

Draft

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Dear Rob

DP 12 The new regulatory reporting environment

The Depositary and Trustee Association (DATA) represents the depositaries and trustees of authorised unit trusts and investment companies with variable capital (ICVCs). At the end of June 2002, the members of DATA were responsible for the safeguarding of £222 billion of funds under management.

DATA welcomes the opportunity to comment on FSA's proposals documented in DP 12 which discusses the reforms to regulatory reporting requirements as part of the FSA's risk based approach to supervision. We note that this discussion paper has two main sections; firstly regulatory reporting and information needs across all sectors; and secondly proposals to reform the reporting requirements for the insurance industry. This response will focus on the main discussion of regulatory reporting and information needs from the viewpoint of the implications for depositaries and trustees of collective investment schemes ("depositaries"). DATA's main concerns are documented in the substance of this letter whilst we have a number of detailed comments on questions raised in the paper in Appendix 1.

Not all members of DATA are structured in the same way. Some are individual legal entities whereas some are divisions or departments of a larger legal entity. Currently much of the financial and regulatory reporting is performed at legal entity level. Our comments are qualified by the fact that where the members of DATA are structured as divisions or departments of a larger legal entity, these legal entities may have views which differ from those expressed in this letter.

We concur with FSA's conclusion that regulatory reporting is nothing more than a way to collect information and as such the information that is collected and distributed should have some purpose and be meaningful. We are of the opinion that FSA's objectives highlighted in paragraph 3.2 of this paper would appear to be logical in monitoring firms in a risk based environment.

The conclusion arrived at in paragraph 3.4 that as each sector has its own characteristics the reporting requirements should be respectively tailored, is certainly a starting point for identifying types of information. We assume that the depositaries will be identified as an individual sector.

Encouraging firms to discreetly share information (Question 12 in the DP)

Although we note FSA's view that this reporting will provide them with information with regard to the practices of firms, we consider that there are many pitfalls to "encouraging" firms to pass on specific concerns and to discreetly share information.

Depositaries are in a very unique position in the market place. In this role depositaries do not sell financial products or advise on them. Their main responsibility is to fulfil the oversight duties required in the collective investment scheme sourcebook. On a day-to-day basis the depositary safeguards the assets of the fund and ensures that the manager of a CIS is abiding by specific regulations. There are requirements in the CIS Sourcebook for the depositary to notify the FSA of specified events or breaches by the manager. However, to place an additional general requirement on the depositary to "discreetly" share information or concerns with the FSA places the depositary in an invidious position.

We note that under section 394 of FSMA the FSA is under an obligation to provide material or secondary material to a firm on which the FSA has relied "in taking the decision which gave rise to the obligation to give the notice". Therefore, there are no safe harbour provisions and there are no confidentiality provisions for firms that "shared" information.

We are also concerned that in requiring firms to report market intelligence, the FSA could be drawn into grievance disputes or malice between competitors rather than instances of genuine malpractice.

If you have any queries with regard to this response, please not hesitate to contact DATA.

Yours sincerely

David England
Chairman

Appendix 1

DATA response to DP 12 – The new regulatory reporting environment

Information considerations

Q1: What do you consider might be a suitable structure for defining reporting requirements? For example, a regime based on legal entities as at present, one based on permissions or by product/activities or a combination of both?

DATA are of the opinion that the structure for defining reporting requirements should typically be a regime based on the product and activities of the individual firm rather than based on permissions or legal entities. Our first reasoning for this conclusion relates to FSA's decision to 'unbundle' the regulated activities within the post N2 permissions environment. Pre-N2 depositaries and trustees were required to have two IMRO permitted business categories. Those firms that acted as trustee for authorised fund managers (AFMs) who ran authorised futures and options, geared futures and options and property schemes, had additional permissions.

However going forward, under the new regulated activities regime, firms carrying out pure trustee and depositary activities require the following regulated activities in their scope of permissions (with relevant limitations):

- acting as trustee of an authorised unit trust scheme;
- acting as a depositary or sole director of an open-ended investment company;
- making arrangements with a view to transactions in investments;
- safeguarding and administration of assets (without arranging);
- arranging safeguarding and administration of assets;
- establishing, operating or winding up a regulated collective investment scheme; and
- agreeing to carry on a regulated activity.

This 'unbundling' means that firms purely acting as trustees and depositaries have similar regulated activities to firms from completely different sectors with different characteristics. As such we consider that to identify reporting requirements by the regulated activities of the individual firm would be complex and inappropriate.

