

Investment entities listing review

Response to CP 07/12 by the Association of Investment Companies

The Association of Investment Companies (AIC) fully supports the FSA's decision to consult again on possible additional changes to the Listing Rules applying to listed investment entities. To date the review process has been lengthy, but it has encouraged a thoughtful and wide-ranging debate that has resulted in beneficial changes to the rules. We are confident this consultation will result in further improvements.

Given the fast moving nature of the market, and the need for the UK's official list to maintain its attractiveness in comparison with overseas jurisdictions, it is also appropriate to introduce an 'interim' rulebook in advance of possible further changes. A 'two-stage' approach to changing the rules helps the market, as the further adjustments discussed in the consultation are deregulatory and support the direction of travel of those already agreed. In addition, the interim rulebook will allow issuers to enjoy the benefits of deregulation as soon as possible.

We also welcome again the decision to close the directive minimum route to listing investment entities once the dedicated investment entity rules have been finalised. Over the long term this will maintain proper standards within the market and support important elements of consumer protection. At the same time, we would reiterate our view that the FSA (in its capacity as the UKLA) should be prepared to deregulate as far as possible without compromising the standards essential to maintain its objectives.

Regulation should be imposed only to the extent that it will achieve required regulatory objectives. It should not impose additional obligations. This response judges each rule on its merits and regulatory impact. We are confident that further deregulation can be achieved for the benefit of the market and without disadvantaging consumers.

Proposed rule changes

Scope of Chapter 14: The AIC strongly supports the FSA's decision to close Chapter 14 (the directive minimum route) for listing investment companies once the dedicated investment entities provisions have been finalised.

We also believe that the definition proposed to prevent investment entities listing under Chapter 14 is sufficient to cover the relevant listed vehicles. It is also appropriate to introduce arrangements to allow investment entities currently listed under Chapter 14 to maintain this status, while allowing them to elect to move to the dedicated investment entity rules if they choose to do so.

Q.1. Do you agree with our proposed change to the scope of Chapter 14?
Yes.

Experience of the investment manager: The AIC has previously supported the rule change that stipulates that a manager with FSA authorisation (or authorisation from an equivalent competent authority) is considered to have appropriate experience to manage the assets of the investment entity. This formulation will provide a clear and simple way for the majority of investment entities to satisfy the FSA that the manager has sufficient experience. It is a welcome change from the current rules.

However, we **recommend** further deregulation in this area. One continuing issue, not addressed by the interim rule, is that it does not assist self-managed investment entities – which do not employ an FSA authorised manager. In this context the requirement for an investment entity to have “adequate experience” focuses on benchmarking the experience of management teams against mechanistic tests that are not suitable for the purpose. The rules applying from September 28th 2007, for example, will recognise that a manager has sufficient experience if they have managed a portfolio of at least 50% of the funds the applicant is proposing to raise. Measurements such as these are not really an accurate test of experience or expertise. This approach also fails to recognise adequately the combined experience of a management team (including the board) and does not fit with the FSA’s laudable desire to move towards principles-based regulation.

The AIC is also sceptical that this provision, which is only relevant on listing, is of any real regulatory value given that management resources (and their adequacy) will change over time as personnel change and other factors within the fund (size of the portfolio or even the investment mandate) evolve. On the other hand, making the experience requirement a continuing obligation is also problematic. It is difficult to see how the FSA can be expected to have greater insight than a sitting board regarding relevant levels of experience within a management team and whether or not it is sufficient for purpose. The FSA can only take such a view by relying on the aforementioned mechanistic tests, which are not, in reality, appropriate. The AIC therefore welcomes the FSA’s proposed revisions, intended to be introduced in Q1 2008, which delete the specific rules related to the expertise of directors and managers.

This said, the AIC accepts entirely that a board has a duty to its shareholders to ensure that the entity has the necessary systems in place to operate effectively. This includes ensuring that the board itself has appropriate expertise and that other essential management functions are adequate. These other functions would include relevant company secretarial functions, broking, legal and accounting services and any number of other aspects of effectively running the company. However, these are part of the general obligations of the board and not a matter for the listing rules for closed-ended investment companies. With this in mind, the AIC

believes that the proposed rules should not single out fund management for specific guidance, as is currently envisaged.

