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A joint submission on behalf of ShareSoc and UKSA

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FCA CP21/12: A new authorised fund regime for investing in long term assets

We welcome this consultation paper CP21/12. We would be pleased to meet with you to explain further our responses. Our key points are summarised below and we then answer the questions you have raised in the consultation paper.

We represent over 8,000 members of our two organisations and over 5 million individual shareholders and 12 million individual investors in the UK. Our two organisations represent the only participants in the stock market who are investing their own money, rather than investing other people's money. Better Finance and our sister organisations in other countries represent individual investors throughout Europe. We are also members of the World Federation of Finance that represent individual investors throughout the world. ShareSoc Chair Mark Northway is also Vice President of the World Federation of Finance.

Our key points:

1. This consultation fails to mention the Woodford debacle where an open ended fund invested in illiquid investments on a large scale, or the alleged failures of the FCA, Woodford, Link, Hargreaves Lansdown and Northern Trust, and/or the failings/ weaknesses of the Regulations in this regard. It also fails to mention that former BoE Governor Mark Carney said that Woodford and other open end funds were "built on a lie".
2. Investors deserve the early conclusion and publication of the FCA report into Woodford. It is difficult to comment on the proposed rulebook Appendix 1 until the FCA concludes its report. There should be no haste to introduce a new Authorised regime until we fully understand the failings in the old regime and the reasons behind those failings.
3. We note your data that the DC investment market is growing from £340bn in 2015 to £1,000 bn in 2030. This statistic highlights the importance of individual investors.
4. We agree with you where you state that investors are missing out on returns of 1.4% p.a. because they do not allocate funds to this area.

5. There are arguments for the default DC fund to have part of DC funds allocated to these new authorised funds.
6. Costs and performance fees need careful consideration. If (say) 10% of the 2030 £1,000bn (i.e. £100 bn) is invested in LTAF (Long Term Authorised Funds), then if the charges are:
    a. 1%, then industry income from this is £1bn a year (n.b. £1bn times margin of 50% and p/e ratio of 20 = £10 bn of asset managers' additional market value, which illustrates how much is at stake here). 1.4% extra return is £1.4bn a year, so the split of industry fees to investor returns is 40% to 60%. Too high!
    b. 2 + 20%, then the industry income from this is c £4bn a year (history tells us that 2+20% averages out at about 4%p.a. when you balance the very good with the bad years). 1.4% extra return is £1.4bn a year, so the split of industry fees to investor returns is 75% to the industry and only 25% to investors. This would be egregiously too high and, if allowed, we would suggest would surely be a future scam.
7. Annex 2 Cost benefit analysis fails to identify the costs and benefits we have (very roughly) calculated in para 6 above.
8. LTAF (Long Term Authorised Funds) is an awful misnomer and suggests a subliminal and reassuring message.
    a. It suggests other funds are not long term.
    b. The key aspect of these funds is that they are investing part of their funds in illiquid assets.
    c. A simple name might be more descriptive and satisfies the requirement for an honest name on the tin – Long Term Illiquid Assets in non-readily realisable securities - shortened to an acronym e.g. LIAs or LIARS?
    d. Putting the word Authorised in the title gives reassuring comfort, where it should not be given. Investment companies are Authorised but do not have the word Authorised in the title.
9. Para 3.13 of the consultation states "disclosures set out fairly, clearly and in plain language. This cannot be the achieved if the title is designed by or for the benefit of the marketing department.
10. Sophisticated individual investors and HNW individual investors should be allowed to invest in these LTAF funds.
11. Governance of LTAF will require the nominee system to clearly identify the owner of the investment (e.g. DC Trust or an individual investor) and there should be a requirement that they automatically get sent a copy (electronically) of the annual report, proxy voting form and AGM and GM circulars. This must be the default position, unless an individual opts out. In the event that an individual asks his/her platform not to send this information she/he should be asked at least annual if they wish to continue this option.
12. There is no mention of liquidity and spreads in quantitative terms. The consultation says that there may be times when the LTAF is not liquid, but does not mention what size of dealing will readily be able to be dealt and what spread may apply. Nor is there a discussion of if a large stake is to be sold, how will this be dealt with. In our experience selling a few percentage points in a company can have a significant impact on the share price. In an open ended fund, the options to help manage liquidity and demands to sell/buy is not available. However the gearing of up to 30% can provide a basis to give indications of what size of stake may be readily sellable.
13. What problem is the FCA trying to solve? We do not think this is clear.
    a. We don't see why the FCA wants to promote an open ended fund structure to invest in something that is so illiquid. The underlying assets

