

**FINANCIAL SERVICES AND MARKETS ACT 2000**  
**TWO YEAR REVIEW - CHANGES TO SECONDARY LEGISLATION**

**A memorandum by the Law Society's Company Law Committee**

**1. INTRODUCTION**

1.1 This Memorandum contains the Committee's comments on the proposals set out in HM Treasury's consultation document on proposed changes to secondary legislation made under the Financial Services and Markets Act 2000 ("FSMA"). Our response is confined to those areas dealt with in the consultation paper that fall within our area of expertise as company lawyers, that is Sections 5, 6, 7, 8, 10 and 11.

1.2 Whilst we welcome the proposals to deal with a number of technical issues that have caused difficulty in practice, in general we are disappointed in the level of response to the many substantive points that have been made on issues which have caused difficulty in practice. In particular:

- (a) Inconsistencies between the approach to regulation of different sectors of the industry which arise purely out of the historic sectoral approach to regulation;
- (b) The breadth of the scope of the financial promotion regime which, unlike regulatory systems elsewhere in Europe, has a much wider focus than the regulation of communications which promote investment services;
- (c) The provisions in Part XII FSMA on controllers which can impose significant compliance cost burdens on both the unregulated and regulated community and which are super-equivalent to the European Directives on which they are based.

1.3 We note from Section 11 of the Consultation Document that HM Treasury recognises that reviewing some of these issues has "potential merit" but gives no indication as to when they might be considered. We see no reason why the issues should not be considered now, in the context of the two year review, particularly because they will continue to cause unnecessary expense for businesses if they are not addressed. We make further reference to these issues in Paragraph 7 of this Memorandum.

1.4 We now comment on the specific issues arising on those sections of the Consultation Paper on which we have comments.

**2. THE FINANCIAL PROMOTION ORDER**

We can respond to the questions raised in Section 5 of the Consultation Paper as follows:

**Q19 Do you agree with the proposed changes to the Financial Promotion Order?**

*"Issued by", "Made to" or "directed at" responses*

We welcome the proposals to make these responses more consistent across the Order, in line with our previous suggestions. In addition, the same changes should be made to articles 34, 41 and 42.

*Article 11 - Combination of different exemptions*

Whilst we welcome the relaxation which enables firms to advertise their range of services in a single communication, we still do not understand why the exemptions for the different types of activity are not modernised and harmonised into a single set of exemptions that apply to all activities. The current structure is a historic relic of the previously diverse regulatory regimes.

*Article 15 - Introductions*

We welcome the extension of the exception to cover both real time and non-real time communications as we have previously suggested.

*Article 18 - Mere Conduits*

We agree with the proposed amendment.

*Article 51 - Associations of high net worth or sophisticated investors*

We welcome the clarifications proposed to be made to this Article.

*Article 55A - Communications by members of Professions*

We welcome the proposed amendment.

**Q20 Are there any further changes to the Financial Promotion Order which you think should be considered?**

We made a number of other suggestions for amendment which have not been adopted and which we believe merit further consideration. For ease of reference these are repeated here:

**Additional exemption:** We think that regulation 8(1) of the Common Unsolicited Calls Regulation 1991 (calls between business partners and fellow directors) should be reinstated. As presently constructed, it would be necessary to find an exemption for unsolicited real time communications to cover communications between these people. Even in relation to solicited real time or non-real time communications you would have to be able to show that the communication was "one off" (which is quite difficult) or that another exemption applies (for example, article 52 creates the absurdity that you have to add legends to communications between this group).

**Article 2:** We think that a definition of "employee" should be included to cover those engaged under a contract for services as well as under a service contract because:

- (a) the promoter communicating with an organisation will not necessarily know the technical employment status of those representing the organisation; and

- (b) even when using an employee exemption there does not seem to be a policy reason to exclude consultants or secondees.

**Article 6:** Section 21 of the Financial Services and Markets Act 2000 provides that causing a communication to be made is a criminal offence unless the contents are approved for the purposes of section 21 by an authorised person. Article 6(d) confirms that "communicate" includes causing a communication to be made or directed. As worded, it appears that a criminal offence would be committed by an unauthorised person who caused a communication to be made even if it was an authorised person who actually issued the communication.

