Investment Management Association

ima

6 February 2014

Mark Glibbery
The Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By email to: cp13-18@fca.org.uk

Dear Mark,

FCA CP 13/18 Quarterly consultation No 3

Please find enclosed IMA's[1] response to Chapter 4 of the above-mentioned consultation paper.

We very much welcome the FCA's willingness to engage with the industry on the ways in which information may be made available to investors. We agree with the FCA that there should be an ability to make short reports and other communications available through publication on a website. However, we disagree with the method of reaching that outcome. We also think that a distinction should be drawn between short reports and *ad hoc* communications.

In looking afresh at this question, the starting point should be the UCITS Directive. It has **never** been a requirement that annual and half-yearly reports be **sent** to investors as a matter of course; the UCITS Directive requirement has always been to **make such reports available** to investors.

This, together with the FCA's consumer protection objective, informs our response.

For short reports, we believe that there is a more effective way to reach the desired outcome: a short, clear and prominent single notification provided sufficiently in advance of the change in method of making short reports available would meet investor needs. This approach would also be in line with the other main jurisdictions whose funds are bought by UK investors.

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[1] The IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes.

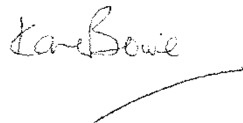
They are responsible for the management of around £4.5 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

To address the FCA's concerns about the possibility of such a notification being overlooked or misunderstood, IMA proposes the development of standard wording and format. We are keen to explore this proposal further with the FCA.

We agree that *ad hoc* communications require contact with the investor, as otherwise the investor would not know of its existence. We therefore agree with the FCA that investors need to be notified when an *ad hoc* communication has been made available on a website.

Please do not hesitate to contact me if you would like to discuss any of the points we have raised in the response.

Yours sincerely



Karen Bowie
Senior Adviser, Product Regulation

IMA – Response to Chapter 4 of CP 13/18 (QCP 3)

Q1 Do you agree that we should allow notices and documents to be communicated to unitholders by making them available on the website?

We commend the FCA for its willingness to engage with the industry on the ways in which information may be made available to investors.

It is some considerable while since the previous regulator, the Financial Services Authority ('FSA') put in place its rules on short reports and, in particular, the requirement to send such reports to investors. At that time, the early 2000s, delivery by post was the norm and internet usage was still in its infancy. Nowadays, investors are much more familiar with accessing information through websites and also being contacted via electronic communications. Investors might therefore expect information to be delivered in a variety of ways.

In the light of the above, we strongly support changes that would enable communications to be made available on a website.

However, we believe that a distinction should be drawn between reports that are routinely published (such as short reports) and *ad hoc* communications. The current proposals seek to treat these in the same way. There is a strong case for a difference in treatment. In the case of regular reports, an up-front disclosure of availability is sufficient – as is evidenced by the way annual and half-yearly report availability is catered for in the UCITS Directive. With *ad hoc* communications, investors will not know that these communications exist unless they are specifically drawn to their attention.

A change in approach to the way in which short reports are made available would also remove some of the gold plating in the current regulation. Under the UCITS Directive, it was **never** a requirement that annual and half-yearly reports be **sent** to investors as a matter of course; the UCITS Directive requirement has always been to **make such reports available** to investors *"in the manner specified in the prospectus and the key investor information document"* (and previously the simplified prospectus) (Article 75). There is also a requirement to make paper copies available to investors on request and free of charge.

There are two aspects to the FSA's gold-plating of the UCITS requirements in so far as annual and half-yearly reporting to investors is concerned, both of which result in additional fund costs, which will ultimately be borne by investors. One is that the FSA introduced rules requires the production of short reports (as well as the long reports required by the UCITS Directive). The second is requiring short reports to be sent to investors rather than being made available.

Removal of this second element of further gold-plating would bring the UK into line, in relation to the method of making annual and half-yearly reports available to investors, with the other main jurisdictions whose funds are bought by UK investors. Those jurisdictions have taken a 'copy out' approach to implementing the UCITS Directive.

Just as important is the fact that the UCITS Directive contains no requirement to keep contacting investors to remind them that annual and half-yearly reports are

available. As regards the availability of such reports, the UCITS Directive requires a one-off disclosure which is provided to investors in the Key Investor Information Document ('KIID'). We return to this in more detail below as it informs our response to Q.2.

