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AITC RESPONDS TO PROPOSED CHANGES TO THE LISTING RULES OF INVESTMENT TRUSTS

The Association of Investment Trust Companies (AITC) has this week responded to the FSA's Consultation Paper 164 on proposed changes to the Listing Rules of investment companies (including investment trusts) and to Conduct of Business (C.O.B.) rules for those promoting their shares. This paper was issued following the problems experienced by a number of split capital trusts.

The AITC fully supports the FSA's objective to enhance investor protection through the making of changes to the Listing Rules and agrees that changes are necessary to strengthen the structure and governance of investment companies as well as to rebuild confidence of investors.

The AITC is in complete agreement with the FSA on the principle of clearer and more prominent disclosure of the risks associated with gearing in the prospectus and other promotional literature.

In its response, the AITC has put forward alternative proposals to a number of the suggestions contained in CP164.

The AITC agrees with the FSA that there should be restrictions on the amount of cross-holdings to which investors should be exposed (where investment companies own each others' shares, either directly or via a network of interconnecting holdings). This is particularly relevant where the holding company and its underlying assets may be highly geared. This is because investors and fund managers can lose track of the effective levels of gearing and the effective levels of charges that they are exposed to when an impenetrable web of holdings is created.

However, the fund-of-funds concept is a legitimate and desirable activity and their operation should not be inadvertently jeopardised by regulations that rightly seek to restrict cross-holdings.

The AITC's proposal to avoid this unwelcome outcome is:

That investment companies should have no more than 10% of their assets invested in investment companies that themselves may invest more than 20% in investment companies.

This would not prevent funds of funds investing in other companies that hold an incidental level of other trusts, but it closes the possibility of large cross-holdings being developed with the consequential loss of transparency for investors and loss of bearings for the managers as they become unable to calculate their effective gearing and expense position.

The AITC also agrees with the objectives behind the proposals on greater disclosure of investment company holdings. It has already been asking all split capital trusts to disclose all their holdings in other investment companies on a monthly basis and has been publishing the data on the AITC website (www.aitc.co.uk).

The AITC has made alternative proposals on disclosure to prevent possible shareholder detriment arising when managers are trying to acquire a stake in a company and where it might be damaging for an otherwise non-declarable holding to be made public. The AITC proposals also seek to avoid unnecessary administrative burden on investment companies in the context of the quantum of their monthly disclosure.

The AITC proposal is that all investment companies should disclose all their holdings in the split capital fund universe on a monthly basis with a two-month delay. Thus all holdings as at the end of April would be disclosed at the latest by the end of June. Disclosure of substantially the entire portfolio is required in the interim and annual accounts.

The AITC has made alternative proposals regarding the eligibility of an employee of the investment company's manager to sit on the Board. The proposal is drawn from the AITC's draft corporate governance code. It states that no more than one employee or professional adviser to the manager may sit on the Board and that that individual should be subject to annual re-election by shareholders.

Daniel Godfrey, Director General of the Association of Investment Trust Companies said: "The AITC fully supports the FSA's objectives behind the proposed changes to the listing rules. It is vital that this action is taken to prevent similar problems occurring in the future and to restore confidence in the investment trust sector. In a very short space of time the FSA has delivered a powerful and thought provoking consultation document.

"The AITC has put forward alternative proposals where we believe that they fulfil the FSA's and our shared objectives whilst minimising the risks of potentially damaging unintended consequences. Our discussions with the FSA to date have been constructive and positive and we believe that in many of these areas they will not only listen but act."

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Note to Editors:

The Association of Investment Trust Companies was founded in 1932 to represent the interests of the investment trust industry – the oldest form of collective investment. Today, the AITC is the primary source for information and statistics on investment trusts. The AITC has 276 members and the industry has total assets of approximately £47 billion.