This is clearly unsatisfactory. FSA, we understand, had considered stating in their guidance that clearly this was not the intent of the legislation and it should be construed accordingly but did not feel able to do so. The problem can be solved by the authorised person stating that he both issues and approves the communication but this seems unnecessary and the current situation creates a trap for the unwary. Also in many cases the authorised person will not need formally to issue and approve the communication e.g. where it is making the communication in circumstances covered by an exemption. In addition, in practice it may be difficult to tell that someone is causing the communication to be made - how much causative effect does an impetus need to give? We therefore suggest that Article 6 be amended to provide that the causing to be made of a communication is exempt if the communication is made by an authorised person.

**Article 8(3)(b):** This article is overly expansive. It would appear to be the case that if the person communicated with asks a question about a controlled activity or investment not in contemplation when the communication was initiated or requested, the communication becomes an unsolicited one in so far as that question is answered. For example, a person who is meeting an IFA on pensions products might ask if they can recommend a fund manager or about investment in equities. Any answer to either of these questions would appear to be unsolicited.

**Article 12:**

- (i) Article 12(1)(b), (5) and (6) prevent the combination of the Article 12 exemption with other exemptions, except for the Article 19 and Article 49 exemptions, by excluding the possibility that the communication is directed at other persons to whom it may lawfully be communicated. This limitation would cause problems in cases such as the following:

*A company is listing securities on a foreign stock exchange, whose rules require the issuer to make available copies of the prospectus or listing particulars to the public in that country. The securities are to be sold in the UK by members of the underwriting syndicate, who include UK authorised persons. The underwriters market the securities to their customers who are not private customers under FSA's rules, relying on the exemptions from the POS Regulations 1995: because of the mismatch between FSA's definition and the Financial Promotion Order definition, these customers may include persons who are not "investment professionals" or "high net worth companies" within Article 12(5). The*

*distribution of the prospectus/listing particulars in the foreign country appears to be a communication of an invitation or inducement to engage in investment activity and, since the securities are to be sold in the UK, it appears that the communication may be regarded as "capable of having an effect in the UK". In addition the prospectus/listing particulars would appear to be a communication which is "addressed to persons generally" for the purposes of Article 6(c). It is therefore far from clear that the communication of the prospectus/listing particulars in the foreign country could be regarded as directed only at persons outside the UK and investment professionals and high net worth companies.*

- (ii) The reference at the end of article 12(4)(c) to "by or on behalf of the same person" is obscure. This should refer to the person directing the communication in line with article 12(4).
- (iii) We think that it should be made clear that article 12(4)(d) is not prejudiced by a communication relating to the same kind of investment activity lawfully made by another group company.
- (iv) Article 12(4)(e) should also include a case where the communication is contained in a document which is only distributed to persons who receive the document outside the UK. For example, prospectuses are often required to be made available for collection by the public in other countries.
- (v) Article 12(6) should be extended to modify article 12(4)(e) to include cases where the document is also distributed to persons in the UK who fall within article 12(5).
- (vi) In addition, article 12(6) should modify article 12(4)(c) to allow for cases where the other communications is made to a person or directed at a person in the UK falling within article 12(5).
- (vii) Article 12(5) should be modified to allow for communications falling within any of articles 30 to 33.
- (viii) We think that the drafting in article 12(6)(b) is wrong (it suggests that even non-professional overseas investors cannot act on the communication). The provision should, presumably, read something like "*...the communication must not be acted upon by persons in the UK except by persons who have professional experience in matters relating to investments or who are high net worth persons...*". Further the wording will need to be amended to reflect our suggestion in (vii) if it is accepted.

**Article 18:** We would recommend deleting the words "the principal purpose of which is" and replacing those words with the words "which involves". Many websites for commercial services include facilities which allow users to communicate with each other as a subsidiary part of the overall services. In addition, the FSA gave guidance to the effect that the previous position under the FS Act was that a mere conduit was not

regarded as "issuing" an investment advertisement regardless of the principal purpose of the conduit's business. The restrictions in section 21 should apply to the person who causes the mere conduit to make a communication not to the mere conduit itself.

