

COMMENT LETTER

January 26, 2017

ICI Global Submits Comments on Financial Conduct Authority's Mission (pdf)

26 January 2017 VIA EMAIL: FCAMission@fca.org.uk Financial Conduct Authority 25 The North Colonnade Canary Wharf London E14 5HS Re: Our future Mission Dear Sir or Madam, ICI Global¹ appreciates the opportunity to comment on Our future Mission (“Mission”), the Financial Conduct Authority’s statement discussing how the FCA will seek to achieve its regulatory objectives.² ICI Global and its members have a keen interest in a strong and resilient financial system that operates on a foundation of sound regulation. We seek to engage actively with policymakers and to provide meaningful input on regulatory initiatives, such as this one, that may have significant implications for regulated funds, their investors and the broader financial markets. As the Mission explains, the FCA wants to ensure that it is “a proportionate and effective regulator as financial services adapt to meet new needs in new ways.”³ The FCA views the Mission as a statement that “clarifies our thinking about the way we regulate and how we decide our priorities.”⁴ We applaud the FCA for its efforts in developing the Mission, which generally envisions a thoughtful and balanced approach to regulation across a widely diverse universe of firms and markets. Setting forth a general framework by which the FCA will approach its responsibilities is an important initiative given the FCA’s relative “youth” as a regulator and 1 ICI Global carries out the international work of the Investment Company Institute, serving a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$20.0 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC. 2 Financial Conduct Authority, Our future Mission (Oct. 2016), available at <https://www.fca.org.uk/publication/corporate/our-future-mission.pdf>. 3 Mission at 4. 4 Id. Financial Conduct Authority 26 January 2017 Page 2 of 8 the vital importance of the financial services sector to consumers and the broader UK economy. This letter begins with our general observations about the FCA’s intended approach to regulation. Next, we highlight two areas that we believe should be prominently featured in the Mission: (1) the FCA’s role with regard to addressing potential systemic risks in the firms and markets that it regulates, and its relationship with other policymakers involved in systemic risk regulation, such as the UK Financial Policy Committee (“FPC”); and (2) the FCA’s involvement in other policymaking bodies. We then briefly discuss the FCA’s use of its competition powers. Our letter concludes with some suggestions for the FCA going forward,

including with regard to the impact of the Brexit vote on the financial services industry. The FCA's Approach to Regulation According to the Mission, the FCA has "an overriding strategic objective set by Parliament to ensure that relevant markets function well," and the Authority seeks to deliver on this objective by "protect[ing] consumers, protect[ing] the integrity of UK markets and enhanc[ing] competition."⁵ ICI Global and its members offer strong support to the FCA as it seeks to regulate according to these objectives because consumer protection, market integrity and robust competition have been—and will remain—fundamental to the success of the regulated fund industry. Regulated funds serve as the vehicle through which investors in the UK save and invest to meet their most important financial goals. These funds offer their investors substantial advantages, including professional money management, diversification, and reasonable cost. They include the benefit of substantive government regulation and oversight, as befits an investment product eligible for sale to the retail public. Specific areas of regulation include investor disclosures (e.g., form, delivery and timing), form of organization, separate custody of fund assets, mark-to-market valuation, and investment restrictions (e.g., leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). FCA regulatory decisions impact regulated funds, the markets in which they invest, and the broader UK financial system in which they operate. For ICI Global members (and regulated entities generally), knowing how the FCA intends to approach its decision making, as well as the regulatory philosophy that will guide those decisions, provides some degree of predictability, both in terms of process and potential outcomes. While there is much to commend in the Mission, we wish to highlight in particular our strong agreement with the following aspects. □ We endorse the "principles of good regulation" that the FCA intends to apply in all of its work: efficient and economical use of resources; proportionality; desirability of sustainable growth in the UK economy; consumer responsibility; senior management responsibility; recognizing the differences in the businesses of different regulated persons; openness and disclosure regarding regulated persons; and transparency of regulatory functions.⁶ To this list, we would suggest adding the principle that the 5 Id. 6 Id. at 17. Financial Conduct Authority 26 January 2017 Page 3 of 8 FCA will have meaningful engagement with regulated entities and the broader public in developing regulatory policy (through, e.g., consultations, roundtables, calls for evidence). □ We concur with the FCA's view that effective regulation can help create a more competitive and innovative financial services market. We see this in our industry, where there is robust competition among regulated funds to deliver the investment strategies and investment results that will help fund investors achieve their financial goals. □ We appreciate the FCA's acknowledgement that regulatory requirements impose costs that ultimately are passed to consumers. For investors in regulated funds, such costs reduce their investment returns, and thus can have a negative impact on their ability to save for higher education, homeownership or retirement. This is why ICI Global and our members consistently advocate for sound regulation based on a thorough examination of both benefits and costs. □ We strongly agree with the FCA's observations regarding market and firm failure, including: o "It is not possible, or desirable, to create markets and firms which never fail. To do so would involve a cost of regulation which would substantially exceed the benefits, and even then provide no guarantee."⁷ o "Regulated firms will inevitably fail, especially when markets are competitive. Our approach is to ensure that these firms exit the market in an orderly way, and that the associated disruption and harm to consumers is minimized."⁸ o "A well-functioning market is not one where consumers will never lose or regulated firms will never fail. It is not our role to adopt a zero-tolerance approach to this kind of failure."⁹ These statements underscore the FCA's understanding of, and appreciation for the proper functioning of, the capital markets. We elaborate on the importance of this perspective in the next section of this letter. □ We applaud the FCA's