We note the reference to the Companies Act 2006. We have, several times previously noted the need to update COLL since website communication has become more common. However, we have also previously indicated that there are differences as between the approach for companies and funds, which would mean it should not be used as an exact precedent. Companies hold annual meetings as a matter of course, so requiring a unitholder vote does not result in additional costs. This is not the case with funds. In addition, as mentioned above, the UCITS Directive is the better precedent in that it is fund-specific and requires only that reports are made available.

Q2 Do you agree with our proposals on how AFMs should obtain the consent of unitholders? Are there any other measures we should take to ensure unitholders are treated fairly when this change is introduced?

We disagree with the proposals because we do not believe that the starting point for a regulatory approach to the making of information available to investors should be based upon the rules put in place by the previous regulator. This is the first substantive consultation by the FCA on the COLL rules since the FCA assumed its powers. We strongly encourage the new regulator not to be hampered by what has gone before but rather to look at the issue of the availability of short reports afresh.

As mentioned in response to Q.1, we believe a distinction should be drawn between reports that are routinely published (such as short reports) and *ad hoc* communications. We split our response to Q2 accordingly. We also provide a number of miscellaneous additional comments at the end of this paper.

1) Short reports

We put forward **two key reasons** for taking a different approach:

a) The UK Government's policy, as outlined in HM Treasury's 'The UK investment strategy'[2] paper. The policy is that *"a 'copy out' approach will be adopted wherever possible to implementing European legislation in order to simplify the regulatory approach for firms, with any gold plating supported by strong justification. In addition, the Government will consult closely with the industry to ensure that opportunities to minimise costs and maximise benefits will be identified and implemented."*

   This is consistent with HMT's statement[3] (made in the context of its consultation on AIFMD implementation) that *"The Government is committed to eliminating unnecessary gold-plating"*.

   The FCA therefore has a real opportunity to take the UCITS Directive as its starting point as far as the delivery mechanism for reports is concerned (i.e.

[2] The UK Investment Management Strategy, paragraph 4.6
[3] Transposition of the Alternative Investment Fund Managers Directive, paragraph 2.24

reports being **made available** in the manner specified in the prospectus and KIID).

b) The **FCA's consumer protection objective,** which requires the securing of an appropriate degree of protection. This requires, amongst other things, a consideration not only of the information needs of investors but also (and importantly, something not explicitly catered for in the FSA's objectives), of the general principle that consumers should take responsibility for their decisions.

Because the proposals take as a starting point the further gold-plated position of the previous regulator (a requirement to **send** short reports), it informs a belief - as reflected in the commentary accompanying the proposed rule changes - that there is a need to require unitholder consent for a change in the way short reports are to be made available. This is not the case.

By basing new FCA policy on both the UK Government's policy of not gold-plating European legislation and the abovementioned aspects of the FCA's consumer protection objective, **the issue to be addressed becomes rather how most effectively to bring about a change in the way reports are made available and brought to investors' attention and how much notice should be given**.

The costs of any approach should be taken into account as these may be borne by the fund and therefore ultimately impact investors in the fund. It is therefore in the interests of investors that the approach be cost-effective.

There are a number of other reasons why we disagree with the FCA's proposals. We set these out below before addressing the issue of effective communication.

- We have already explained why the premise behind a unitholder consent being required is not correct. Even if it were correct, we question the rationale for proposing that a unitholder vote (as opposed to notification) be held in order then to invite unitholders to agree to receive short reports on an 'opt out' basis. The rationale given is that *"unitholders may overlook the notification or misunderstand its significance."*

  We do not believe that the proposals take sufficient account of the Financial Services Act 2012 requirement that, in securing an appropriate degree of protection, the FCA should have regard to the general principles that consumers need to be provided with timely information that is fit for purpose and that consumers should take responsibility for their decisions. The principles recognise that there are responsibilities on both the regulated firm (in this case, providing information that is easy to understand) and upon consumers (in this case, to read notifications required by the regulator). It is implicit in the principle that consumers take responsibility for their decisions and that they have a responsibility to read notifications required by the regulator.

- In addition, if the FCA's rationale is followed to its logical conclusion, it would call into question the UK's longstanding and effective regulatory approach to communicating significant and notifiable changes to investors (COLL 4.3.6R-9): This is based upon the giving of notifications to investors and the

regulator's expectation that investors will not overlook notifications and that such communications are capable of being understood.

- In fact the FCA's argument is illogical for another reason. If a unitholder might overlook the notification or misunderstand its significance, the same argument could be made for a communication about a unitholder vote.