**Article 19:** Article 19(4) does not (unlike article 49(4)) work in a satisfactory way where a communication is directed both at investment professionals and other lawful recipients. We would suggest the addition of appropriate wording in article 19(6) modifying article 19(4).

**Article 20:** Article 20(2)(c) discriminates against non-UK based EEA publications. We think that article 20(3)(b) should only apply where the journalist knows of the interest (for example, the journalist may unwittingly benefit because the investments are held by a unit trust he or she holds).

**Article 30:** The definition of "overseas communicator" is used elsewhere than just article 30 (e.g. articles 31 and 32) so should be made of more general application.

**Part V:** We cannot see why an unauthorised person cannot, without committing a criminal offence, make a communication relating to a deposit or insurance contract, even where the resulting deposit or contract is to be with an authorised person or EEA firm, unless he makes the disclosures prescribed by Part V. Such a restriction did not exist before N2 and there seems no good reason for it to apply to deposits or contracts with authorised as opposed to unauthorised deposit takers and insurers. Similarly we do not understand why the "one-off" exemptions do not apply to deposits or general insurance communications.

**Articles 43 and 60:** For consistency, the exemptions in these articles should apply to options over securities in the relevant companies as well as warrants to subscribe for such securities.

**Article 42:** We think that it is anomalous that a company can make an offer to existing holders of its debt securities to exchange those debt securities for new securities issued by that company (under article 43). However, if those existing securities are in bearer form it cannot make the same offer directed at those holders (even though there is no other means of reaching those holders). The securities issued in exchange are not securities to which the existing securities confer rights.

**Article 46:** This article is unduly restrictive. For example, it is not a regulated activity to make a loan to a sole trader or a partnership of individuals secured on business premises or to an unincorporated association secured on property it uses for the purposes of its activities. Also it is not a regulated activity to lend on a second mortgage or on security of timeshare accommodation or on foreign land. Therefore someone who is not a regulated mortgage lender can freely promote its business for these purposes directly or through intermediaries. However, credit brokers and other third parties cannot promote equivalent loans from someone who happens to be a regulated mortgage lender without having their promotions approved (or finding an exemption). This distorts competition. We would suggest adding a new paragraph to cover communications accompanied by an indication that the qualifying credit is available where the land over which the security is

given is not used as a dwelling, on a second mortgage on timeshare accommodation or on land outside the UK.

**Articles 48 and 50:** We have already responded to the recent Consultation Paper on Informal Capital Raising which deals with amendments to these Articles. However, bearing in mind that Article 50 has a wider application than to unlisted securities and covers all types of investment it is clear that the subject matter of these exemptions goes wider than informal capital raising and we reiterate the points we made in response to that consultation that the inconsistency between the coverage of Article 48 and Article 50 should be removed.

**Article 59:** This should be extended to cover half yearly or other interim accounts.

**Article 67(1)(b):** FSA's guidance suggests that this provision can cover securities of an existing issued class which have not yet themselves been issued. We find it difficult to construe the provision in this wide manner and therefore suggest the wording is clarified to put the matter beyond doubt.

Finally, we would have preferred that the consolidated order retained the original numbering of the existing order. The change will mean a revision to existing templates referring to the relevant exemptions at unnecessary cost.

**Q21 Do you agree that the current Article 69 of the Financial Promotion Order is too complex and should if possible be simplified?**

We agree and welcome the proposals to streamline the conditions applying to the exemption.

**Q22 Do you agree with narrowing the scope of the exemption but widening the circumstances in which it can be used and with applying conditions to its use?**

We agree with the proposals in this regard, but the exemption should (like its predecessor under the previous legislation) cover depositary receipts issued by a third party depository under an arrangement with the issuer. This would be consistent with Article 43 - see Article 43(4), now carried forward in proposed Article 49(4).

