THE
INVESTMENT
ASSOCIATION

Response to consultation

CP23/12: EXPANSION OF THE DORMANT ASSETS SCHEME – SECOND PHASE

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £10 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 46% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

We have been involved in the development of scheme expansion over many years including via the Dormant Assets Expansion Board and in supporting the Industry Champion for the Investment and Wealth Management sector. As a result we are keen to see the dormant assets scheme ('DAS') succeed.

The need for a reassessment

Our comments here build on our interim response of 19 June 2023 **(see Appendix)**. This set out our high-level view on the direction of travel, which risks leaving key stakeholders dissatisfied in light of efforts deployed to date in making the DAS a success.

Answers to selected questions

Q1: Do you agree that these proposals are necessary and proportionate to allow AFMs and depositaries to be participants in the DAS?

No. As explained in our interim response, the accumulation of measures in the proposals are disproportionate to the risks they seek to mitigate. Importantly, the proposals make participation less attractive and also make it more difficult for firms to participate in the DAS than to transfer funds directly to charities.

This is disappointing given the level of industry engagement in scheme expansion over many years. We do not believe that the FCA's objectives and success measures, outlined in the first chapter, will be achieved by the proposals.

In addition to that high-level view, we make a number of specific additional points:

- **Requirement to cancel units**
  As mentioned in our interim response, the proposed requirement to cancel units relating to a transfer is operationally complex when weighed against the risk apparently being mitigated.

Additionally, it, via the Glossary definitions, assumes that the manager is dealing as a principal in the trading with investors. If this is the case, there is little purpose served from this requirement. If the investor trading is performed directly with the fund (such as under our Direct2Fund proposals) the cancellation performed is of the investor holding in any event and reference to COLL 6.2.17BR becomes inappropriate.

- **Unwanted assets**
  An investor's instruction to make payment relating to unwanted assets to a registered charity or the DAS under section 21 ('S21') of the Dormant Assets Act 2022 (the 'Act') is already permitted by COLL. It is the investor's instruction to make the payment, rather than the firm deciding to do so on a unilateral basis, in the same way that a transfer with a client instruction is permitted under CASS 3.2.5.
- **Orphan monies**
  The FCA's proposal that orphan monies cannot be transferred in their entirety on winding up, if some or all the unitholders in the fund are still contactable, will potentially severely limit any possible usage or more likely eliminate its potential use since the amounts attributable to any one investor will be very small.
- **DAS-specific requirements**
  As a principle it seems unreasonable to make requirements of participants in the DAS that are not already present for the same transfers that are made other than to the DAS. An example of this is the comment in paragraph 4.17 'We therefore propose to amend COLL 6.6.6R by adding new provisions where the AFM or the depositary are participants in the DAS.'
- **Platforms & ISA Manager entities**
  As you know, HM Treasury are currently looking into utilising secondary powers under the Act to enable investment platforms and ISA Plan Managers to more easily participate in the DAS. In order to future-proof the FCA rules and avoid requiring a secondary stage of changes, it would be worth reviewing the proposals with these developments in mind. For example, whether the proposals regarding unclaimed distributions would be able to apply to ISA cash (held as client money) as well as direct book ('unwrapped') money.

Q2: In particular, do you have any comments on the proposal to treat changes to the instrument and prospectus of the fund as significant changes requiring prior written notice to unitholders?

We strongly disagree with this proposal, which has the effect of greatly complicating the onboarding process for potential participant firms and delaying the benefit for beneficiary causes. We hope that you will therefore utilise the option to instead treat the changes as notifiable.

We dispute the assertion that a 'unitholder's ability to exercise their rights' is affected. As we outlined in our memo of 21 March 2023, all holders will effectively remain the owners of the assets and clients of the firm, and can instruct changes to their investments/account once they have proved their identity, in the same way as any other dormant investor. The implication of categorising the changes as significant is that there is a detrimental impact on investors, or that the interaction with the DAS constitutes special arrangements or are more deserving of note than, for example, paying client money balances directly to charity.

