THE
INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

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Dear Nick

RE: CP19/27 Quarterly Consultation No 25 – Chapter 3 Amendments to the Collective Investment Schemes Sourcebook

The Investment Association is delighted to provide input to your consultation. This response relates only to chapter 3 of the quarterly consultation, which relates to proposed changes to the Collective Investment Schemes Sourcebook. Responses from The Investment Association to other chapters in the quarterly consultation, which relate to other sourcebooks, will be sent separately.

The IA has long called for the definition of eligible counterparties for OTC derivatives transactions in COLL 5.2.23R to be broadened to ensure managers of UK UCITS and NURS are able to trade in US OTC derivative contracts. We therefore welcome the proposed amendments which will remove the barrier to managers of UK UCITS and NURS being able to enter into cleared US OTC derivatives transactions, but believe that there is scope for further alignment between the rules in COLL 5.2.23R and COLL 5.4.4R, which sets out the eligibility criteria for counterparties in securities lending and repurchase agreement transactions.

The IA does not support the introduction of a requirement to produce an annual certificate for s.272 recognised schemes until the future post-Brexit recognition scheme for EEA UCITS has been determined.

Please do not hesitate to contact me if you have any questions regarding our response.

Yours sincerely

Peter Capper

Fund & Investment Risk Specialist

ANNEX I
CONSULTATION RESPONSE

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets.

More information can be viewed on our website.

AMENDMENT TO COLL 5.2.23R: ELIGIBLE COUNTERPARTIES FOR OVER THE COUNTER (OTC) DERIVATIVES TRANSACTIONS

Q3.1: Do you have any comments on the proposed amendments to COLL 5.2.23R? If so, please elaborate.

The IA welcomes the proposed amendments to COLL 5.2.23R, which we believe will be sufficient to allow UK UCITS to trade in cleared OTC derivatives contracts through US Central Clearing Counterparties (CCPs). As noted in our response to CP15/27, the criteria for eligible counterparties in COLL 5.2.23R has been more restrictive than those applied in other EU jurisdictions, and in particular restricted the ability of managers of UK UCITS to enter into OTC derivative transactions with US counterparties. The amendments proposed will go some way to addressing these issues and are therefore supported by the IA.

While supporting the proposed amendments, there will still be some barriers remaining to managers of UK UCITS entering into uncleared OTC derivatives transactions and cleared securities lending transactions and repurchase agreements (repos) with US counterparties. As such, the IA proposes that the FCA seek to further align the criteria for eligible OTC derivatives counterparties in COLL 5.2.23R with the criteria for eligible counterparties for securities lending or repo transactions in COLL 5.4.4R(1)(b). We therefore propose a further

amendment is made to COLL 5.2.23R to also reference the institutions in listed in COLL 5.4.4R(1)(b)(iii), to allow to allow managers of UK UCITS and NURS to enter into uncleared OTC derivatives transactions with persons registered as a broker-dealer with the Securities and Exchange Commission of the United States of America. Since these latter institutions have been assessed by the FCA as being prudentially regulated for the purposes of COLL 5.4.4R(1)(b), these should also satisfy the criteria of an eligible counterparty for an OTC derivatives transaction under COLL 5.2.23R.

It is also important that COLL 5.4.4R is aligned with COLL 5.2.23R, to explicitly allow managers of UK UCITS and NURS to centrally clear securities lending and repo transactions on US and EU CCPs. We understand that securities lending and repo transactions tend to be built on agency structures, with the clearing member being a sponsoring member rather than the counterparty, and with the counterparty being the CCP. As such, we propose the additions to COL 5.2.23R(1)(c) to (e) are also mirrored in COLL 5.4.4R, so that these CCPs are also explicitly eligible counterparties for securities lending and repo transactions entered into by UK UCITS and NURS.

More broadly, the current OTC derivative counterparty exposure limits in the UCITS Directive need to be revised as more OTC derivative transactions move to clearing, as recognised by ESMA in its 2015 Opinion to the European Commission on the Impact of EMIR on UCITS[1]. We recognise these changes will be needed at the level of the UCITS Directive, but until these can be made the IA would welcome further guidance from the FCA on how exposure limits should be applied in the context of cleared OTC derivatives.

AMENDMENTS TO COLL 6.2.23R AND 8.5.12AR: PROPERTY AUTHORISED INVESTMENT FUNDS

Q3.2: Do you have any comments on the proposed amendments to COLL 6.2.23R and 8.5.12AR? If so, please elaborate.

We support the proposed amendments to COLL 6.2.23R and 8.5.12AR, and the policy intention to align the corporate ownership condition applicable to PAIFs with the underlying tax regulations (69K and 69L of the Authorised Investment Fund (Tax) Regulations 2006 or "the tax regulations").

The existing rules COLL 6.2.23R and 8.5.12AR ("the COLL rules") provide that the authorised fund manager "must *take reasonable steps to ensure* that no body corporate holds more than 10% of the net asset value of that fund" (our emphasis). What constitutes taking "reasonable steps to ensure" is not defined in the COLL rules. The tax regulations provide that managers have a reasonable period of time to correct situations where a corporate investor inadvertently exceeds the 10% limit. It would be helpful for the FCA to clarify in its Handbook Notice that "taking reasonable steps to ensure" in the COLL rules is aligned with the provisions in 69K of the tax regulations, ie a manager who complies with the steps in 69K of the tax regulations is also complying with the COLL rules.

[1] https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-880_esma_opinion_on_impact_of_emir_on_ucits.pdf

COLL 9.3: NOTIFICATIONS BY INDIVIDUALLY RECOGNISED SCHEMES

Q3.3: Do you agree with our proposal to add a direction in COLL. 9.3 requiring operators of s.272 recognised schemes to provide an annual certificate? If not, please elaborate.

We do not believe that additional requirements, such as the introduction of an annual certificate should be placed on operators of s.272 recognised schemes at this stage. HM Treasury has announced that it is reviewing the s.272 recognition process, as post-Brexit this is currently the only route to recognition that will be available to EEA UCITS to be sold into the UK at the end of the Temporary Permissions Regime (TPR). Recognition under s.272 will already be significantly more onerous for EEA UCITS than recognition under s.264. Introducing the requirement for a certificate will only make the s.272 process more onerous and the UK market less attractive for EEA UCITS, and we question whether it would be necessary for each manager of EEA UCITS in key jurisdictions to separately submit information on the same regulations for key EEA fund domiciles such as Ireland and Luxembourg.

The IA therefore requests that the FCA refrain from introducing additional requirements for the operators of s.272 recognised schemes until the future post-Brexit recognition scheme for EEA UCITS has been determined.

MINOR AMENDMENTS TO COLL 6.6.12R, 8.5.4R AND 5.2.4R (2)

Q3.4: Do you have any comments on the proposed amendments to COLL 6.6.12R, 8.5.4R and 5.2.4R (2)? If so, please elaborate.

We support the intention to align COLL 6.6.12R and COLL 8.5.4R with the UCITS and AIFMD Level 2 Regulation, and have no further comments on the proposed amendments.