Of course, effective portfolio management is critical to running the company, but it is not the only service that is fundamental to the delivery of shareholder value. If the entity does not have, say, adequate custodial arrangements, in the worst case scenario this could lead to a catastrophic result for shareholders which would be just as damaging as a portfolio management failure. Despite this, other individual services such as this are not specifically identified, so it is not clear why fund management should be singled out.

Indeed, the inclusion of guidance on fund management is arguably contrary to the very purpose of the Listing Rules. These rules are not designed to protect shareholders from the risk of poor performance, they are to maintain adequate regulatory safeguards. Given the board's general role in overseeing the operation of the entity it is difficult to see that this guidance has any part to play in the revised rules. There is no objective reason to single the issue of fund management out for special attention and the guidance should be removed.

It is also difficult to see what justification there is for this guidance when, as the text itself acknowledges, this specific consideration is not a requirement for listing, but instead part of the general duties of the board. It is wrong in principle that the rules should include 'guidance' in relation to a listing rule that does not exist.

The AIC therefore **recommends** that, as a minimum step, the new formulation proposed in the consultation should be adopted. We also believe that the FSA should revise the requirement further. The AIC **recommends** that the FSA should delete the guidance set out in 15.2.10 G.

Q.2. Do you agree we should delete the detailed requirements to demonstrate sufficient experience on the part of the investment manager?
Yes. The FSA should also go further and delete the proposed, 'residual', guidance on this point.

Board independence criteria: The AIC agrees that there is further scope to deregulate the rules relating to board independence. The key requirement of the rules is that boards' should have an independent majority and that they should be able to satisfy investors that this is the case. Once this principle is established, detailed rules, which could compromise the ability of boards to recruit the directors they want (and who shareholders have to elect), should be avoided. This position leads the AIC to a number of conclusions.

The AIC agrees that the current restriction on the number of managers appointed to the board should be removed and **recommends** that the FSA adopt this course. After all, if the majority of the board are independent, concerns about the

composition of the minority (which cannot dictate the strategy or direction of the company) fall away.

The AIC also **recommends** that the FSA should delete or clarify the guidance (set out in 15.2.12 G) which sets out a range of detailed circumstances where board members would not be deemed independent.

Independence is not a function of whether or not an individual board member meets set criteria - it is a reflection of their state of mind and approach to decision making. Directors can be questioning and challenging regardless of their relationships. The judgement of independence is for the board to assess and shareholders to judge. If shareholders are not happy with the performance or perspective of the board they are able to vote on directors' appointments accordingly. With this, and the FSA's stated desire to move to a principles-based regime, in mind, the ideal approach would be to delete all the guidance on independence.

The current rules can lead to anomalies. For example, take a board that has three directors, one of whom is a manager and two of whom meet the current criteria for independence. The Board decides to fire the current manager for persistent underperformance and hire a new one. Clearly these board directors have demonstrated their ability to act independently of the manager.

In a beauty parade, the remaining board members appoint a new management company. They also recruit a new board member (to replace the director from the previous management group, who has stood down). None of the new board have a relevant connection with the new management company. The new arrangements are a success and performance improves.

Twelve months later the management company is taken over by a competitor. The two original directors have one board appointment each with separate investment companies also managed by the new manager.

According to the current rules these two directors are no longer independent – despite the fact that they have previously demonstrated independence of mind and their new 'relationship' with the manager was outside their control. Under the current rules at least one of the board members would have to stand down and be replaced to maintain an independent majority on a three-person board.

In an alternative scenario, a five-person investment company board decides to move to a multi-manager model. The company has a global investment mandate and the board is concerned about unsatisfactory performance in parts of the portfolio. The board decides to retain the existing manager to run the UK part of the portfolio (which is performing strongly) and to carry out the other administrative functions supporting the company. However, they wish to recruit four new firms to

manage investments in North America, continental Europe, Asia Pacific, and Japan.