It is right that changes will be required to the Prospectus and Instrument to enable the necessary powers for participants to take part. However, practically, the requirement to write to unitholders is futile – those receiving the mailing will, by definition, not be affected for at least six years, while those more immediately affected cannot be contacted.

In addition to that high-level view, we make a number of specific additional points:

- **Alternative methods of disclosure**
  Investors with active relationships with the firm would most likely be notified of the new ability of the firm to transfer assets to the DAS through existing scheduled communications, such as statement mailings. The industry has made significant progress in recent years in encouraging investors to provide contact details in multiple formats, such as email addresses, and in transferring payment mandates

away from cheques towards electronic payment, and a similar message around the importance of keeping contact details up to date could be utilised via this channel.
We would be happy to explore industry-level or joint publicity solutions with the FCA to leverage the unique newsworthy opportunity that expansion of the DAS provides. We found that the launch last year of the IA Unclaimed Assets Portal and the various HMG publications about the Scheme generated a lot of consumer activities and enquiries, which could be more effective than a formal unitholder notice.

- **Unclaimed distributions**
The existing option in COLL is to make payment to the originating fund with no right of reclaim after a period of 6 years (or such longer time as specified in the prospectus). This action is deemed reasonable on account of the prospectus disclosure and convention.
However, if the investor were still a unitholder in the originating fund the FCA could instead require the reinvestment of the distribution into the investor's account.
If permitted by the prospectus the transfer to the DAS should also be permitted under S21 (i.e., with no right of reclaim) since this is, from the dormant investor's perspective, similar to the effect of the existing provisions in COLL.
It is hard to see why a transfer to the DAS after 6 years, under either S21 or with a right to reclaim, would require prior written notice to unitholders. From the dormant investor's perspective:
  - a transfer to the DAS under S21 has no impact at all.
  - a transfer to the DAS with a right to reclaim can only be advantageous. There is a change, but it is hardly significant.
It can be argued that the change to the prospectus being communicated is the loss to the current fund holders of the benefit for the sum of unclaimed distributions, but to conclude that this requires prior written notice to all unitholders is disproportionate.

Q3: Are there any other steps we should take to enable participation, or to protect the rights of fund investors whose dormant assets are transferred to the ARF?

Q4: Do you agree that the proposed amendments provide sufficient certainty the requirement to hold the money as client money is extinguished for all relevant chapters of CASS? If not, what else should we consider?

We take questions 3 and 4 together.

We agree that the proposed changes make clear that funds transferred to the DAS will cease to be Client Money. However, the proposed rules do not make any mention of the client money process to be followed in the event of a reclaim, in particular whether (and in what circumstances) funds paid by the ARF to the firm, to then be passed on to the customer, would become client money while held by the firm. Clarity in these areas would be useful in order to provide certainty and confidence within the industry and eliminate scope for varying interpretations:

1. There is currently no mention within the proposals of an obligation on the firm to make payment to the investor;
2. Nor is there mention of whether the obligation to the investor is, or is not, dependent on the cash receipt from the DAS;
3. No mention of when the requirement to hold a client obligation as client money arises e.g., when investor contact is made, when the reclaim is made, or when the reclaim is paid?
4. No mention of whether the CASS firm is, or is not permitted to hold cash in respect of a reclaim as client money that was not client money at the point of sending to the DAS (e.g., because it was a distribution from a fund and the fund has now closed).

Additionally, you may consider whether other steps are required in relation to the multiple definitions of dormancy that will be in place once the rules are effective. Clearly, the definition of dormancy is different in the Act than in the current CASS rules. While the time periods are consistent, one looks at the last communication date and the other looks at the last activity on the account, which means there will be different definitions for paying to charity and paying to the DAS.

