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By email to: cp15-27@fca.org.uk

Date: 9 November 2015

Dear Matteo,

RE: CP 15/27 Part I: FCA Consultation Paper (CP 15/27) – UCITS Implementation and other changes to the Handbook affecting investment funds

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association represents UK investment managers. We have over 200 members who manage more than £5 trillion for clients around the world. Our aim is to make investment better for clients so they achieve their financial goals, better for companies so they get the capital they need to grow, and better for the economy so that everyone prospers.

We cover every link in the investment chain:

- We work with investors, helping them to understand the industry and the options available to them. We know investing can seem daunting, so we work hard to make it clear and accessible.
- We work with investment managers, promoting high standards and the need to put clients first. Our work includes helping members to manage money efficiently and communicate effectively.
- We work with the companies we invest in, helping them to achieve better long-term results and, ultimately, greater returns for investors and the economy.
- We work with regulators and governments around the world. We've built close, trusting relationships with these bodies and play an active role in shaping the rules that govern the industry.

The Investment Association's purpose is to ensure that investment managers are in the best possible position to help people build resilience to financial adversity, achieve their financial objectives and maintain a decent standard of living as they get older. It is also to help investment managers maximise their contribution to economic growth through the efficient allocation of capital.

RESPONSE FROM THE INVESTMENT ASSOCIATION

The Investment Association welcomes the opportunity to respond to the proposed changes to the FCA's Handbook in relation to the transposition of the UCITS V Directive. Our responses to applicable questions are attached to this letter.

If you would like to discuss any of the points raised in our response further, please contact me on 020 7831 0898 or by email to karen.bowie@theinvestmentassociation.org.

Yours sincerely

Karen Bowie
Senior Adviser, Product Regulation

APPENDIX

CP 15/27 Part I: FCA Consultation Paper (CP 15/27) – UCITS Implementation

Q1: Do you agree with the proposed Remuneration Code in SYSC 19E?

We welcome that the FCA is aligning SYSC 19E with the FCA handbook rules on remuneration under AIFMD, but we would suggest, given that most parts of the handbook sections SYSC 19E and SYSC 19B are identical, that merging the two handbook sections. This would simplify the application of the rules for firms and could be developed to a genuine single rule book. It would be possible to take the differences between AIFMD and UCITS into account without creating two nearly identical regimes. It would also be the right signal for legislators in Europe and could encourage further harmonisation and consolidation in EU financial services legislation.

It is also helpful that the FCA proposes to include SYSC 19C.1.1 B G into the handbook and to clarify, that the remuneration rules for UCITS cover the rules for BIPRU firms as well. We would like to encourage the FCA to develop a similar provision for IFPRU firms.

With regard to the more detailed provisions we are not convinced that SYSC 19E.2.1 (4) reflects the requirements of UCITS V appropriately and would suggest rephrasing that point.

Ideally management companies should have the possibility to opt for the sectoral remuneration regime, which is deemed most effective in terms ensuring risk alignment and apply it to all staff performing services subject to different sectoral remuneration rules. The pro-rated approach would be less effective in ensuring risk alignment particularly in relation to use of multiple instruments for the payment of variable remuneration.

Q2: Do you agree that management companies should apply the SYSC 19E Code to their first full performance period beginning after 18 March 2016?

We believe that the proposed transitional provisions are both a prudent and sensible approach for UCITS V implementation.

Due to the requirement to update relevant documentation in the prospectus and the KIID annually and the cyclical nature of this process, there is a strong likelihood that multiple updates of the documentation will be required within the month(s) post-completion of the annual KIID update to subsequently comply with the UCITS V Directive. This would create logistical, procedural and timing issues which would be difficult to mitigate without the transitional provisions.

Clear guidance on transitional provisions has not been provided by other national regulators nor ESMA. We would encourage the FCA to propose the transitional provisions to other regulators and authorities to support a pan-European adoption of these provisions. A cross-jurisdictional approach to transitional provisions would ensure that all funds within Europe are captured and would mitigate the difficulty of having to update various fund documentation across a number of jurisdictions at different points in time.

Q3: Do you agree with our proposed guidance on payments of variable remuneration in non-cash instruments?

