5</i>; (d) <i>COLL 6</i>; (e) <i>COLL 7</i> (except <i>COLL 7.3.3G</i> and <i>COLL 7.3.7R(9)</i>); and (f) <i>COLL 8</i>.</p> <p>(3) The chapters and provisions referred to in <i>COLL TP 1.1(15)(2)</i> above shall apply as described in respect of an <i>ICVC</i> until the date on which it becomes subject to Regulation 11A of the <i>OEIC Regulations</i> (and whether or not Regulation 11A(1) to (3) of the <i>OEIC Regulations</i> applies to any of its agreements entered into after [date]).</p> <p>(4) The <i>ACD</i> of an <i>ICVC</i> to which this transitional provision applies must ensure that the <i>ICVC</i> complies with paragraphs (3) and (insofar as it relates to paragraph (3)) (6) of Regulation 4 of the <i>Open-Ended Investment Companies (Amendment) (No. 2) Regulations 2009</i>.</p>		
...					

COLL Sch 2 Notification requirements

COLL Sch 2.2 G 1 Notification requirements

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...				
<u>COLL TP 1.1 15(5)</u>	<u>Agreements consistent with principle of limited recourse.</u>	<u>Prescribed notification</u>	<u>Notification of intention to amend instrument of incorporation under Regulation 21 of the OEIC Regulations</u>	<u>At same time as notification under Regulation 21.</u>
...				



Responses to better regulation consultation

In May 2007 HM Treasury published a Consultation on Better Regulation Measures for the Asset Management Sector¹, in line with its better regulation agenda. The consultation sought views on proposals to reform aspects of the legislation with the aim of reducing regulatory costs for UK asset managers and promoting international competitiveness.

Respondents

- Association of Private Client Investment Managers and Stockbrokers (APCIMS)
- Aviva
- Baillie Gifford
- Capita
- Depository and Trust Association (DATA)
- Dickinson Dees LLP
- Euroclear
- Eversheds
- Fidelity International
- Financial Services Consumer Panel (FSCP)
- Halifax
- HBOS
- Insolvency Service
- International Financial Data Services
- Investment Management Association (IMA)
- JP Morgan
- Legal & General
- M&G
- PFS Asset Management
- Schroders
- Scottish Widows
- The Law Society

¹ <http://www.hm-treasury.gov.uk>

Summary of responses

Paperless settlements

Question	Summary of response	Final provisions
Q2. Do you agree that the law should be changed to allow paperless settlement of trades in OEIC shares and AUT units	A large majority of respondents supported the proposal	Legislation permitting paperless settlements was passed in March 2009
Q3. If paperless settlement is to be allowed, what standards should be applied to ensure investor protection is maintained? Is the proposal to “take reasonable steps” appropriate and sufficient?	Majority thought it was sufficient, although there were some requests for guidance. One respondent pointed out that there were legal risks in allowing the legal effectiveness of transfer of title to depend on whether the manager had taken reasonable steps to verify the identity of the instructor. This was because such an approach would imply that a fraudulent transfer could still be effective in law, provided the manager had taken these reasonable steps and that a legitimate transfer could be void if the manager had not taken reasonable steps.	The FSA has approved guidance by the Investment Management Association setting detailed standards for reasonable steps. On the legal certainty point, the draft legislation was amended so that the legal effectiveness of the transfer turned only on the legitimacy of the instructions. We then imposed the reasonable steps requirement as a separate conduct of business obligation.
Q4. Would it be appropriate for provision to be made to allow electronic transfer of OEIC shares by a duly authorised agent, but to make no provision for paper transfer of OEIC shares by an agent?	The views varied, but many wanted consistency. Later discussions with stakeholders indicated that although consistency was desirable in principle, in practice a facility to act on paper instructions from an agent would be unlikely to be used widely in practice.	Only electronic transfer of OEIC shares by an agent was provided. Also providing for paper transfer by an agent would have required primary legislation
Q5. Do you think the draft statutory instruments provide adequately for the possibility in the context of an electronic communication of more than one person having the right to transfer the legal title to the AUT units or OEIC shares?	The majority said yes, although a few were unsure	Legislation taken forward
Q6. Do you agree that adequate provision for paperless transfer and settlement of OEIC shares and AUT units can be made without modification of the Stock Transfer Act 1963?	Almost all yes	No changes made to the 1963 Act

