THE INVESTMENT ASSOCIATION

The Investment Association Response to CP25/9: Further proposals on product information for Consumer Composite Investments

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 £9.1 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 49% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

We welcome the opportunity to respond to the FCA's second consultation ("CP") on the new product information framework for Consumer Composite Investments ("CCI"), especially the proposal not to require any calculation or disclosure of implicit transaction costs. Together with the establishment of working groups to consider other challenging aspects of the original consultation, this should facilitate the development of a more effective, decision-useful disclosure regime and contribute to improving retail investor confidence and engagement.

Building on comments in our response to CP24/30, our key messages in this response are:

- **Summary cost illustrations:** Summary cost illustrations combining one-off, ongoing, and transaction costs should be removed from both the CCI regime and the wider MiFID-derived rules allowing the emphasis to be on headline product charges. New IA research reinforces the primacy of such charges in understanding and decision-making.
- **Role and disclosure of transaction costs:** Transaction costs as part of the investment process behave in completely different ways to product charges. Implicit costs are complex in nature and difficult to measure so it is right that they are being removed. Explicit transaction costs, while readily quantifiable, are not equivalent to ongoing charges and should not be presented as if they are. We recommend that transaction costs should be explained in the product summary as part of

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the investment strategy with signposting to where properly contextualised and more detailed information can be found.

- **MiFID costs and charges:** Further amendments are needed to rationalise MiFID-derived rules and align with our comments on the changes needed to the CCI regime. This focuses on distributor aggregation requirements in respect of transaction costs and pull through costs.
- **Transition periods:** Our overall recommendation is to align the end of the transition period with the natural cycle for republishing KIIDs each year so that firms have the option to transition as at the end of 2026 and must transition as at the end of 2027.

We look forward to our continued engagement with the FCA and other stakeholders on aspects of the CCI regime that are not covered in this new CP, notably the shape of the new product summary to ensure a clearer connection between the original FCA vision, much of which we share, and the final policy proposals. This discussion should include the regulatory status of the product summary relative to marketing material which still requires greater clarity both within the CCI rules and the wider rulebook.

Response to consultation questions

THE WIDER CONTEXT

Question 1: Do you have any additional comments on our approach to the Consumer Duty?

Given that the FCA's proposed approach remains unchanged from that outlined in CP24/30, we reiterate our view that the application of Consumer Duty to CCI remains appropriate. We would emphasise the importance of ensuring that there is no unnecessary duplication of requirements to ensure alignment with the broader policy objective of streamlining regulation. As previously stated, we are concerned that the proposals may not lead to an improved information set for investors, which may work against consumer understanding.

TRANSACTION COSTS

Question 2: Do you agree with our proposal to require disclosure of explicit transaction costs? If not, why?

We do not agree with the proposal to require disclosure of explicit transaction costs in the way described because doing so implies they are equivalent to ongoing charges and can be assessed in the same way. In this specific respect, our approach to implicit costs and explicit costs is the same. Ongoing charges represent a reasonably predictable, readily comparable and clearly linear drag on return. By contrast, transaction costs - whether implicit or explicit - are harder to predict, cannot easily be compared across strategies, and have a very different relationship to investment return than ongoing charges. The central difference between explicit and implicit costs is that the former can be readily quantified, while the latter cannot. However, that does not mean that such information is decision-useful or helps understanding unless presented in the right context.

We disagree with the core policy narrative assertion that (explicit) transaction costs are a "key" cost that can have a significant impact on the net returns of a product (CP24/30 5.18) leading to the conclusion that knowing the quantum of explicit transaction costs can support consumers' understanding and their ability to compare products (CP25/9 3.4) and will ultimately lead to products being offered at lower prices (CP24/30 1.20).