intention to “take specific action, including a review of our Handbook, to reduce the restrictions our regulations cause without compromising our objectives.”¹⁰ The financial services industry is dynamic and rapidly evolving, raising the prospect that regulations adopted in the past under different conditions or circumstances may no longer provide optimal cost/benefit tradeoffs for consumers and the broader economy. We appreciate the FCA’s commitment to considering whether certain of its regulations need to be revised or replaced to ensure that the regulatory scheme keeps pace with industry developments, and we urge the Id. at 4. Id. at 7. Id. at 12. 10 Id. at 14. Financial Conduct Authority 26 January 2017 Page 4 of 8 Authority to commit to conducting a “retrospective” review of its Handbook on a periodic basis going forward (e.g., every five years). □ We welcome the FCA’s view that it has a specific role to play in promoting technological innovation in the interests of users. And we appreciate the FCA’s willingness to consider “non-traditional regulatory responses,” including fostering discussion amongst market participants and “opening FCA processes to all to allow technological solutions to be developed to meet our concerns.”¹¹ More generally, we believe that greater collaboration between the FCA and industry to identify challenges and develop solutions should help to achieve workable and effective regulatory outcomes. □ We appreciate the FCA’s commitment to providing support for new firms or business models looking to enter the market. Robust competition, as we have noted earlier, has been fundamental to our industry’s success. Forward-looking initiatives such as the FCA’s “regulatory sandbox” are a way to foster innovation while still providing appropriate regulatory oversight. We note that the Mission contains occasional references to the FCA’s business plan, which sets forth the Authority’s current regulatory priorities and how it will measure “success” in meeting those priorities.¹² We recommend that the FCA consider specifying in the Mission how the two documents relate to one another and how the FCA develops its business plan. Role of the FCA in Systemic Risk Regulation One area that we believe should be more prominently developed in the Mission is the FCA’s role in systemic risk policymaking that has implications for the firms and markets that it regulates. This includes the FCA’s involvement with, and contributions to, the FPC. In the years since the global financial crisis, policymakers in jurisdictions around the globe have sought to incorporate a system-wide perspective into their financial regulatory frameworks. Broadly stated, the goal of those efforts is to identify and address risks that could pose a threat to the overall financial system. Maintaining a strong and resilient financial system is fundamentally important to regulated funds and their investors. ICI Global believes that regulators can—and should— look at all sectors of the financial system to identify potential risks. To lead to good policy outcomes, reviews of this nature must be thorough, balanced and fact-based. This, in our view, means active involvement by regulators with requisite expertise. For capital markets, this means contributions from regulators like the FCA who understand how those markets and their participants (including regulated funds) operate and the potential risks (or lack thereof) they may present. What we have seen in practice, however, deeply concerns us. Far too often, the views of the policymaking bodies charged with identifying systemic risks—for example, the global Financial Stability Board (“FSB”), the United States Financial Stability Oversight Council, and the European Systemic Risk Board—have reflected the mindset of the central bankers who dominate their membership. From this perspective, non-bank financial entities arouse

