HOUSE OF LORDS
Financial Services Regulation Committee

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By email

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Dear Nikhil,

Thank you for recently briefing the Financial Services Regulation Committee in private. I am writing to follow up on cost disclosure requirements for listed investment companies, which we raised during the session.

More than a third of FTSE 250 companies are investment trusts, some of which are in the FTSE 350. These trusts, which have a 150-year history, have positioned the UK as a market leader due to the diverse range of assets they can hold, enabling 'permanent' investment into start-ups, smaller companies, property, renewables, and infrastructure. These are among the areas highlighted as a priority for investment by the Chancellor in his Mansion House speech and Edinburgh Reforms.

The cost disclosure regime applied to investment trusts in the UK has been a cause for concern in the industry for some time now. UK application of retained EU Regulations requires the investment trusts to report costs in the same format as unlisted open-ended funds, thus failing to recognise the role of listed company shares as the value of the financial instrument invested in, and indeed the mechanism creating investment permanence. This creates a falsely elevated number for aggregated ongoing cost forecasts of funds which are held by investment trusts, giving misleading information to investors and indicating that costs/expenses are to be deducted annually from shareholdings.

As a result, the investment flowing into them has been significantly reduced, with industry leaders stating that investment trusts are missing out on £7bn per year that could be directly allocated to sectors of the real economy, such as green energy, infrastructure maintenance, including road and rail repairs, and building hospitals. In addition, there has also been a material loss of permanent investment into the capital market via equity trusts, as well as foreign investors acquiring UK real assets at significantly reduced prices.

This issue is founded on an interpretation of EU-retained MiFID and PRIIPs not shared by any other country. This ultimately creates an unlevel playing field on an international level.

While the Government has announced that it aims to act on the issue and legislate on these matters in 2024, it has left matters with the FCA to create an interim solution to mitigate the impacts on the investment industry in the short term. In our view, the FCA's forbearance statement, issued in November 2023, was helpful but does not go far enough.

However, challenges persist regarding the disclosure of these costs through the European MiFID template (EMT). While this is a voluntary undertaking by the European fund industry, the interpretation by the FCA of MiFID II Delegated Regulation Article 50/51, Annex II, Table 2 is the source of the problem. A potential solution lies in requiring Authorised Corporate Directors (ACDs) responsible for completing the EMT on behalf of the relevant funds and trusts to enter zero into the appropriate column that is for ongoing fund charges, aligning with the practices of EU funds, rather than inputting figures that result in misleading disclosure.

Urgent steps are necessary to resolve issues which have come as a result of the UK's unique interpretation. Key issues include:

- Reduced investment in SMEs by investment trusts leading to reduced investment by SMEs in the real economy, which is affecting jobs, tax revenue, and leading to cheap asset sales to foreign buyers;
- The deprivation of consumers and pension funds of investment opportunity in the real economy;
- Reputational damage to UK markets and regulation; and
- Harming the UK's international competitiveness.

It would be helpful, both for the Committee and for the wider financial services sector, to receive answers to the following questions.

1. Can you explain why the FCA has made and sustained the decision to require investment trusts to be included in the cost-disclosure and aggregation format when no other country in Europe must do likewise?
2. When was the inclusion of investment trusts in this format consulted upon, as it does not appear a straightforward requirement derived from EU legislation?
3. How is the FCA working on resolving the market disruption which has come as a result of the cost disclosure requirements?
4. Given the urgency of the situation, and your understanding that once the legislation is enacted, the issue will transition to the FCA's rulebook, when do you expect to launch a consultation on the changes to the cost-disclosure regime and can you take immediate emergency action?
5. Could you confirm that once the statutory instruments are made, this issue will be solved?
6. Could you provide examples of where the FCA has engaged with industry on this matter?
7. What is being done by way of communication to regulated entities such as investment platforms and ACDs to alert them and ensure the data trail via the EMT is brought into line with the principles of the forbearance and to prevent further elaboration of wrongful cost explanations and delisting from platforms?

I would appreciate a response to the questions listed above by 7 May.

Yours sincerely,

Lord Forsyth of Drumlean,
Chair, Financial Services Regulation Committee

Members of the Committee have declared interests in relation to financial services. They are published on the Committee's webpage, here.