**Q23 Do you agree with the proposed specific conditions for the exemption to apply?**

We agree, subject to one further point. The execution should allow for continuance of the exemption during periods where the promoter's shares are subject to temporary suspension. It is arguable that the requirements that the shares "*are permitted to be traded, on a relevant market*" would no longer apply during a suspension, and so the exemption would not be available. However, such suspensions can occur for a variety of reasons, many beyond the company's control, and so the exemption should be extended to these.

**3. SALE OF A BODY CORPORATE**

3.1 We set out in our views in relation to the proposals set out in Section 6 of the Consultation Document.

- 3.2 We understand the policy behind the proposals to be:
- (i) Advice to or communications to persons holding shares for commercial rather than investment purposes should be excluded from regulation (see paragraph 6.4 of the Consultation Paper); and
  - (ii) Acquisition or disposal of shares in a small company for the purpose of obtaining day-to-day control is likewise excluded.
- 3.3 We do not believe that the drafting of the proposed new exemption in the FPO and the RAO achieves these objectives.
- 3.4 The drafting of the exclusion is complex. In effect there are two exclusions in one provision, the first relating to a transaction involving any company (BC) which is closely held or as a result of the transaction is to be closely held. This exclusion seems to be aiming at the first policy objective, which is that such a transaction is to be considered to be for commercial rather than investment purposes, because in such a company the shares are really held for commercial purposes rather than investment purposes. The body corporate is effectively a wrapper around a business and the transaction is essentially a business sale.
- 3.5 The second exclusion relates to a body corporate (BD) which is also closely held but on a different test, i.e. by reference to the number of shareholders or whether it is listed or not. Here, the exclusion only operates in relation to investment activity or communications with or for the controlling or proposed controlling shareholder, so it is no longer the transaction itself which is excluded. There are three problems with this approach. First it can be difficult with the "*making arrangements*" limb of regulated activity in establishing who is providing a service to whom. This is a problem in corporate finance transactions recognised by the FSA which in its special rules on corporate finance transactions effectively excludes activity carried on incidentally with other persons where the adviser is acting for a party on a corporate finance transaction. This is achieved by excluding corporate finance contacts from the definition of "Client" in FSA Rules. The new approach suggested here goes against the philosophy of that regime.
- 3.6 Secondly, the exclusion is not wide enough in the FPO to enable T to reply to any communication made to him without the need for that communication to be approved.
- 3.7 Thirdly, by not excluding investment activities with or promotions to minority shareholders, there is a potential encouragement to exclude such a minority from any offer and only deal with the majority shareholder which could operate to the detriment of the minority.
- 3.8 If the revised approach is persisted with, we believe the provision would be easier to follow if it were recast as two separate provisions.
- 3.9 However, our preferred approach would be for a single much more straightforward provision. As the Consultation Paper points out, the purposive test of acquiring day-to-day control was introduced as an alternative to the "*hard edged test*" because of the inflexibility of the latter test, which could be inapplicable even if only a handful of

shareholders did not come within the prescribed categories. It would therefore appear that the prime policy objective is to continue to exempt transactions relating to closely held companies which are essentially business rather than investment transactions. That policy objective seems to be less clear with the test no longer being transaction based.

