

26 May 2004

Mr Hideki Takada
Financial Stability and Markets Team
HM Treasury
1 Horseguards Road
London SW1A 2HQ

Dear Mr Takada

FINANCIAL SERVICES AND MARKETS ACT 2000 (FSMA): Two year review

I refer to the recent 'Two Year Review' Consultation Paper (CP) issued by HMT and to our previous meetings and correspondence with Mr Justin Wray relating to the review of FSMA. We have now reviewed the changes to secondary legislation proposed in the CP and we are writing to give our feedback. As you will appreciate we have not commented on areas that have no or little relevance to investment management.

Please see the attached outlining our replies to the questions raised in the CP. We are grateful for the inclusion in the CP, following our request of a proposal to give OEICs the ability to elect to dispense with AGMs. We are, however, very concerned that as drafted the provisions are excessively onerous and, therefore, in practice will not result in any change. The attached provides more detail.

In addition, as you know from our previous correspondence, we strongly support any further consideration of the provisions on 'Controllers of Authorised Persons' and we are pleased this is on your list of things to consider in due course.

We are, though, disappointed that a number of items on our original submission (copy attached) have not been mentioned. We would stress that the outstanding issues raised in our list remain of material interest and concern. We have set these out again in our response to Chapter 11 and we would hope that HMT consider these issues as a matter of priority.

We are happy to discuss with you any of the matters raised. Please do not hesitate to contact me (on 020 7831 0898) if you have any questions.

Yours sincerely

Tom Rice
Senior Legal Adviser

HMT FSMA: Two year review Changes to Secondary Legislation

Chapter 3: The Impact of FSMA on Advice Centres

Questions 1 to 9

These questions are not within IMA's remit

Chapter 4: The Impact of FSMA on Employers Offering Pension Products

Q10: Do you agree that there should be an exemption for both real time and non-real time promotions made by employers (option 1(c))? If not, which of options 1(a) and (b) do you prefer?

The proposal to provide an exemption to cover both real time and non-real time promotions made by employers appears sensible.

Q11: Do you agree that any exemption should be subject to conditions and not be unrestricted?

Q12: Do you agree with the conditions outlined in paragraph 4.31?

Yes. In general we agree with the proposed conditions. However, we note that the CP's proposals relate only to FSMA regulation in relation to group personal pensions and stakeholder pension schemes. We believe this is somewhat restrictive and that there may be other circumstances where currently FSMA applies and where it would help to provide an exemption to employers. We suggest that the conditions should not only allow promotion of schemes but also allow the promotion of the underlying investments that relate to such schemes i.e. the individual funds on offer under the pensions scheme. We believe that, for all types of pension scheme, any promotion to or information provided to employees by employers for the purposes of the employee making an investment decision relating to the employee's investment in or contribution to the scheme (e.g. contributions to a DC scheme, AVCs etc) should be covered by an exemption.

We are also aware that there has been reticence in the past both from employers, trustees and their advisers to using certain specialised pension products, such as pension fund pooling vehicles, specifically because of the unregulated nature of these vehicles and the dangers of contravening the financial promotion regime at staff presentations and the like. This risk has been an unnecessary obstacle to these kinds of vehicle being utilised and an appropriate exemption may promote their use.

Q13: Do you think that there should be other conditions?

We do not believe any other conditions are necessary or appropriate.

Q14: Do you think that the exemption should contain an additional condition

restricting the ability of employers to provide individual advice to employees?

Yes. We believe that the majority of employers will not be qualified to provide appropriate individual advice to employees, and any provision of individual financial advice rightly falls with FSA's regulatory ambit.

Q15: If so do you think that limiting the ability of employers to make promotions by a requirement that they do not provide pensions advice in relation to an employee's individual circumstances is an appropriate condition?

Q16: Do you think that limiting the ability of employers to make promotions by reference to the definition of the activity of advising in article 53 RAO is an appropriate condition above?

Q17: Do you think that limiting the ability of employers to make promotions by prohibiting reference to unfavourable comparisons with other pensions is a viable alternative condition above?

These proposals seem sensible.