They decide to invite managers to participate in a beauty parade for the relevant management contracts. They undertake research to identify managers who should be invited to pitch. Their intention is to ask the five managers operating in each geographic area who have been the top performing in the relevant region over a certain duration to make a pitch. However, this exercise identifies one or more firms in relation to each contract that would make one of the current independent directors non-independent. Therefore appointing one of these firms would mean that the board no longer have an independent majority under the FSA's view on independence. This situation would arise because individual directors already serve on companies with portfolios managed by those managers.

Perhaps the most commonplace situation where the current rules create problems, and the potential for shareholder detriment, will be where a board simply wants to replace a retiring board member who was previously part of the independent majority. They would be excluded from considering many experienced – and independent minded - candidates just because they also serve on another board of a company managed by the same manager.

These examples demonstrate the flaws in the current rules and how they could have an adverse impact on the shareholder interest. The rules should not be allowed to affect board composition and the allocation of management contracts in this way.

The case for deleting the provisions is reinforced because investment entities listed under these rules have to report against the Combined Code. Detailed provisions within the Code require the annual report to identify independent non-executives and that it must:

“identify in the annual report each non-executive director it considers to be independent. determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect , the director's judgement ... state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination”. (The Combined Code on Corporate Governance. Principle A.3. Board balance and independence. Code provisions A.3.1)

This overarching requirement is supported by a list of circumstances that might be relevant to this explanation. It includes the key issues raised in 15.2.12 G. The AIC **recommends** that relying on the Combined Code – which is monitored closely by corporate governance agencies who advise investors – is the way to deal with the issue of independence. It also has the advantage that the Code is 'comply or explain' and therefore maximises commercial flexibility while acting to maintain appropriate standards.

The fact that the Combined Code is a 'comply or explain' regime highlights a further problem with the Listing Rule's detailed provisions on independence. The rules present the detailed independence provisions as 'guidance' – which also suggests it has the character of a comply or explain regime. However, we understand from discussions with the FSA that it considers these conditions to be compulsory.

It is therefore inappropriate to label these provisions as 'guidance'. If the approach is compulsory then it should be made clear – to do otherwise is very unhelpful. The issue of 'guidance' is covered in more detail below, but the AIC **recommends** that (if its preferred approach of deleting the guidance cannot be achieved and the FSA is not prepared to change its policy position) the compulsory nature of these requirements should be made clear and these obligations should be labelled as rules.

Q. 3. Do you support allowing more than one manager representative on the board of a listed closed-ended investment fund? Yes. The AIC also supports deleting the more detailed provisions on independence as they are not appropriate in a principles-based regime – particularly as the requirements of the Combined Code could act as suitable guidance in relation to determining independence.

Feeder funds: The AIC agrees with the proposed rule amendments designed to encourage the listing of feeder funds and **recommends** they be adopted.

Q. 4. Do you agree that, subject to the conditions proposed above, feeder funds should be listed? Yes.

Quarterly portfolio disclosure: The AIC strongly **recommends** that the quarterly portfolio requirements of major holdings (as set out in 15.6.8 R (2) of the proposed final rules) should be deleted.

A fundamental problem with this disclosure is that it creates a barrier to listings of certain types of fund – notably hedge funds. As the FSA recognised in its previous consultation, the disclosure of major positions, particularly where alternative investment strategies such as short selling are involved, could ultimately compromise the ability of an investment entity to achieve its investment objectives. This would be damaging to the shareholders in that fund and it is inconceivable that entities with investment strategies of this type would list in London if rules remain in place that could threaten their successful implementation.

The FSA is rightly trying to enhance the attractiveness of the UK as a listing venue. Given the anticipated growth of non-traditional fund sectors it would be undesirable if the rules discouraged their listing. This argument is particularly compelling as the AIC is unconvinced that this specific rule provides any real value.

The proposed rule does not provide any benefit from a regulatory perspective i.e. it does not address any possible market failure or provide any consumer protection. This is because the relevant information required for regulatory and consumer protection purposes is already provided through other required disclosures.