- 3.10 We would, therefore, propose a single exemption which continued to exempt the transaction rather than activity with or promotions to the controller or proposed controller on the basis of one of the three options outlined in the Consultation Paper, designed to meet the policy objective of exempting transactions in closely held companies. The "hard edged" test could then be abolished.
- 3.11 We do not believe that minority shareholders in this situation need the protection of financial services regulation. Shares in closely held companies of this nature should not be regarded as investments in the conventional sense. The protections available to minority shareholders under the Companies Act and the anti-fraud provisions of Section 397 of FSMA should be sufficient protection in these circumstances. The Takeover Code also focuses on transactions rather than the nature of the shareholder.
- 3.12 With regard to the three Options outlined, although Option 1 effectively permits transactions relating to closely held companies to be exempt, Option 2 is preferable as it is wider and therefore provides greater flexibility.
- 3.13 The advantage of Option 3 would be to create symmetry with the Takeover Code and thus ensure all offers subject to the Code involved an authorised person to conduct relevant investment activities and approve relevant financial promotions. It is, however narrower in scope than Option 2 and therefore offers less flexibility and more complexity. We therefore prefer Option 2.
- 3.14 If the 50 person ownership test is adopted, there needs to be clarity as to whether it applies to legal holders of the shares or beneficial owners. Paragraph 6.18 of the Consultation Paper suggests the latter, but the drafting of the new provisions in the draft Statutory Instrument clearly provides for the former. A legal ownership test means that a company owned by significantly more than 50 people but whose shares were held in a nominee account would fall within the exemption. A beneficial ownership test would require a reasonable belief qualification, i.e. the exemption would apply where the offeror reasonably believed the shares were beneficially owned by no more than 50 persons and shares held by a trustee which is not a bare trustee or nominee should be regarded as held by one person, so as to count, for instance, a unit trust as a single owner. Shares held by connected family members should also be aggregated so as to be treated as a single holder.
- 3.15 We believe that the exemption should also be expressly extended to cover transactions in warrants or options to subscribe shares on the basis that the rights conferred by those instruments should be deemed to have been exercised for the purpose of determining if the exemption applies.
- 3.16 The exemption needs to cover ancillary transactions: see current article 70(1)(a) "or is entered into for the purposes of such an acquisition or disposal...".

3.17 We can now turn to the specific questions raised on this issue in the Consultation Paper.

**Q24: Do you agree that the exclusion in the Regulated Activities Order should be narrowed so that the "may reasonably be regarded" test will apply only in relation to a party who is acquiring or disposing of the day to day control of that body corporate and hence not to advice given to a party whose object is not acquisition or disposal of day to day control?**

We do not agree with this approach, and for the reasons stated above, believe the exclusion should continue to focus on the overall transaction itself.

**Q25: Do you agree that the exclusion in the Regulated Activities Order should be narrowed so that the "may reasonably be regarded" test will apply only in relation to takeovers of small companies?**

We agree with this proposal, which should apply to the exclusion as a whole.

**Q26: Which option do you prefer as the definition of "small" company in respect of which the "may reasonably be regarded" test should apply? Do you have any other suggestions?**

We prefer Option 2 for the reasons stated above.

**Q27: Do you agree that the exemption for promotions in respect of takeovers should be subject to the same conditions as those which apply under the revised RAO?**

We agree the conditions should be the same.

**Q28: do you agree that it is desirable to have some form of regulation or conditions on unauthorised persons who are carrying out telephone campaigns?**

We agree with this principle. One possible approach is for the person, such as a telephone marketing agency, making the call to be made an appointed representative of the financial adviser, and then rely on the provisions of Article 16(2) of the FPO which would effectively mean the financial adviser would be supervising the persons making the call. The difficulty is that the appointed representative may not actually be undertaking any regulated activity as opposed to merely making financial promotions and thus may not qualify to be an appointed representative. This leads to the conclusion that a further specific exception for someone acting under the supervision of an authorised person as was the case pre N2 would be the most appropriate way forward. It seems to us irrelevant that the concept of supervision is not generally used elsewhere; this is no bar to a specific provision that applies the same principles as apply in the principal/agent relationship created under an appointed representative arrangement.

**Q29: Do you agree that broadly speaking we should regulate to the same extent as under previous legislation?**

We agree as is implicit in our answer to question 28 above.

**Q30: Which of the three options above do you prefer and why?**

For the reasons given in our answer to question 28 we prefer the third option. The first option involves the FSA changing its policy of not allowing unsolicited real time communications to be approved and we have no reason to believe that they wish to relax this policy.

**Q31: Do you agree that under the proposed regulatory framework the provisions for the Financial Promotion Order providing exemptions for takeovers of relevant unlisted companies (i.e. Articles 63-66) are no longer necessary?**

We agree. The existing provisions are cumbersome and were rendered unnecessary by the width of Article 62 of the FPO as currently drafted.

4. **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?**

We have previously indicated that the addition of the "routine" test was unhelpful and created uncertainty. We therefore welcome the proposed reversion to the position prevailing under the previous legislation.

**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?**

It seems logical to widen the scope of this provision to include what are lower risk investments than those to which the provision currently applies.