We secondly consider that to structure reporting requirements based on the individual legal entities could produce meaningless statistical information. For example some members of DATA have a corporate structure with one legal entity that operates on the basis of accepting deposits, custodian activities, and acting as a depositary and/or trustee. To analyse and interpret information supplied by these firms in comparison to firms with a different group corporate structure

would produce inconsistencies and would be exceptionally difficult. Having that said, we would note that when reporting on the capital adequacy of a firm this would most logically be reported at legal entity level due the firm's internal calculation of this requirement however this would have to be determined on a case by case basis.

Therefore DATA are of the opinion that regulatory reporting requirements should be on a like for like basis on the products and services offered by the individual firms with the exception of capital adequacy which should be reported on the basis of the legal entity.

Q2: Do you consider that we can make more use of the information that a firm uses to manage its own risks? Do you have any examples which are relevant?

DATA do not in principle disagree with the FSA obtaining information that a firm uses to manage its own risks, however we consider this could possibly produce contradictory information. Risk management will vary from firm to firm based:

- on the types of products sold;
- the corporate structure of the firm (i.e. single legal entity or group corporate structure);
- whether activities are delegated to a third party administrator; and
- the nature and internal structure and workings of the firm.

However, there may be some core information that would apply across all firms, but in order to provide accurate, relevant data, investigations would need to be carried out to identify these core identifiable risks.

Q3. Do you agree that we should design a new baseline framework for all firms based as far as possible on what is already done for internal management purposes or where applicable group accounting purposes?

DATA support FSA's proposals in basing regulatory reporting on what is already done by firms internally, either to manage risks or for other purposes, as this could minimise reporting costs for firms. However, the analysis and interpretation of such reports may be difficult as there are likely to be inconsistencies in the way the information is prepared and presented, both by a particular firm from year to year and by different firms. The analysis of such information would most certainly require specialist skills, which will either have to be brought into the FSA or diverted from more critical areas of monitoring.

We concur that there are inconsistencies in the reporting requirements of condition 4 of the Threshold Conditions for authorisation. Therefore, it would certainly seem appropriate to collect, collate and monitor a firm's compliance with this condition. A firm's capital adequacy can only make sense in the context of the overall risk profile of the

individual firm. We are unaware of how this information could be used for comparison purposes between firms. As mentioned in our answer to question 2 this information would vary considerably between firms due to a number of factors not based on the actual risk profile of the firm.

We also note that firms will have varying capital adequacy buffers over and above any prudential requirements. For example a firm could have a lower requirement than another but have a smaller buffer and hence have a greater risk of breaching these requirements.

We are unsure as to the exact benefit of making this information public as mentioned in paragraph 3.9. This information by its very nature is complex and as such could give misleading signals to investors as to the health of the firm.

DATA also consider that this information may be price sensitive and public availability may impact the share price of the company or other entities within the group. The FSA would therefore need to ensure that this data is accurate and relevant.

Q4. Can we distinguish between data required routinely; that required on request and that required by a trigger event. For example through exemption?

DATA are unsure as to what the FSA is driving at in this question.

Q5. Should we rely more on derived data such as ratios rather than input data, providing the firm maintains a record of how the ratios were derived. This could be investigated through case specific reporting if needed, for example by skilled persons reports?

We believe that for the FSA to rely on derived data such as ratios could be misleading and inaccurate. The FSA would have to provide firms with a standardised method of arriving at the ratio else there will be inconsistencies in the computation rendering the comparison of such data useless. In order to prevent inconsistencies we believe the FSA would have to provide prescriptive rules or evidential provisions which would seem to be contrary to the FSA's aim of providing principle based regulation.

Whether the FSA rely on ratios or input data, we are concerned that the collation and reporting of such data could be costly and time consuming, for both firms and the FSA, for very little benefit.

Q6. Can we rely more on developments in business reporting and technology more generally, for example through the use of XML standards?

In the ever developing world of e-commerce it would certainly seem prudent that reporting methods move towards being more electronically based rather than paper based. However, the FSA must be aware that a change to electronic reporting may have cost implications on firms. The implementation of such changes generally requires appropriate software or internal IT developments. We therefore recommend that the FSA fully investigate the cost benefit implications of such changes prior to implementation and also, if this method of reporting is to be mandatory, that sufficient transitional provisions are provided. This will be imperative for smaller firms who have less financial and resource capacity to provide for such changes.

Achieving better information about firms for consumers

Q7. What sort of information do consumers (or their advisers) and market participants want to have disclosed? For example, are there key performance indicators or areas that are currently not publicly disclosed which consumers need? Examples might include number of customer complaints, commission rates or compliance breaches of firms. Are there areas currently disclosed which add little value?

DATA supports the principle of improved transparency and increased disclosure to consumers, other market participants and advisers. However, we are concerned how the FSA will meet these aims. It is important to note that both consumers and advisers, when purchasing units in a collective investment scheme, require information with regard to the manager and the fund. Information with regard to the depositary is secondary and as such could potentially be misleading to consumers.