Question	Summary of response	Final provisions
Q7. Do you agree that a general provision for paperless settlement of transfers of OEIC shares and AUT units could be an effective complement to the more specific provisions for electronic transfer under the USRs?	Yes	Legislation taken forward
Q8. Are there legislative barriers to electronic transfer of OEIC shares and AUT units under the terms of the USRs? What action would be needed to remove them?	Mixed responses, some thought there could be issues: merits examination	The Government believes there is a good case for amending the USRs to allow AIF units and shares to be traded on recognised systems. We intend to develop proposals based on experience of the operation of these general provisions.
Q9. Would the potential for differential treatment of electronic settlement and transfers of AUT units and OEIC shares under these proposals and electronic transfers of equities and bonds under the USRs raise any concerns?	Almost all had no concern	Legislation taken forward
Q10. Do you have any other comments on the draft Statutory Instruments?	Request to treat OEICs like AUTs	OEICs and AUTs treated equally

Protected cell regime

Question	Summary of response	Draft provisions
Q11. Do you support the proposal to develop a protected cell regime for UK OEICs?	Yes	Draft SI developed
Q12. Should protected cell status be compulsory or voluntary for new OEICs? Should there be any differentiation in the rules between schemes aimed at the retail and wholesale markets?	Majority advocated compulsion with no difference between retail and wholesale, with one voluntary for all, and two voluntary for only wholesale	Compulsory for all
Q13. Do you agree that provision should be made to allow existing OEIC umbrellas to convert to protected cell status?	Three compulsion, while the rest advocated enabling conversion	For simplicity and effectiveness the draft makes it compulsory, but provides existing OEICs with a transitional period
Q14. Do you agree that unanimous creditor approval should be required for conversion to segregated liability?	Varied response, about equal yes/no	Not if agreements on segregated liability basis, otherwise, yes.
Q15. Do you agree that prior shareholder approval should not be required for conversion?	Only one advocated approval, the rest were all not required or only prior written notification	Prior approval not required

Question	Summary of response	Draft provisions
Q16. What impact would conversion to protected cell status have on creditors? Would creditors be likely to oppose conversion or demand compensation from OEIC borrowers in order to permit conversion to a protected cell?	Majority stated low impact, with one saying big creditors may be worse off	OEICs with all agreements on segregated liability basis can convert immediately. For those with other agreements the transitional period allows time for expiration or renegotiation.
Q17. Do you agree that assets in individual sub-funds should not be protected in the event that the umbrella becomes insolvent?	Majority advocated protection of the sub-fund	Sub-fund protected
Q18. Do you agree that the assets of the umbrella should be protected where one or more sub-funds become insolvent?	All advocated protection of the umbrella	Umbrella protected
Q19. Do you agree that protection from cross-liability should not apply in cases of fraud?	All most all advocated no cross-liability	No cross-liability
Q20. Do you agree that the existing procedure for winding up OEICs could be applied to winding up individual OEIC sub-funds? What modifications might be needed?	Majority advocated applying existing procedures	Existing procedures for unregistered companies modified and applied
Q21. Do you agree that if a protected cell regime is introduced, OEIC umbrellas should be required to disclose their status clearly to actual and potential investors and creditors? How should such a requirement be specified and enforced?	All advocated for disclosure requirements, with variations of how and where	Disclosure in instrument of incorporation and prospectus, and requirements in the draft SI and FSA rules
Q22. Are there other measures that could be pursued to address issues around this transition period?	No	Draft provides with a transitional period
Q23. Is there a significant risk that segregated liability might not be enforceable in the event of a sub-fund insolvency where the umbrella continued to operate? How could that risk be minimised?	Not many answers or clear indication	SI drafted
Q24. Do you believe that any further legislation would be needed to ensure effective segregation of liability between sub-funds in AUT umbrella arrangements?	Majority answered no	Nothing at this time, although we will continue to examine

Question	Summary of response	Draft provisions
Q25. Do you have any further comments on the most desirable approach to developing a protected cell regime?	Comments: Need to inform and educate investors; clarify tax points, also deduction of conversion costs; minimise regulatory impact through light touch requirements, e.g. for disclosure; allow time to convert existing OEICs.	Disclosures requirements in SI and FSA Rules; Regulation 11A allows for distribution of umbrella's liabilities/assets across sub-funds (where appropriate); transitional period provided.

