

24 May 2004

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Ms E Engledow  
FSMA Secondary Legislation Consultation Responses  
Financial Stability & Regulatory Policy Team  
Room 4/23  
HM Treasury  
1 Horse Guards Road  
London SW1A 2HQ

Dear Ms Engledow

### **Treasury consultation on FSMA secondary legislation**

This response is submitted on behalf of the Institute of Chartered Accountants in England and Wales, The Institute of Chartered Accountants of Scotland and the Institute of Chartered Accountants in Ireland.

The Institutes welcome the Treasury review of the secondary FSMA legislation. The period since the inception of this legislation has highlighted some unintended consequences and it is appropriate to address these. The annex to this letter deals with the matters raised in the consultation that the Institutes wish to comment on.

The need for this consultation raises, in our view, a far larger issue. The FSMA has undoubtedly reduced the availability of the provision of advice. Small firms, and not just firms of chartered accountants, have concluded that the regulation surrounding financial services is too onerous. That reluctance to provide advice can only be to the detriment of the consumer. Chartered accountants come from a background that puts the needs of the client first but precludes undertaking work for which they are not competent. However, the type of advice that much of the consultation is about (advice centres etc) is well within the skill set of the 'ordinary' chartered accountant.

We note the comment in the consultation paper (in paragraph 3.11) that "some advice (even if slightly flawed) may be better than no advice at all". While we appreciate the sentiment behind the comment, we wonder if the FSA would accept this if offered as a defence by an authorised person. Again chartered accountants are required to deal only with work that they are competent to do and to recognise when this point is reached.

The consultation also indicates that the drafting of the Regulated Activities Order (RAO) and the Financial Promotion Order (FPO) is causing problems. Broadly speaking, the FPO is the RAO without the RAO's various exemptions. In our view this is a complication that is not warranted. The RAO is about regulated activities and regulated investments. The FPO repeats much of this when all it needs to deal with is the communications part (non-real time etc). In



our view, if an activity is not regulated due to an exemption in the RAO, then promotions about it should be similarly exempt from the prohibition on financial promotions.

The consultation further highlights differences in guidance from the FSA, caused by the different wording of the legislation. For financial promotion the guidance is about in the 'course of business,' for regulated activities it is about 'by way of business.' We would urge that all the legislation should use the narrower 'by way of business.' Then there could be one set of guidance (on by way of business) which applies to financial promotions and regulated activities. Such simplifications are needed to provide greater clarity and we believe that this would not undermine the overall objective of the legislation.

In our view the financial services legislation should be reviewed so as to remove the need for such extensive guidance. This is particularly so on matters concerning the perimeter of financial services and the need for authorisation. It is inappropriate that such issues cannot be determined from the legislation.

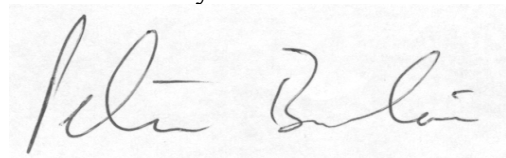
The consultation document (question 20) asks about other possible changes to the FPO and the section on future work suggests other ways of dealing with the financial promotions arrangements.

As we have already commented, the financial prohibition uses an 'in the course of business' test while the undertaking of regulated activities is subject to a 'by way of business' test. In our view the FPO is overly complex and probably poorly understood. It would benefit from a radical overhaul. Any future legislation would be based on the principle that promotions should be clear and not misleading, and that the receipt of detailed promotional material can only be at the specific request of the recipient. This would also make use of existing arrangements such as the advertising standards code and the data protection legislation. The key point is the one raised in the consultation paper that the communication should not be misleading.

We note that the outcome of the consultation would be a consolidated FPO. In our view there should also be a consolidated RAO and a consolidated Non-exempt Activities Order.

If you have any queries on the response please contact Peter Burton, Head of Regulatory Policy, on 01908 546273 or email, [Peter.Burton@icaew.co.uk](mailto:Peter.Burton@icaew.co.uk). We would also be happy to meet with you to discuss our response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter F Green', is written over a light grey rectangular background.

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Peter F Green  
Chairman  
Joint Investment Business Committee

**A. Impact of the FSMA on advice centres**

1. We agree that advice centres provide a useful function in society and this should not be unnecessarily impeded. Indeed, many chartered accountants freely provide their time to advice centres. That some advice centres are reluctant to provide advice is symptomatic of a larger issue, raised in our covering letter, that the FSMA has undoubtedly reduced the availability of the provision of advice.
2. However, we are concerned by the comment in the consultation paper (in paragraph 3.11) that “some advice (even if slightly flawed) may be better than no advice at all”. This suggests that advisers in advice centres may overstep the mark, so we would suggest that FSA organised training as a condition of giving financial advice in advice centres (unless an appropriate professional qualification is held) will help raise the standard of advice provided.