Explicit transaction costs are an important factor for the manager to consider as part of each decision to trade because they represent a hurdle to be overcome, rather than a cost that can be avoided, in order that the trade can make a positive contribution to performance. Managers have only a limited degree of control over explicit transaction costs – transfer taxes (such as stamp duty) cannot be negotiated, and broker fees are subject to significant downward pressure exerted by the FCA's best execution rules and supervisory practices – which means the only option to mitigate explicit transaction costs is not to trade. Such a decision will remove both the explicit transaction cost and the contribution to performance which means explicit transaction costs can only be understood in the context of future performance expectations about a particular trade. At the product level, net returns are the combined result of the contributions of all trades regardless of the return profile of any individual holding. Aggregate transaction costs and their impact on net returns cannot be understood without the context of individual trades and do not provide a meaningful basis on which to compare products.

The comparison point is important. Disclosing explicit transaction costs because they are readily quantifiable places the wrong emphasis on explicit transaction costs relative to product charges and risks, inviting the wrong conclusions for investors both within specific asset classes, e.g. equity funds, and across different asset classes.

We commissioned The Wisdom Council to explore the way retail investors respond to transaction costs information and its usefulness in their decision making. They recruited a group of knowledgeable retail investors and facilitated a roundtable discussion. Their final report shows that this group of investors preferred the ongoing charge figure (OCF) for looking at costs and considered this to be the most important figure to see. The information about transaction costs detracted from the significance of the OCF, was poorly understood, and did not help them choose the cheapest fund. Therefore, it is our conclusion that presenting transaction cost information in the same way as ongoing charges does not meet the information needs of retail investors, does not aid their understanding, and does not equip them to make properly informed decisions.

Instead of quantifying explicit transaction costs in pre-sale disclosures, we recommend including a statement that they are not included in the disclosed charges and providing an explanation of the nature and significance of transaction costs as part of the investment strategy. This could also be combined with the explanations of dilution and the mechanisms used to mitigate dilution.

Providing information about transaction costs in narrative form and avoiding a quantitative disclosure of explicit transaction costs in the product summary will also help to alleviate the risk of inappropriate comparisons with the quantitative transaction cost information provided for products originating in EU jurisdictions, which include both implicit and explicit transaction costs.

Our comments in this answer are made in the context of information provided to retail investors before or at the point of sale only and we remain of the view that explicit transaction costs should continue to be made available in the annual accounts of funds and on firms' websites.

Notwithstanding our position against quantifying explicit transaction costs in the way set out in this CP, if the FCA proceeds with the proposal for calculating transaction costs in DISC 6.4, it will be necessary to retain the ability to offset the benefit of the appropriate proportion of any amounts collected through anti-dilution mechanisms.

Question 3: Do you agree with our proposal not to require disclosure of implicit transaction costs? If not, why?

We agree with the proposal not to require disclosure of implicit transaction costs which is a very positive step for the reasons given in more detail in our response to CP24/30. Fundamentally, the quantification of 'implicit' costs is by its nature extremely challenging. It has resulted in confusing and counter-intuitive disclosures since the introduction of MiFID and PRIIPs requirements. It is not decision-useful information.

The FCA should make the same amendments to the COBS 19.8 rules for the disclosure of transaction costs by workplace pension schemes within the same timeframe as the CCI regime. It should also be made clear that the same approach should be taken in other cost disclosures to institutional and professional investors.

Question 4: Do you agree with our proposal to require the separate disclosure of transaction costs, and their inclusion in the summary cost figure? If not, why?

In our response to CP24/30, we strongly disagreed with the proposal to disclose a summary cost figure because it obscures the significance of each category of cost and is contrary to the objective of facilitating properly informed decisions. It must be removed entirely to prevent potential harm.

We also disagreed with presenting transaction costs in the same way as one-off and ongoing charges because doing so implies they are broadly equivalent costs and encourages them to be added to ongoing charges. Our reasoning is set out in our answer to question 2 of CP25/9.

MIFID REFORM

Question 5: Do you agree with our proposed rewriting of Article 50 requirements? If not, why?