Q18: Do you agree that there should be no restriction on which employer's representatives can promote the employer's pension schemes?

We believe that, whilst employer's representatives need not be limited by, say, function or seniority, the chosen individuals should be required to have an appropriate level of competence including being fully cognizant with all the facts and fully aware of the boundary regarding the provision of personal advice.

Chapter 5: The Financial Promotion Order

Questions 19 to 23

We have no specific comments on the questions arising from Chapter 5 and we support the proposed changes to the FPO to the extent that these relate to investment management.

Chapter 6: Sale of a Body Corporate

Questions 24 to 31

These questions are not within IMA's remit.

Chapter 7: Investment By Occupational Pension Scheme Trustees

Q32: Do you agree that the expression "routine or day to day decisions" should be replaced with "day to day decisions" so as to increase the scope of decisions which unauthorised trustees are permitted to take?

Yes, we agree with the proposal to replace the expression "routine or day to day

decisions" with "day to day decisions".

Q33: Do you agree that the scope of products in which unauthorised trustees are permitted to invest should include pooled investment vehicles and contracts of insurance?

Yes, we support the proposal that the scope of products in which unauthorised trustees are permitted to invest should include pooled investment vehicles (whether or not regulated).

Q34: Do you agree that the condition under which unauthorised trustees can invest in certain products should be relaxed so that they only have to obtain and consider independent advice rather than act in accordance with it?

Yes, we support the proposal.

Q35: Do you agree that the condition under which unauthorised trustees can invest in certain products should be relaxed so that advice can also be given by professional firms operating under Part XX of FSMA?

This proposal appears sensible.

Q36: Do you agree with the rationale for our proposals for deregulating trustees' investment activities?

Yes, we agree with the rationale. For the reasons given, it is an anomaly that private equity should be allowed and pooled investment vehicles (that, as mentioned, are generally a lower risk investment) should not be permitted. We agree this anomaly discriminates against pooled investment vehicles and we support the proposals.

Q37: Do you agree that the scope of exempt products should be limited to pooled investment vehicles or contracts of insurance and not include individual quoted securities or derivatives?

Yes, we agree that limiting the scope of exempt products to pooled investment vehicles (and/or contracts of insurance), and not extending the exemption to include individual quoted securities or derivatives, achieves a reasonable balance between investment freedom and potential risk.

Chapter 8: Changes to the Regulated Activities Order

Q38: What are your views on the three changes proposed to the Regulated Activities Order in chapter 8? We seek, in particular, views on the question of theatrical debentures.

The changes relating to Article 15(2)(e) (absence of holding out) and the proposed amendment to Article 77 relating to Theatrical Debentures are not within IMA's remit.

In relation to the proposed new exclusion covering Trustees arranging for qualifying custodians to safeguard and administer trust assets, it should be made clear that this

includes Trustees agreeing to their custodian's arrangements for overseas assets to be held by its sub-custodian network. If not, Trustees and their advisers will be concerned about whether or not they are carrying on the Article 40 regulated activity. You may wish to widen slightly the suggested exclusion to 'arranging for a relevant person to safeguard and administer, or arrange for the safeguarding and administering, of assets of the trust'.

Chapter 9: Other Secondary Legislation

Questions 39 to 49

These questions are not within IMA's remit.

Chapter 10: Open-Ended Investment Companies

Procedure for approving proposed changes

Q50: Do you agree that such a change to Regulations 22(5) should be made?

IMA welcomes this change and considers that the procedures for approving proposed changes for OEICs should be aligned to the requirements in Section 252(4) of Financial Services and Markets Act for authorised unit trusts (AUTs). This will further align the regulatory requirements of these two products in accordance with Governance Policy and as initiated by FSA in their CIS Review and the implementation of the COLL Sourcebook.

Requirement for an Annual General Meeting

Q51: Do you agree that the costs of requiring OEICs to have an AGM outweigh the benefits?

As noted in our letter of 15 July 2003, we consider that the costs of requiring OEICs to hold AGMs outweighs any benefits or protections AGMs are believed to provide shareholders. The business transacted at a company's (excluding OEICs) AGM typically includes the following:

- the company's accounts and the reports of the directors and the auditors on the accounts;
- appointment or re-appointment of the company's auditors; and
- election or re-election of directors.