**B. Impact of the FSMA on employers offering pension products.**

3. We appreciate the problem that employers face when trying to present pension options to their employees. We also appreciate the Government’s desire to increase the awareness of pensions etc.
4. However the need for the proposals in the consultation paper indicates the inconsistencies which the FSMA and the FPO have brought about. The paper already notes that an ‘occupational’ pension scheme is not an investment, and so the provision of information and advice about such schemes is not regulated. In respect of a ‘defined contribution’ scheme there is no required contribution that an employer need make. Thus we do not see that restrictions should be placed on the promotion of group personal pension schemes and stakeholder pension schemes of the type envisaged in the proposed exemption. This only seems to disadvantage the employees.
5. In reality the employer will already have selected a particular pension option to offer its employees. The advice leading to that selection is not regulated as the employer is not the beneficiary of the scheme. Any written material will have been provided by an authorised person, and inevitably the authorised person will be assisting the employer in making any promotion to the employees.
6. In our view the exemption should be allowed, without any additional restrictions. If any additional restrictions are considered necessary then these should be limited to disclosures about:
  - any direct financial benefit that the employer receives as a result of promoting the particular scheme.
  - any contribution made by the employer, although this could be zero.
  - the employee’s right to seek independent financial advice.
7. We realise the need for the last point as a statement of fact. However, for the vast majority of employees this is not an option they can avail themselves of. We also have concerns about the variability of how employers will make promotions. Small to

medium enterprises may not have the expertise to answer questions appropriately and could stray into the provision of advice.

8. Thus in conjunction with the FSA employers pack, a similar pack should be developed for employees. (It is not clear if the employers' pack will include material for provision to employees.) This would set out the various options open to an employee, depending on what the employer is offering. This is a logical extension to the claim made in paragraph 4.5 of the consultation paper, that pensions information provided in the workplace is more likely to be acted upon than information received elsewhere.
9. The approach of the consultation paper seems to be that as the employer will not be providing advice by way of business, it will, because of the new FPO exemption, be able to provide advice on such matters as:
  - The particular fund within the pension scheme to invest in, or
  - Whether to transfer benefits under an old scheme into the new one.
10. The implicit conclusion in the consultation paper is that this is acceptable. While we do not think that it is appropriate for employers to give advice, we accept that the subsequent intervention of an authorised person, before a contract is concluded, will provide appropriate consumer protection.
11. Therefore, in our view, there is no need to provide an exclusion in the RAO.

## **C The Financial Promotion Order**

12. We agree with the proposals made in this part. In respect of the proposed changes to article 69, it should be made clear that this exemption is also available to someone making such a communication on behalf of the company.
13. We would also observe that the fifth bullet point of paragraph 5.16 illustrates the unnecessary complexity of this legislation. A distinction is made between a communication which is an invitation to engage in investment activity – ie it directly promotes an investment, and a communication which is an inducement - ie there is an element of design or intent to engage someone in investment activity. This is a subtle distinction.
14. We have already commented on the first Treasury consultation about the exemptions for high net worth individuals etc. We would simply repeat here that the whole area of promotions to high net worth individuals, groups of such individuals and high net worth companies should be re-thought and simplified.

## **D Sale of a body corporate**

15. Before N2 the Institutes did query the appropriateness of the drafting of article 70 of the RAO. Therefore we welcome that the exemption is to be narrowed as described in the consultation paper.
16. There are some aspects of the proposal that we wish to comment on.

17. We are of the view that the restriction of the 'day to day control' test to certain types of company is overly complicated and unnecessary. The consultation paper notes a lack of evidence of any consumer detriment. That the proposal will only allow 'authorised' advice to the minority parties is sufficient. There is no need to restrict the type of companies that it applies to.
18. In such situations, a DPB firm is likely to be better placed to advise than a 'traditional' FSA authorised advisor. Thus while we agree with the overall thrust of the change, we also believe that there is an opportunity to extend the range of provision of advice. Under the current arrangements, a DPB licensed firm cannot advise on the acquisition of a listed company share, but they can advise on the sale of any type of share. Frequently in take-over situations the consideration is shares in a listed company. Thus in such a situation a DPB firm could advise a client to sell shares in the 'target', but not advise on the acquisition of the listed company shares. In our view, where a transaction falls within article 70, then a DPB firm should be able to advise any party involved in the transaction. Firms licensed by the Institutes are included in a compensation scheme and thus there is no consumer detriment but there will be increased consumer choice.
19. We also have concerns about the corresponding changes to the FPO. This would exempt any communication to the main parties to the transaction, assuming these can be identified, but not communications to the other parties. This could lead to a situation where the unregulated transaction suddenly needs the input from an authorised person to approve some, but not all, of the communications relating to the transaction.
20. This could be a particular problem in the sale of a company where some employees may hold a few shares, perhaps from past share options.
21. We believe that the draft FPO article should be amended so that communications can be made to persons who are not 'S' or 'T', provided they are accompanied by a warning that advice should be sought from an authorised person or a DPB licensed firm.
22. In relation to the proposed deletion of articles 63 - 66 we have some comments. There are situations where a private company is in the hands of a number of different members and in such cases it is not possible to identify a controlling group of connected individuals. Articles 63 - 66 are helpful in these cases but as currently drafted these pose a number of conditions that limit the use of this exclusion, hence your comment in the consultation document that these exclusions are little used.
23. In our view these articles have two major drawbacks, the need for approval by all the directors of the proposed transaction and the extremely long list of information required by schedule 4 of the Financial Promotions Order. The agreement of all the directors may not be forthcoming or, for entirely practical reasons unconnected with the transaction, a decision by all the directors cannot be reached. This has the effect that either the offer is not made, or the transaction costs increase due to the involvement of an authorised person to approve the communication. There is also the considerable cost in bringing together all the documentation required by schedule 4.