The proposed rewriting of Article 50 provides a more elegant drafting style but has missed the opportunity to address issues with the substance of the MiFID requirements set out in rules 11, 12 and 14 of COBS 6.1ZA and therefore falls short of expectations under the Consumer Duty. It is essential that the wider review referred to in CP25/9 3.8 is conducted, and its findings implemented, as soon as possible to address the issues set out in our answer to question 6 of CP25/9.

Question 6: Do our draft rules replacing Article 50 achieve the intended rationalisation and alignment with proposed CCI rules? If not, why?

In our answer to question 26 of CP24/30, we endorsed the use of a single, aggregated ongoing charges figure as the primary cost metric for CCIs. At this level, aggregation is appropriate because it captures charges of a similar nature that the manager controls or can negotiate. At the same time, we strongly disagreed with the proposal to aggregate one-off, ongoing, and transaction costs as a single figure because these categories of cost are fundamentally different in their nature and combining them in the way proposed obscures their significance and is contrary to the objective of facilitating properly informed decisions.

MiFID II adds a third layer of aggregation intended to ensure the costs arising along the distribution chain and their effect can be understood. The validity of this aggregation by distributors needs to be explored as part of the wider review of the MiFID requirements, but in the meantime it is essential this aggregation does not include product transaction costs for the same reasons as set out in our answer to question 2 of CP25/9. Our recommendation therein to explain rather than quantify transaction costs in the product summary would ensure that the proposed rule in DISC 6.1ZA.14BR(3)(b) transmits the appropriate figures to distributors.

Where the distributor is managing investments on a discretionary basis, it is essential that the approach to aggregation is the same as for the pull through of costs specified in the CCI regime for funds investing in other funds. Since our response to CP24/30, which indicated that further reflection was needed in the industry, we have conducted consumer testing to help establish the most appropriate approach for any pull through requirement relating to funds investing in other funds. The results are imminent, and the conclusions should also be used to determine the approach to aggregation of charges for discretionary management services.

Beyond the aggregation requirement, and in line with our position on the summary costs illustration for CCIs, the proposed cost illustration set out in COBS 6.1ZA.14BR(1)(c) should be removed because it combines costs of a fundamentally different nature, thereby obscuring their significance and compromising the objective of facilitating properly informed decisions.

Unlike the CCI regime, which applies only to activities in respect of retail investors, MiFID costs and charges disclosures are also required for professional investors where the investment service is investment advice or portfolio management. If the FCA intend to retain these requirements for professional investors it will be necessary to specify the basis for calculating costs and charges where there is no requirement to provide a product summary as anticipated in DISC 6.1ZA.14BR(3)(b).

Further rationalisation of the draft rules could be achieved by including COBS 6.1ZA.11 and 12 in the redrafting exercise to reflect that the original purpose of Article 50 was to expand on the detail of these MiFID II derived COBS requirements. This would avoid considerable duplication and restatement of requirements and provide better alignment of the COBS requirements with the Handbook terminology.

In addition to redrafting MiFID rules, it would be helpful to clarify the FCA's expectations regarding level 3 materials, especially the ongoing relevance of chapter 9 (information on costs and charges) of the ESMA Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics.

Question 7: Do you agree with our proposal to delete Article 51 of the MiFID Org Reg (COBS 14.3A.11)? If not, why?

Yes, we agree with deleting Article 51 because it deals with the misalignment of MiFID cost disclosures with product regulations and is not necessary if the redrafted rules are properly aligned.

TRANSITIONAL PROVISIONS

Question 8: Do you agree with the proposed options available to firms during the transition period? If not, why?

The transition to the new regime is complex and raises a number of issues due to the variety of products involved, the disclosure basis from which they are transitioning, and the number of parties affected along the distribution chain.