In COLL the Glossary definitions of ‘eligible distribution of income’ and ‘eligible redemption proceeds’ refer to sections 9(3)(c) and 9(3)(b) of the Act respectively. This suggests that the relevant section of the Act for redemption payments is 9(3)(b). However, the glossary defines ‘redemption’ solely when the manager is acting as a principal. When the manager is acting as principal the redemption amount held will be client money (section 12 & 13 of the Act rather than section 9).

Additionally, on scope, we do not agree with the rationale for excluding LTAFs given the recent policy statement expanding the distribution rules to include some retail investors. While all firms have procedures in place to maintain regular contact with their investors over a prolonged period, there is nevertheless a reliance on investors keeping the firm updated. Although obviously not a current concern, it would be beneficial to include LTAFs within scope now to ensure that future cases are able to be dealt with on a consistent basis across firms’ wider fund range.

Finally, we consider some of the requirements to be overly onerous and disproportionate, particularly in the context of many firms’ balances being for small amounts including those under £1. Introducing a low value de-minimis where the requirements were less onerous could encourage greater levels of participation.

Q5: Do you agree that payments to the DAS should be given preference to paying away to charity where the firm is already a participant in the DAS?

No, and we strongly disagree with the restrictive nature of rule CASS 7.11.49AR(2), whose proposed wording (‘must not’) is not as optionally preferential as the question suggests.

Firms are likely to select using the scheme rather than paying away to charity where they have a choice, as the amount transferred is available to be subsequently reclaimed by the investor, rather than the firm having to fund such a reclaim. Ultimately though, participation in the DAS is voluntary. The requirement in this rule appears to be inflexible and there may be unforeseen consequences in forcing firms to choose the DAS in all cases over other charitable options.

We also need to bear in mind that circumstances change. The DAS will exist in perpetuity, but firms cannot necessarily commit to such an open-ended timeframe, and they may decide in future that the scheme no longer works for them. The proposals as drafted prevent them reverting to other options in the future.

Each of these two elements put the DAS at a disadvantage when firms are reviewing their options.

We note that the FCA provide no explicit justification for this proposed requirement and in the absence of such, it seems counter-intuitive that the voluntary participation in DAS impacts other arrangements. A justification may be that investors should be treated consistently, and we can see how this may work for unclaimed distributions, and for investment assets. However, for client money there seems to be no implication on client outcomes as they retain a reclaim right to the same value regardless of whether the money was paid to charity or the DAS. Indeed, COLL makes no reference today to the provisions contained in CASS for payments to charity of client money, so it seems odd for it to do so for the DAS. Some investors like to provide direction on which charity the money should be donated, which would not be possible under this scenario.

There may also be implications for independent ACDs, providing services across multiple fund ranges. It appears that such an ACD may not be able to apply a mixed model across their business. This is especially problematic should they choose to opt out of the DAS initially but then onboard new business from an ACD that had opted into the scheme.

Q6: Do you agree that the CASS rules should be amended to include tracing requirements in addition to firms’ contractual obligations with the ARF?

Q7: Do you agree the requirements are proportionate? If not, what should we consider?

We take questions 6 and 7 together.

We welcome the approach of recognising industry guidance such as that produced in anticipation of the DAS expansion[1], which focusses on reunification but is agnostic in terms of other outcomes.

However, we see no reason why the existing provisions in CASS need amendment regarding tracing due to any arrangements with the DAS. CASS should concern itself solely with the requirements to release the cash held from CASS obligations. It is counter-intuitive to argue that the tracing requirements to permit the release from CASS are different because of arrangements with an ARF. The tracing requirements in CASS should be the same for transfers to the DAS as transfers to charity.

Tracing requirements for transfers to charities already exist in the CASS rules and we see no rationale in changing them because of the DAS. Of course, the ARF might determine that different tracing requirements are necessary but that should be solely a matter for the contractual arrangements between the ARF and the participant.

Each of these two elements put the DAS at a disadvantage when firms are reviewing their options.