24. The involvement of an authorised person is, from one perspective, merely to ensure that the communication is clear etc. In our view articles 63 - 66 could be simplified by;
- requiring the communication to say if the transaction was approved by all the directors;
  - including some information, but less than is required now (and we would be happy to assist in constructing a more suitable list); and
  - a warning that advice should be sought from an authorised person or a DPB licensed firm.
25. Again, as has been noted above for transactions that fall within the revised sale of body corporate exclusion, we are suggesting that communications are permitted to the 'non- controlling' shareholders in these circumstances, provided they are accompanied by a warning that advice should be sought from an authorised person or a DPB licensed firm.

## **E Changes to the Regulated Activities Order**

26. Our only comment is in relation to theatrical debentures. Clearly there has been innovation in funding theatrical productions in that a 'product' has developed that is not a regulated investment under the RAO.
27. Our view is that, although these may be a 'risky investment', there is no need for regulation. The 'investment' criteria are likely to relate to consideration of the past achievements (not a good guide to future performance?) of the playwright, director and cast, and the 'investor's' desire to be associated with the production. None of these are traditional investment issues so we would caution against making this type of financing a regulated investment.

## **F Other Secondary Legislation**

28. We only wish to comment on the proposal in respect of trustees in bankruptcy. Insolvency practitioners are already subject to legislation and we would be reluctant to see additional extensive legislation applying to their activities. Nor are we aware of the number of times that an insolvency practitioner has been appointed as trustee to an authorised person, nor the length of such appointments and this aspect is not dealt with in the regulatory impact assessment. It is therefore difficult to judge whether this is a solution in search of a problem.
29. Effectively the authorised person would still be carrying on the business, as the insolvency practitioner may have no specialist investment business knowledge. The insolvency practitioner would effectively be acting in one of the significant influence controlled functions. In our view the aim of any proposed legislation should be to continue to subject the business to the FSA's requirements, not the insolvency practitioner.

## **G Open-ended investment companies (OEICs)**

30. We agree that the AGM has little real benefit and tends to be a formality. However the proposal that where an OEIC elects not to hold an AGM it should send to shareholders the documents that would otherwise be required to be made available for

inspection at the AGM seems onerous and potentially costly. It would seem more appropriate to require shareholders to be provided with a short report and details of how to obtain the other documents, which would then be provided to shareholders who request them. Alternatively, these documents could be placed on a website and only sent to those who request them. Similar arrangements work well for public companies (section 251 of the Companies Act 1985).

31. The elective requirement for an AGM is sensible, but in our view to allow a single shareholder to require an AGM seems overly protective. It would seem more appropriate for the calling of an AGM in cases where there is an elective resolution in place to involve 5% (or other suitable percentage) of shareholders to request such a meeting.
32. As noted above, it seems impractical to require ALL shareholders to elect for this. This would enable one small shareholder to block the proposal. We note that, where a private company makes an election to dispense with AGMs, any member may, by notice no later than three months before the year-end, require the holding of an AGM. The fact that OEICs typically have a substantially larger number of shareholders than the majority of private companies justifies having a different threshold. Given our suggestion that a 5% holding can subsequently call for an AGM, our view is that a far lower percentage could be in place for the original elective resolution and a 75% threshold of votes cast may be more appropriate.
33. The proposals for the appointment of directors to fill vacancies when an OEIC has elected not to hold an AGM are unclear. It is proposed to limit any appointment to twelve months, but it is unclear as to what happens after this period has elapsed. The appointment of directors is normally ratified at the AGM. The proposals do not provide adequate information on the alternative mechanisms for the appointment of directors for periods of office of over twelve months. An AGM should not be required simply to ratify the appointment of directors, which could be approved by written resolution. Similar issues apply to the appointment of auditors, which must currently be ratified at an AGM and which also could be approved by written resolution.
34. In general terms, the proposals look more closely at the current retail OEICs. The FSA is in the process of introducing Qualified Investor Schemes (QISs), which are non-retail schemes with less investment restrictions. The AGM might take on a different role for these QISs to reflect their different nature and shareholder base. Institutional investors in QISs may find the AGM an opportune forum for raising the issues of large investors with the board and managers. By contrast, it is doubtful that the AGM adds any real benefit for retail schemes. The distinction between retail schemes and non-retail QISs might require separate consideration.