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Comment Letter on Draft U.K. Financial Services and Markets Bill, December 1998

November 25, 1998

Regulatory Reform Team
Room 55A/G
HM Treasury
Parliament Street
London, SW1P 3AG England

Re: Comments on Draft Financial Services and Markets Bill

To Regulatory Reform Team:

The Investment Company Institute appreciates the opportunity to comment on the draft United Kingdom Financial and Markets Bill. The Institute is the national association of the American investment company industry. Its membership includes 7,335 open-end investment companies ("mutual funds"), 451 closed-end investment companies, and 9 sponsors of unit investment trusts. As of October 31, 1998, its mutual fund members had assets of about $4.837 trillion, accounting for approximately 95% of total industry assets, and had over 62 million individual shareholders. The investment company industry has become a global business and, accordingly, we have followed with great interest the U.K.'s proposals to modernize its financial regulatory system.

The Institute strongly endorses the U.K.'s efforts to provide the foundation of a financial regulatory system that is ready for the 21st Century. These efforts come at a critical time. The pace of change in the global securities markets has increased dramatically, in part because of rapid developments in the use of the Internet. We recognize the challenges posed to regulators by the need to both accommodate market innovations and ensure the protection of U.K. investors.

There are two broad aspects of the draft legislation where clarification is needed to assist market participants engaged in cross-border business. The first relates to the fact that the Bill, as presently drafted, does not resolve the jurisdictional issues posed by the global character of today's markets, including issues arising from the growth of cross-border Internet communications and electronic commerce. While the Bill recognizes that jurisdiction can no longer be strictly territorial, it provides no guidance as to when the U.K. will assert jurisdiction over Internet communications. In particular, the Bill fails to provide an exemption for Web site communications by issuers that are not directing their securities to the U.K. and have no intention of making unauthorized sales in the U.K.

The second area in which clarification is needed relates to the draft Bill's provisions with respect to regulatory guidance. While the Bill authorizes the Financial Services Authority ("FSA") to furnish guidance as to the FSA's views on matters such as proposed business innovations, the Bill does not provide a mechanism by which that guidance, once provided to a particular business or industry segment, will be made generally available so that similarly situated entities also may rely on it.

Each of these matters is discussed below. We hope that this letter will help to advance the debate on the proposed Bill and assist the Treasury in drafting legislation to deal with these matters.

Jurisdictional issues created by cross-border communication and commerce

As the overview discussion that accompanies the draft Bill explicitly recognizes, capital and information flow rapidly across national borders today. The Bill, however, does not provide a touchstone for when the U.K. will assert jurisdiction over cross-border activity and when it will not. Rather, the Bill's provisions potentially criminalize a wide range of activity by non-U.K. firms. Specifically, Section 17(1) of the draft Bill prohibits "financial promotion"— broadly defined as communicating an invitation to engage in investment activity

or communicating information that is intended or might reasonably be presumed to be intended to lead directly or indirectly to engaging in investment activity — by unauthorized persons, unless the content of the communication has been approved by an authorized person. Section 17(2) further specifies that a communication originating outside the U.K. is subject to this prohibition if it is "capable of having an effect in the U.K." This approach creates uncertainty and fails to incorporate the broad concept embodied in the Financial Services Act 1986 that persons who do not carry on an investment business in the U.K. need not be regulated by the U.K.[1] In this global environment it is critical that businesses be able to discern what laws govern their activities. Large financial services providers whose businesses already are comprehensively regulated in a non-U.K. jurisdiction, such as the U.S., would benefit substantially from clarification of these jurisdictional questions.

The widespread use today of Internet Web sites by securities firms illustrates both the potential reach of the proposed "financial promotion" provisions and the need for greater jurisdictional certainty. Because materials placed on an Internet Web site may be accessed by Internet users anywhere in the world, communications on any Web site may be "capable of having an effect in the U.K." under proposed Section 17(2) of the draft Bill.

The FSA took a significant step earlier this year in the Policy Statement issued on May 28, 1998, which explicitly recognized the Internet World Wide Web's "important role," and advised that the FSA was "keen not to stifle legitimate commercial development of the Internet to deliver financial services." The statement clarified the FSA's views on the treatment of materials posted on the Internet that are accessible to, but not intended for, U.K. investors. The statement and the letter simultaneously issued to the Institute made clear that the FSA would be unlikely to take enforcement action against a U.S.-based investment company that operates a Web site directed to non-U.K. investors if that company satisfies certain conditions, including the use of appropriate legends on its Web site and the adoption and enforcement of reasonable procedures designed to assure that unauthorized sales will not be made in the U.K. The proposed Bill does not incorporate any similar standard and thus could be viewed as a repudiation of the Policy Statement. This would expose companies that have no intention of marketing financial services in the U.K. but that may, for instance, post investment information on their Web sites to potential liability (including criminal charges) under U.K. securities laws. We think this uncertainty should be eliminated through legislation providing an exception for financial promotion that, although available in the U.K., is not directed at the U.K.

Need for published guidance

The proposed Bill recognizes that it is essential that the FSA have the authority to issue guidance regarding the operation of the new law and any rules made under it. This authority is necessary in rapidly changing global marketplaces to permit to go forward, among other things, market innovations that do not implicate investor protection concerns. Because regulatory guidance is key to an effective and efficient market, it should be accessible to all market participants. The draft provisions permit the FSA to provide guidance but do not afford a mechanism for widespread dissemination of that guidance. Such a mechanism would assure a level playing field. To address concerns about commercial confidentiality, the mechanism could include appropriately tailored and narrow exceptions from public dissemination of the advice.[2] Making the FSA's interpretative advice publicly available will help assure that industry participants who are interested in implementing market innovations can do so while also remaining in compliance with U.K. law.

The concept that interpretative guidance should be generally available is well recognized. For example, the General Agreement on Trade in Services requires prompt publication of all relevant measures of general application which pertain to or affect trade in services. The September 1998 Report of the International Organization of Securities Commissions titled Objectives and Principles of Securities Regulation highlights the desirability of public disclosure of policy in important operational areas. Moreover, the overview discussion that accompanies the proposed Bill specifies that "[f]or reasons of fairness and transparency" all FSA waivers of rules, in the absence of overriding reasons of commercial or regulatory confidentiality, must be published. For these same reasons of fairness and transparency, FSA interpretive guidance should be available to all market participants. Because of the importance of assuring that FSA views receive widespread dissemination, we urge that the Bill mandate disclosure of FSA interpretive guidance.

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The two issues discussed above are of great interest to American investment companies. We hope that the Treasury will act promptly on these matters, either in the primary legislation or in secondary legislation, in order to remove the uncertainties created by the draft Bill and to permit industry participants to plan for the future.

Thank you for your consideration of these comments. The Institute would be happy to provide additional information or clarification of our views.

Sincerely,

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General Counsel

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ENDNOTES

[1] For example, the Financial Services Act 1986's "overseas persons" exemptions from authorization (including the unsolicited and legitimately solicited transaction exemptions) embody this concept.

[2] For example, publication of the guidance could be delayed for a short period of time, perhaps 30 days, or some longer period upon appropriate cause. The FSA recognized this principle in its Consultation Paper on Market Abuse. That paper states that providing FSA's views on a novel or complex transaction to a single firm might provide a commercial advantage to that firm and that delaying publication of the advice might strike a reasonable balance so as not to dissuade firms from seeking FSA guidance. See FSA Consultation Paper 10 (Market Abuse) at 38.