The Investment Association supports the principle approach the FCA has taken with regard to the payment in non-cash instruments. However, we would like to encourage the FCA to clarify the

provisions in SYSC 19E.2.17 R et seq. 19E.2.18 G refers currently to "the management of UCITS". The text of the directive and the ESMA guidelines refer to "management of the UCITS". Using the singular form makes a significant difference for the application of the 50% threshold. ESMA provided in its guidelines on sound remuneration principles under the UCITS Directive and AIFMD provide a useful clarification. ESMA clarifies in Paragraphs 36 and 37 of Section 6.5 Payment in instruments, that "the UCITS refers to a single instrument and not to a multitude of UCITS managed by the same management company.

With regard to the term "any variable remuneration component", we ask the FCA to clarify that this refers to the individual remuneration of a specific member of staff with regard to the management of UCITS.

Additionally, we think it would be appropriate to allow management companies to disapply the requirement to pay parts of the variable remuneration in non-cash instruments were a meaningful alignment of incentives and the interest of investors could not be achieved any longer or would be disproportionate. SYSC 19E.2.18 G (2) allows to determine a percentage below 50% of variable remuneration to be paid out in non-cash instruments. If the management of UCITS accounts for less than 50% of the total portfolio managed by the management company, we would suggest to enable firms to set this percentage, in agreement with its supervisor, to 0% where appropriate and proportionate.

Q4: Do you agree with our proposed approach to proportionality?

It would be appropriate to fully align the rules on proportionality with the approach taken under AIFMD. The FCA published its proposals before ESMA published its guidelines on remuneration. The ESMA guidelines allow for the full alignment and we would encourage the FCA to take this chance to simplify the handbook on this point by the means of alignment. A not fully aligned approach to proportionality could have significantly disruptive consequences for established and new delegation arrangements and would be detrimental for investors.

Q5: Do you agree with our proposed guidance on the application of the UCITS Remuneration Code to management companies that are BIPRU firms?

We agree with the approach taken by the FCA as mentioned in our response to Q1. However, it would be helpful if the FCA would establish a regime for IFPRU firms which covers the SYSC 19 E rules as well. Firms should be able to opt for a single regime for all their activities and all their members of staff. This will be the most cost-effective approach for firms and it would avoid overly complex variable remuneration and deferral arrangements resulting in a dilution of risk alignment as staff have a less clear line of sight between their remuneration and the interests of investors.

Q6: Do you agree with how we propose to transpose the investor disclosure requirements under UCITS V?

Depositary disclosures – We agree with the changes to COLL 4.2.5R (8) for UCITS.

Proposed extension of UCITS requirements to NURS prospectuses

However, we disagree with the proposal to require similar disclosure in NURS prospectuses too. Whilst paragraph 3.28 of the CP suggests that AIFMD already requires all these disclosures except COLL 4.2.5R (8)(h) on the availability of up-to-date information, AIFMD Art 23.1(f) specifies only the identification of delegates – unlike UCITS which specifies delegates **and sub-delegates**. For NURS there is currently no requirement to list all sub-delegates. Therefore, NURS AFMs would also be

required to update their prospectuses to include this new and additional information. This would impose what could be a significant burden on such AFMs, as well as on NURS depositaries (who will need to review these updates) and on the FCA (who will also have to receive and review such updates).

In addition, there may be NURS AFMs who have chosen to make available the AIFMD disclosures in ways other than via the fund prospectus. If this is the case, even the inclusion of the other depositary disclosures in NURS prospectuses will cause additional work.

We recommend that the UCITS depositary prospectus disclosure requirements are not extended to NURS for the reasons given above.

Regulatory Responsibility for provision of depositary-related information to AFMs for inclusion in prospectuses

We also recommend the addition of a rule, either in COLL 6.6B or in COLL 4.2 which places a responsibility on depositaries of UCITS to provide AFMs with the required depositary disclosures for inclusion in the prospectuses. Whilst the obligation to produce the prospectus rests with an investment company or, in the case of a unit trust or ACS, with the management company, it is dependent upon getting accurate and timely information from its depositary in relation to required depositary disclosures.

With regard to activities which a depositary might carry out for a UCITS or AFM and which might conflict with its depositary tasks, Art 25 second paragraph requires that a depositary makes these disclosures to investors. For ease we call these 'non-depositary tasks'. It does not specify how the depositary should make these disclosures to investors. It might be appropriate to include guidance under COLL 6.6B.3 or in COLL 4.2, that such disclosure could be met through inclusion in the prospectus and that the depositary should provide the AFM with the necessary information for inclusion if this disclosure route is taken.