11 Id. at 23. 12 The FCA’s current business plan, Business Plan 2016/17, is available at <https://www.fca.org.uk/publication/corporate/business-plan-2016-17.pdf>. Financial Conduct Authority 26 January 2017 Page 5 of 8 skepticism based on the fact that they are not regulated in the same way as banks. Potential areas of risk are identified by close reference to the experience of banks, and there is a tendency to presuppose the appropriateness of bank-oriented regulatory solutions. We believe strongly that policymakers should refrain from seeking financial “stability” through a rigid, bank-centered system and the avoidance

of risk. Instead, we have argued that policymakers should strive for a “robust” financial system that offers and promotes diversity, encourages innovation and experimentation, and is adaptable.¹³ We are pleased to see this broader view of financial system “success” reflected in the Mission. The Mission, however, does not discuss the FCA’s role in addressing potential systemic risks in the markets and firms that it regulates. Nor does the Mission discuss the FCA’s contributions to, or involvement in, the FPC. We note, however, that the FCA’s business plan says the following: The Financial Policy Committee (FPC) is the UK’s prime body for analysing financial stability and is the main lens through which the FCA views systemic risk. As part of our role to protect and enhance the integrity of the UK financial system, we closely monitor financial stability risks, including the soundness, stability and resilience of financial markets. Our Chief Executive is a member of the FPC and we work closely with the Bank of England on areas of interest to the FPC such as market liquidity and housing issues.¹⁴ We believe it is critically important for the FCA to bring its perspective and expertise to bear in the work of the FPC. Doing so will help to ensure that the FPC’s views and decisions are reflective of the diverse UK financial system and not just its banking sector. We accordingly urge the FCA to participate in the FPC to the fullest possible extent, including by advocating for the appointment of external members with capital markets expertise. This commitment, we believe, needs to be featured prominently in the Mission, along with a discussion of how the FCA expects to contribute to the work of the FPC.

Involvement of the FCA in Other Policymaking Bodies

In a foreword to the FCA’s current business plan, Chairman John Griffith-Jones observes that the FCA “will continue to be involved in the EU and international policy agenda, seeking particularly to maintain the wellbeing of the UK’s market place, reinforced by the high conduct standards expected of a global financial centre.”¹⁵ The business plan describes the FCA as “a significant and influential voice in international regulatory bodies.”¹⁶ We agree with this description of the FCA. As we observed earlier in this letter, the FCA has articulated a balanced and thoughtful regulatory philosophy that will guide its regulation of a wide and diverse segment of the UK financial system. The FCA’s approach, and its deep understanding of the capital markets and capital markets participants, likewise

¹³ See, e.g., Enough Already: Is Post-Crisis Financial Reform Going Too Far?, Luncheon Keynote Speech by Paul Schott Stevens, President & CEO, Investment Company Institute, at the American Chamber of Commerce in Japan (19 Oct. 2016), available at https://www.ici.org/pressroom/speeches/16_pss_japan_finreg.

¹⁴ Business Plan 2016/17, supra note 12, at 43.

¹⁵ Id. at 6.

¹⁶ Id. at 43.

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Page 6 of 8 would be beneficial in guiding other policymaking efforts of import to regulated funds and their investors. We offer two brief examples. First, the FCA is an active participant in the International Organization of Securities Commissions (“IOSCO”). Earlier this month, the FSB delegated to IOSCO responsibility for considering FSB recommendations to address perceived “structural vulnerabilities” in asset management. ICI Global welcomed the FSB’s confirmation that IOSCO is the correct body to evaluate these recommendations and consider next steps. As we have repeatedly urged, IOSCO and capital markets regulators in each jurisdiction have the appropriate expertise to identify and examine any areas of potential risk in asset management and to determine the appropriate regulatory response. Second, the FCA is actively involved in work to develop a new prudential regime for EU investment firms. Conducted under the direction of the European Banking Authority (“EBA”), this work aims to develop: (1) a framework tailored to the risks of investment firms, as opposed to one based on global prudential standards for banking; and (2) a clear, single set of harmonized requirements that are reasonably simple, proportionate and more relevant to the nature of an investment business. It is our understanding that the EBA intends to deliver its final recommendations to the European Commission in June 2017. We urge the FCA’s full engagement in the two work streams