Finally, a de-minimis value should be considered to reduce the tracing requirements for small amounts, such as those less than £1. We also feel that further consideration should be given to unclaimed estate cases as tracing costs are significantly higher for these, and as such the requirements would be commercially disproportionate.

Q9: Do you agree that dormant client money held under CASS 7 should, where possible, be paid to the ARF in preference to applying it to any shortfall in the client money pool following a PPE?

This depends on the contractual arrangements between the CASS firm and the client investor.

- If the CASS firm is contractually obligated to their client to have sent the cash to the DAS before the time of the PPE then the cash should be sent to the DAS.
- If, as in most current cases, the CASS firm is not contractually obligated to send the cash to the DAS at a specified and definitive time then the treatment of the cash at the PPE should follow from how the cash is held at the PPE.
- CASS firms would be unlikely to make the transfer to the DAS at a specified and definitive time a part of their contractual commitments to clients but merely may seek to permit it in some circumstances. Since moving the cash to the DAS does not seek to change the investor’s entitlement to the dormant assets in an on-going business situation, it would seem strange that not moving the cash to the DAS in a PPE would, or could, impact the investor’s entitlement to the asset.
- Payments to investors from the CASS firm and DAS participant (that are the subject of a reclaim from the ARF to the participant) would be routed via the CASS firm. A PPE event before payment was made to the client investor, but after receipt of the reclaim from the DAS would, we understand, be treated in accordance with the provisions of CASS not the DAS.

Q11: Do you agree with our proposal to enable persons who were entitled to certain dormant investment assets owing to them, or client money held for them to refer a complaint about the dormant asset fund operator to the Financial Ombudsman Service?

As a principle the client investor’s rights stem from the firm not whether the investor’s assets are held in the DAS. We cannot see any need for any further dispute resolution processes other than between the DAS participant (the investment firm) and RFL administering the DAS.

[1] The Investment Association: *Principles for Maintaining Active Client Relationships* April 2022

However, this view is dependent on a satisfactory outcome to the points we make in answer to questions 3 and 4. Should there remain ambiguity on the relative roles of the participant and the DAS operator then there may need to be a mechanism for relevant persons to be able to escalate areas of concern in specific cases.

Appendix

INTERIM RESPONSE TO CONSULTATION – SUBMITTED PREVIOUSLY

Context

The Investment Association welcomes the long-awaited consultation on rules for the investment sector to participate in an expanded Dormant Assets scheme (DAS). We have previously, for example in our response to recent DP23/2, highlighted the need for more interactive and collaborative policy making that can move at speed. Therefore, we are taking the step of making an interim response in the hope that you are able to give due consideration to our initial feedback, in order to rectify the current direction of travel which we believe risks leaving key stakeholders dissatisfied in light of efforts deployed to date in making the DAS a success.

We will follow-up with a more detailed response in the coming weeks.

Achieving objectives through sound principles

The FCA's objectives, as set out in the consultation document, are:

> *'primarily… to advance the FCA's operational objective of consumer protection…. [and] support firms in contributing assets to the dormant assets scheme.'*

The IA and the investment funds industry strongly support both objectives. Indeed, consumers have the ultimate protection of being able to reclaim their investments in perpetuity, and in some cases will receive enhanced protection under the DAS (such as in the case of unclaimed distributions where they otherwise will have lost their entitlement after six years). We do, however, need to ensure that regulatory measures also take consideration of the practical obligations placed on firms interested in participating. Otherwise, the second objective will likely not be achieved – and good causes will not benefit – because firms will choose to not participate, defeating the whole purpose of this initiative.

The DAS is a voluntary scheme. Firms have expressed an interest participating to help support charitable and other good causes, including helping consumers with financial and other vulnerabilities and those who would benefit from financial education. Firms are also interested in operational solutions for dormant assets, in removing client money obligations where they have exhausted all possible tracing and reunification efforts.