naturally belong in a closed ended fund which is then listed on a stock exchange. In other words, ainvestment companyinvestment company closed ended investment company, regardless of whether it is an authorised investment company or not.

b. There are already listed infrastructure funds which perform at least part of the role that LTAF appear to be aimed at.
c. Given the very valid point that closed end investment companies do this already and a LTAF is not necessary, our view is that the proposals should be killed at birth.

Questions in this paper and our responses

Q1: Do you consider that these proposals raise any equality and diversity issues? If so, please provide further details and suggest action we might take to address these.

No comment.

Q2: Do you agree that clear disclosures and additional governance (as set out in 3.9-3.13 and 3.39-3.43), in addition to the existing rules, provide appropriate levels of protection for potential investors in an LTAF? If not, what alternative approach would you suggest?

We would like to see the FCA's report into the Woodford debacle, the diagnosis of what went wrong and its recommendations for change before we comment further. We think it is too early to suggest alternative approaches until we know what went wrong with Woodford ("WWWWW").

Q3: Do you agree with the detailed requirements (on purpose, investment powers, borrowing, valuation, redemptions and subscriptions, due diligence, knowledge, skills and experience, and reporting) which we propose for the LTAF? If not, which requirements do you not agree with, and why? What alternative requirements would you suggest?

Same answer as Q2.

We would like to see the FCA's report into the Woodford debacle, the diagnosis of what went wrong and its recommendations for change before we comment further. We think it is too early to suggest alternative approaches until we know what went wrong with Woodford ("WWWWW").

Q4: Do you have any other observations on the proposed regime for LTAFs?

No.

Q5: Do you agree with our proposals to allow investments in LTAF for default arrangements of DC schemes if the conditions as outlined above are satisfied? If not, how would you change them to make them more workable for DC default arrangements?

It should depend on the age of the DC member. The requirement for liquidity of someone who has not drawing benefits is much less than someone who has retired and is drawing benefits.

Q6: Are there any assets which can be included in an LTAF which may be of concern regarding wider use for DC schemes? If so, which assets are you concerned about and why, and how would you mitigate the risk involved?

No comment.

Q7: Do you agree that LTAFs should initially be treated as QIS for distribution purposes? Do you agree that LTAFs should be subject to the same guidance as QIS on sophisticated and high net worth retail investors? If not, what alternative approach would you propose?

Sophisticated retail investors should be allowed to invest in LTAFs. We would favour some form of test (e.g. for comparison many hours of training on the road and in the classroom are required to pass a driving test). ShareSoc is currently developing a financial education course on the basics of investing.

Q8: Do you see any barriers within the existing NMPI rules that will prevent the LTAF from being distributed to the target market set out in 5.4? If so, please provide details and evidence of the barriers.

No comment, except that we note that the FCA rules allowed Woodford funds to be promoted to retail investors, most notably by Hargreaves Lansdown via its special incentive arrangement. The commercial incentives of platforms need careful assessment because they often pit the commercial interests of the platform against the best interests of the investors.

Q9: Do you think that the LTAF should be available for promotion more widely than to retail investors permitted to invest in NMPI? If not, why not?

Yes.