The main disclosure required of investment entities under the revised rules will be an annual statement of the investment policy of the fund and how it is achieving those objectives. Companies will also have to provide a comprehensive analysis of the investment portfolio. These disclosures will provide the critical information for consumers and provide assurance from a regulatory perspective that these entities are suitable to be listed under the investment entities rules.

We note that the portfolio analysis included in the annual report is likely to include detailed information akin to that required under the quarterly portfolio rules. This disclosure should not create insurmountable difficulties for hedge funds because of the timing of the announcement.

The proposed listing rule on quarterly disclosure requires information to be provided within five business days of the end of each quarter. While this is an improvement on the 'interim' rule – which has a two-business-day deadline – it is still a very short timeframe in the context of a fund seeking to secure investment returns from, say, short selling. In contrast, the portfolio analysis required by the annual reporting requirements is far more flexible. Under the new requirements of the Transparency Directive, the analysis in the annual report can be published up to four months after the year-end. Also, the principles-based nature of the annual disclosure will allow flexibility on how the investments within the portfolio are described. This should mean that positions that might be compromised by disclosure in a prescribed manner, as proposed by the quarterly disclosure rules, can instead be made in a way that does not compromise shareholders' interests.

In addition to the more flexible approach offered by the annual report, there are a number of other disclosures, which the AIC fully supports, which also provide specific regulatory and consumer value and make the quarterly disclosure of major holdings redundant.

Retained disclosures which continue to have value include: the quarterly disclosure of cross-holdings; disclosures (as required) on inside information; and disclosures in relation to major acquisitions or disposals. Investment entities are also required to provide interim management statements on a quarterly basis that describe the "*general financial position and position of the issuer*" and "*material events and transactions*". Investors therefore have regular and comprehensive information about the overall operation of the company and major events that could affect its future prospects. This should be the limit of what is required for regulatory purposes.

The AIC recognises that there are some market participants that would like to have additional information on the holdings of a company – and that this information would be disclosed under rule 15.6.8 R (2) as currently proposed. However, the fact that some parties with particular interests might want this information does not justify making the disclosures a regulatory requirement (particularly when the requirement could, in effect, prevent listings of some funds).

The deletion of the specific rule on quarterly portfolio disclosure will not prevent portfolio information being provided to the market. Where it is clear that shareholders, analysts and other market participants value the information, and that disclosure will not compromise the interests of the entity and its shareholders, the AIC envisages that information on major holdings will continue to be provided. It will be disclosed where there is sufficient demand or where the company can identify marketing or other commercial value in releasing the information. The AIC anticipates that many investment entities will continue to make disclosures on a quarterly basis (or even more regularly as many already issue monthly 'factsheets'). However, allowing the market to determine disclosures of this nature is very different to creating a regulatory requirement.

The FSA should regulate only to the extent that rules are required to achieve its specific objectives. It should not set rules simply to satisfy the desires of particular interest groups. The AIC therefore strongly **recommends** that rule 15.6.8 R (2) be deleted from the final investment entity rules.

Q. 5. Do you agree with the proposed minimum level of disclosure we set out in paragraph 4.24 above? We assume this question is intended to refer to the disclosures set out in paragraph 4.25 i.e. on cross-holdings, inside information, acquisitions or disposals of major shareholdings, and portfolio information in periodic disclosures. These should be retained as the minimum required. They should not be supplemented by a requirement on quarterly portfolio disclosure.

Q. 6. Do you agree with our proposal to require, in addition to the minimum level, quarterly disclosure of positions of excess of 10%? Would your view be different if the disclosure threshold were raised to 20%? No, the AIC does not support quarterly portfolio disclosure of major holdings. If further disclosures were required (in spite of AIC opposition) it may be that some of the problems created might be in part alleviated by a higher disclosure threshold - but this is not certain. On that basis, if the FSA does decide to press ahead with additional disclosures, a higher threshold of 20% should be introduced.