However, this does not necessarily apply to AGMs of OEICs.

OEICs have the ability to have more than one director. However, in practice, the only director is the ACD (authorised corporate director). There are therefore no provisions in the OEIC regulations for the rotation of directors. Where there is a subsequent appointment of a director, this must be made by the company at the AGM (section 34 (2)), which is an infrequent event.

Generally the actual business transacted at an OEIC's AGM is:

- the laying of the report and accounts (Regulation 66 (3));
- the election or re-election of the auditors (Schedule 5 paragraph 4 (2));
- the power for the directors to fix the auditors' remuneration (Schedule 5 paragraph 10(1)).

The business transacted at an OEIC's AGM could not be considered to be fundamental to the operation of the OEIC and therefore the removal of such a requirement does not lessen the shareholders' participation or rights in the scheme. The removal of this requirement will in fact align the requirements for OEICs with those for AUTs, where there is no requirement to hold AGMs.

Anecdotal evidence from IMA members identifies that AGMs are very poorly attended by shareholders, with many managers noting that no shareholders have attended the meeting. IMA considers that the main reason for this lack of attendance is that the business transacted at an OEIC's AGM is of minimal significance.

Q52: Do you agree that OEICs should be able to elect to dispense with the holding of AGMs?

Q53: Do you agree that there will be adequate safeguards to protect shareholders if the requirement for OEICs to have an AGM is changed to an elective requirement?

IMA agrees that election to dispense with the holding of AGMs is appropriate but considers the requirement for an elective resolution to be too prescriptive and unworkable. If one considers that there are, on average, approximately 10,000 accounts per sub-fund, and around 10 sub-funds per umbrella OEIC, a manager would need approximately 100,000 shareholders per OEIC not only to vote but vote in favour of dispensing with AGMs. In a similar vein, it is not unusual for a manager of an AUT to struggle to achieve a quorum (10% of unitholders) for an extraordinary meeting. Any requirement for an elective resolution will in effect mean that all OEICs will have to continue holding AGMs. This runs counter to long-standing Government Policy to align the regulatory position of AUTs and OEICs.

Q54: Is the requirement that all shareholders agree to an elective resolution too onerous a requirement for OEICs to meet? Should the threshold be lower e.g. 95 per cent of shareholders?

As part of its CIS Review, FSA consulted on shareholders' interaction with the fund, including what changes to the fund would require shareholder approval or pre or post-event notification. Changes were considered to be fundamental, significant or notifiable, with only fundamental changes requiring shareholder approval by way of an extraordinary resolution. Fundamental changes are defined (COLL 4.3.4R(2)) as those changes which:

- changes the purposes or nature of the scheme;
- may materially prejudice a shareholder;
- alters the risk profile of the scheme; or
- introduces any new type of payment out of the scheme property.

The examples provided as fundamental changes (COLL 4.3.5G(2)) include:

- schemes of arrangement;
- change of investment policy to achieve capital growth from investment in one country rather than another;
- change of investment objective or policy to achieve capital growth through investment in fixed interest rather than equity investments;
- change in the investment policy to allow investment in derivatives as an investment strategy which increases its volatility;
- change to the characteristics of a scheme to distribute income annually rather than monthly; and
- introduction of limited redemption arrangements.

The proposal to require an elective resolution is too onerous a requirement and is not in line with FSA's policy on changes to schemes. We would suggest that ACDs should be able to dispense with holding AGMs by giving prior notice (say, 60 days) to shareholders.

Where an OEIC is launched after the implementation of the proposal allowing OEICs to dispense with AGMs, the policy of the ACD to hold, or dispense with holding, AGMs should be contained in the OEIC's instrument of incorporation (reviewed by the FSA as part of the authorisations process). No further requirement is then necessary.

Q55: Should an ordinary resolution be sufficient to revoke the elective resolution?

