Roy Bartholomew
Financial Conduct Authority
12 Endeavour Square
London E20 1JN
By email: cp18-40@fca.org.uk

8 March 2019

Dear Mr Bartholomew

Re: BVCA response to FCA CP18/40 – Consultation on proposed amendment of COBS 21.3 permitted links rules

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, the BVCA represents the vast majority of all UK-based firms, as well as their professional advisers and investors. Over the past five years (2013-2017), BVCA members have invested over £32bn into nearly 2,500 companies based in the UK. Our members currently back around 3,380 companies, employing close to 1.4 million people on a full-time equivalent basis ("FTEs") across the world. Of these, around 692,000 FTEs are employed in the UK. Of the UK companies invested in during 2017, around 83% were SMEs.

The BVCA is delighted to have the opportunity to respond to the FCA's Consultation Paper on proposed amendment of COBS 21.3 permitted links rules (CP18/40). The BVCA has also submitted a response to the FCA's Discussion Paper on Patient Capital and Authorised Funds (DP18/10). The BVCA welcomes the FCA's proposed amendments. However, as noted in our responses to the questions below and in our response to DP18/10, we consider that more significant changes, for example the introduction of a new authorised fund vehicle, are required to permit retail investors to participate in the economic benefits associated with exposure to patient capital, including venture capital and private equity.

Q1: Do you agree with our proposal to allow investment in immovable structures or installations as above? If not, how could we change it?

We consider that the FCA's proposal to allow investment in immovable assets, which allows for unit-linked funds to invest in such assets, is a positive step in increasing the ability of retail investors to take advantage of the benefits that exposure to private assets can provide.

Q2: Do you agree with our proposal to remove, for firms that meet the conditions as above, the current 10% limit on the proportion of fund assets that may be held in land and property, relying instead on the overall limit on illiquid investments? If not, what percentage limit would you suggest is appropriate?

The removal of the 10% limit is a welcome simplification, as we believe setting limits at the asset class level makes it unnecessarily difficult for fund providers to produce appropriately diversified portfolios to meet their investors' needs.

We understand that the limitation to 50% of the gross assets of the linked fund applies at the level of the notional fund maintained by the life insurance company, from which investments are made in underlying assets. We think it would be helpful for the Handbook to include guidance clarifying this point. The guidance would be particularly helpful for non-insurance companies who may wish to engage with life insurance companies in the context of linked funds. If firms read the restriction of 50% as applying at the level of a UCITS fund or AIF into which the life insurance company invests, this could lead to a practical limitation on the ability of retail investors to invest in illiquid asset classes, because many of those funds are 100% invested in the relevant asset class.

Q3: Do you agree with our proposals only to allow additional investments if the conditions in paragraph 3.17 are satisfied?

The BVCA supports the case for investor protections, and we also consider the language in the proposed COBS 21.3.1B about rights being exercised "within a reasonable timeframe" to be helpful to an extent. In particular, we welcome the recognition that the investment timeframe for illiquid investments could be compatible with the investment needs of pension investors.

Q4: Do you agree with our proposal to relax the requirement for unlisted securities to be 'realisable in the short term' and to replace this with a liquidity test at the level of the investment fund, as set out above? If not, how could we change it, if at all? Do you think either of the alternative asset-level restrictions would work better?

We welcome the proposal to relax the 'realisable in the short term' requirement and support this being replaced by a liquidity test at the fund level. We agree that it would not be advisable to introduce an asset level restriction as this could have the effect of restricting or preventing investment in illiquid securities.

Q5: Do you agree with our proposal to remove, for firms meeting the investor protection conditions, the current 20% on holdings of assets through QIS/UCIS and instead rely on the overall limit of 50%? If not, how could we change it?

We welcome the proposal to remove the 20% limit because it should make it easier for retail investors to access patient capital investments. However, please note also our response to Q2, concerning how any such limits must apply in order to be effective.

Q6: Do you agree with our proposal to set an amalgamated overall threshold limit for firms meeting the conditions as above? If not, what could we change? Do you agree with the percentage level proposed, or if not, what should it be and why?

We consider that the drafting of the provisions relating to the qualifying conditions of underlying funds could be clarified and we would welcome the opportunity to discuss this with you. We are concerned about the inclusion within the new definition of permitted scheme interest at (b)(v) of "a qualified investor scheme or its EEA equivalent or any unregulated collective investor scheme that invests only in permitted links and publishes its prices regularly...". If this is intended to mean that an insurance company may invest in underlying patient capital funds provided that: (i) the insurance company satisfies the overall limit of 50% on illiquid assets; and (ii) the funds themselves only invest in permitted links and publish prices regularly, we believe this may limit access to patient capital and / or limit the investment activities / strategies of such underlying funds. Underlying private equity funds invest up to 100% of their capital in private securities; they are closed ended and illiquid and do not publish prices regularly.

Q7: Do you agree that the obligation on firms to provide adequate risk warnings about liquidity and investment risk would contribute to better understanding of those risks by investors in unit-linked funds?

As noted above, we do not consider that liquidity should be selected above other risks as meaning a particular investment is "risky". However, we note the importance of investor protection and consider that the liquidity risks should be explained to potential investors because of the inherent illiquidity of patient capital investments.

Q8: Do you agree with our proposal to require provider firms to ensure that any unit-linked investment does not interfere with retail investors' rights to switch funds, take benefits or to withdraw of transfer funds? And our proposal that links to the new categories of investment are only offered/taken up in suitable and appropriate investment contexts? If not, how would you change it?

We understand the FCA's focus on retail investors' retention of their current rights to switch funds. However, we consider that this should be balanced against the FCA's intention to encourage greater investment in patient capital, where assets are generally more illiquid. Getting the balance wrong could incentivise product providers to include a suboptimal amount of patient capital investments within their funds as they would fear being unable to facilitate a retail investor's right to switch funds without damaging the overall returns of the fund. Inevitably, this would hinder the ability of the industry to achieve the stated policy aim of increasing patient capital investments. We would encourage the FCA to take a more flexible approach towards this issue. With respect to suitability and appropriateness assessments, such assessments should be the responsibility of the product provider, distributor or adviser. We consider that putting in place increased protections, which we do not believe are strictly necessary, will act as an impediment to the ability of investors to take advantage of the benefits of investing in patient capital.

We would be happy to discuss the contents of this letter with you; please contact Tom Taylor (ttaylor@bvca.co.uk).

Yours faithfully,

Tim Lewis
Chair, BVCA Regulatory Committee