Transactions with related parties: The AIC welcomes the FSA's decision to look carefully at related party transactions as part of this consultation. The issue is an important one for our members, particularly Venture Capital Trusts (VCTs) and private equity investment companies, and we agree that there is potential for deregulation in this area.

Deregulation which removes administrative burdens in relation to transactions involving the listed entity and its manager will be important primarily because of the practice of 'co-investment'. Co-investment is the situation where the manager purchases assets that the investment entity itself also buys. This is a common technique in some investment areas, notably venture capital and private equity, because it provides strong incentives which closely align the interests of managers with the fund and because it can help provide the required scale of investment in certain transactions. Indeed, the value of this approach was recognised in the dedicated VCT rules, which are to be abolished as part of the process of moving to a unified regime.

The problem with deeming managers related parties is not that it places an absolute prohibition on co-investment but that it creates an additional administrative and cost burden where boards choose to agree to co-investment as part of the arrangement between the investment entity and the manager. This is unnecessary as the board must be independent of the manager – as required by the Listing Rules – and the conditions for co-investment will be governed by comprehensive contractual arrangements that dictate the terms and conditions under which this activity is undertaken.

With this in mind, the AIC strongly supports the FSA's suggestion that an exemption reflecting current VCT rules in relation to related party transactions should be introduced into the final investment entity rules. The AIC therefore **recommends** that, as a minimum, an exemption to the related party rules should be introduced for all investment entities where a transaction is designed to facilitate the provision of finance to an investee company and where the transaction is in accordance with a pre-existing agreement (as set out in the proposed rule 15.5.5 R). This will allow co-investment to be undertaken, support the delivery of high-quality fund management services and maximise investment opportunities for listed investment entities.

However, there is a strong case for the FSA to go further. One further adjustment the AIC **recommends** is extending the exemption as currently proposed to rule 11.1.11, which sets out provisions in relation to aggregated transactions. If the investment company has arrangements in place which ensure that investment by the manager is on the same terms and in accordance with a pre-existing agreement – and this is acceptable from a regulatory perspective – it is not clear why the exemption should not also apply equally to aggregated transactions that are individually subject to an exemption. After all, given that shareholders have approved the policy of the company and the agreement, there is no scope for detriment.

Not extending the exemption to rule 11.1.11 could significantly reduce the benefit of the existing exemption as, after all, it is likely to be inherent in the business of affected investment entities that they make successive investments in conjunction with the manager. In addition, we do not believe that the provision on aggregated transactions has any value from a regulatory perspective once the conditions which secure an exemption for individual transactions are met.

As well as extending the proposed exemption to rule 11.1.11, there is a strong case for going even further. Listed investment entities are required to have a board that is independent of the manager. In these circumstances it is difficult to see how the manager can be deemed a related party for the purposes of the rules set out in Chapter 11. The AIC **recommends** that the FSA should go further than the limited 'co-investment' exemption set out above and instead no longer stipulate that the investment manager is a related party. This would be fully in accord with its overall intention of principles-based regulation and the desire to introduce rules only where they provide regulatory value.

Q. 7. Do you agree that we should retain the stipulation in the Listing Rules that the investment manager is a related party? No, the investment manager should not be deemed to be a related party.

Q. 8. Given the significant influence their investment managers often exert over listed funds, do you agree with our proposed new exemption for co-investment arrangements? Is it sufficient to enable legitimate investment fund business? The ideal solution would be to remove the stipulation that the investment manager is a related party. However, failing that, the FSA should introduce a specific exemption for co-investment. As discussed above, this should be extended to rule 11.1.11, which deals with aggregated transactions.

The role of 'guidance' within the proposed investment entity Listing Rules

The AIC is concerned about the use of 'guidance' within the investment entity rules. There are various reasons for this:

- It is not clear what status these provisions have. In some circumstances different guidance provisions seem to have different force and some are *de facto* rules;
- Some of the guidance fails to have a distinct regulatory purpose, particularly where it does not relate to specific rules – how can there be guidance in these circumstances?
- In places the guidance goes further than is suggested by the rules.