Please can the FCA use plain English and not use so many abbreviations. Non-Mainstream Pooled Investment (**NMPI**) is a new term for Unregulated Collective Investment Schemes (UCIS). The FCA Handbook defines NMPI as:

non-mainstream pooled investment

any of the following *investments*:

1. (a) a *unit* in an *unregulated collective investment scheme*;
2. (b) a *unit* in a *qualified investor scheme*;
3. (c) a *security* issued by a *special purpose vehicle*, other than an *excluded security*;
4. (d) a *traded life policy investment*;
5. (e) *rights to or interests in investments* that are any of (a) to (d).

Q10: To what extent do you think the appropriateness assessment would help to protect retail investors in the LTAF?

This overlaps with the Duty of Care and Consumer Duty consultation. The FCA needs to act to make the Duty of Care principles work, as it did not work with Woodford.

Q11: Do you think that the NRRS regime would work as a way of restricting investment in LTAFs, permitting them to be promoted to restricted investors? If not, why not?

Possibly.

DP21/1 is the latest instalment in a series of materials and measures promulgated by the FCA over the course of the last twelve months pursuant to its mission statement set out in last year's business plan to make the topic of consumer investments a regulatory priority.

Other recent actions taken by the FCA include January's separate bans on the mass-marketing of speculative illiquid securities and the sale of crypto-derivatives to retail customers, and a 'call for input' paper published in September 2020 seeking stakeholder feedback on the consumer investment market.

In parallel, the Government (acting by HM Treasury) have consulted the market on both the promotion of cryptoassets and a new gateway through which FCA-authorised firms would need to pass to be able to approve the financial promotions of unauthorised firms. The fine balance between protecting consumers and consumers taking responsibility for their own actions is evidently foremost in regulators' minds at the moment.

The timing of this wave of regulatory consultation and action could not be more relevant. Since the publication of the FCA's business plan in April 2020, the COVID-19 pandemic has accelerated the UK's digital transition and caused all manner of economic upheaval. Caught in such crosswinds, a generation of (often younger) investors have been either searching for yield or searching for entertainment (or both) in perceived 'high-risk' investments. Crowdfunding, cryptocurrencies and commission-free app-based trading platforms all feature in this arena, as does peer-to-peer lending, collective investment schemes and mini-bonds (the latter made infamous by the collapse in 2019 of London Capital & Finance).

Q12: Do you think that a minimum level of investment from professional clients would provide sufficient protection for retail investors? If so, what would an appropriate minimum level be?

We do not consider that the proposal in paragraph 5.23 would provide sufficient protection for retail investors. The objectives, liquidity requirements, and investment timescales of institutional and retail investors are too different. The inclusion of institutional investors as owners of a specified percentage of an open ended fund investing in illiquid assets cannot convert a wholly unsuitable structure into one that is suitable.

Q13: What changes would need to be made to the FAIF regime to enable FAIFs to operate a portfolio of LTAFs?

We would be concerned about excessive fees. Each layer of intermediation tends to increase costs to consumers, but not necessarily provide a better service.

Q14: What other options could we consider to make the promotion of the LTAF to retail clients more appropriate?

We suggest you turn the question around and ask why the FCA is not promoting the benefits of closed ended investment companies, especially investment companies, which have a long term history and whose risks are well understood.

Q15: Who else do you think the LTAF should be capable of being marketed to, and why? What are the barriers currently preventing this from happening?

No comment.

Q16: Do you think we should enable wider use of the LTAF as a permitted link or conditional permitted link to long-term contracts of insurance? What do you see as the main obstacles to this and how would you resolve them?

No comment.

Q17: Do you have any views on how permitted links might be expanded to other fund structures or direct investments in illiquid assets?

No comment.

Q18: Do you have any comments on our cost benefit analysis?

No comment.

For the convenience of readers we have appended the FCA's Principles which describe the Duty of Care. If these principle were enforced, rigorously and effectively, we would be much happier and believe this would be a better way to decide on:

a. the marketing of LTAFS to retail investors and
b. any proposed rules based assessment criteria for deciding whether consumers can be marketed LTAFS.

