

Sally Rigg
Collective Investment Schemes team
Retail Policy and Themes Division
Financial Services Authority
25 The North Colonnade
London E14 5HS

29 May 2008

Dear Sally,

Whilst DATA welcomes the feedback on CP 07/6 and second round of proposals for FAIFs described in CP 08/4, we believe that some of the issues outlined in the first consultation require further attention.

We welcome and support the following:

1. A strengthened due diligence approach will allow the FAIF to invest in underlyings which do not have independent valuation or do utilise side pockets. We do believe, however, that more emphasis should be placed on due diligence in general. More comments are made later in our response.
2. For the FAIF to be a second tier feeder into another feeder which ultimately invests in the master fund. However, we believe that the rules as drafted are inconsistent with the intentions of the regime. This is discussed in more detail later in the paper.
3. We also seek confirmation that the NURS only has to fulfil its enhanced due diligence on the securities which are classified as unregulated/unapproved as opposed to the entire fund once the critical level of 20% has been reached.

We would request that the FSA give further attention to:

4. Aggregation of unregulated schemes and unapproved securities

We believe that the 20% limit for unapproved securities should be disaggregated from unregulated schemes. As a FAIF will be able to invest up to 100% in unregulated CIS, the AFM will already be adopting an appropriate liquidity policy and redemption strategy to efficiently manage their scheme. Furthermore, the flexibility of a property fund to borrow from a combination of unapproved securities and mortgages would be removed. We therefore strongly recommend that FSA revisit their policy on this matter.

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5. Redemption Management and Repayment Standards for FAIFs

DATA believes the FAIF must be able to strike a balance between an investor's right of redemption and the constraints of the underlying hedge funds. The redemption policy of the FAIF should therefore reflect the redemption policies of the underlying investments.

Redemptions can be managed by three techniques: by way of borrowing, extending the settlement period or use of notice periods.

a) Borrowing

We are aware that some respondents to the original CP asked for a relaxation of the borrowing rules to allow a FAIF to better manage redemption requests from its unit holders. DATA agrees with the views expressed by the FSA that the existing rules on borrowing should not be changed, in particular because creating the potential for leverage above 10 per cent would be inappropriate.

b) Extension of Settlement T+4

This is a more viable option for FAIFs. However, it does not deal with the nature of the underlying investments and the prevalence of notice periods in unregulated schemes. Nevertheless, we do believe that extension of this rule would allow added flexibility for some FAIFs to manage the liquidity of their schemes more satisfactorily. Were an existing fund to opt to extend the settlement period beyond T+4 DATA take the view that this should be treated as a fundamental change requiring investor approval before implementation.

c) Notice periods

We note in the policy statement FSA's reluctance to allow notice periods for FAIFs. As you are aware, a significant proportion of, if not all, funds of this nature (i.e. unregulated funds) operate with some form of notice period. By not allowing notice periods, we believe that the FAIF regime is largely unworkable. It should also be noted that funds of hedge funds can be made available to retail investors through closed ended vehicles listed on a recognised stock exchange. This allows the manager to have fixed capital and although discount mechanisms have to be maintained, unit holder redemptions are not an issue. This alternative would be made all the more attractive if FAIFs cannot use notice periods.

Furthermore, there are still competitive pressures at play which will differentiate FAIFs in terms of complexity, risk and redemption standards. A FAIF targeted at relatively unsophisticated investors with low net worth is likely to be structured so as to qualify as an ISA investment. This would mean that the FAIF would have to apply at least bi-monthly dealing with no notice periods. On the other hand, a FAIF with more complex underlyings is more likely to be targeted at the more sophisticated investor and would probably have a greater need for a notice period. There will also be pressures from platforms to provide a more 'liquid' fund. These requirements will almost "self-police" the FAIF for its target market.

We would comment further on the draft rules as follows:

5.6.10 D G (8) – "*the implications of currency convertibility (if any)*" – we would appreciate clarification on what this means.

5.6.10 E R (2) (b) – "*that its investors must comprise a large number of persons that are not associates*" – whilst we appreciate the rule the FSA must be consistent with the Treasury's draft regulation we believe that as drafted this rule may not allow a fund to be launched with seed monies. We note that the draft regulations (4A.2.3 condition B) refers to "the intended categories of investors" and believe it was not designed to preclude seed monies.

6.2.19 R (1) – *"The instrument constituting the scheme and the prospectus of a non-UCITS retail scheme that investing more than 20% of its scheme property in unregulated schemes and/or qualified investor schemes, that invests substantially in immovables or whose investment objective is to provide a specified level of return, may provide for limited redemption arrangements appropriate to its aims and objectives."* We believe that the draft wording of this rule lacks clarity in relation to regulatory intent, since it is not clear that each of the fund strategies and asset types mentioned above may operate limited redemption.

We will be happy to discuss any of these points in more detail.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Cargill', written in a cursive style.