These concerns are explored in more detail below, but the AIC's starting position is that guidance should only be included where it provides a useful clarification of a specific rule. It should not impose additional obligations over and above that provided for in the relevant rule.

An example of helpful guidance is 15.2.6A G, where the guidance provides insight into how an investment entity should apply 15.2.6 R (which sets out requirements in relation to listed feeder funds).

The guidance which is of concern includes:

- **15.2.3 G:** This guidance, on investment companies taking control in investee companies, is fundamentally flawed as it does not relate to a rule on control. As there is no rule, there is no place within Chapter 15 for guidance. Including guidance in these circumstances is both confusing and contrary to developing an effective principles-based regime. Even without this fundamental problem, the guidance is still seriously flawed.

The guidance initially indicates that there is no restriction on a listed fund taking control of an investee company. This is welcome as there is no intrinsic reason why an investment entity should not exercise such control. The AIC understands the provisions on control in the old rules served an administrative function. They were used to distinguish investment entities from conglomerates, which should list under a different chapter. In the current investment environment this is no longer required as the obligation to spread investment risk, and publish an investment policy explaining how this is achieved, creates a boundary between the two regimes. This makes provisions relating to 'control' redundant. That is, they are no longer required to distinguish an investment entity from a trading conglomerate. However, maintaining these provisions on control (even in their proposed form) risks hindering the listing of funds with legitimate investment approaches – for example, private equity investment strategies.

With all this in mind, the continued inclusion of guidance on control – particularly the references to cross-financing and common treasury functions – is inappropriate. Cross-financing and the provision of common treasury functions can be used legitimately by an investment entity to provide value for shareholders. We would hope that the guidance does not preclude these practices. However, this is not clear. For the avoidance of doubt the guidance should be removed.

Of course, if in fact the FSA intends that entities must not cross-finance or have common treasury functions, then the FSA should make these provisions into rules. (Although the AIC would oppose this approach, if it were adopted then at least the rules would provide clarity over what is required.)

The current draft should also be amended because if the FSA envisages that these practices would be permitted, but this is not made clear, there remains a danger that the 'guidance' could become a *de facto* rule that will unhelpfully restrict the legitimate activities of investment entities.

Taking all these considerations into account the AIC **recommends** that 15.2.3 G should be deleted entirely from the rules.

As a consequence of the AIC's recommendation regarding 15.2.3 G, the AIC also **recommends** that 15.4.3 G, the reference to control in the continuing obligations, should also be deleted.

- **15.2.8 G (1)** relates to an entity's investment policy and is problematic because it implies requirements that overreach the actual requirements of the rule itself.

Overall, the guidance on the information which should be included in an investment policy is helpful. However, part (1) implies that an investor should be able to use the investment policy to 'assess' the investment opportunity. This is clearly impossible. Such an assessment can only be made using a much wider range of information, including, for example, the prospectus, detailed financial information included in annual reports and other regular company statements. It could even be argued that an 'assessment' of a particular investment opportunity could only be made by considering information quite unrelated to the company itself – prevailing market conditions, competing vehicles, even the individual's own attitude to risk etc.

At the same time parts (2) and (3) of the guidance will ensure that consumers are able to understand the critical issues associated with the company's activities i.e. how the objective of risk spreading is to be achieved and the significance of any change in investment policy. These are the fundamental considerations and are properly addressed by those parts of the guidance.

With this in mind, the AIC **recommends** that the final investment entity rules delete 15.2.8 G (1).

- As discussed above, **15.2.10A G**, which deals with sufficient and appropriate experience, is unhelpful. A fundamental problem is that it deals with an issue that is not a requirement for listing. As this is the case it is difficult to see how the guidance provides any value from a regulatory perspective. Chapter 15 should therefore not address this issue at all.

15.2.10A G is also problematic as it does not clarify an identifiable rule. There is no general duty within the Listing Rules for boards to be confident about the expertise within a company (whether its business is an investment entity or trading company). The AIC therefore **recommends** that 15.2.10A G should be deleted entirely from the rules.