- There is also greater scope for investor confusion/exasperation with a unitholder vote. It is important to consider the proposals from an investors' perspective:-

  - First, they may be surprised and exasperated at being asked to vote on something that, under the FCA's own rules (as below), would not be considered an event requiring a vote.
  - Second, they will receive more paperwork than they would with a one page notification and may be daunted/put off by the need to take formal action by completing a voting form.
  - Third, assuming that enough people take the trouble to vote (practical issues arising with voting covered in the next paragraph) and the vote is passed, they will then receive yet another communication inviting them to agree that the AFM may serve or send them notices or documents generally, or the notice or document in question, by means of a website and explaining that the unitholder's consent will be deemed received unless he has objected within a specified period (Proposed COLL 4.4.20). Investors who voted for the change may be confused at getting a further communication. Investors who voted against may be confused that, whilst they voted against the change, they are being asked to take yet more action.
  - Fourth, in both cases, they might also question the costs in terms of paper and postage - both of which may be charged to the fund – and the time it has taken them to deal with the voting paperwork and subsequent communication. One AFM estimated that the costs of a unitholder vote would be around £90,000. By contrast, a simple highlighted paragraph in an already planned mailing should incur no additional cost.
  - Finally, confusion and exasperation may arise if they hold units in non-UK funds. The other main jurisdictions whose funds are bought by UK investors are Luxembourg and Ireland. Neither require the sending of reports and, even where managers might choose to do so and change the method of making available short reports, there is no requirement for those funds to hold a unitholder vote. AFMs have experience of investors who hold both UK and offshore funds and common questions are 'why do I get this for one fund but not another?' and 'why can't you stop sending me these reports?'

    For your information, we attach at Annex 2 an example of the notification a Luxembourg fund sent its investors about a change in its method of making reports available. As will be seen, it is a simple and clear notification. The manager who provided this example confirmed that no issues had arisen as a result of providing this clear notification.

    For fullness of information, an example wording from a Luxembourg fund Prospectus is also included.

- As regards practical issues with proposing a vote, there are a number of aspects that do not make it an appropriate approach for changes that are not fundamental in nature and for this change in particular:-

  - The change in the way in which reports are made available may be seen by investors as a minor matter (compared to the type of matter that is generally put to a unitholder vote – please see next main bullet point) and may therefore not take the trouble to vote. If the vote fails through investor apathy, it fails not because investors are really against it but simply because the matter is not of great interest to them. This is not a good investor outcome.

    One AFM advised that, even with votes on fund mergers, voting numbers are generally low, so a failure though lack of responses would not be surprising.

  - A significant proportion of units might be held by Platforms. Is it right that whether or not platforms choose to vote should have an impact upon the outcome of a vote that will impact investors who hold units directly rather than via a Platform? Platforms will have their own arrangements with their clients as regards communications (as has been covered in FSA CP 10/29 and PS 11/9).

  - A failed vote could potentially lead to two sets of costs – the costs of a meeting, then the cost of another notification.

- We are also concerned that asking unitholders to vote on something as basic as how annual and half yearly reports are made available is a misuse of this mechanism and belittles the importance of unitholder voting. The FCA rules reserve unitholder voting (COLL 4.3.4-5) for matters which are described as 'fundamental changes'. These are matters which change the purpose or nature of the fund, may materially prejudice a unitholder, alter the risk profile of the fund or introduce any new type of payment out of the property of a fund. The examples given in the FCA guidance at COLL 4.3.5 are a change in investment policy to achieve capital growth from investment in one country to another, a change to investment policy to allow investment in derivatives, and introducing limited redemption arrangements. In other words, fundamental issues.

  This comes back to our encouragement that the FCA looks afresh at the matter of making available to investors. It is within the FCA's power to go back to basics as the requirement to send short reports is not driven by any EU Directive requirement. If it removes the further gold-plating, and an AFM proposes to change the way it makes reports available to investors, the key question becomes 'How should AFMs treat the change for the purposes of the FCA rules on change events?'

  As outlined above, it is not something which falls within the definition of a fundamental change. It is also not something that would fall within the definition of a 'significant change'. As defined in COLL 4.3.6, these are changes which affect a unitholder's ability to exercise his rights in relation to

his investment or would reasonably be expected to cause the unitholder to reconsider his participation in the fund, increase payments out of the fund to the AFM/associates or materially increase other types of payment out of the scheme. A change to the way in which short reports are made available does not fall within this definition.