We welcome the proposed transitional provisions which clarify that UCITS manufacturers that continue to produce KIIDs will be compliant with the CCI regime throughout the transition period even where this extends beyond the end of 2026. The proposals complement the exemption of UCITS from the PRIIP Regulation until 31 December 2026 provided under the Financial Services Act 2021 and the temporary exemption provided by the CCI Regulation allowing UCITS and NURS to continue providing a KIID until that date. According to the draft transitional provisions in DISC TP 2, UCITS and NURS will continue to have a choice of providing a KIID or a product summary from the commencement of the new regime and simultaneous revocation of PRIIPs for the duration of the transitional period.

We also welcome the proposal to align the application of the full CCI regime for UK-listed closed-ended investment companies (LCICs) at the end of 18 months rather than 12 months as had been proposed in CP24/30. However, this remains a complex transition that results from the multiple steps in unwinding the temporary legislative exemptions currently in place. These steps include:

- The transfer of the MiFID Org Regulation into the Handbook, as proposed in CP24/24, which will trigger the end of the MiFID part of the temporary exemption (SI 2024/1204 reg 3) and thereby reset distributors' MiFID obligations to obtain and aggregate LCICs costs in their disclosures to clients.
- The commencement of the CCI regime, expected to be at the end of 2025, which will trigger the end of the PRIIPs part of the temporary exemption (SI 2024/1204 reg 2). Although an equivalent exemption is proposed for the first 12 months of the new regime, LCICs will need to start producing a disclosure document either in the form of a product summary, or by reinstating a compliant PRIIP KID, for the last six months of the transition period.

Taken together this sequencing risks reinstating the MiFID aggregation requirement without a clear specification to support the calculation of LCIC product costs and thereby risks prolonging the period of uncertainty about the costs that LCICs should disclose. This potentially forces early application of the CCI regime in order to provide such a specification, effectively negating the benefit of the transitional period for LCICs.

Our overall view is that the proposed transitional timetable is too short. Industry needs more time to digest methodologies and to update systems, data-feeds and disclosures. As set out in our response to CP24/30, we would support a longer transition period of two years. As an alternative option, assuming the final rules are published by the end of 2025, we recommend aligning the end of the transition period with the natural cycle for republishing KIIDs each year so that firms have the option to transition as at the end of 2026 and must transition as at the end of 2027 (in each case taking account of the 35 business day production cycle). Importantly, this would avoid a mandatory transition in the middle of 2027 shortly after the KIID refresh for the end of 2026. If the final rules are not made by the end of 2025, a transition period of two years should be maintained and the final KIID refresh for the end of 2027 should be waived allowing firms to move straight to their product summary without republishing a KIID that will be in place for only a few months.

Feedback from members indicates mixed views on whether it is preferable to provide a choice of disclosure documents during the transitional period, or to set a mandatory date for implementation. The key concern is that distributors would need to provide clients different document types throughout the transition period.

CONSEQUENTIAL AMENDMENTS

Question 9: Do you identify any potential problems with or omissions from our proposed consequential amendments to the Handbook?

We agree with the revocation set out in the draft instrument of three items of PRIIPs Level 3 Materials as these will become redundant once PRIIPs is revoked. We recommend that four items of UCITS Level 3 Materials issued by CESR should also be revoked, namely the methodology for the calculation of the SRRI in the KII, the methodology for the calculation of the OCF in the KII, the guide to clear language and layout for the KIID, and the template for the KIID. We are also interested in the FCA's intentions for Chapter 9 of the ESMA Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics which create extensive linkages between MiFID costs and charges disclosures and the requirements of PRIIPs.

We note the intention to exclude ACS and QIS from the CCI requirements. ACS and QIS fall within the definition of a CCI set out on the CCI Regulation and there are no powers to amend this definition other than in respect of debt securities. Therefore, we are concerned that the exclusion of ACS and QIS in DISC 1A.2.1R(1)(d) is not reliable. We recommend an alternative approach whereby the conditions set out in DISC 1A.1.6R are applied more widely to exclude any CCI which is not made available to a retail investor. This comment expands our answer to question 7 of CP24/30 and would align the exclusion more closely with non-retail activity rather than a specific product type.

