



# FSA Compatibility Statement

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## Introduction

**D.1** In this Annex the FSA sets out its view on how its proposals and draft rules in this paper are compatible with its general duties under Section 2 of FSMA and its regulatory objectives set out in Sections 3 to 6 of FSMA. It also outlines how the proposals are consistent with the principles of good regulation (also in section 2 of FSMA) to which it must have due regard.

## Compatibility with statutory objectives

**D.2** The proposals outlined in this consultation paper will support our statutory objectives of working towards improving confidence in the financial system and securing the appropriate degree of protection for consumers.

## Market Confidence

**D.3** Funds which comply with the UCITS Directive are widely perceived as operating to high regulatory standards, which has enabled them to be marketed successfully in many jurisdictions. The changes brought about by UCITS IV will improve market efficiency by removing barriers to the provision of cross-border services, while at the same time imposing more rigorous harmonised requirements for systems and controls, including risk management and monitoring processes. This will enhance confidence that UCITS as a product have a regulatory framework that is keeping pace with the current commercial and regulatory environment for retail financial services.

## Consumer Protection

**D.4** As noted above, the UCITS IV changes strike a balance between innovation and investor protection. The enhanced controls framework will help to ensure UCITS management companies are run with due skill, care and diligence, and the risk controls in particular will limit the danger of firms failing to protect their customers because of insufficient understanding or oversight of the risk profile they are exposing their customers to. The introduction of key investor information is an important investor protection tool since better and more focussed pre-sale disclosure, in an easily comparable format, will improve consumers' understanding and enable them to make better choices.

**D.5** The proposed extensions to the scope of the Financial Ombudsman Service and the Financial Services Compensation Scheme will ensure that consumers, who deal with a UK firm or buy units in a UK-authorized fund in the new, more flexible environment of the UCITS management company passport, will benefit from the redress mechanisms established under FSMA.

## Compatibility with the principles of good regulation

**D.6** Section 2(3) of FSMA requires that, in carrying out our general functions, we have regard to the principles of good regulation. The proposals set out by the FSA in this paper fulfil the following principles:

## **The need to use our resources in the most efficient and economic way**

**D.7** The Directive sets out various duties which the Treasury propose to impose on us through legislation. Some of these, such as the processes for approving fund mergers, setting up master-feeder structures or transmitting fund notifications, are prescribed in detail by the Directive and require us to implement efficient and timely procedures. Others, such as the general duties of supervisory co-operation, require the appropriate exercise of our discretion.

**D.8** We will design internal procedures that make use as far as possible of existing systems (e.g. use of standard e-mail to transmit notifications, rather than a bespoke system). We will also give further consideration to modifying our fee-charging structure to ensure that any additional costs we incur are borne by the appropriate firm or constituency of firms. As regards supervisory co-operation, we will continue to take a risk-based approach in determining which matters should be reported, investigated and if necessary subjected to enforcement proceedings.

## **The responsibility of those who manage the affairs of authorised persons**

**D.9** UCITS IV introduces new requirements to ensure the risk management function of a firm reports on its activities to its senior management on a regular basis, and requires senior management to review the reports and the effectiveness of the risk management procedures on a regular basis. This should ensure that a firm's senior management have a proper understanding of the level of risk to which their customers are exposed and can exercise effective oversight and control of their fund managers.

## **The principle that a burden or restriction which is imposed should be proportionate to the benefits**

**D.10** We have tried as far as possible to copy out Directive requirements without elaborating or augmenting them in a way that would add burdens to UK firms. We have developed policy proposals only in areas where necessary to ensure the new Directive requirements fit coherently into our existing regulatory regime (e.g. in relation to FOS and FSCS coverage, or the treatment of fundamental, significant and notifiable fund changes). The proportionality of our approach is addressed in the cost-benefit analysis which forms part of Annex E of this paper.

## **The desirability of facilitating innovation**

**D.11** The changes to the Directive introduce various innovations which we are implementing in full. The United Kingdom has consistently supported the introduction of the management company passport and we are keen to ensure that firms are able to take full advantage of it from 2011. We will also ensure that systems and procedures are in place for the new simplified fund notification procedure and the setting up of master-feeder UCITS structures.

## **The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom**

**D.12** The UCITS IV package seeks to increase the level of harmonisation provided by the Directive in order to ensure a level playing field for the operation and distribution of funds. We have had regard to the need to avoid transposing the requirements in a way that would put UK firms and funds at a disadvantage to those established in other member States. We are supported in this by the Treasury's announcements concerning the tax treatment of UCITS and their management companies. Together we aim to ensure that the United Kingdom will be an attractive domicile for both UCITS schemes and UCITS management companies, while remaining committed to the principles of the single market and our enhanced duties of co-operation with the regulatory authorities of other member States.

## The need to minimise adverse effects on competition

**D.13** It may be argued that the new organisational, conduct of business and risk management requirements placed on UCITS management companies constitute a higher barrier to market entry for firms. This is balanced to some degree by the freedom of those firms to passport their services into other countries, although small firms that have established UCITS without wishing to penetrate other EEA or global markets are unlikely to benefit from the new opportunities offered.

## The desirability of facilitating competition

**D.14** The introduction of the management company passport will facilitate competition by allowing firms established in other EEA States to enter the UK market by establishing UK- authorised UCITS schemes, just as it will allow UK firms to enter other EEA markets in the same way. Similarly, the new fund notification process should make it quicker and simpler for funds to access the markets of other member States. The improvements to pre-sale consumer disclosure through key investor information should result in consumers having better and more focussed information about product features and risks. This will make it easier for them to draw comparisons between products, help them and their advisers select suitable products, and encourage competition between product providers based on standardised presentations of risk and reward, and charges figures.

## Why our proposals are the most appropriate for the purpose of meeting our statutory objectives

**D.15** The purpose of the proposals is to transpose the requirements of the UCITS Directive into UK law and regulation in the most correct and efficient way. Our general approach is to implement the Directive text as rules, supplementing it with guidance based on the recitals to the Directive where this is helpful to clarify the purpose or intended application of the rule.

**D.16** We have included guidance drawing the attention of firms to the need to comply with certain level 3 guidelines produced by CESR in relation to the Directive; we have pointed out the likelihood that some or all of this material will be adopted as binding technical standards under the new EU process to be introduced in 2011.

**D.17** We have tried to avoid proposals that impose our own interpretation of the Directive requirements or add detail of our own making, although in some places it has been necessary to include rules and guidance that align the new requirements with existing principles of fund regulation. Where that is the case we aim to keep any burden on firms to the minimum necessary to ensure that existing standards of investor protection are not negatively impacted.

## Equality Impact Assessment

**D.18** We have conducted an initial equality impact assessment and do not believe our proposals give rise to any discrimination prohibited by equality legislation. As a result of our assessment, we are not proposing any additional requirements or guidance as being necessary to support the equality objectives.

**D.19** We would welcome your comments on whether you agree with this approach.