In addition, and as importantly, no other significant change requires a unitholder consent. The rationale for the significant event rules was set out in CP 185 (paragraph 5.18 ii). They proposed that a 60 day notice period was appropriate for significant change events as it provided unitholders with sufficient time to leave the fund, if they wished to, before the change took effect.

The final category of change, a 'notifiable change', is something that is defined (COLL 4.3.8) as neither a fundamental nor significant change of which the manager concludes a unitholder must be made aware unless an AFM concludes that the change is insignificant. We believe that that a change in to the way in which short reports are made available falls within this definition.

In summary, having identified that the premise (that there is a regulatory requirement to obtain consent) is incorrect, the FCA rules on change events already provide appropriate rules and guidance for the categorising the change under discussion.

Aside from the concerns with the unitholder vote aspect, the proposals (by seeking to cover all communications) fail to take into account the distinguishing features of regular reports such as short reports. *Ad hoc* communications, by their very nature, can be made at any time, so investors will not be aware of them unless they receive a specific communication. Short reports, on the other hand, must be published by set dates and investors will know this and where to access them.

Why then, for short reports, should there be a need for an investor to supply an e-mail address? In fact, it renders redundant the ability to assume consent - as investors are still required by the regulator to supply an e-mail address. Even for the proposal for the 'opt in' route, which requires consent, the rule requires that the investor must provide an e-mail address. Again, why should this be necessary where reports are to be made available via publication on a website and an investor has consented to the change?

The justification for the requirement for an e-mail address (and indeed the requirement proposed for notification by e-mail every time a short report is made available) appears to flow from the FCA having regard to the UCITS Directive concepts of 'durable medium' (which also includes website requirements). However, as already discussed, there is a deliberate distinction in the UCITS Directive between the way in which the KIID and prospectus must be made available and the way in which annual/half-yearly reports must be made available. This is most clearly seen in Article 75 which shows the different treatment between prospectuses and reports:-

Article 75

1. The prospectus and the latest published annual and half-yearly reports shall be provided to investors on request and free of charge.

2. The prospectus may be provided in a durable medium or by means of a website. A paper copy shall be delivered to the investors on request and free of charge.

3. The annual and half-yearly reports shall be available to investors in the manner specified in the prospectus and in the key investor information referred to in Article 78. A paper copy of the annual and half-yearly reports shall be delivered to the investors on request and free of charge.

Investors may not wish to provide e-mail addresses and the ability to make short reports available on a website should not be dependent upon it.

It is a practical issue, too. By way of example, one AFM indicated to us that it has e-mail addresses for approximately 25% of its unitholder base. The rules as drafted would mean an AFM could not make use of the deemed consent provisions for such investors simply because the AFM does not have e-mail addresses on file. The AFM would then need to keep requesting the information until it is supplied. The deemed consent approach loses its value if it is dependent upon having e-mail addresses.

Another AFM has indicated that it does not currently have the facility to record e-mail addresses on its system.

The various permutations of voting/opt out/opt in will likely to be difficult to administer and potentially require systems changes. This, also, will lead to increased costs.

There needs to be an approach that is not confusing to investors and that is administratively simple.

There is no strong justification for imposing more onerous requirements regarding annual/half-yearly report availability that those set out in the UCITS Directive.

In addition, there is already precedent, within the COLL Rules, for the making available of information to investors via one off notification to investors and website publication (COLL 7.2.1R (2B)(c) and (2C).

How most effectively to bring a change in the way reports are made available and brought to investors' attention

We believe that a short, clear and prominent notification would meet investor needs. Such notification would have to meet the requirements of COLL 4.3.8 and 9.

To address the FCA's concerns about the possibility of such a notification being overlooked or misunderstood, IMA proposes the development of standard wording and format. We are keen to explore this proposal further with the FCA.

We are conscious that the costs of such a regulatory notification may be borne by the funds and therefore ultimately by investors. Accordingly, we propose that the notification may be included within material sent to investors already planned to be sent to investors, but we would be open to discussing this further. It could, for

example, be included in the last short report the AFM is proposing to send out in hard copy.

The FCA proposals envisage that a communication be sent to investors each and every time a yearly or half-yearly short report is published. Again, this adds to costs. And, going back to the UCITS Directive, there is no requirement to send short reports let alone send reminders each time a report is published. European Law judges it appropriate that the requirements regarding report availability be different to requirements for KIIDs and Prospectuses. Retail investors, through receipt of the KIID, are made aware where and how annual and half yearly reports may be obtained free of charge. We support this approach. Further gold-plating is not required.