mentioned above, which have important implications for the firms and markets that the FCA regulates. More broadly, we recommend that the FCA modify the Mission to reflect its commitment to involvement in EU and international policymaking bodies whose work likewise will impact FCA-regulated entities. Use of Competition Policy Tools By statute, the FCA “must discharge its general functions in a way which promotes effective competition in the interests of consumers.”¹⁷ As an initial matter, we note that the United States Securities and Exchange Commission (“SEC”) has a similar statutory mandate in respect of its rulemaking. Specifically, in instances where the SEC must consider whether its proposed action is consistent with the public interest, the agency must consider both the protection of investors and whether the action will promote efficiency, competition and capital formation.¹⁸ The executive summary to the Mission indicates that it is the FCA’s preference “to use our competition policy tools where our actions will improve functioning of markets as a whole.”¹⁹ As the FCA surely appreciates, exercising this authority must be done judiciously, given the relative interconnectedness of UK financial markets with those in Europe and beyond. Addressing (or even identifying) problems in the UK marketplace must be approached carefully so as to avoid triggering any distortion in the operation of financial markets more broadly. In a section entitled Competition and market design, the Mission indicates that “[w]hen we are developing interventions on market design, our market studies are key” and 17 Section 1B(4) of the Financial Services and Markets Act. The full statute is available at <http://www.legislation.gov.uk/ukpga/2012/21/section/6/enacted>. 18 Section 2(c) of the Investment Company Act of 1940. 19 Mission at 4. Financial Conduct Authority 26 January 2017 Page 7 of 8 that as a result of such studies, “we can use our powers to seek to remedy any concerns we have identified.”²⁰ As a threshold matter, we believe the references to “market design” are unfortunate, because they could be read to suggest that it is for the regulator to determine the overall structure and shape of competitive markets. While it is true that the FCA could encounter particular market failures that require regulatory intervention, FCA “redesign” of a market is unlikely to be an appropriate response. Given the weight that the FCA intends to afford its market studies, it is imperative that the Authority makes every effort to “get it right.” Recently, the FCA published an interim report on its asset management market study and requested public comment on its “emerging thinking and analysis,” including “our findings about how competition works for asset management products and services” and “our emerging thinking on potential remedies.”²¹ Contrary to the FCA’s initial conclusion that price competition in this market needs to be strengthened, the report in fact shows that the UK market exhibits the hallmarks of a very competitive industry. ICI Global intends to file a detailed comment letter explaining why this is so and providing additional supporting data. Our letter will reflect our firm belief that capital markets regulators should refrain from any temptation to “place a finger on the scale” and push investors toward particular products or providers, with attendant negative implications for competition and innovation. Our concerns with the interim report on asset management underscore a broader point—the critical importance of public feedback in any market examination by the FCA. Market participants and other stakeholders may well have insights and empirical data that the FCA as a regulator does not. In our view, the FCA must be willing to consider carefully all public input that it receives, particularly data or other information that may be at odds with the FCA’s initial views of a particular market. And it also must be willing to take that input into account when drawing final conclusions about the state of the market being examined and the policy responses (if any) that the FCA should consider. Looking Ahead We conclude our comments with two additional, forward-looking suggestions for the FCA. First, although we respectfully acknowledge the FCA’s statement in the foreword to the Mission that “this is not a document about Brexit,” there is no denying that the FCA will have a role in managing Brexit and its implications for regulated firms and the markets in which they operate.

Accordingly, as part of the FCA's consideration of its approach to regulation, we recommend that the FCA make a conscious effort to "calibrate" its regulatory activity in light of the challenges that Brexit will pose for regulated firms. Such calibration should aim to ensure that any transitions necessitated by Brexit (including those that will affect regulated funds and their investors) are orderly and do not undermine the FCA's regulatory objectives of protecting consumers, protecting the integrity of UK markets and enhancing competition. Second, we recommend more generally that the FCA, on an ongoing basis, should consider carefully the pace of regulatory change so that firms have time to adapt to significant new regulatory obligations (or to the market or other impact on their businesses 20 *Id.* at 37. 21 FCA, Interim Report, Asset Management Market Study (Nov. 2016) at 22, available at <https://www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf>. Financial Conduct Authority 26 January 2017 Page 8 of 8 brought about by regulatory change). A related concern is that at a certain point, the costs and burdens of regulatory overload could lead some firms to exit the business, or raise barriers to entry for others. The result would be greater concentration and less competition— an undesirable outcome and one at odds with the FCA's objectives. As part of carrying out its mission, the FCA should be mindful of and seek to avoid these potential consequences. * * * * * We appreciate the opportunity to comment on the FCA's Mission. If you have any questions regarding our comments or would like additional information, please contact me at +44 (0) 207-961-0830 or dan.waters@iciglobal.org; or Susan Olson, Chief Counsel, at +1 (202) 326-5813. Sincerely, /s/ Dan Waters Dan Waters Managing Director ICI Global