- **15.2.12 G**, on board independence, creates substantial difficulties. While the provision purports to be guidance, the AIC understands from its discussions with the FSA that the regulator regards these provisions as requirements. Therefore, for example, a director would automatically be deemed non-independent from the FSA's perspective if they served on the board of more than one company managed by the same manager, regardless of the assessment of the board and the company's shareholders.

If the FSA considers that the stipulations included in the guidance are in fact compulsory then the AIC **recommends** that they should be made into rules. (As discussed above, the AIC does not agree with this but it is important that the requirements of the rules are clear.)

If the provisions are merely advisory and intended to provide clarification of the issues that should be considered in assessing independence, then the AIC **recommends** that this should be made clear in the guidance.

An alternative approach, if guidance on director independence is to be included at all, would be to indicate that issuers should consider issues raised by the Combined Code in drawing conclusions on the independence of the board. The AIC **recommends** this approach be taken if any guidance on board independence is to be included.

- **15.2.13 G**, on the annual re-election of directors who are deemed not be independent by the criteria set out in 15.2.12 G, also raises issues. The AIC understands that the FSA intends that a director who falls into the categories set out in 15.2.12 G must be subject to annual re-election. If this is the case, 15.2.13 G should be made into a clear rule (depending, of course, on the decision over the ultimate inclusion of the provisions set out in 15.2.12 G. See discussion below.)

However, there are also difficulties in principle with the aim of this guidance. Non-independent directors who do not fall into the categories set out in 15.2.12 G do not have to be subject to annual re-election. Why then should those who do? No justification for this has been advanced. This provision unnecessarily discriminates against the appointment of certain directors. This is particularly unhelpful in an environment where the board is already required to be independent and other rules on board re-election already apply. The AIC **recommends** that the ideal solution would be for 15.2.13 G to be deleted in its entirety.

There is also one area where the AIC believes that additional guidance could be usefully included in the final rules. The AIC **recommends** that guidance should be included on what 'quantitative' information and analysis involves. (The concept of quantitative information/analysis is used in 15.2.8 G and 15.6.2 R (1)). We understand that the FSA does not intend that complex statistical data should be provided. Rather it envisages that simple tabular and graphical representations, or other explanations readily understandable by retail investors, will be sufficient to meet the requirements of the rule. It would be extremely useful if the nature of the qualitative requirements were clarified by guidance explaining this point.

Detailed drafting

The AIC would be pleased to provide detailed input on the drafting of the final rules before they are introduced. This could include technical comments regarding changes to the obligations for investment companies as set out in the revised chapter but could also involve clarification of some of the interim requirements.

For example, it may be useful to look again at the definition of closed-ended investment funds. We note that, whilst the definition is clear about what an investment fund is, it does not address what makes it "closed-ended". As presently drafted, the definition could equally apply to an open-ended company. Although Chapter 16 is specifically aimed at open-ended funds there does not appear to be any rule precluding such funds being subject to Chapter 15 as well.

Wider considerations

The AIC is confident that, once this consultation process is complete, the specific investment entity rules will be commercially attractive while still delivering key FSA goals in relation to consumer protection, market stability etc.

The key reason that so much progress has been made in achieving deregulation is that the rules have been reassessed through the new 'optic' of principles-based regulation and recognition of the importance of maintaining the competitiveness of UK markets. However, it is not just the dedicated investment entity rules that affect the regulatory burden that is placed upon the sector. Investment companies are also subject to the broader requirements of the listing regime. The wider rules were last looked at in 2005 but it is clear that both the market and the regulatory approach adopted by the FSA have evolved since then.

With this in mind, the AIC **recommends** that the FSA should look again at the wider rulebook and establish if further deregulation can be achieved. This would benefit both investment entities and conventional trading companies. A process that has been as rigorous and considered as the current review could result in a significant reduction in the overall compliance burden of listing in the UK.

We recognise that this would be a major task but the realities of the current environment indicate that the whole rulebook should be under regular review. A further examination now would be more than appropriate, particularly given the FSA's own emphasis on principles-based regulation.

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