Reforming notification rules for non-UK UCITS

Question	Summary of response
Q26. Do you agree that FSMA should be amended to allow incoming UCITS to begin marketing as soon as they have received approval from the FSA?	Yes
Q27. Do you have any comments on the draft Statutory Instrument?	One comment: would written notice include electronic forms of Communication?

D

FSA compatibility statement

Introduction

This annex explains the reasons why we (FSA) believe that our proposed rule changes in this CP arising from the changes to the OEIC regulations and introduction of a protected cell regime for OEIC umbrella funds are compatible with our general duties under section 2 of FSMA and with the regulatory objectives set out in sections 3 to 6. We are required, as outlined in sections 155 and 157 of FSMA, to make this statement.

Compatibility with our statutory objectives

Our duty is, as far as is reasonably possible, to act in a way that is compatible with our regulatory objectives and that we consider most appropriate for the purpose of meeting those objectives. The proposals in this CP are consistent with our statutory objectives of securing the appropriate degree of consumer protection, market confidence, public awareness and reducing financial crime.

Consumer protection

Our proposals are designed to provide appropriate protection for consumers in the event of the default of a sub-fund in which they are not explicitly invested. The Treasury legislation is designed to provide for the segregated liability of sub-funds under a single umbrella and the FSA rules envisage that there is appropriate disclosure to unit-holders (both current and prospective).

Market confidence

We suspect that many consumers are not aware of the cross contagion risk endemic in some funds as there has not yet been a sub-fund default. However, were a problem to arise the lack of understating would likely damage consumer confidence in the collective investment scheme market. This initiative will also help the competitiveness of the UK as other EU jurisdictions have already introduced a similar regime and some managers have found the lack of segregation to be a barrier to sales in Europe.

Public awareness

In this instance we have determined that although consumers may not appreciate the liability to which they are exposed that simplifying the system (from the customer perspective) is the best way to improve understanding. We are also proposing compulsory adoption so that there is single system in existence in the UK.

Financial crime

Following the introduction of a protected cell regime for OEIC umbrella sub-funds the segregated nature of the assets should reduce the risk of fraud relating to one sub-fund contaminating a different sub-fund.

Compatibility with the Principles of Good Regulation

Section 2(3) of FSMA requires that, in carrying out our general functions, we must have regard to a number of specific matters.

Efficiency and Economy

As there is no expected ongoing cost to FSA of this proposal, and we are proposing a transitional period to stagger applications and thus cost we are using resources in a economic and efficient way.

Role of management

There is no expected change to our reliance on senior management arising from these proposals.

Proportionality

The cost benefit analysis set out in Chapter 4 describes the relative economic costs and benefits of our proposals. It is our view that the proposals will create benefits that are greater than the costs.

Innovation

Our proposals should increase product innovation as we propose to allow cross sub-fund investment within a single umbrella.

International character of financial services and markets and the desirability of maintaining the competitive position of the UK

Our discussions with industry indicate that they welcome the idea of a protected cell regime on the basis that this should aid the competitive position of the UK.

The desirability of facilitating competition

The introduction of a Protected cell regime for Umbrella ICVCs will bring these closer to their AUT alternates.

E

Impact Assessment

Impact Assessment follows overleaf.

Summary: Intervention & Options

Department /Agency:
HM Treasury

Title:
Impact Assessment of HM Treasury and FSA proposals
for a Protected Cell Regime

Stage: Consultation

Version: 1

Date: 16 July 2009

Related Publications: Joint FSA and HM Treasury consultation on introducing a protected cell regime for OEICs, July 2009

Available to view or download at:

http://www.hm-treasury.gov.uk/consult_index.htm

Contact for enquiries: Matthew Cowie

Telephone: 020 7270 5890

What is the problem under consideration? Why is government intervention necessary?