Where the ACD has elected to dispense with the requirement to hold AGMs, an ordinary resolution should be sufficient to reinstate the holding of AGMs. The reference in paragraph 10.12, that any single shareholder would be able by notice to the company to require the holding of an AGM in any given year, is far too onerous and would in many cases make the elective regime unworkable. It would introduce disproportionate influence to any one shareholder and may as a result impose unnecessary costs to the fund and other investors. We would suggest that either an ordinary resolution should be required (in line with the above and the current position - CIS 11.2.1(3)) or the level of shareholding to require the holding of an AGM on notice in any given year should be of some materiality e.g. 10%.

Q56: Regarding the proposed amendments to regulation 34 outlined in paragraph 10.18, do you agree that appointments should not have effect for longer than twelve months starting on the date of the appointment?

Provided shareholders have been given 60 days prior notification of such a change, then in accordance with FSA policy (outlined above), the election should continue in perpetuity unless and until changed, at which point an ordinary resolution is sufficient.

Q57: Do you have any comments on our proposed amendment for regulation 36 outlined in paragraph 10.19?

The requirement to send copies of the directors' contracts where the ACD elects to dispense with AGMs is too prescriptive and quite unnecessary. As the majority, if not all OEICs, only have one director, the ACD, this will mean that a copy of the contract between the ACD and OEIC will be sent. This legal agreement will be of little or no interest to investors and is certainly not drafted with consumers in mind.

The ACD already offers at the point of sale, or provides on request, all product documentation and this will include the scheme prospectus which describes the operation of the fund and the ACD's terms of appointment. IMA can see no sense or benefit (but considerable cost) in any requirement to send the contractual documentation underlying the scheme to investors and would recommend that, as with the scheme prospectus, it should simply be made available on request.

Public notice by the FSA of receipt and issue of certain documents

Q58: If it is possible to do so, should any amendments be made to the requirement in regulation 78 regarding the information that is made public?

As shareholders will already have been notified of such changes or will have in fact have approved such changes there is no benefit in requiring this information to be made public. Therefore, we would support amendment of regulation 78.

Q59: If it is possible to do so, should any amendments be made to the requirement in regulation 78 regarding the manner in which information is made public? Is publication in the London or Edinburgh Gazettes appropriate or would publication elsewhere be more useful?

IMA does not consider that publication of such information will be useful, and in any event the choice of the London and Edinburgh Gazettes now looks decidedly dated, and is arguably anti-competitive.

Chapter 11: Future Work

What is your view of the issues which we might consider in due course? Are there any other issues?

We attach our original submission for the FSMA review.

We support the proposed review of the current requirements relating to "control" over other regulated entities. As we have previously outlined, these cause a variety of practical difficulties for both our members and the FSA.

The other issues raised in our original submission remain a priority and include:-

- Making any necessary amendments to the Law of Property Act 1925, Stock Transfer Act 1963 and OEIC Regulations to facilitate the transfer of title of units/shares in investment funds without the need for a written instrument (the requirement for which represents a real barrier to the industry making progress in the area of straight through processing and e-commerce and is thus a hurdle to more efficient settlement of fund units/shares);
- The provision of a protected cell regime for umbrella OEICs to remove the risk of contagion on the insolvency of a sub-fund, now wide-spread throughout the Continent and thereby putting the UK industry at a competitive disadvantage and leaving investors in OEICs less secure. This issue is particularly pertinent as the European Commission, via the UCITS Contact Committee, has produced an issue paper on UCITS umbrella funds.

This paper questions the acceptability of investors in a sub-fund being exposed to risks which are not directly related to their investment. The preliminary view of the Commission is that contagion across sub-funds should be avoided and individual national laws should clearly provide for safe legal structures (i.e. "protected cells"); and

- The relaxation of the requirement for individual sub-funds of an OEIC to have the same accounting reference date.
- The Application of RAO Article 51 to operators of CIS and the problems caused by the FSA 'unbundling' permissions, apparently as a consequence of the wording of the RAO;
- Section 148 – the inability of the FSA to exercise discretion to waive or modify the application of rules, particularly in relation to financial resources which form part of the "threshold conditions" (we have previously written with examples that have arisen in practice relating to large exposures and consolidated supervision);