John Cargill
Chairman - DATA

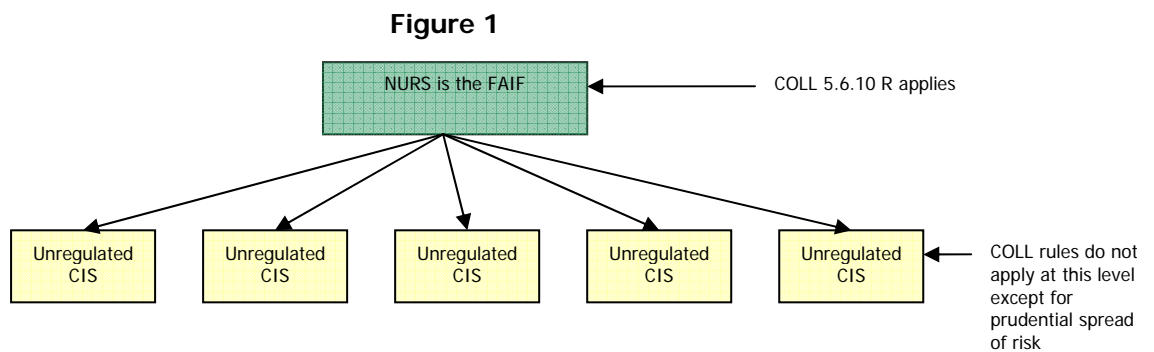
Items consulted on in CP 08/4

1. Do we need to make any changes to the NURS repayment standards? If so, what changes would need to be made and why? Should this be extended to all limited redemption NURS or just FAIFs?

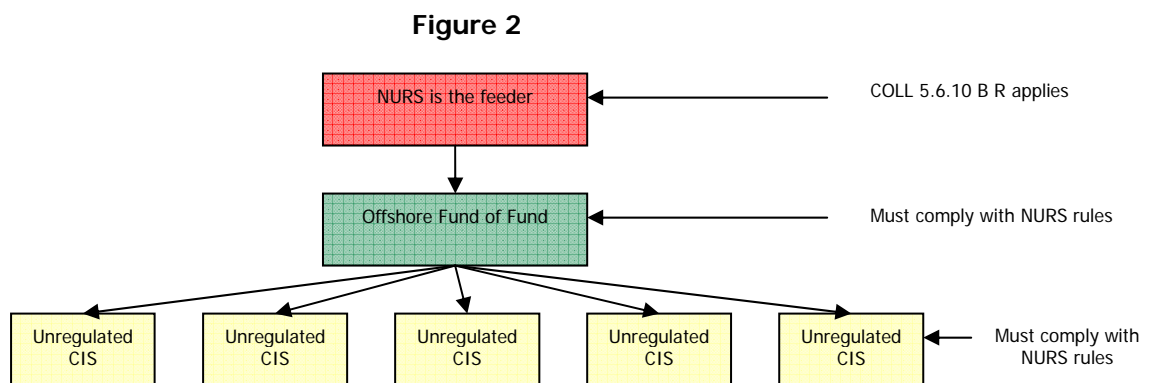
Our main comments have been made above. We believe that if notice periods are allowed, an extension of T+4 would not be as necessary but we do believe that the added flexibility, should the fund require it, be made available not only to FAIFs but to all NURS. We also recognise that the NURS would need to seek investor approval if it was to extend its repayment period from t+4.

2. Do you agree with our approach to the issue of master/feeder structures? Are there any other key COLL rules that should be applied? If so, please specify and explain why.

We welcome FSA's proposals to allow the NURS to act as a feeder fund. However we do believe there are some contradictions in the rules and the body of the paper which need to be addressed. The following diagrams illustrate this point:



In this example, the NURS is the fund of fund (FAIF) and COLL 5.6.10 R applies to it. The unregulated schemes are not subject to any conditions except for prudent spread of risk and the FAIF being reasonably satisfied that the CIS will not invest more than 15% of its value in other CIS.



In this example, the NURS is the feeder into an offshore fund of fund. As COLL 5.6.10B R applies to a NURS which acts as a feeder, COLL 5.6.10B R states that "The authorised fund manager of a non-UCITS retail scheme which is a feeder scheme must ensure that its master scheme and any scheme into which that master scheme invests operate on a basis that is consistent with the rules in this section".

This therefore creates a discrepancy between figure 1 and figure 2. Whilst in figure 1, the NURS must comply with COLL 5.6, the unregulated CIS do not. In figure 2, the unregulated CIS must also comply with COLL 5.6. We do not believe that this is the intention of the draft regulations.

3. What are your views of the strengthened due diligence? Are there any other matters which are needed to be taken into consideration?

Whilst DATA welcomes FSA's enhanced due diligence, we do have concerns that the guidance may become a 'tick list' which may be adopted by some fund managers to discharge their duties. We are aware of a number of different procedures which could be used in various ways and for various underlying funds, whether these are fund of hedge funds, property funds, private equity funds or multi asset funds. We therefore believe that the FSA guidance should state that the AFM should utilise additional guidance available to the Industry on due diligence in keeping with the nature of the underlying investment schemes without specifically referring to particular due diligence guides .

4. Genuine Diversity of Ownership

Subject to our general comments on the draft rules above, we support these proposals.