OEICs are investment funds structures as bodies corporate. Large fund managers generally operate a small number OEIC umbrella companies with a large number of sub-funds within each umbrella. This helps them to operate a large range of funds more efficiently. Under current law, there is no segregation of liabilities between different sub-funds. Many investors may be unaware of this contagion risk. There is also evidence that the unsegregated nature of liabilities within OEIC umbrellas may reduce the attractiveness of investing in UK OEICs for overseas investors.

What are the policy objectives and the intended effects?

The policy objective is to protect investors from the risk of contagion within OEIC umbrellas and to increase the attractiveness of the OEIC as an investment vehicle to overseas investors.

What policy options have been considered? Please justify any preferred option.

The Government could: (a) do nothing; (b) introduce a compulsory protected cell regime for both new and existing OEICs.

The Government's preferred option is the introduction of the regime as this increases investor protection and UK competitiveness. The Government prefers compulsion for all OEICs, as this is the simplest option and avoids investor confusion.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? July 2012

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

Financial Services Secretary to the Treasury

Date: 21.7.9

Summary: Analysis & Evidence

Policy Option: (a)	Description: Introduce a compulsory protected cell regime for new and existing OEICs
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' One-off legal fees for firms with existing OEICs (up to £1.81m); one-off renegotiation of agreements not on segregated liability (not expiring in transition) (£2.73m to £4.10m); and FSA authorisation costs (£31675 to £54300).
	One-off (Transition)	Yrs	
	£ 4.57m - 5.96m	1	
	Average Annual Cost (excluding one-off)		
	£ 0	Total Cost (PV)	£ 4.57m - 5.96m
Other key non-monetised costs by 'main affected groups' N/A			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' N/A
	One-off	Yrs	
	£ N/A		
	Average Annual Benefit (excluding one-off)		
	£ not quantifiable	Total Benefit (PV)	£ Not quantifiable
Other key non-monetised benefits by 'main affected groups' Increased competitiveness of UK funds, due to increased attractiveness of UK OEIC investments. Removal of contagion risk and therefore protecting OEIC investors from having to meet the liabilities of another sub-fund in the event of insolvency.			

Key Assumptions/Sensitivities/Risks

No on-going costs; legal costs per OEIC of up to £5,000; 25 per cent of existing OEICs having to renegotiate credit agreements; cost of renegotiation of between £30,000 and £45,000 per OEIC

Price Base Year 2009	Time Period Years	Net Benefit Range (NPV) £ Not quantifiable	NET BENEFIT (NPV Best estimate) £ Not quantifiable
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What is the geographic coverage of the policy/option?	United Kingdom			
On what date will the policy be implemented?	TBC			
Which organisation(s) will enforce the policy?	FSA			
What is the total annual cost of enforcement for these organisations?	£ 31675 - 54300			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	N/A			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ 0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of	£ 0	Decrease of	£ 0
		Net Impact	£ 0

Key: Annual costs and benefits: Constant Prices

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

What is the problem under consideration?

OEICs are investment funds structured as bodies corporate. Large fund managers generally operate a small number of OEIC umbrella companies with a large number of sub-funds within each umbrella, allowing them to operate a large range of funds more efficiently. The sub-funds do not have a separate legal personality, but are separately managed, charged, accounted for and assessed for tax. Under current law there is no segregation of liabilities between different sub-funds. For example, if an umbrella fund contained one cautious UK bond fund and one high-risk Far-east equity fund and the Far-East equity fund collapsed with liabilities exceeding its assets, creditors could have a claim on the assets of the UK bond fund. Investors in the cautious fund therefore bear some of the risk of the riskier fund.

In practice the probability of an OEIC collapse is small, as OEICs must comply with borrowing limits imposed by the FSA, but not zero. Current FSA rules require disclosure of the contagion risk in the fund prospectus and periodic reports, although there is a danger that some OEIC investors do not fully understand it.

Recent events highlight the importance of investors understanding the risks they are subject to. Investors into a very low-risk fund should not be subject to the risks in a separate sub-fund holding riskier assets. Furthermore, many investors have become risk-averse and see any possible risk of contagion as a reason not to invest, or at least to invest elsewhere. Feedback from stakeholders indicates this has become a contributing factor to investors' decisions not to invest in UK funds, instead favouring investment in funds in jurisdictions such as Jersey, Ireland or Luxembourg, which operate protected cell regimes.

