The City of London Law Society

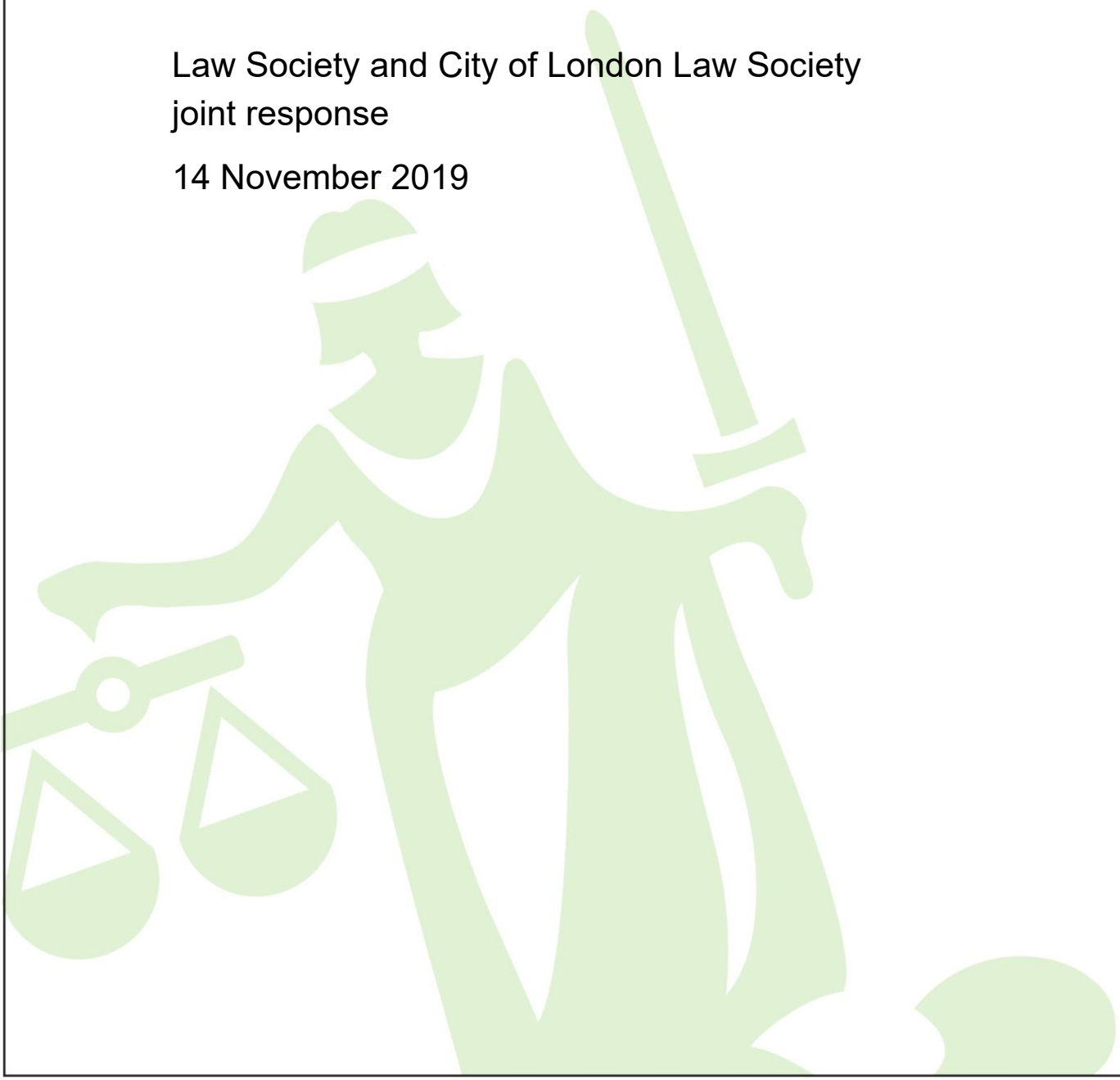
The Law Society

FCA Primary Market Bulletin No.24

Consultation on proposed amendments to Technical Notes

Law Society and City of London Law Society joint response

14 November 2019



Introduction

1. The views set out in this paper have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society (**CLLS**) and the Law Society of England and Wales (the **Law Society**).

2. The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

3. The Law Society is the professional body for solicitors in England and Wales, representing over 160,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

4. The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to capital markets.

Response

5. We refer to the FCA's Primary Market Bulletin No.24 in respect of its consultation on two technical guidance notes concerning closed-ended investment funds. We set out our comments on each of the technical notes below.

FCA/TN/409.1 – Master-feeder structures (Amendment)

6. We agree with the proposed amendments to this technical note and have no further comments to raise.

***FCA/TN/411.1 – Class testing changes to an investment management agreement where there are unquantifiable benefits* (*New*)**

7. We understand that the intention behind the new technical note is to provide guidance to a closed-ended fund and its investment manager on the application of Listing Rule 11 (related party transaction rules) where the benefit of any changes to an investment management agreement (IMA) may be difficult to quantify and, consequently, the class tests are difficult to apply.

8. In the fourth paragraph of the technical note, the FCA accept that, where, as a result of a change to the IMA, there is no financial benefit to a related party which is capable of being quantified, the percentage ratio would be zero. It follows that only *quantifiable* benefits of a change to the IMA would potentially fall within the scope of LR 11.

9. In the light of this, it is unclear why the technical note states that, when providing individual guidance on whether LR 11 applies, the FCA may also ask questions to determine whether there are any unquantifiable benefits to the related party, including whether there is any other impact of the change "*such as a change in the regulatory status of either party*". This is somewhat confusing, as it suggests that non-economic considerations may be relevant whereas the related party tests only work for economic changes. We think that it would be helpful for there to be clarity whether the intention is that only changes with an economic impact should be caught or whether the FCA is trying to cast the net wider than this. If the latter is the case, then there would need to be guidance as to the kind of changes with a non-economic impact which the FCA have in mind. As we say, there needs to be clarity as to whether only economic changes are to

be caught or whether there is to be a general principle that any material change to the IMA should be caught in the same way as a material change to the investment policy.

10. The note seems inconsistent as regards the introduction of a provision for a termination payment which we understand would be caught by the related party rules and the extension of the term of an IMA which the note states would not be caught where there is no change in the level of the fees. However if the term of an IMA is extended and the agreement is subsequently terminated early, the result will be no different than if a provision entitling the manager to an equivalent termination payment had been introduced. We think that this difference in treatment might give scope for issuers to structure arrangements so to avoid the need for shareholder approval in connection with a change of this nature and we think that it would be sensible to avoid this possibility.

11. The proposed treatment of changes to an IMA which involve changing a cash payment obligation to an arrangement for the provision of non-cash consideration seems somewhat inconsistent with the approach taken to alterations to investment management fees in TN 403.1. The latter note states that, where there is no definitive way of calculating the maximum value of the variation, the variation will be treated as uncapped and yet in this new note the FCA is proposing that any future variation in value between the amount of the original cash payment and the substituted non-cash consideration should be ignored on the basis that the future amount of the variation cannot be calculated and is speculative.

12. We would also suggest that the new note should be combined with TN 403.1 given that they both cover the topic of changes to IMAs and it is easier for market participants and advisers to be able to refer to one note when considering such matters.

FOR FURTHER INFORMATION PLEASE CONTACT:

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