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Adnan Ahmed
Asset Management & Funds Policy
Financial Conduct Authority
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By email: cp22-14@fca.org.uk

10 October 2022

Dear Mr Ahmed

Re: Broadening retail access to the long-term asset fund

The BVCA is the industry body and public policy advocate for the private equity and venture capital (PE/VC) industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based PE/VC firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over 2 million people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

We supported the introduction of the Long-Term Asset Fund (LTAF) to enable more investors with long-term investment horizons and who understand the risks to invest in private market assets. We have worked with the Productive Finance Working Group to develop practical solutions to the barriers to investing in long-term, less liquid assets.

The LTAF is of significant interest to certain of our members as a potential vehicle for raising capital for investment in PE/VC assets, particularly from Defined Contribution (DC) pension schemes, advised investors and wealth management clients. We think it is important to the success of LTAFs that an expansive pool of investors is eligible to invest.

We welcome the opportunity to feedback on proposals to broaden retail access to the LTAF and have responded to consultation questions on which our members have specific views.

Q1: Do you have any comments on our assessment of the effects of our proposals?

We agree that greater access to long-term illiquid assets, like PE/VC funds, will benefit retail investors with long-term investment horizons and who understand the risks. These assets have historically provided diversification and higher returns to various UK and international institutional investors, including overseas pension schemes.

When comparing the performance of the UK PE/VC industry with public markets in 2020, the five-year and ten-year annual returns were 21.1% and 13.9% respectively, compared to the FTSE All-Share, which returned 5.1% and 5.6% to investors over the same respective periods.[1] As well as delivering positive, long-term, investment outcomes for investors, UK managed PE/VC funds played a vital role in the growth of the UK economy and the industry supports two million jobs.

Q3: Do you agree that the LTAF should be recategorised as a RMMI (as per PS22/10), from its previous category as an NMPI, thus broadening retail access to include restricted investors?

[1] Performance and Public Market Equivalent Report 2020

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In general, we understand that most of our member firms currently do not have a commercial interest in making LTAFs directly available to retail investors. We recognise that recategorising LTAFs as RMMIs will enable retail investors to invest up to 10% of their net investible assets in LTAFs and other RMMI products. This, combined with the related proposals to broaden pension scheme coverage, will help to achieve the FCA's objective in broadening retail access to the LTAF and allow investors to improve their portfolio construction and potential returns, and increase the likelihood that LTAFs will reach sufficient scale. However, at this stage we are not aware of private equity or venture capital firms looking to make LTAFs available to this part of the market.

Q4: Do you agree with the wording of the proposed LTAF risk warning and risk summary? Please explain your answer and suggest alternative drafting if appropriate.

We broadly support the wording. However we are concerned that the FCA's proposed standardised risk warnings and risk summary template conflate liquidity risk with investment risk. The opening statement in the risk summary template that LTAFs are high risk "due to the illiquidity of the LTAF fund structure" is unhelpful, particularly as the LTAF will be categorised as an RMMI alongside much more volatile (and potentially high-risk) investment products, like cryptoassets. Also we think it is misleading to talk about "getting your money back": these investments put an investors' capital at risk. To help address these issues, we suggest that the language in the LTAF risk warnings should be amended to focus more clearly on the illiquid and capital at risk nature of the product, e.g.:

This is an illiquid investment. Only invest if you're prepared to wait to be paid the cash value of your investment. Assets in this fund take a long time to buy and sell. It will take several years to make any money on your investment.

This is an illiquid investment, so only invest if you're prepared to wait to be paid the cash value of your investment.

Q5: Do you agree that when investors buy units in an LTAF, they should not have to comply with the 24-hour cooling off period?

Yes. We did not support the proposed introduction of the 24-hour cooling off period to RMMIs, which has since been confirmed in the FCA's policy statement on strengthening the financial promotion rules for high-risk investments (PS22/10). The FCA acknowledged in its consultation paper (CP22/2) that there is little evidence to suggest that a cooling-off period would help consumers to reflect on their investment decision-making and we disagree with the decision to apply 24-hour cooling off periods to RMMIs from 1 February 2023.

We agree with the FCA's analysis in CP22/14 that appropriateness assessments mean that prospective investors have sufficient time to consider investing and negates the need for an additional 24-hour period.

We are also concerned that cooling off periods will frustrate investors and incentivise investors to remain with their existing investment product providers. A restriction on the consumer's ability to engage with new platforms and product providers is unlikely to be in the consumer's best interests and is anti-competitive in nature.

Q6: Do you agree that the retail fund rules noted above should be applied to LTAFs with retail investors?

Yes, assuming the below issue is clarified/addressed in the final rules.

Collective Investment Scheme Sourcebook (COLL) 4.3.4R requires an authorised fund manager to obtain prior approval from unitholders, by way of an extraordinary resolution, for any change to a scheme which is a fundamental change. Guidance in COLL 4.3.5G(2)(f) says that a 'fundamental change' is likely to

include the introduction of 'limited redemption arrangements', which is defined in the FCA Handbook Glossary as a redemption frequency of less than twice in a calendar month.