Policy option objective

The policy objective is to protect investors from the risk of contagion within OEIC umbrellas and to increase the attractiveness of the OEIC as an investment vehicle to overseas investors. A viable protected cell regime would remove the contagion risk and bring the UK in line with other jurisdictions, improving the UK's ability to compete with those jurisdictions.

Feedback and stakeholder input

In May 2007 HM Treasury published a Consultation on Better Regulation Measures for the Asset Management Sector, in line with its better regulation agenda. The consultation sought views on three proposals to reform aspects of the legislation with the aim of reducing regulatory costs for UK asset managers and promoting international competitiveness. One of those proposals was the introduction of a protected cell regime for OEICs. The overall response to the proposals was good, with responses from 22 stakeholders (firms, government and trade bodies).

The responses to the consultation were unanimously in favour of developing a protected cell regime. On some of the details, however, the opinions of stakeholders differed. The Government set up an expert group with membership¹ consisting of fund managers, fund lawyers, insolvency lawyers and a depositary, making it possible to utilise the expertise and experience of the industry and gain direct stakeholder input. As Treasury legislation on this matter requires the FSA to amend its rules and to ensure smooth implementation, the Government and FSA have collaborated to develop the protected cell regime.

¹ Firms/organisations that provided assistance and expertise: Investment Management Association, The Insolvency Service, M&G, Insight, Schroders, State Street Trustees, Norton Rose, Herbert Smith, Macfarlanes, Linklaters, KPMG

Estimated industry benefits

The industry is supportive of this regime, as it will improve the competitiveness of UK funds, by increasing the attractiveness of UK OEIC investments. It is hard to quantify these benefits, although as explained above feedback from stakeholders suggests that as investors have become more risk averse following the global downturn, the potential of this benefit has increased. Although it is relatively unlikely that a protected cell regime could be sufficient to sway a decision on fund domicile on its own, it could materialise through increased sales of existing funds, and through cost savings if UK fund managers chose to maintain a consolidated UK fund range rather than adding a Luxembourg or Dublin range.

Estimated industry costs

It is unlikely that there would be any ongoing administrative costs from the proposal. The previous consultation estimated that there could be additional costs in terms of higher borrowing costs, as creditors may demand higher risk premia given the lack of access to assets of other sub-funds. However, the industry indications that umbrellas already contract with creditors on a segregated liability basis would mean that these costs are not likely to crystallise.

The main costs of the proposal will be the conversion costs for existing OEICs. There are two broad scenarios:

1. OEICs can have no agreements or only agreements that are on a segregated liability basis; or
2. OEICs can have at least one agreement that specifies cross-liability or at least one agreement that does not specify either way.

Although feedback suggests that most OEIC umbrellas meet Scenario 1, it is reasonable to estimate that 25 per cent fall under Scenario 2, and will need to let expire or renegotiate at least one agreement during the transitional period.

There are also two types of one-off costs per OEIC:

A) legal advice and cost of notifying the FSA of conversion and amending the instrument of incorporation and prospectus; and

B) ongoing legal counsel and internal costs depending on negotiation and complexity of agreements.

Industry feedback indicates that Cost A is up to £5,000 per OEIC. For OEICs registered in other EU countries, there could be another £10,000 per OEIC to file revised fund documentation with EU regulators, although not many firms currently passport UK funds to the EU. The estimates for Cost B look at industry indications and at what the costs of one of the more complicated and lengthy credit agreement (ISDA Master Agreement) negotiations might be, to establish an upper range. According to the latest ISDA survey (2006), negotiations of ISDA Master Agreements are likely to take 30-90 days. Feedback from stakeholders indicates that the global downturn has made negotiation of terms more involved, and will therefore take longer. This is difficult to quantify, but a reasonable estimate is 50 per cent more time or 45-135 days. If we then assume that on average it will take 90 days at an estimated cost of £500 per day, negotiations will, on average, cost £45,000. Compare this with an industry-estimated cost of £10,000 per agreement, and that to satisfy regulations on risk diversifications it is likely firms will operate with a minimum of three agreements per OEIC. These estimates can be used as a range for Cost B of between £30,000 and £45,000.