However, that said, we are of the opinion that the use of key performance indicators, customer complaints or compliance breaches may provide misleading and inaccurate information. Specifically with regard to complaints, firms only have to comply with the complaints procedures laid down in the FSA Handbook, if they are dealing with "eligible complainants" (who are generally defined as private individuals or small firms). Therefore, the number of complaints which are reported to the FSA will be entirely dependent on the firm's customer base and the ratio between institutional and retail consumers. The number of complaints may also correlate with flow of funds, so that a firm with a high volume of sales is likely to have more complaints than a firm with low sales. In these instances, data on complaints could mislead the customer and alarm them when there is no justification for doing so. We would however consider that it would be more appropriate and helpful for firms to identify the number of complaints per 1000 private customers rather than the total number of complaints received by the firm.

Similar issues arise from disclosure of breaches, the incidence of which will be dependent on the products offered by the firm and also perhaps on the diligence of the firm in logging such breaches. For example, collective investment schemes are the only products within the financial services industry which are themselves authorised by the FSA. These products and their providers must abide by extensive rules and regulations contained in the Collective Investment Scheme Sourcebook, the OEIC Regulations 2001 plus additional provisions provided for in the Conduct of Business Sourcebook. Therefore, due to the high number of rules, the likelihood of breaches occurring increases, and disclosure of such could erroneously act as a catalyst for consumers.

We note in paragraph 3.16 that the FSA consider that disclosure of the number and nature of legal actions taken by customers against the firm will enhance competitiveness and market efficiency. However, DATA take the view that this information could place firms in an invidious position. Firms may attempt to resolve complaints prior to a legal action being taken not due to any considered liability on the side of the firm but rather on the basis that they do not want this information disclosed. Also disclosure of legal actions may be contrary to other legal requirements and may prejudice the outcome.

DATA therefore considers that potential issues arising from the disclosure of this information may not only mislead consumers but also destabilise the functioning of the financial system as a whole.

Q8. What sort of format would be useful for disclosure of industry-wide information? For example, would summarised/simplified information, such as ratios, be adequate or is more precise detailed information required?

The more straightforward and simple that industry-wide information is, then the easier it will be for consumers to understand it and draw meaningful conclusions. The precise format should depend on the type of information disclosed; the DP is not clear on this. What is important is that there is consistency in how the information is prepared and presented, both year-on-year and sector-by-sector, so that consumers can make useful comparisons.

Q9. Are there any other factors that should be taken into account when considering consumer needs?

We have not identified any other factors to be taken into account in considering consumer needs.

Openly gathering market intelligence from all firms

- Q10. Should firms be given more access to information collected by us, such as aggregate data on a market-wide basis, to increase transparency and allow them to benchmark themselves?**

We believe that many firms would welcome the ability to benchmark themselves. However, as some of this information may be price sensitive and in the realm of competitiveness, this data should be generic rather than firm specific.

- Q11. Do you think transaction reporting (for example to identify market wide data on who is selling what products to which customers) is a feasible way of monitoring regulated firms?**

This question has little relevance in relation to depositaries as they do not sell financial products to private investors.

Encouraging firms to discreetly share information or concerns with us

- Q12. Do you agree that firms should provide more information, on a private basis, on market intelligence? What practical difficulties would need to be addressed in order to facilitate gathering of such intelligence?**

Our comments in relation to question 12 are set out in the covering letter.

Understanding systems and controls implications

- Q13. Do you think that systems changes can be distinguished between presentation/disclosure and underlying transaction engine issues in the way we envisage?**

Changes to reporting requirements, whether by disclosure or "underlying transaction engine" issues, will generally require systems changes and as such any proposals should be subject to a cost-benefit analysis.

The transitional provision of 12 months could be quite restrictive for some firms. In light of the ever changing regulatory environment which requires system changes, we consider that a 2 year transitional provision would be more appropriate and realistic.

Determining sources of assurance

- Q14. Of the data you currently report to the regulator, are there some areas where you would view external assurance as an unnecessary burden? Is there information not currently subject to external assurance that should be?**

DATA considers that the current level of external assurance provides the right balance and any additional requirements would be an unnecessary burden.

- Q15. Does information given to the regulator or disclosed to the public need to have a high level of external assurance provided by auditors and actuaries or is board/management internal assurance enough?**

DATA consider that as senior management are required to abide by the approved persons regime that there should be no further requirement for external assurance provided by auditors and actuaries. To require this additional external assurance should be subject to a cost benefit analysis.

Determining timing, frequency and accessibility

- Q16. Do you have any views on the timing, frequency and accessibility of information about regulated firms?**

We have no specific comments on the proposed reporting requirements in terms of timing, frequency and accessibility.