Financial Services Consumer Panel

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By email: cp26-16@fca.org.uk

Dear FCA,

Financial Services Consumer Panel response to FCA CP 26/16: Registration of Authorised Fund Assets

The Financial Services Consumer Panel (the Panel) welcomes the opportunity to respond to the FCA's consultation paper (the CP) titled Registration of Authorised Fund Assets. We are an independent panel that represents the interests of consumers of financial services including both individuals and small businesses. Our focus is on the outcomes and impacts to these stakeholders.

The Panel supports the FCA's position that the private market is important for the UK's economy. We also support the position that consumers should be able to invest in private market assets when they meet their needs, objectives, and attitude to risk, but only when appropriate consumer protections are in place.

The role that depositaries play in the governance of authorised funds is critically important. Depositaries provide assurance to fund investors that the assets of the fund are securely safeguarded, regardless of the situation of the authorised fund manager (AFM). In order to accomplish this, under current regulations, the depositary or a delegate it controls must be the registered owner of all fund assets. To prevent the possibility of any actual or perceived conflict of interest, the depositary must be independent of the authorised fund manager (AFM).

As the CP notes, current regulations may create problems in the context of the private market, particularly for Alternative Investment Funds (AIFs) that include assets such as real estate or partnerships. Law changes and other issues mean that the registered owner of these asset classes may be subject to potential liabilities, including criminal penalties. Given that a depositary has no decision-making capability over the assets themselves – either the decision to invest or management of the invested assets – this exposes the depositary to serious liabilities over which they have no control. The Panel agrees that this is an untenable situation that should be resolved. We agree that the FCA proposal to allow the registration of ownership of these assets in the name of an affiliate of the AFM (but not the AFM) is likely to be the best solution, as long as the depositary must still have a high degree of oversight.

The Panel believes that the depositary must implement controls to ensure that the assets are properly recorded when placed in the fund and when there are any changes in ownership. In addition, we expect the depositary to monitor that the AFM and its affiliate are not taking actions that will jeopardise the value of the asset, as well as monitoring the solvency of the registered owner.

The Panel has always taken a strong view that the regulatory approach should be the same for the same regulatory risk, regardless of asset, structure, or size. Therefore, we agree with the FCA's proposals to align the rules between fund structures. This means that, for these same assets, the depositary can only delegate registration to affiliates of the AFM and the same investor protections are imposed. This will ensure a clear and consistent regulatory framework, making it easier for firms to explain and consumers to understand.

We also encourage the FCA to ensure that consumers investing in these fund structures and asset classes are provided with fully transparent disclosures and that the consumer can demonstrate their understanding of the product and the various risks.

We have provided brief responses to some of the questions in the attached annex. However, we did not answer question 5 or questions 8 to 11 as the CP did not provide enough information for us to determine an appropriate response. However, our view is simply that the FCA should ensure that there is no increased risk to consumers as a result of the proposals.

The Panel would also like to take this opportunity to encourage the FCA to explore simplification of the structure and terminology relating to authorised funds. Paragraph 2.2 of the CP highlights just some of the complexity. We point out the following:

- Only the most sophisticated market participants will be able to understand the distinctions between these concepts.
- It is likely that only the largest firms will be able to keep up with associated innovation and regulatory change.
- Consumers are far less likely to invest if their introduction to an investment is via terminology that is beyond their vocabulary.
- Competitors from other jurisdictions will find it easy to capture market share with simpler product structures that "speak to" consumers.

Yours sincerely,

Chris Pond
Chair, Financial Services Consumer Panel
Annex

Question 1: Do you agree that we should allow the depositary of an authorised AIF managed by a full-scope UK AIFM the option of delegating its COLL registration function and CASS 6 custody function for assets that are not AIF custodial assets?

Yes, the Panel agrees that the depositary should be able to delegate the registration function for asset classes, such as real estate and partnerships, that have the potential to create material liabilities that are not within the depositaries control. Please see our cover letter for additional detail.

Question 2: Do you agree that the persons able to act as the delegate of a depositary of an authorised AIF managed by a full scope UK AIFM, for its COLL registration function in respect of assets that are not safe custody investments or AIF custodial assets, should only be 'affiliates' of the AFM?

Yes, the Panel agrees that only affiliates of the AFM, but not the AFM itself, can be the registered owner or partner of asset classes that may create liabilities associated with the ownership and management of the assets, to ensure that the liabilities and associated decision making are aligned. Although this does not fully eliminate risks relating to potential conflicts of interest or insolvency of the AFM or members its group, we believe that the FCA should implement and / or enforce relevant rules to mitigate such risks.