Regulatory expectations as to timescales for updating prospectuses where there is a change in delegates/sub-delegates

It would also be helpful if the FCA were to clarify its expectations in terms of the timing of how quickly a prospectus should be updated in the event of a change to the list of delegates and sub-delegates. In this regard, we believe that changes to the list should be updated at the next planned update rather than immediately, particularly in view of the fact that an investor can, at any time, request up-to-date information. The clarification could be provided in the Feedback Statement commentary.

Regulatory expectations as to approval vs filing with the FCA

It would also be helpful if the FCA confirmed that its *approval* is not required where a prospectus is being updated solely to reflect changes to the list of delegates and sub-delegates. We believe that such a change requires only the filing of the updated prospectus. The clarification could be provided in the Feedback Statement commentary.

Means of communication of where up-to-date information can be found

We also welcome clarification an AFM can make such up-to-date information available by through the provision of a link to a website which contains such up-to-date information. The clarification could be provided in the Feedback Statement commentary (ie similar to the way in which remuneration disclosure is dealt with).

Remuneration disclosures – Finally, we agree with the proposals with regard to disclosure of remuneration.

Q7: Do you agree with how we propose to transpose the whistle-blowing requirements for management companies and depositaries?

Yes. The proposed approach is a simple and clear way in which to establish appropriate whistle-blowing mechanisms. It remains consistent with existing whistle-blowing requirements, so should minimise the work required to implement.

The FCA should endeavour to ensure that the final rules are consistent with those implemented following FCA CP15/4 on whistleblowing in deposit takers, PRA designated investment firms and insurers.

Q8: Do you agree with our proposed transitional provisions, for firms to update their fund documents?

General comment covering UK implementation of the UCITS V requirements and request for clarification

Paragraph 3.36 suggests that there might be a need for prior approval for prospectus changes. Prior approval, as opposed to simply filing prospectuses, would cause a significant amount of work and impact already tight timescales, with no appreciable benefit to investors. In effect, it would bring the UK deadline for action forward to 18 February. This allows UK firms very little time following the finalisation of the UK provisions giving effect to UCITS V implementation.

If changes to the prospectus are made to meet the UCITS V disclosure requirements (ie no additional changes are made at the same time which necessitate approval), we do not believe that changes to implement UCITS V necessitate pre-approval by the FCA. This would place not only a significant burden upon AFMs but also on the FCA. Filing updated prospectuses/KIIDs with the FCA is, we believe, all that is required to implement UCITS V.

If there are any aspects of UCITS V implementation which the FCA believes would require prior approval,early specification of those matters would assist the industry. One solution would be an amendment to the legislation (s 251 FSMA and s 21 of the OEIC Regulations). As this is within the remit of HMT, we will discuss this issue with HMT. Such change would reduce the regulatory burden (and related costs) upon firms as well as ensuring that such firms have the full period until 18 March to effect compliance with UCITS V.

Depositary disclosures

We agree with the FCA's proposed transitional provisions regarding depositary disclosures.

Remuneration disclosures

We agree with the FCA's proposed transitional provisions regarding remuneration disclosures.

Q9: Do you agree with our approach to implementing the rules applicable to depositaries of UCITS in COLL?

Yes, we agree with this approach.

Q10: Do you agree with how we propose to transpose the depositary requirements in COLL 6.6B, and the requirements for management companies in relation to depositaries in COLL 6.6A?

Transposition of depositary requirements

Conditions for delegation to a third party

Unless it will be covered by a change which HMT is responsible for transposing, we believe that COLL 6.6B.25R should include a provision transposing Art 22a(3) (d) regarding the taking of all necessary steps to ensure the unavailability of UCITS assets in the event of the insolvency of the third party. We appreciate that L2 measures will contain details as to expectations but this L1 requirement needs to be reflected either in changes the FCA or HMT makes.

Custody requirements

With regard to the reference to CASS in 6.6B.18R (2)(b), please see comments in response to Q16 and our suggestion that all UCITS custody requirements be contained in COLL rather than being spread across two sourcebooks.

Conflict obligations: Non-depositary tasks

With regard to COLL 6.6B.3R – 'Conflicts of interest: depositaries', we assume that this provision deals with situations where the depositary carries out activities (e.g fund accounting) (for ease, we call these 'non-depositary tasks') for the UCITS/AFM other than activities which flow from its duties as depositary. If this is correct, it might be useful to draw that out in the heading.

It might also be helpful to include guidance that these obligations are distinct from, and in addition to conflicts of interest obligations relating to the depositary carrying out of its depositary duties.

