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By email: Nikhil.Rathi@fca.org.uk and Katharine.Braddick@hmtreasury.gov.uk

7 April 2021

Dear Mr. Rathi and Ms. Braddick,

RE: Financial Services Compensation Scheme Look Through Provisions

I am writing to you on behalf of members of the Investment Company Institute (ICI), including ICI Global,¹ to urge you to limit the scope of the Financial Services Compensation Scheme's (FSCS) *look through* provision to United Kingdom (UK) domiciled investment funds. As set out below, the costs resulting from the application of the look through to funds domiciled outside the UK ("overseas funds") are not commensurate to investor protection benefits and reduce the UK's competitiveness as an investment management centre.

Background

The FSCS² provides important protection for consumers by compensating them for loss when an authorised firm's financial circumstances prevents the firm from doing so. More precisely, the FSCS enables *eligible claimants* who have a *protected claim* against a *relevant person in default* to receive *compensation* for loss.³ Levies imposed on *participant firms* and their *appointed representatives* cover the FSCS' management expenses and compensation costs.⁴

¹ [ICI Global](#) carries out the international work of the [Investment Company Institute](#), the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$38.7 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Brussels, Hong Kong, and Washington, DC.

² Established in accordance with Part XV of the Financial Services and Markets Act 2000 (as amended)

³ As defined in the FCA's *COMP* rules, an *eligible claimant* is a person (COMP 4) whom, in connection with protected business, is eligible to bring a *protected claim* (COMP 5.2) against a *relevant person in default* (COMP 6) for *compensation* (COMP 11).

⁴ As set out in the FCA's *FEES* rules, *participant firms* (FEES 1) pay management expenses levies (FEES 6.4) and compensation costs levies (FEES 6.5)

Fund investors can seek compensation from the FSCS for loss resulting from the activities⁵ of investment fund managers (IFMs)⁶ and delegated investment managers (DIMs)⁷ where the loss is not solely due to market movements. Claims for loss can either be brought directly by fund investors against an IFM,⁸ or on their behalf⁹ against an IFM or a DIM¹⁰ by the Collective Investment Scheme (CIS) or an intervening *operator* or *manager* of the CIS.

In 2016 and 2017, the FCA consulted on reforms¹¹ intended to bring greater consistency to fund investors' compensation claims by addressing instances where fund investors do not have a valid direct civil liability claim for loss against the IFM¹² and therefore may not have a protected claim under the FSCS. The FCA's remedy was to introduce a look through provision in April 2018 to enable *participants* in a CIS to be treated as having a claim rather than the CIS or any intervening operator or manager who may be the actual claimant.¹³

FCA Should Not Extend Coverage to Funds that are not Domiciled or Sold to UK Investors

Claims for loss against IFMs under the FSCS are limited to the management of UK domiciled funds¹⁴ and cannot be brought against IFMs managing overseas funds,¹⁵ even if those funds are marketed in the UK.¹⁶ Claims for loss against DIMs under the FSCS are not, however, subject to a similar territorial scope limitation and may be brought by eligible claimants regardless of where the fund is domiciled, marketed, or managed. The FCA has sought to justify the absence of a territorial scope limitation for claims against DIMs on the basis that investors outside the UK might "expect" some degree of compensation.¹⁷

⁵ i.e., designated investment business as defined in COMP 5.5. and including activities such as *managing investments*, *managing a UK UCITS* and *managing an AIF*.

⁶ e.g., in accordance with COMP 5.5.1 that are acting as the manager of an Authorised Unit Trust (AUT), the Authorised Corporate Director (ACD) of an ICVC, the authorised contractual scheme manager of an Authorised Contractual Scheme (ACS) or the manager of a Long Term Investment Fund.

⁷ e.g., in accordance with COMP 12A.3.1(2)(a)(ii) that are *managing investments*.

⁸ In their capacity as *holders of units* in an *authorised fund* or *other collective investment scheme (CIS)*

⁹ As *participants* in the *CIS*.

¹⁰ For instance, *managing investments* for the *CIS*

¹¹ CP16/42: Reviewing the funding of the Financial Services Compensation Scheme (FSCS), 1 May 2018, available from <https://www.fca.org.uk/publication/consultation/cp16-42.pdf>; CP17/36: Reviewing the funding of the Financial Services Compensation Scheme (FSCS), feedback from CP16/42, final rules and new proposals for consultation, 30 October 2017, available from <https://www.fca.org.uk/publication/consultation/cp17-36.pdf>

¹² For instance, where investors do not have a direct contractual relationship with the IFM as may be the case for an externally managed Investment Company with Variable Capital

¹³ Paragraph 9.23, CP 16/42

¹⁴ COMP 5.5.2

¹⁵ The FCA's Cross-Sectoral and Funds Policy Department has confirmed on several occasions that the territorial limitation in COMP 5.5.3 has the effect of excluding the management of offshore funds from being the subject of a protected claim.

