

## **FSA's consultation on 'Listing Regime Review' (CP 09/28)**

### **Submission from the Association of Investment Companies (AIC)**

The AIC welcomes the opportunity to respond to the FSA's consultation on changes to the listing categories (CP 09/28).

The AIC is the trade body representing some 350 closed-ended investment companies with £67 billion of assets under management. The vast majority of our Members are listed on the London Stock Exchange and apply chapter 15 of the Listing Rules.

#### **General observations**

The AIC supports effective labelling of the listing regime to help consumers understand the standards which apply to the securities they own. The issue is particularly significant for the investment company sector as it has high levels of retail ownership which makes communicating clearly to non-professional investors and their advisors a high priority.

However, the AIC is concerned that the consultation, which started as a relabeling exercise to ensure that all securities can be allocated to a listing category, now includes rule revisions to fit the categories identified by the FSA. These rule revisions may have wider implications than simply clarifying the structure of the listing framework.

One outcome of the proposals is that non-equity securities issued by investment companies will be located in the Standard Listing segment. This creates a particular issue for split capital investment companies, which form a significant proportion of the sector and whose share classes often appeal particularly to retail investors. Some split capital investment companies (currently 13 of our Members) issue Zero Dividend Preference shares, which, under the proposals, will be moved from the Premium Listing segment to the Standard segment. This will also be the case for other types of non-equity shares issued by investment companies.

Putting non-equity investment company securities in the Standard segment may affect the market's perceptions of the regulatory standards that these companies adopt. The new segment labels may confuse shareholders and obscure the fact that they get the benefit of the super-equivalent rules which will apply at issuer level. For example, all investment company shareholders (regardless of their class of share) get to vote on a change of investment policy (as required by LR 15.4.8), arguably the most critical aspect of the governance of the company.

The AIC is concerned that the relabeling exercise risks damaging the market for shares listed in the Standard segment if it is perceived that standards have been eroded. Over the last couple of years, the AIC has worked with the FSA to resolve regulatory concerns arising from the splits crisis by creating an effective super-equivalent regime for investment company shares. This has

had ongoing value in reassuring external stakeholders (including consumers, advisors, policy-makers and the media) that the sector is governed by suitable levels of regulation. The outcome of the market segmentation exercise should not undermine these achievements.

Furthermore, the reclassification exercise should not result in a lower quality regime or diluted standards. The AIC has been assured by the FSA that there will be no dilution of standards, particularly where securities are moved out of Chapter 15. This is because investors will receive protection from rules which apply to other securities which retain a Chapter 15 listing (although we are aware of one minor area where standards for preference shareholders will be reduced which is notification of board changes and directors' details). This does however raise the question that, if those security holders benefit from super-equivalent provisions applied to the company, why should the securities they hold be within the Standard segment?

The AIC is strongly of the view that non-equity securities issued by investment companies belong in the Premium Listing segment. The standards which are applied via Chapter 15 are fundamental to the regulation of the sector. These notably include the requirement on the company to publish an investment policy and manage the portfolio in conjunction with that policy and for the board to be independent of the external manager.

The AIC understands that the reclassification of non-equity securities in the Standard Listing category is based on the inability of shareholders to vote on issues covered by Chapter 10 (significant transactions) and Chapter 11 (related party transactions) of the Listing Rules. The AIC **does not** agree that the issue of voting should assume such a critical role in the classification of securities between the Premium and Standard Listing segments. Our recollection is that voting has not been a key issue for discussion in the consultations on market segmentation which preceded CP 09/24.

Also, although non-equity shareholders do not get a direct right to vote on issues covered by Chapter 10, where such a transaction falls within the investment policy then LR 15.5.2 provides for an exemption from Chapter 10. Where it falls outside the investment policy, it has, in any event, to be approved via a change of policy. Therefore the lack of a direct vote on significant transactions does not have any material impact on the regulatory standards which apply to non-equity shareholders where significant transactions are concerned.

