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UK FSA Publishes Policy Statement on Soft Dollar Disclosure to Retail Fund Investors

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [20155] July 6, 2006 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 13-06 INTERNATIONAL MEMBERS No. 10-06 INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 16-06 INVESTMENT ADVISER MEMBERS No. 19-06 SEC RULES MEMBERS No. 60-06 RE: UK FSA PUBLISHES POLICY STATEMENT ON SOFT DOLLAR DISCLOSURE TO RETAIL FUND INVESTORS The UK Financial Services Authority (FSA) has published a policy statement indicating that it will not issue new rules and guidance at this time on the disclosure of bundled brokerage and soft dollar arrangements for retail investment funds.¹ The policy statement is the result of a consultation process begun by the FSA in September 2005.² In its consultation paper, the FSA proposed that an “investor’s representative” receive and consider commission-related disclosures about a retail fund on behalf of the fund’s investors. The FSA also sought comment on who would carry out the representative function for different types of funds and what information should then be made available to the fund’s investors. The policy statement announces the FSA’s decision not to issue new rules and guidance, but instead to rely on industry-led approaches to soft dollar disclosure for retail funds. The FSA reiterated its belief that its proposed “investors’ representative” could provide the necessary oversight of commission disclosures, but also declared itself open to other oversight models that ensure commission disclosures are “appropriately and regularly reviewed.” The FSA noted that major UK trade associations, including the Investment Management Association (IMA), agreed that a disclosure-based approach to bundled brokerage and soft dollar arrangements can work for retail funds, and has left it to those associations to document existing standards and/or develop new standards of good practice for 1 See PS06/5, Bundled Brokerage and Soft Commission Arrangements for Retail Investment Funds, Feedback on CP05/13 (June 2006), available at http://www.fsa.gov.uk/pubs/policy/ps06_05.pdf. 2 See Memorandum No. 19235, dated Oct. 7, 2005. 2 retail fund disclosures. This is consistent with the FSA’s approach to commission disclosures generally, where the FSA has adopted rules requiring disclosure of the execution and research components of commissions but has deferred to a disclosure code developed by the UK fund and brokerage industries to determine the form of disclosures. The policy statement makes reference to the concerns expressed by the Institute over the effectiveness of unbundled commission disclosure and, more specifically, over the lack of any requirement in the UK for brokers to assist investment managers in estimating unbundled commission costs. The FSA responded that its “overall analysis of the potential and actual market failures that arise from the use of softened and bundled dealing

arrangements has not changed” and that it remains “committed to the outcomes [it] previously stated – that investment managers have stronger incentives to make efficient decisions about the use of dealing commission to purchase execution and research services, and are accountable to their clients for those decisions and the resulting expenditure.”³ The FSA indicated that it intends to conduct a comprehensive review of bundled brokerage and soft dollar disclosure in 2008, including disclosure with respect to retail funds. Despite the lack of formal guidance, the FSA made clear the outcome it wants to see: “more transparency and challenge on the use of fund assets to purchase research and execution services.”⁴ Glen S. Guymon Assistant Counsel - International Affairs ³ See section 2.3 of the policy statement. The Institute’s comment letter on the FSA’s consultation is available at http://www.ici.org/statements/cmltr/06_eu_soft_dollar_com.html. ⁴ See Statement of Dan Waters, FSA Director of Retail Policy, in Press Release on PS06/5 (June 29, 2006), available at <http://www.fsa.gov.uk/pages/Library/Communication/PR/2006/065.shtml>.

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