Question 3: Do you agree with our proposed additional protections, to apply when the depositary of authorised AIF managed by a full-scope UK AIFM delegates its COLL registration function in respect of assets that are not safe custody investments or AIF custodial assets to the AFM's affiliates?

The Panel agrees with the FCA's proposed additional protections to apply when the depositary delegates its registration function to the AFM's affiliates. In line with these, we believe that the FCA should expect all parties - the AFM, the AFM affiliate, and the depositary - to document a full risk assessment of the various risks associated with these asset classes and the firms' respective roles. The FCA should engage its supervision team and / or perform good and poor practice and / or multi-firm reviews to ensure that this is done at an expected level of competence.

Question 4: Do you agree that in the case of immovables located in the UK, the persons able to act as the delegate of the depositary of an authorised AIF managed by a full scope UK AIFM, for its COLL registration function, should only be 'affiliates' of the AFM that also take the form of a UK company subject to the Companies Act 2006?

Yes, the Panel agrees that, in these cases, the AFM affiliate must take the form of a UK company subject to the Companies Act 2006, for the reasons set out in the CP. However, the Panel would encourage the FCA to carefully consider whether, given the connection between the AFM and the AFM affiliate, there could be situations where the fiduciary duties of the directors of the relevant AFM affiliate could conflict with the policy aims of these proposals.

Question 5: Do you have any feedback on matters relevant for UK property overreaching?

The Panel notes the current proposals do not prevent multiple transfers in the legal ownership of the relevant fund assets. It is essential that, save where any such transfer is removing the assets from the fund, such transfer ensures the assets continue to be held on trust for the depository by an AFM affiliate. Before proceeding, the FCA must ensure its proposals achieve this and will not be frustrated by UK property law.

Question 6: Do you agree with our proposed changes to the COLL registration function requirements for depositaries of authorised AIFs managed by small UK AIFMs, in respect of assets that are neither safe custody investments nor AIF custodial assets?

As we noted in our cover letter, the Panel believes strongly that the same regulatory risk should have the same regulatory treatment; therefore, we agree that these proposed changes create regulatory consistency. In addition, the changes eliminate the potential for issues arising when a small UK AIFM grows to a point where it no longer meets the criteria of a small UK AIFM.

Question 7: Do you agree with a rule change preventing a UCITS AFM from acting as a delegate for the depositary for any task?

Yes, the Panel agrees that a UCITS AFM should be prevented from acting as a delegate for the depositary for any task. To do otherwise creates the potential for significant conflicts of interest and control weaknesses or failures.

Question 8: Do you have any other feedback on COLL registration function (or custody) issues for UCITS funds?

No response.

Question 9: Do you agree with our proposed re-drafting of the COLL registration function rules and the new guidance which aim to clarify their requirements in respect of assets that are neither safe custody investments nor AIF custodial assets?

No response.

Question 10: Do you agree with our proposed change to the COLL registration function rules that, for safe custody investments, the depositary can only have the assets registered in its own name in the

case of partnerships that are a CIS but that are not AIF or UCITS custodial assets?

No response.

Question 11: Do you agree with our interpretation of CASS 6's application to UCITS and AIF depositaries as set out in this CP and do you agree with our proposed CASS 6 rules changes and new guidance?

No response.

Question 12: Do you think any of these proposed CASS 6 rules changes and new guidance could create unintended consequences that would negatively impact the protection of client assets?

The Panel is not directly responding to this question; however, we believe that the FCA must carefully analyse the various potential impacts of these changes to ensure that there are no unintended consequences of the rule changes and guidance. The FCA should also have an action plan at the ready if unanticipated consequences do arise.

Question 13: Do you agree that, should feedback indicate that our objectives would be advanced by the rule changes in this CP, we should proceed to make them at the earliest opportunity, and before any later changes that may stem from our planned broader review of depositary rules?

The Panel does not object to making changes at the earliest opportunity. However, we do suggest that the FCA carefully considers the risks of layering regulatory changes, as that is likely to create confusion, may lead to non-compliance as firms may not keep up and could add extra costs that are then passed on to consumers.

Question 14: Do you agree that we should replace the Modification by Consent for COLL 5.6.22R with permanent rule changes?

The Panel supports the replacement of the Modification by Consent with permanent rule changes in order to establish a tighter regulatory framework that is clear to stakeholders. This also includes the associated obligations imposed on depositaries as noted in paragraph 4.6.