More generally, the interactions with the rest of the Handbook will only be tested as the new regime is implemented and it will be necessary for the FCA to be flexible and responsive as potential problems and omissions become apparent. As we note in our response to CP24/30, there are already areas identified which may require further attention such as the relationship between proposed CCI rules for past performance and the parallel requirements in COBS 4.5A.10 and COBS 4.6.2R.

COMPLAINTS HANDLING

Question 10: Do you agree with our approach to complaints handling for unauthorised persons and our proposal for simplified requirements on unauthorised firms within scope of CCI rules to implement complaints handling procedures? If not, why?

The IA broadly supports a proportionate complaints-handling regime for unauthorised CCI manufacturers. We welcome the exemption for recognised schemes/operators of OFR funds within the draft proposals with respect to complaints handling given existing obligations under the COLL rules.

USE OF FSMA POWERS

Question 11: Do you agree with our proposal to extend the policies and procedures in DEPP which relate to the exercise of powers under Part 11 and Part 14 to breaches of CCI requirements? If not, why?

The IA has no comments on this question.

Question 12: Do you agree with our proposal that decisions to take enforcement action under Part 14, together with determinations of applications under section 206B(4), should be taken by the RDC? If not, why?

The IA has no comments on this question.

Question 13: Do you agree with our proposal that Executive Procedures is the right mechanism for making decisions when giving directions or determining an application to vary or revoke a direction? If not, why?

The IA has no comments on this question.

COST BENEFIT ANALYSIS

Question 14: Do you agree with our Cost Benefit Analysis? If not, why?

Taken together, we do not consider the estimated costs in CP24/30 of £48.8m and £3.2m in CP25/9 to be a realistic reflection of the likely costs incurred, especially for smaller firms with fewer resources. For example, the estimated familiarisation costs do not appear to cover the internal process of analysis, discussion and review that would be required with stakeholders from across compliance, data and distribution. We reiterate our view that this will likely be a much more complex and therefore expensive exercise for the industry.

Further, the analysis again fails to consider the significant operational and regulatory costs to distributors to implement this regime in its current form. Further consideration should also be given to the added cost for distributors to implement the transition arrangements with concurrent regimes. A more robust and methodologically sound approach is required to ensure an accurate reflection of the costs associated with this regulatory change – across all stakeholder groups, including manufacturers, distributors and technology providers.

We also question the rationale provided for the proposed approach relating to transaction cost disclosure in paragraph 14 of the CBA. As we outline above, we do not agree with the proposal to require disclosure of explicit transaction costs in the way described because doing so implies they are equivalent to ongoing charges and can be assessed in the same way.

Figures taken from CP24/30				
Manufacturer firms (authorised and unauthorised)				
Item description	Small firms (591)	Medium firms (150)	Large firms (37)	**Total cost across firms**
Familiarisation and legal costs (Direct)	£930	£4,800	£15,200	**£1.8m**
IT costs (Direct)	£1,900	£66,000	£240,000	**£19.9m**
Change costs (Direct)	£2,200	£114,000	£234,000	**£27.1m**
Combined cost:				**£48.8m**
Figures taken from CP25/9				
Manufacturer firms (authorised and unauthorised)				
Item description	Small firms (591)	Medium firms (150)	Large firms (37)	**Total cost across firms**
Familiarisation and legal costs (Direct)	£1,380	£8,040	£24,300	**£2.9m**
Manufacturer firms (unauthorised)				
Item description	Small firms (98)	Medium firms (32)	Large firms (8)	**Total cost across firms**
Complaints handling costs (Direct)	£630	£700	£4,300	**£0.3m**
Total overall cost of CCI for manufacturers:				**£52m**