Institute and Faculty of Actuaries

25 June 2021

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

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

Key points

1. We welcome the proposal to allow DC default funds to invest in LTAFs. We would also encourage the FCA to consider extending this to other DC funds. We also support wider participation across the retail sector in LTAFs, not just by DC funds.

2. We would highlight potential barriers to the introduction of the LTAF such as the charge cap, which can be particularly challenging for asset classes like private equity, where fees are high. Costs tend to be significant for illiquid assets even when they are below the cap. Past experience of challenges with illiquid investments, such as gating of property funds, could also be a barrier to investment in LTAFs.

3. We would support manager discretion on the balance between liquid and illiquid assets in a LTAF, since requiring a specific proportion of the assets to be illiquid could be difficult to reconcile with the goal of avoiding forced sales of assets.

4. The FCA proposes that the scheme must have a valuation point on each dealing day, with a valuation at least monthly. We note that many private assets are valued quarterly (and not necessarily in full detail even then), and would ask the FCA to clarify that it is comfortable with using stale pricing for assets that are valued less than monthly.

Beijing 14F China World Office 1 · 1 Jianwai Avenue · Beijing · China 100004 · **Tel**: +86 (10) 6535 0248
Edinburgh Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA · **Tel**: +44 (0) 131 240 1300
Hong Kong 1803 Tower One · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +852 2147 9418
London (registered office) 7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · **Tel**: +44 (0) 20 7632 2100
Oxford 1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · **Tel**: +44 (0) 1865 268 200
Singapore 163 Tras Street · #07-05 Lian Huat Building · Singapore 079024 · **Tel**: +65 6906 0889

1. The Institute and Faculty of Actuaries (IFoA) welcomes the FCA's consultation paper CP21/12 *A new authorised fund regime for investing in long term assets.* This response has been prepared with the benefit of the expertise and experience of our Finance and Investment Board, together with the Private Credit Working Party. We are grateful to the FCA for making the time to discuss this consultation.in detail with our members earlier in June.

2. The IFoA's response focuses on the earlier consultation questions about the design of the LTAF. We have not responded to the later questions about more specific regulatory issues, where we generally have less direct expertise.

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?

3. Additional governance is appropriate given that the LTAF is aimed at smaller institutional or retail investors who may find the investment vehicles challenging to understand.

4. It is possible that having assets invested in LTAFs could make it harder for some small DC schemes to consolidate, since they may seem risky from the perspective of the larger group. This may be one example where robust governance and disclosure arrangements could help to remove such concerns.

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?

5. We appreciate that substantial investment in long term and illiquid assets is part of the essence of a LTAF. However we would caution against requiring a specific proportion of the assets to be of these kinds, since this could be difficult to reconcile with the goal of avoiding forced sales of assets. We would therefore support manager discretion on the balance between liquid and illiquid assets[1].

6. The FCA proposes that the manager be required to appoint an external valuer to value the assets of the LTAF, unless it can demonstrate that it has the competence and experience to value the assets itself. The FCA proposes that the depositary of the LTAF would be required to assess the competence of the manager to carry out such valuations, however in our view depositories do not necessarily have the relevant experience to address this.

7. During our recent discussion you provided some reassurance that in practice you expect firms to have the competency to do their own valuations. However, we are aware of current practice where the manager of the underlying private assets within a fund appoints an external valuer for those assets. In those circumstances we do not think that the manager of the top-fund should be required to appoint a second external valuer to cover the same assets. Can the FCA please provide more clarity as to what is required at the top-fund level?

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1. 50% illiquid assets is mentioned in the paper, but in reality we would expect a much higher exposure to these assets e.g. 70-90%. We trust that the FCA understand this and are comfortable with this exposure.

8. The proposal for a borrowing limit with no look through is sensible, as many private market strategies do have some element of leverage or a credit facility for liquidity management. The suggested limit of 30% of net assets is lower than for comparable funds. We think any limit should take account of the frequent practice for managers to operate with a lower, unofficial limit of their own to reduce the risk of exceeding the official limit.

9. LTAFs will be expected to achieve a prudent spread of risk within 24 months. Although there are no specific diversification requirements in the consultation paper, we think 24 months is on the short side. Ideally there would be more flexibility to set an appropriate ramp up time period, depending on target exposure to long-term assets.

10. Regarding the spread of risk of underlying assets, the consultation says that managers should ensure that “the assets or investments held in the scheme property provide a sufficient diversification of exposure including, for example, in respect of the underlying assets or investments held by any holding company or other collective investment scheme”. We suggest that this may not be a realistic requirement, since investments in joint ventures or directly in co-investments, for example, would not meet the diversification requirement.

11. The FCA proposes that dealing frequency of LTAFs should match the liquidity of the fund assets, and that the scheme must have a valuation point on each dealing day, with a valuation at least monthly. Since many private assets are valued quarterly (and not necessarily in full detail even then), is the FCA comfortable with using stale pricing for assets that are valued less than monthly? If not, what is their expectation?

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

12. During our recent discussion with the FCA, you explained that the broad goal was to enable open-ended, illiquid investments providing both flexibility and high governance standards, features which would appeal to DC default funds and sophisticated retail investors. The open-ended aspect in particular was difficult to achieve at present.

13. We noted that within DC funds, the LTAF will not be relevant to larger Master Trusts because they tend to avoid life platforms and their associated restrictions, and so the permitted links rules do not apply to them.

14. However, it may benefit funds that use life wrappers, such as smaller Master Trusts and single-employer trusts. Even for smaller Master Trusts, though, there may be a trend away from using such wrappers, which suggests that LTAFs may have only a transitional role for DC.

15. We note that as well as DC funds, LTAF could benefit collective defined contribution (CDC) schemes and help them to become established. CDC schemes do not have the constraints of lifestyling strategies as members approach retirement and so have some flexibility to invest in illiquid assets.

16. LTAF would increase the choice of available vehicle structures to investors, but they face other, arguably more important barriers such as the charge cap, which can be particularly challenging for asset classes like private equity, where fees are high. Costs tend to be significant for illiquid assets even when they are below the cap. Past experience of challenges with illiquid investments, such as gating of property funds, could also be a barrier to investment in LTAFs.

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?

17. We welcome allowing DC default funds to invest in LTAFs. We highlighted a potential problem in limiting access to the LTAF to default funds, since there could also be demand from members who have made their own investment choices. We note that although default funds make up the majority of most DC schemes this is not always the case. We would therefore support the FCA considering if the LTAF avenue could be made available to other DC funds.

18. We would go further and support wider participation across the retail sector in LTAFs, not just in DC funds. We understand that the DC environment has a relatively strong advice structure and that increased consumer protections may be needed in other sectors before access to LTAFs would be realistic.

If you would like to discuss any of the points raised in this response, please contact Matthew Levine, Policy Manager (matthew.levine@actuaries.org.uk), in the first instance.