**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?**

We agree with this 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?**

We agree with this proposal.

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

We agree.

**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?**

We agree.

## 5. **CHANGES TO THE REGULATED ACTIVITIES ORDER**

- 5.1 We welcome the proposals detailed in paragraphs 8.2 and 8.3 of the Consultation Paper which deal with issues we have raised previously. 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.
- 5.2 However, with regard to the proposal regarding theatrical debentures this appears to have potentially unforeseen consequences. Although there are conflicting views on the breadth of the term "debenture" the generally held view is that instruments that create contingent debts are not debentures and therefore do not fall to be regulated as securities. For example, the extension proposed would bring within the scope of regulation traditional loan agreements which are currently not believed to be regulated as debt securities as there is no acknowledgement of current indebtedness but merely an undertaking to make repayments in the future.
- 5.3 Additionally, some other instruments which create contingent obligations to make payments in the future, such as cash settled instruments giving a return by reference to a basket of securities, which are currently regulated as contracts for differences would also be classified as debt securities. This would mean for instance, that they would be eligible as transferable securities for inclusion in UCITS schemes and offer documents relating to such instruments would be subject to prospectus law. There would also be implications for FSA conduct of business rules.
- 5.4 We would therefore not be in favour of a blanket change of this nature and would prefer an approach that specifically classified this type of instrument by description as an instrument falling within Article 77 of the RAO.

## 6. **OPEN-ENDED INVESTMENT COMPANIES**

The Committee welcomes the purpose of the three proposed changes, namely:

- procedure for approving proposed changes;
- requirement for an annual general meeting; and
- public notice by the FSA of receipt and issue of certain documents.

### 6.1 *Annual General Meetings*

Our principal comment is in respect of question 54, namely the threshold for agreement of shareholders to dispensing with annual general meetings in OEICs.

The elective regime proposed in the Document follows exactly the existing elective regime for private companies contained in Sections 366A and 379A, Companies Act 1985. Private companies are however very different vehicles from OEICs and the suggestion that 100% of shareholders in an OEIC (or even 95% of the shareholders, as mooted in question 54) is unrealistic and would make the proposal sterile.

OEICs are usually formed as umbrella schemes, with a number of sub-funds. The shareholder base of a sub-fund of an OEIC often consists of several thousand people. Since the OEIC would be treated as a single entity for the purposes of effecting this proposal, the consent of each shareholder in each sub-fund would be required. In a private company, the shareholder-base is likely to be less than 100 and often less than 20, with shares held within the family or by close associates, so that the elective regime is appropriate for it.

Further, as the Treasury Consultation Document records (paragraph 10.11), shareholders in an OEIC are likely to view their holding as the vehicle for their participation in pooled investment management by the Authorised Corporate Director or its delegated fund manager. A shareholder response rate of 25% by proxy to a notice of resolution of a general meeting to approve a corporate act such as an amalgamation of funds would be considered successful. The response rate to the resolutions of an AGM is usually substantially less than this; attendance in person at the meeting will seldom exceed 10 and often be one or two.

Given the desirability of enabling an OEIC to obtain relaxation of the requirement to hold AGMs (see question 51 below) the power for this to happen needs to reflect both the different nature of an OEIC and the reality of response rates. For these reasons we suggest, first, that for new OEICs the instrument of incorporation be allowed to provide that there will be no AGMs unless shareholders vote to the contrary. Such a vote would probably involve requisition of the meeting by a requisite number of shareholders as the ACD is unlikely to propose this itself. The resolution at the meeting should be an Extraordinary Resolution. For existing OEICs, we suggest power be conferred by regulation for the passing of a resolution removing the need for AGMs, to be passed as an Extraordinary Resolution, namely requiring a majority in favour of 75% of those voting.

## 6.2 *Procedure for approving proposed changes*

### **Q50: Do you agree that [the proposed] change to regulation 22(5) should be made?**

We agree that the strict procedure to be followed by the FSA in approving changes to an OEIC is unduly onerous and that, where the FSA decides to approve a proposal after having previously issued a warning notice, it should only be required to provide a “written notice” of its decision.