¹⁶ HM Treasury confirmed in its response to the Overseas Funds Regime (OFR) consultation that it intends to leave the scope of FSCS jurisdiction unchanged, so that it will not apply to overseas funds under the OFR, see paragraph 2.39, "Overseas funds regime, a summary of responses", available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933879/FINAL_OFR_Consultation_Response.pdf.

¹⁷ Letter from Andrew Bailey, CEO, FCA to Chris Cummings, CEO, Investment Association, RE: FSCS Levies, dated 27 July 2018.

We disagree and believe that non-UK investors in overseas funds would not seek to obtain compensation from the FSCS.

We respectfully submit that non-UK fund investors are far less likely to expect and/or be aware of the FSCS. Furthermore, even if non-UK investors are aware of the FSCS, they may not in all cases be able to ascertain if a UK DIM has been appointed and whether they are covered by the FSCS. In the event that a non-UK fund investor suffers loss, they are likely, in the first instance, to seek compensation directly from the overseas fund and/or the overseas primary fund manager. Moreover, a non-UK fund investor will likely only turn to the FSCS if the overseas primary fund manager is in default, or the claim is unsuccessful, and the UK DIM is in default. We have not identified any prior FSCS default claims for DIM brought by non-UK fund investors. The tenuous circumstances in which a claim against a DIM could possibly be brought does not appear to justify extending the scope of the FSCS coverage to these situations.

In fact, in the Overseas Funds Regime, HM Treasury rightly determined that FSCS coverage should not be extended to overseas funds that are marketed into the UK because of their highly regulated nature (e.g., EU UCITS.)¹⁸ HM Treasury also did not identify examples of loss or harm to UK investors in overseas funds resulting from a lack of access to the FSCS. Therefore, rather than extending FSCS coverage to overseas funds, HM Treasury has sensibly proposed that the absence or existence of compensation scheme coverage, including overseas schemes, should be disclosed to UK investors at the point of subscription.¹⁹

Implications for FSCS levies from the absence of a territorial scope limitation for DIM claims

In the absence of a territorial scope limitation for claims against DIMs, it is necessary for DIMs to identify, on a worldwide basis, whether the underlying investors in the overseas funds under their management²⁰ are eligible claimants for the purpose of calculating their FSCS levy.²¹ As recently acknowledged by the FCA, this is a significant undertaking as it may involve identifying the ultimate source of investor subscriptions²² and may be resulting in some DIMs unnecessarily overreporting income for the FSCS levy.²³

¹⁸ Paragraph 2.39, Overseas Funds Regime: A summary of responses

¹⁹ Paragraph 2.38, Overseas Funds Regime: A summary of responses

²⁰ i.e., “beneficiaries”.

²¹ i.e. to determine eligible income.

²² These subscriptions may be from many different investor types (e.g., individual vs institutional investors), multiple investment vehicles (e.g., funds, separately managed accounts) and multiple jurisdictions (e.g., if a fund is distributed across the world), and may have been made via third party intermediaries with whom the DIM may not have a contractual relationship.

²³ FCA News Publication: Options for reporting income for FSCS levy calculations, 18 November 2020, available from <https://www.fca.org.uk/firms/reporting-income-fscs-levy-calculations>

Conclusion

The FCA is required to take into account the desirability of ensuring that FSCS levies imposed on a class of firms are commensurate with the value of claims made on that class.²⁴ The absence of a territorial scope limitation for claims against DIMs of overseas funds does not, in our view, represent a reasonable application of this “polluter pays” principle. Furthermore, it penalises DIMs of overseas funds by imposing a disproportionate levy that neither IFMs of overseas funds nor DIMs located in other jurisdictions are subject (e.g., France and Germany.)

The costs resulting from the absence of a territorial scope limitation for overseas funds are not commensurate to investor protection benefits and create an incentive to undertake delegated investment management outside the UK. We strongly urge the FCA to introduce a territorial scope limitation for claims against DIMs similar to that for IFMs managing overseas funds,²⁵ thereby limiting the scope of FSCS’ look through provision to just UK domiciled investment funds.

We welcome the opportunity to discuss this matter further with you.

Yours sincerely

/s/

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ICI Global

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²⁴ Section 213(5), Financial Services and Markets Act 2000

²⁵ COMP 5.5.3