The only area of regulatory concern where non-equity shareholders may not have a vote therefore seems to be Chapter 11. Related party transactions are not common in the investment company sector and we are not convinced that this one difference provides a sufficient reason to exclude an investment company's non-equity shares from the Premium segment. After all, the critical protections discussed in developing a tailored investment company regime will apply at the issuer level. For example, the Listing Rules require that the board is independent of the manager. Therefore, putting non-equity securities in the Standard category is inappropriate given the protections

investors enjoy on critical issues. Consequently, using a Standard label may hinder rather than help effective communication over regulatory quality.

In summary, these proposed rule changes risk unintentional and undesirable consequences. The process of changing the rules should not be driven by the process of market segmentation if there is any risk that the standards which apply are eroded. The changes should only be introduced in their current form if they maintain standards and increase consumer understanding. We are not convinced that this will be the outcome. Therefore, the AIC's **recommendations** are:

- The FSA should give further consideration to how the market might respond to the outcome of this reclassification exercise before introducing any changes.
- All investment company's shares and securities should remain within Chapter 15. Moving any of these securities to Chapter 14 could cause confusion and send the wrong signals to the market. It would also suggest that lower standards apply when this is not the case.
- A more useful classification for consumers would be for investment company non-equity shares to be labelled under an additional category of 'Premium (non-equity) shares'. This would indicate that these securities benefit from higher standards than the Standard segment but signal that there is some difference from the overall standard which consumers should potentially be aware of.
- If creating an additional label is not possible, the FSA should consider other options for clarifying the labelling structure, for example by using additional consumer indicators within the different market segments.
- Proposed rule 1.5.1 (6) should be redrafted. We are unconvinced that it delivers the intended outcome as it could be read as allowing an equity share to be allocated to the Standard listing segment even though it is subject to the full rulebook. The rule should be amended to remove this confusion.

Our comments on the specific questions raised in CP 09/28 are set out below.

### **Consultation questions**

**Q1: Do you agree with the implementation of our policy to clarify that the Premium Listing segment is only available to equity shares, and the consequent deletion of certain super-equivalent rules for securities other than equity shares (e.g. preference shares and securities convertible into equity shares) that are not eligible for the Premium Listing segment under the model that has been previously consulted upon and agreed?**

The AIC is not convinced that the proposed approach will maintain standards and increase consumer understanding. Our reasons are set out above. We **recommend** that the FSA gives further consideration to how the market might respond to the outcome of this reclassification exercise. The AIC **recommends** an alternative approach which will enable all investment company shares to remain within Chapter 15 by labelling investment company non-equity shares under an additional category of 'Premium (non-equity) shares'. This would demonstrate to the market that these securities benefit from higher standards than the Standard segment but indicate that there is some difference from the overall standard which consumers should potentially be aware of.

The AIC also **recommends** that the FSA should consider other options for clarifying the labelling structure, for example by using additional consumer indicators within the different market segments.

**Q2: Do you agree with our proposal to limit LR12.5.1 and LR12.5.2 to purchases of securities convertible into Premium Listed equity shares?**

As a result of the proposed changes to LR12.5.1 and LR12.5.2, the market will receive less information in the event that an issuer purchases its own preference shares. This represents a dilution in standards. The AIC is unconvinced that this approach is appropriate.

**Q3: Given that there are a number of shares that cannot at present be allocated to a listing category, do you agree with our proposal to rename the fourth listing category 'Standard Listing (shares)'?**

See 'general observations' above.

**Q4: Do you agree with the definition of miscellaneous security and the rules applicable to such securities?**

A number of investment companies have issued warrants and subscription shares, and indeed there has been a growing number of subscription share issues in recent times. Under the proposals, these securities would be allocated to a new Chapter 20 within the Standard Listing segment. The AIC does not believe that it is any more correct to categorise these securities outside of the Premium Listing segment as it is for preference shares, as discussed under 'general observations' above. The AIC **recommends** that the proposals are amended to ensure that such securities remain in Chapter 15.

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