



Financial Conduct Authority
12 Endeavour Square London
E20 1JN
By email to: ps237@fca.org.uk

10 August 2023

Dear Sirs,

Re: DATA response to PS23/7: Broadening retail and pensions access to the long-term asset fund. Chapter 4: Access to the Financial Services Compensation Scheme

The Depository and Trustee Association (DATA) represents the depositaries of UK authorised funds and alternative investment funds. DATA welcomes the opportunity to comment on the consultation.

Our key comments are as follows: -

- DATA has been advocating for a fundamental review of the Financial Services Compensation Scheme for several years including its scope, funding, and calculation methodology. We do not believe that a case has been made for solely excluding activities related to the LTAF from the FSCS.
- According to the most recent FSCS Annual Report & Class Statements¹, there was a decrease of the total compensation paid in the Investment Provision Class to £31m in 2022/2023 (previously £122m). Most claims in this class were for SIPP Operator claims and no claims have arisen, in that period, because of the failure of a depository or an Authorised Fund Manager (AFM).
- DATA considers that there is a broader need for the FCA to review the funding groups with a view to moving depositaries away from the investment provider category, and from any contributions to claims against the intermediary classes.

¹ <https://www.fscs.org.uk/globalassets/annual-reports-and-class-statements/arac-2223/fscs-class-statements-2022-23-accessible.pdf>

Please do not hesitate to contact DATA if you would like to discuss any points made in this consultation response.

Yours faithfully

A handwritten signature in black ink that reads "Thérèse Craig". The signature is written in a cursive style with a distinct loop at the end of the word "Craig".

Thérèse Craig
DATA Chair

PS23/7: Chapter 4 - Access to the Financial Services Compensation Scheme

Q1: Do you consider that we should consult on removing FSCS protection for either (a) some activities relating to LTAF – in which case which ones; or (b) all activities? If not, why not.

In, DATA's view there should not be an exemption from FSCS coverage on a product basis. We do not believe that a case has been made for solely excluding activities related to the LTAF from the FSCS. The risks of a claim are likely due to be because of mis-selling, inappropriate advice or distributing the fund to someone inappropriate – there is less likely to be a claim against an AFM (product provider) or depositary of an LTAF.

Q2: If you support removal of LTAF from FSCS coverage, do you agree that steps should be taken to confirm the policy rules for this as soon as possible, so that these changes are made at this early stage in the process of LTAFs being distributed directly to retail investors?

FSCS principle 2 states that FSCS protection for a particular regulated activity and category of individual should help to maintain consumer confidence in the financial services sector. DATA's view is that the scope of the FSCS should cover those products and services that are intended for or delivered to retail consumers, where the failure of a firm could result in losses to the consumer. Therefore, DATA does not agree in principle with the removal of the LTAF from FSCS coverage.

Q3: If not, do you consider this should be kept under review as part of our wider work on FSCS cover for activities relating to investment products?

DATA believes that the FSCS needs reform more generally rather than removing specific products or activities on a piecemeal basis.

However, depositaries should not be viewed as a product provider or a distributor and should not bear the costs of claims that have arisen due to failings in the distribution of products. In the case of collective investment schemes, the product provider is the AFM – it is the AFM that determines the target market, is responsible for the product governance in respect of the design of the product, which issues marketing and promotional literature, and which determines the distribution channels through which the product will be sold. The depositary is not involved with these activities and cannot therefore influence or control the distribution of the product. As such, the depositary should not be expected to participate in the funding of the FSCS.

DATA also does not agree that product providers should share the FSCS funding relating to claims caused solely by intermediary defaults. Most products are designed by the product provider for a particular target investor audience or designed to be a component of a broader investment portfolio. If these are inappropriately sold by advisers to investors for whom the product is not suited or not appropriately diversified, this could result in mis selling claims involving products that would have been suitable for the right investors. Claims that arise solely from advisors mis selling products to inappropriate investors, i.e. that have occurred

solely due to failings down the distribution chain, should be borne solely by the investment intermediation groups.

DATA recognises that investors in funds should be properly protected in the event of a default of one of the parties directly involved in the operation of the fund. However, when considering the scope of the FSCS, the FCA should consider the wider investor protection regime already provided under existing UK legislation. In addition, the costs investors in funds ultimately contribute to any compensation scheme must be consistent with the benefits that group of investors would receive, not simply to fund claims made by other financial services sectors.

DATA believes consideration should ultimately be given on whether depositaries should be within the scope of coverage of FSCS. DATA's view is that depositaries have been inappropriately grouped with CIS operators in the FCA's fee block structure, which remains unaddressed despite repeated entreaties by the depositary community. This is despite FCA rules that require depositaries to be structurally independent of managers. This inclusion of depositaries in the same group as CIS operators has resulted in fees being inappropriately applied to depositaries that ordinarily would be expected to apply only to product providers, e.g., the pensions advice levy, costs relating to SIPP provider claims, and more recently contributions to the intermediary levy. DATA therefore considers, that at the very least, there is a broader need for the FCA to review the funding groups with a view to moving depositaries away from the investment provider category, and from any contributions to claims against the intermediary classes.

Q4: Are there other amendments to FCA rules, for example, on distribution and the operation of LTAFs, that you would make if FSCS coverage was limited, to enhance consumer protection?

The FSCS should not be a substitute for robust and timely supervisory action against activities most likely to result in FSCS claims. We support the FCA's work outlined in its three-year strategy² and in FS22/5 "Compensation framework review: response to feedback and next steps" that set out commitments to reduce and prevent serious harm which should decrease the likelihood of claims being passed onto the FSCS in future.

If activities related to the LTAF are excluded from FSCS coverage, then DATA's view is that the FCA will need to enhance its supervision and sanctions regime to avoid or minimise the risk of such products being mis-sold to investors.

² <https://www.fca.org.uk/publication/corporate/our-strategy-2022-25.pdf>