Yours sincerely

Cliff Weight
Director
ShareSoc

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Existing FCA Principles

It should be noted that these are guidance. There is no legal duty of care at present.

PRIN 2.1 The Principles

PRIN 2.1.1 R 03/01/2018 *RP*

The Principles

1 Integrity	A *firm* must conduct its business with integrity.
2 Skill, care and diligence	A *firm* must conduct its business with due skill, care and diligence.
3 Management and control	A *firm* must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4 Financial prudence	A *firm* must maintain adequate financial resources.
5 Market conduct	A *firm* must observe proper standards of market conduct.
6 Customers' interests	A *firm* must pay due regard to the interests of its *customers* and treat them fairly.
7Communications with clients	A *firm* must pay due regard to the information needs of its *clients*, and communicate information to them in a way which is clear, fair and not misleading.
8 Conflicts of interest	A *firm* must manage conflicts of interest fairly, both between itself and its *customers* and between a *customer* and another *client*.
9 Customers: relationships of trust	A *firm* must take reasonable care to ensure the suitability of its advice and discretionary decisions for any *customer* who is entitled to rely upon its judgment.
10 Clients' assets	A *firm* must arrange adequate protection for *clients'* assets when it is responsible for them.
11 Relations with regulators	A *firm* must deal with its regulators in an open and cooperative way, and must disclose to the *FCA* appropriately anything relating to the *firm* of which that regulator would reasonably expect notice.

Context of the above Principles

Fair treatment of customers

First published: 12/05/2015 Last updated: 24/03/2021

All firms must be able to show consistently that fair treatment of customers is at the heart of their business model.

Above all, customers expect financial services and products that meet their needs from firms they trust.

Consumer outcomes

There are six consumer outcomes that firms should strive to achieve to ensure fair treatment of customers. These remain core to what we expect of firms.

- **Outcome 1:** Consumers can be confident they are dealing with firms where the fair treatment of customers is central to the corporate culture.
- **Outcome 2:** Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
- **Outcome 3:** Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
- **Outcome 4:** Where consumers receive advice, the advice is suitable and takes account of their circumstances.
- **Outcome 5:** Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.
- **Outcome 6:** Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

Regulatory responsibilities

Firms are responsible for making sure customers are treated fairly.
Our principles (PRIN) include explicit and implicit guidance on the fair treatment of customers. Principle 6 says: 'A firm must pay due regard to the interests of its customers and treat them fairly', but other principles also apply to this area of business behaviour.

These principles apply even for firms that do not have direct contact with retail customers. Risks and poor conduct can be carried from wholesale to retail markets.

Guidance for firms on the fair treatment of vulnerable customers

In February 2021, we published finalised Guidance setting out our view of what firms should do to comply with their obligations under the Principles and take particular care to ensure vulnerable customers are treated fairly.

The Guidance sets out the types of actions firms can take to achieve this, and includes examples of how to put the Guidance into practice.

Because anyone can find themselves in vulnerable circumstances at any time, our Guidance is relevant to firms serving retail customers, including some business customers, regardless of the firm's size or sector.

Sole advisers

Sole advisers have the same responsibility as larger firms to demonstrate the fair treatment of customers. This responsibility cannot be delegated away but it should be proportionate and relevant to the size of your firm.

For example, we would not expect to see the same level of documentation or analysis of management information for a sole adviser as we would expect in a firm with a large team of advisers.

Customer feedback

Customer feedback can help you identify where you are treating customers fairly and where improvements are needed. Remember that a satisfied customer is not necessarily being treated fairly. Feedback responses helps flag risks for you to consider.

- Consider how and when you could use the feedback to get the most from it.
- Ask unhappy or disgruntled customers – their opinions and reasons for complaint or termination should matter to you.

If you use customer feedback, think about the questions you are asking and if they help you identify areas where your firm and its advisers are or are not treating customers fairly and therefore areas where improvements are needed.