## 6.3 *Requirement for an annual general meeting*

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

It has been apparent since the introduction of OEICs that the holding of an AGM is in the nature of a technicality, arising from the corporate form of the OEIC, rather than having any practical advantage for shareholders. The business transacted at the AGM is often solely the appointment or reappointment of the company’s auditors. There are very few OEICs which have any directors other than the ACD, and so election or re-election of directors does not apply. The company’s accounts and reports of the ACD and the

auditors will have been distributed to investors and there is no requirement for these to be approved by the meeting and no declaration of dividend based on them, such as would be the case with other companies. When OEICs were introduced, it may have been assumed that the holding of an AGM was a necessary requirement for qualification as a corporate vehicle as distinct from the unit trust which has no such requirement.

Whilst the Committee does not have information as to the cost of holding an AGM, that cost may not be very material given, first, that the notice will usually be dispatched with the accounts which must be distributed to shareholders and, secondly, that the low level of response means the reply paid cost is not high, and the forum for the meeting is likely to be an existing meeting room of the ACD rather than a hired venue. Nonetheless the attention given to the preparation of the AGM and the involvement of senior personnel beforehand and at the event, with no real purpose to the event, means the Committee agrees that the costs outweigh the benefits.

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

We have answered this already in paragraph 6.1 above. We go further and suggest that an OEIC should be able to be formed with provision in its instrument of incorporation dispensing with the need for the holding of an AGM unless shareholders by extraordinary resolution so require. The dispensation with the requirement for the holding of an AGM should be referred to in the prospectus for the OEIC and so treated as disclosed to investing shareholders.

We comment in paragraph 6.1 above on the procedure to dispense with an AGM in an existing OEIC.

**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?**

We have already commented on the nature of the business at an AGM of an OEIC. In our view an AGM, the sole business of which is to appoint the company's auditors, does not confer much in the way of protection on shareholders. An AGM might be thought by shareholders to be a forum at which they can question the ACD as to the management of the OEIC but, since that is not within the formal business of an AGM, an ACD would be entitled to refuse to treat that as legitimate business at the AGM; in other words the ACD's response to questions on its management of the OEIC and the performance of it would only be permitted if the ACD so chose.

**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 eg 95% of shareholders?**

We have already commented on this in paragraph 6.1 above. We have suggested that if this proposal is to have any practical relevance, the resolution to dispense with the AGM should be an Extraordinary Resolution.

We are also concerned at the proposal that a single shareholder can requisition an AGM when an election has been made to dispense with it. See draft regulation 37A(3). As

indicated at paragraph 6.1 above, an OEIC may have several thousand shareholders and we consider it unsatisfactory for a single shareholder to be able to frustrate the will of the great majority in this way, perhaps for no substantial reason, and involve the OEIC in additional costs as a result. We suggest that an AGM should be capable of being requisitioned if shareholders representing 5% by value of the OEIC so require. That is half the threshold required to requisition an EGM.

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

Logic would suggest that if an Extraordinary Resolution may dispense with the holding of AGMs, as proposed in paragraph 6.1 above, an Extraordinary Resolution should be required to reinstate the holding of AGMs. We would not however have any objection to the use of an ordinary resolution for this purpose.

**Q56: Regarding the proposed amendments to regulation 34 outlined in paragraph 10.18, do you agree that appointments [of co-opted directors] should not have effect for longer than 12 months starting on the date of the appointment?**

This question relates to the power of the directors of an OEIC to appoint a person to act as director to fill any vacancy until such time as the next AGM takes place. The proposal in the Consultation Document is that in the case of OEICs that elect not to hold AGMs such an appointment should not have effect for longer than 12 months starting on the date of the appointment. We do not consider this is practical. In our view it has to be accepted that once an AGM has been dispensed with, the various powers of an AGM also lapse until the holding of an AGM is reinstated. As we comment above, there are very few OEICs which have any directors other than the ACD so the question of co-opting directors onto the board will seldom arise but when directors are co-opted their appointment should run until they are removed in accordance with the other provisions of the Regulations and Instrument of Incorporation and there should be no 12 months time limit.