In addition, as mentioned in response to Q6, COLL 6.6B.3 does not specify how the depositary should make these disclosures relating to non-depositary tasks to investors. It might be appropriate to include guidance under COLL 6.6B.3 or in COLL 4.2, that such disclosure could be met through inclusion in the prospectus.

Regulatory Responsibility for provision of depositary-related information to AFMs for inclusion in prospectuses

As mentioned in response to Q6, we recommend the addition of a rule, either in COLL 6.6B or in COLL 4.2 which places a responsibility on depositaries of UCITS to provide AFMs with the required depositary disclosures for inclusion in the prospectus. Whilst the obligation to produce the prospectus rests with an investment company or, in the case of a unit trust or ACS, with the management company, it is dependent upon getting accurate and timely information from its depositary in relation to required depositary disclosures.

Transposition on the Reuse of Assets

The requirement in COLL 5.4.3 R (1) (b), in specifying an arrangement or contract must be "in the best interests of its unitholders", goes beyond the requirement under article 22(7)(c), which requires "the reuse is for the benefit of the UCITS and in the interest of the unit holders". In practice, it will be difficult to demonstrate a transaction is in the "best interests" of unit holders. The requirement in article 22(7)(c), that the arrangement or contract must be "in the interest of the unit holders" already sets a high, although achievable, threshold for managers of UCITS, and is sufficient to ensure investors in UCITS are protected. The addition of "best" to this requirement will not enhance this investor protection measure, rather it will be a barrier to UCITS managers entering into stocklending arrangements that benefit the UCITS. We therefore request that the word "best" is removed from

COLL 5.4.3 R (1)(b) to align this rule with article 22(7)(c). This would also be in keeping with the FCA's general approach of not imposing any new requirements over and above what is required in UCITS V.

We recognise the proposed rule in COLL 5.4.3 R (2) is intended to replicate the current requirements in COLL 5.4.3 R (1), however this rule will impose an additional requirement above those in the UCITS Directive. Given an appropriate standard has now been set in the UCITS Directive to ensure stocklending arrangements are for the benefit and in the interests of unit holders, the rules in COLL relating to stock lending should be aligned with the UCITS Directive and imposing additional rules over and above the Directive, such as the proposed rule COLL 5.4.3 R (2), should be avoided. However, as this provides a useful indication of the FCA's expectations on what it considers an arrangement or contract that meets the requirement of being in the interests of unit holders, we suggest the requirements of COLL 5.4.3 R (2) are redrafted to take the form of guidance rather than a rule.

Transposition of management company requirements

We agree with the transposition of management company requirements in relation to depositaries in COLL 6.6A.

The numbering in COLL 6.6.A.7R (2) should refer to 'COLL 6.6B.1**8**R and COLL 6.6B.19R' rather than 'COLL 6.6B.19R and COLL 6.6B.**20**R'.

Q11: Do you agree with the proposed eligibility criteria for a depositary of UCITS funds, including the definition of when a depositary is established in the UK?

Yes. It is important that the UK regulatory regime continues to support the range of entities currently acting as depositaries for UCITS. The FCA's approach achieves this.

Q12: Do you agree with our proposed capital resources requirements for non-bank depositaries?

Yes. As the consultation paper notes, maintaining the current minimum requirement of £4 million for non-bank depositaries rather than lowering it to the permissible Euro 730,000 offers a better level of protection to investors in UCITS schemes. It is also in keeping with the requirement for capital resources requirement for depositaries of Authorised AIFs.

We also support the application of this requirement to incoming EEA firms with a top up permission to act as depositaries for UK UCITS. This provides investors with the same level of protection.

It also ensures that UK depositary firms are not at a competitive disadvantage, on the capital resources requirement front as compared to incoming EEA firms. This would have been the case if such firms were subject only to a Euro 730 000 requirement.

Q13: Do you agree with our proposed approach to cross-refer to the Pillar II requirements in IFPRU 2?

The cross-reference to part of the rulebook covering the Pillar II requirements is useful. Sign-posting will be particularly helpful to new entrants to the depositary market.

Q14: Do you agree with our proposed revised reporting requirements for non-bank depositaries subject to IPRU (INV) 5?

We have no comments on regulatory reporting requirements.

Q15: Do you have any comments on using the definition of 'financial instruments' under MiFID II for UCITS schemes?

No. We agree that UCITS V defines 'financial instrument' by reference to MiFID II.