As FCA rules prevent LTAFs from allowing redemptions more than once a month, can the FCA please confirm that a change to a reasonable redemption frequency (e.g. monthly) will not constitute a fundamental change for LTAF schemes or require prior approval from unit holders? We suggest that this issue can be resolved by disapplying guidance in COLL 4.3.5G(2)(f) or amending, for the purposes of LTAF schemes, the meaning of limited redemption rights to a more suitable frequency.

Q8: Do you agree that the LTAF should require an appropriateness test for all potential retail investors?

Yes. Where a client is non-advised, we agree that appropriateness tests, designed to ensure the prospective investors have an appropriate level of knowledge and experience, are a necessary and important consumer protection.

Q9: Do you agree with the proposal to enable a FAIF to invest up to 35% into a single LTAF?

Yes. We agree that Fund of Alternative Investment Funds (FAIF) should be enabled to invest in LTAFs as a way for investors to get exposure to a diversified portfolio of LTAFs (and other funds). We also believe that the spread rules in COLL 5.7.5R(7), which say that a NURS FAIF cannot invest more than 35% in the units of any one scheme, serve as a reasonable precedent.

Q10: Should we apply a limit to the value, as a percentage of the Net Asset Value (NAV), that a FAIF can invest in multiple LTAFs?

No. Unlike the 35% limit proposed for investment into a single LTAF (Q9), there does not appear to be a precedent for a 50% aggregated investment limit on FAIFs investing in any type of secondary scheme. Investing more than 50% of scheme property across several LTAFs would breach the existing threshold for Funds with Inherently Illiquid Assets (FIIA). This will require additional disclosures, enhanced depositary oversight and liquidity risk contingency plans. The consequences would be no different to a FAIF investing more than 50% in any other 'inherently illiquid asset(s)', defined in the FCA Handbook Glossary as including immovables, infrastructure projects, non-transferable/unlisted securities etc, units in FIIAs or funds with similar features.

Given that additional requirements already exist for FAIFs investing more than 50% in inherently illiquid assets, we see no reason, precedent, or policy rationale for limiting the value, as a percentage of Net Asset Value (NAV), that a FAIF can invest in a selection of LTAFs.

Q11: Do you agree that COLL 5.7.9R (1) and (2) should be switched off for FAIFs that invest in units of LTAFs, given the existing detailed LTAF due diligence rules?

Yes. The LTAF rules on due diligence in COLL 15.6.9R are comprehensive and cover the same areas of due diligence.

Q12: Do you agree with our proposals to extend distribution of the LTAF beyond defaults in qualifying schemes?

Yes. We agree it is important to the success of LTAFs that an expansive pool of investors is eligible to invest, particularly as the UK's DC default market may take time to begin allocating to PE/VC funds. However, we disagree that the distribution of LTAFs to a qualifying scheme's self-select options should be limited to the level of investment in LTAFs by the default arrangement of the same qualifying scheme.

For various reasons highlighted by the Productive Finance Working Group and others, defaults' allocations to LTAFs may remain low for some time (although we acknowledge the work of the Productive Finance Working Group to address these issues). We recommend self-select options should allow for an

allocation of at least up to 10% (aligned to the proposed limit for restricted retail investors). However, as pension savers that opt to self-select funds have taken an interest in and responsibility for how their pension savings are allocated across selected funds, a higher limit of 20% would be less restrictive and potentially more appropriate.

While it is outside the scope of this consultation, we would encourage the FCA to recognise that removing carried interest and performance fees from the charge cap calculation is essential to the LTAF having a significant impact on UK DC default investment in private markets. We welcome the Department for Work and Pensions' open consultation on reforms to the charge cap calculation methodology that will help create a level playing field between UK DC pension scheme beneficiaries and those of global pension schemes that have historically benefitted from access to UK PE/VC funds.

Q13: Do you agree with our proposals to extend distribution of the LTAF more widely where investors in long-term unit-linked product have appropriate professional support on fund selection as above?

Yes. We agree that advised investors in non-workplace pensions and workplace pensions that are not qualifying schemes should be permitted to invest in LTAFs. As in our response to the question on extending the distribution of LTAFs beyond defaults in qualifying schemes (Q12), we believe an allocation limit of at least 10% (aligned to the limit for restricted retail investors) is reasonable.

Q14: Do you agree with our proposal to make rules to give equivalent status to that of LTAFs under the permitted links rules to other illiquid assets where the conditions for securing an appropriate degree of consumer protection can be met?

Yes.

Q15: Do you consider there to be any unintended consequences from categorising the LTAF as a non-standard product for SIPPs?

Yes. We believe that a capital surcharge on Self-Invested Personal Pensions (SIPP) providers will make LTAFs less attractive and discourage them from making LTAFs available to scheme members.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor ttaylor@bvca.co.uk / Nick Chipperfield nchipperfield@bvca.co.uk).

Yours sincerely,

Tim Lewis, Chair, BVCA Regulatory Committee