**Q57: Do you have any comments on our proposed amendments for Regulation 36 outlined in paragraph 10.19?**

Paragraph 10.19 proposes that certain documents which currently have to be made available for inspection at the OEIC's AGM should be sent to all the shareholders of the OEIC who would have been entitled to attend any such AGM. These documents are, in the case of each director whose contract of service with the OEIC is in writing, a copy of that contract and, in the case of each director whose contract of service with the OEIC is not in writing, a written memorandum setting out its terms. We are not persuaded that it is necessary for copies of such documents to be circulated to all shareholders (whether annually or when amended - the proposal is not clear on this) and that adequate disclosure is made by the requirement which already exists for the documents to be available for inspection by any shareholder at the company's head office and place where the company's register of shareholders is kept. In most cases the only such contract will be that with the ACD, as sole director, and the relevant terms of the contract will be summarised in the prospectus.

6.4 *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 requirements in Regulation 78 regarding the information that is made public?**

The Treasury's Second Consultation Document on OEICs, April 1995, stated, paragraph 49:

"Except where there is a specific exemption for investment companies, the open-ended company will be subject to relevant EC Company Law Directives."

The First Company Law Directive (68/151/EEC) requires disclosure of company information in a national gazette (Article 3.4). Amendment made by the Act of Accession of 27 March 1973 specifies the Directive as applying to UK companies incorporated with limited liability. Section 711 of the Companies Act 1985 implements the Directive. The Companies Act does not apply to OEICs, except where specifically so provided.

If the Treasury concludes that the Directive does not apply to OEICs and that it is possible to remove the requirement to publish notice of the issue or receipt by the FSA of certain documents in the London Gazette or Edinburgh Gazette, we agree that this should happen. Such publication only has value if there are persons with an interest in an OEIC other than the shareholders, particularly creditors. Creditors of an OEIC are unlikely to be interested in the changes which these notices would cover. Even in the case of notices in relation to reconstructions, amalgamations, winding up orders and dissolutions of an OEIC, creditors are unlikely to have an interest in receiving the information and credit reference agencies may not attach importance to such notifications. It will be appreciated that an OEIC is unlikely to be insolvent, and that on reconstruction or amalgamation of an OEIC, discharge of liabilities in full will be provided for in the scheme of reconstruction, by retention or from the assets of the ongoing fund.

**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?**

We have to some extent responded to this in answering question 58. On the assumption publication nationally is required and that the London Gazette and Edinburgh Gazette are the publications monitored by credit reference agencies, we are unable to suggest a more appropriate form of publication

**7. FUTURE WORK**

As indicated in the introduction to this Memorandum, we are disappointed that the opportunity is not being taken now to address most of the issues referred to in section 11 of the Consultation Paper that is:-

**7.1 *Controllers of authorised persons***

The current provisions are super-equivalent to the relevant European Directives and unduly burdensome for both regulated and unregulated entities.

7.2 *Interaction between the RAO and the ISD*

We welcome the commitment to look at this issue in the context of implementation of MiFID.

7.3 *Promotions to overseas recipients*

As indicated in paragraph 2 of this memorandum, we believe significant changes to Article 12 of the FPO are necessary.

7.4 *The overseas persons exclusion*

We can see no justification to continue the historic relic of different tests (which are, in the case of banking and insurance, case law based) for different types of regulated activities. The tests as regarding banking and insurance lack the clarity of that for investment services because of their basis.

7.5 *Financial promotion framework*

We remain of the view that the width of the scope of the financial promotion prohibition in Section 21 FSMA makes it necessary to have a lengthy and complex set of exemptions which require amendment on a regular basis to ensure all eventualities are covered as they arise in practice.

No other major jurisdiction has, to our knowledge felt it necessary to have such a wide ranging restriction on communications which relate to financial activities. We believe there is a strong case to see whether the provisions can be refocused so as to concentrate on those communications which relate more directly to the provision of financial services.

A first step would certainly be to move to more risk based than sectorally based legislation as raised in the Consultation Paper. Removing some financial promotions from the general prohibition in Section 21 but retaining the application of Section 397 would also be worth considering.

**MAY 2004**