There are 362 authorised umbrella OEICs (as of 4 June 2009) and their minimum conversion costs are Cost A, and therefore, assuming a cost of £5,000 per OEIC, would be up to £1.81m. Assuming 25 per cent, or 91 OEICs, will need to negotiate an agreement at Cost B of £30,000-£45,000 per OEIC, this adds costs of between £2.73m and £4.10m. This amounts to between £4.54m and £5.91m in one-off costs spread over the transitional period.

Further one-off costs arise for FSA approval of conversion. At 3.5-6 hours per approval of revised documentation per umbrella at a cost of £25 per hour and with 362 OEIC umbrellas, this is between £31,675 and £54,300 over the transitional period

Estimated consumer benefits

The other key benefit would be protecting OEIC investors from having to meet the liabilities of another sub-fund in the event of insolvency. New consumers will be made aware of the status of their investments by the prospectus disclosure and existing customers will be notified in accordance with the requirements in COLL 4.3.

There is reason to believe that in aggregate risks could be borne more cheaply under a protected cell regime than with unsegregated liability. Under the current rules, assessing the creditworthiness of an OEIC sub-fund requires an assessment of the solvency of the umbrella as a whole. Potential investors would also have to assess the creditworthiness of other sub-funds in an umbrella to gain a complete picture of the risks of a possible investment. With segregated liability, both parties would only require information on the sub-fund and the umbrella (not including other sub-funds) in order to make a complete assessment of risk. Thus it is likely that the net benefit in terms of distribution of risk and payment of risk premia would be positive.

Estimated consumer costs

There is no material detriment to consumers of this new regime as it improves consumer protection by removing a potential risk to investors in sub-funds of UK OEICs. However as explained above there is the possibility of creditors charging more under the new regime, although assuming OEIC investors have the same risk preferences as creditors, the benefit to investors would be equal to the additional amount creditors charge for bearing the extra risk and those costs and benefits would cancel each other out.

Finally, although a two-tier system will exist over the transitional period whereby there will be both protected cells companies and non-protected cell companies, investor confusion is mitigated by the disclosure requirements proposed by the FSA and by the intention that, in the interest of simplicity for consumers, all OEIC umbrellas will convert by the end of the transitional period.

Summary

The aim of the policy option is to remove investor confusion and contagion risk, and to provide UK OEICs with a competitive legislative landscape. The two key benefits are removing the contagion risk to OEIC investors and improving the international attractiveness of the UK OEIC vehicle. It is unlikely there are any ongoing net costs. The estimated one-off costs to industry are between £4.54m and £5.91m. One-off costs to the FSA are estimated at between £31,675 and £54,300. These costs can be put into context with estimated revenue for the sector of £1.13bn (using figures from the Investment Management Association's Annual Survey 2008 and assuming a similar ratio of revenue to assets under management.)

Specific impact tests

Competition Assessment

The competition assessment impact from this policy option is positive, as it will increase the ability for UK firms to compete with firms in other jurisdiction which also operate protected cell regimes.

Small Firms Impact Test

This policy option does not impact on small firms.

Legal Aid

There is no impact on legal aid from this policy option.

Sustainable Development

There is no impact on sustainable development from this policy option.

Carbon Assessment

The carbon impact from this policy option is neutral

Other environment

The other environment impact from this policy option is neutral.

Health Impact Assessment

The health impact assessment from this policy is neutral.

Race Equality

The race equality impact from this policy option is neutral.

Disability Equality

The disability equality impact from this policy option is neutral.

Gender Equality

The gender equality impact from this policy option is neutral.

Human Rights

Many creditors of sub-funds already operate under contracts that limit their claims upon other sub-funds of the same umbrella. However, this policy option would enshrine this in legislation. To mitigate the possibility of interfering with previous contractual rights the policy option does not take away those rights, but includes a transition period of 1 year, during which agreements not made on a segregated liability basis should be renegotiated.

Rural Proofing

The rural proofing impact from this policy option is neutral.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

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HM Treasury contacts

This document can be found in full on our website at:
hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London

SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk

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