Q16: Do you agree with the proposed application of CASS and CASS-related Handbook provisions in relation to depositaries of UCITS? If not, please provide reasons.

We wonder whether this is an opportunity to take a different approach as regards the custody of assets – for UCITS schemes and, on reflection, for AIFs too. Historically, there was little by way of detailed custody requirements for depositaries of UCITS and AIFs. CASS 6 filled that gap. Now, with both AIFMD (and its L2 Regulation) and UCITSD (and expected L2 Regulation will) set out depositary custody requirements in significant detail, we suggest all depositary custody requirements be set out in the respective investment fund sourcebooks. The bulk of the Directives' custody requirements already sit in FUND for AIFs and will sit in COLL for UCITS.

It would reduce complexity to locate all depositary custody rules in the relevant investment funds sourcebook. This would likely be helpful to potential new entrants to the depositary market.

This could be achieved by making clear in CASS 6 that all custody requirements for depositaries of UCITS or AIFs, is contained in COLL or FUND respectively and including in COLL/FUND any additional (ie non AIFD/UCITSD custody requirements, the FCA considers necessary).

Looking at the small list of additional provisions set out in draft CASS 6.1.16I as applicable to UCITS depositaries, this should be achievable. Indeed, the UCITS L2 Regulation may reduce this list further or lead to amendment of items in the list. We comment below:

6.1.1R – This would not be necessary if all depositary custody rules are in COLL.

6.1.1BR(3) – This could be included within COLL.

6.1.9G – This could be included within COLL.

6.1.16IEG - This would not be necessary if all depositary custody rules are in COLL.

6.1.22G-6.1.24G – 22 and 23 could be included within COLL. 24 appears to be guidance relevant to MiFID firms. Is this relevant to firms in respect of their obligations as depositaries of UCITS?

CASS 6.2.3R, CASS 6.2.3AR, CASS 6.2.3BG, CASS 6.2.7R – These could be included in COLL. CASS 6.2.3BG might need tailoring to cater for potential L2 measures which might require the obtaining of independent legal advice on 3rd country insolvency laws.

If the FCA decides to proceed with the approach outlined in the CP, we comment as follow:-

In due course, CASS 1.4.6B and 6.1.16IE will need to be updated assuming, as with AIFMD implementation, the L2 measures take the form of a Regulation.

6.1.24G –As noted above, appears to be guidance relevant to MiFID firms. Is this relevant to firms in respect of their obligations as depositaries of UCITS?

CASS6.1.16IE should refer to COLL 6.6B.2**2** rather than COLL 6.6B.2**3** (based on the numeration of the draft COLL rule on 'Limit on delegation').

Q17: Do you agree with the proposed transitional provisions for depositaries of UCITS?

Yes - We support the UK making full use of the transitional provisions allowed for within the UCITS Directive.

Q18: Are any other transitional arrangements required for non-bank depositaries to be able to comply with our proposed capital requirements?

We are not aware of any additional matters which might require additional transitional provisions.

Q53: Do you agree with our cost benefit analysis for changes to the Handbook implementing the UCITS V requirements?

Remuneration - Most of our member firms expect the implementation of the UCITS remuneration provisions to be at least as cost and time consuming as the implementation of AIFMD. Even in the case of a full alignment with the SYSC 19 B, firms will have to go through the whole process before they can disapply certain provisions on proportionality reason. A number of firms which are currently subject to the SYSC 19 B or SYSC 19 A are able to disapply some of those provisions, but they are likely to be subject to the full set of rules under SYSC 19 E.

Depositary – The analysis appears reasonable. The only comment we have is in relation to the proposal to extend UCITS depositary disclosure requirements to NURS prospectuses. We disagree with the proposal for the reasons given in response to Q6.

This would incur additional costs for NURS managers, depositaries and the FCA if it is required. We believe that AIFMD requirements already meet investor needs and the extension of UCITS requirements for prospectuses to NURS is unnecessary and would not justify any costs involved.

Sanctions – We agree that the cost of the proposals should not be excessive, their being consistent with existing standards. We also note that the FCA is obliged to impose these requirements, and is doing so in a way that should minimise the cost.

Q54: Do you agree with our assessment that the proposed new capital requirements will have a limited effect on competition in the market for depositary services and potential new business models?

As the FCA notes, the current capital requirements do not appear to have hampered the recent growth in the number of Authorised Fund Depositaries in recent years so this would suggest the proposals would have limited effect on competition.