Appropriate period of notice

Given the simplicity of the communication and its nature, we propose a 28 day notice period before the change in practice is implemented. This is in keeping with the timescale the FCA proposed for giving unitholders time to consider an AFM's plans under the vote/then invitation to opt out route.

What changes to the rules are needed to give our proposals on short reports effect?

The title before COLL 4.5.13R together with that rule would need to be amended so that, as with long reports (COLL 4.5.14R), it covers the publication **and availability** of short reports. It should make reference to those reports being made available in accordance with the prospectus. It could be accompanied by guidance that, where annual and half-yearly short reports are made available via publication on a website, these should remain available until at least the next set of reports have been published.

The notifiable changes guidance in COLL 4.3.9G (2) could include as (f) a change to the way in which short reports are made available. The guidance section could also make reference to a 28 day notice period (although this would be out of keeping with the FCA's general approach of placing responsibility for such decisions upon the AFM 4.3.9G (3)). For that reason, we do not think additional guidance as to notice period is required. The guidance could also indicate that AFMs should ensure that any investor who has sold his entire holding in a fund, between the end of an accounting period and the change is implemented in the way short reports are to be made available, is notified of the change so the investor knows how he can access the latest report if he so wishes.

COLL 4.2.5R 4 (d) would need to be amended to refer to short reports being made available in accordance with COLL 4.5.13R.

Finally, changes to the way in which short reports are made available to direct investors by AFMs should also feed though to the forthcoming rules for the provision of information by intermediate unitholders.

2) *Ad hoc* communications

Our comments below on the draft rules are based on the distinction between short reports and *ad hoc* reports being drawn, for the reasons given in 1) above.

We agree that an *ad hoc* communication requires contact with the investor, as otherwise, the investor would not know of its existence. We therefore agree with the FCA that investors need to be notified when an *ad hoc* communication has been made available on a website.

However, as with short reports, we see no reason for requiring a unitholder vote and deeming consent or for requiring explicit consent to a change in method of making information available via publication on a website. Treating the change in practice as a notifiable change with a suitable period of notice is sufficient and is in keeping with the FCA's existing rules on change events. For *ad hoc* communications, the key issue for investors is that they are notified when something, which they would otherwise not know about, has been published on the website.

Such an approach will also keep costs to a minimum. As costs of unitholder votes and seeking explicit consent may be borne by a fund and therefore by investors, this is a factor that should be taken into account when putting in place an appropriate and proportionate regulatory approach.

For *ad hoc* communications, the above could be achieved though a similar change to the notifiable change provisions as outlined in 1) above, and a version of 4.4 16R and 17R that provides that such publication by means of a website is allowed if this is permitted by the prospectus, and unitholders are notified (by e-mail or by post) when such a communication has been made available on the website.

3) Miscellaneous general comments

Depending on the approach adopted, some minor changes may be needed to a small number of rules that relate to short reports.

The rules in COLL apply only to a subset of collective investments. We would welcome recognition of mechanisms for making information available in FUND as well in order explicitly to recognise the ability to perform client reporting electronically. It is important for investors that reporting is as streamlined as possible.

We ask whether GEN could be updated too – to refer to publication via means of a website.

Annex 2

Example notification provided by Luxembourg fund about a change in the way it would make reports available to fund investors:-

" Report & Accounts

In line with regulatory requirements, we will continue to produce the [ ] Fund Annual and Interim Report & Accounts but we will no longer print and mail these Reports & Accounts to you. This will reduce costs to the [ ] Fund and to you as a Shareholder in the Fund. The Report & Accounts will be available on our website [link] or can be obtained by contacting us directly. "

Example Prospectus wording for the Luxembourg fund:-

"Report and Accounts

Audited annual reports shall be available within four months following the end of the Fund's financial year being 31 December and unaudited semi-annual reports shall be available within two months as at the end of the preceding June.

The annual and semi-annual reports shall be made available at the registered offices of the Fund and the Custodian during ordinary office hours. The annual and semi-annual reports shall be made available via the Co-ordinator's website (www.XYZ.com). Shareholders may also request a paper copy of the annual and semi-annual reports free of charge. Please contact your usual XYZ Representative should you wish to receive a paper copy."