As you will be aware, the scheme is based upon three principles:

1. Reunification
2. Voluntary Participation
3. Right to reclaim in perpetuity

The sector has worked extensively with government and the public sector on these principles in recent years, making sure that the scheme is designed optimally to attract firms to want to take part, whilst importantly making good progress on enhancing tracing and reunification. This includes the publication of updated industry guidance on steps to take on reunification[2], and the launch of a new consumer-facing tracing service[3]. The right of consumers to reclaim their assets in full at any time is a fundamental principle that the sector wholeheartedly supports.

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[2] The Investment Association: *Principles for Maintaining Active Client Relationships* April 2022
[3] *The IA Unclaimed Assets Portal powered by Gretel*

Around £600m has been identified by members as an amount that could be contributed to the DAS over time. We anticipate this could be a conservative estimate given the success of DAS in the banking sector. Our industry has been actively engaged and sees the commercial and client benefits of participating in DAS, but this could be significantly undermined if the approach outlined in the consultation is adopted.

The case for reassessment

It is in this context, and the extensive work over many years that will have been done by participants on individual dormancy cases before even considering transferring them to the scheme, that we request a re-assessment of the proposals to better enable participation and provide the scheme with sufficient support from the sector to remain viable.

In our view, much more attention should be provided at a holistic level to facilitate confidence that the regulator is supportive of the scheme and what it is attempting to achieve, and that unlocking value from dormant assets is a laudable endeavour rather than a compliance and operational exercise. An example of a minor edit that, when combined with others, may prove consequential in aggregate is the removal of the requirement for units to be cancelled (proposed 6.2.17B R (2) (a)) which is operationally complex when weighed against the risk being mitigated.

Initial feedback

More substantially, and based upon our initial reading of the proposals and member feedback, we provide feedback in two areas and seek confirmation of our interpretation on a third:

1. Categorisation of changes as 'significant'

As previously articulated, we do not agree that the changes should be classified as 'significant' under COLL 4.3.6R, which places disproportionate obligations on firms. The FCA have acknowledged in the paper that the resulting requirement for pre-notification to all unitholders is ultimately futile as the very unitholders impacted will, by definition, not receive it. More fundamentally, though, we do not agree that the effect of an AFM transferring assets to the scheme should be considered to affect unitholders' ability to exercise their rights in relation to their investments.

The holder is legally still a customer of the firm and will be able to interact with the firms and their assets as they would otherwise have been able to. We should bear in mind the context in that the transfer of the assets to the scheme has not taken place in isolation; many years of dormancy and resultant unsuccessful tracing attempts by the firm mean that such a customer re-presenting themselves to a firm after many years of inactivity, would necessarily not be in the same position as an actively engaged unitholder.

In several scenarios, such as unclaimed distributions, where the investor retains rather than loses their entitlement to the payment, investors would be in a more beneficial position under the DAS. However, firms may not in reality participate if the changes are classified as 'significant' as it provides a further level of preparatory work before they can contribute to the DAS.

2. Mandatory usage

The requirement for participants to always choose the scheme over other charitable options, as laid out in proposed 7.11.49A R (2), seems inappropriate for what is a voluntary arrangement. While this is understandable in some situations, such as ensuring consistency of outcome for consumers in the same scenario, it is too rigid a position to cover all cases. Firms will feel constrained by a lack of flexibility around client money in particular (where there is no effect on the client's entitlement or calculation of value) especially where they run multiple fund ranges or product types, and would restrict other charitable giving.

3. Role of the register

Beyond these two areas, members have long been concerned with the mechanics of record-keeping given they would need to be held separately to the unitholder register and so fall outside of mainstream systems and other arrangements. We were grateful for the recent clarification provided by the FCA that the fund-level datapoint requirements in 6.6.6R (6) (b) (iv) are able to be held separate to the client records, and wish to be clear at an early stage that firms do not envisage operating a continuously updated register. Client entitlements will generally be calculated only at the point of reclaim and with reference to fund-level datapoints where required. If this interpretation is incorrect please let us know.

Ends