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Dear Michael and Tom,

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

The IA welcomes the consultation on the creation of a Long-Term Asset Fund (LTAF). The proposals provide a very well-considered structural foundation for this new product. With the right distribution rules, the LTAF will offer significant investment opportunities to a broader set of customers as well as additional sources of productive funding for companies and projects in the wider economy.

As you recognise, a key distinguishing feature of the LTAF is to provide wider investment powers than typically seen in the mainstream fund market, combined with the use of notice periods to ensure alignment between liquidity of assets and fund. The departure from daily dealing fund structures addresses two critical issues, from both a customer and policymaker perspective. First, it facilitates wider access to less liquid and/or inherently illiquid assets. Second, it provides a way of addressing the potential challenge of liquidity mismatch within investment funds, which has been a particular – and growing - area of concern for regulators.

Addressing these concerns is important because a well-functioning LTAF serves to benefit investors with the ability to access a more diversified portfolio and the potential for superior returns; for managers to grow their assets under management and create greater economies of scale; and for policymakers to improve economic growth and productivity.

However, we believe that there are specific elements of the proposed regime that must be improved to ensure that the LTAF is attractive to the widest possible range of market participants and consequently more likely to be recognised as a viable investment vehicle.

These improvements focus specifically on the target market. As we have set out in previous papers, our view is that the LTAF will provide an additional route for the investment of long-term capital alongside more established vehicles, notably closed-ended, listed investment companies. In the view of the IA, there is no perfect way to combine illiquid assets with an expectation of daily liquidity. The important issue is to understand where the potential cost will lie – whether in the form of a potentially steep discount or a long redemption cycle to allow the management of fund flows. That calculation of cost relative to benefit will incline some customers towards a closed-ended route, and others towards an LTAF. Indeed, depending on the investment strategy, it will also guide decisions by fund providers, some of whom may prefer closed-ended vehicles. It would be incorrect, in our view, to significantly limit this choice rather than allow the market to develop to accommodate different preferences based on a range of high-quality options. We think that there should be a wide range of ways to invest to enable managers to choose the vehicles that best achieve their investor's aims.

At the same time, as the work of the Productive Finance Working Group is also emphasising, the introduction of a non-daily dealing structure in a daily dealing retail and DC delivery environment is a major cultural and logistical challenge, albeit one that will result in significant benefits. For that reason, while it is urgent to put in place the foundations now, the LTAF is not a project that will reach full potential in 2021 or 2022. Rather, it is a project that re-imagines the fund architecture and looks ahead to a world in which the investment needs and time horizons of private savers will continue to evolve, given both greater longevity and individual responsibility for lifetime and retirement saving.

The critical importance of the distribution regime

In this context, our response to CP21/12 sees the questions of distribution and customer access as being critical. While, in principle, there is some merit in targeting a core market for initial development, the question of how scale is achieved in a new product area means that too narrow an approach risks making the approach unattractive commercially with the wider impact of denying a range of customers greater opportunity to achieve diversified long-term returns. The 'DC for now' route runs exactly this risk. A process of adoption in the DC market, which is likely to be slow, combined with distribution rules that prove highly restrictive for wealth managers, advisers, and platforms, pose a serious challenge to the project. This challenge, in essence, focuses on the rules surrounding Non-Mainstream Pooled Investments (NMPI) that we focus on in detail below.

Instead, we propose a broader approach, which lays a foundation for development by facilitating from the outset the ability to reach beyond the DC market and into the private wealth and retail markets. This approach is wholly aligned with the important statement in Para 5.16 of the CP that it is "unlikely to be desirable to permit an LTAF to be marketed directly to retail investors without any restrictions", with which we strongly agree.

The difference in our approach lies in the way in which that roadmap is constructed from a distribution rules perspective. It involves avoiding classifying an LTAF as a NMPI, which is a fundamental problem in our view. Instead, we propose building on the existing suitability and appropriateness rules in COBS 9A and 10A. This could involve the use of current product governance processes at both manufacturer and distributor level, along with a series of objective conditions, to ensure that the right investors could access the LTAF.

In this regard, we would encourage the FCA to consider the principles around the approach to distribution used in the ELTIF, which has a similar ambition to broaden participation in private market investment. Currently, the LTAF helpfully overcomes some of the investment limitations of the ELTIF but has moved in the opposite direction with more restrictive distribution rules. This creates the possibility of establishing an LTIF (the UK post-Brexit variation of the ELTIF) in the UK under current law which could be marketed to retail investors, where the LTAF would not. This imbalance could undermine the viability and market perception of the LTAF. Without different distribution rules, many investment managers are most unlikely to regard the LTAF as viable.

This is linked to a final and important point. We note the reference to the LTAF investing in "higher risk assets" (5.14) and the wider discussion currently taking place on access and financial promotions of high-risk investments. With respect to the LTAF, it is important to stress that the strong level of regulation applied to this new vehicle will set it quite clearly apart from many categories of high-risk investment. The LTAF should therefore be considered for what it is – an expansion of the regulated funds universe – with governance and distribution rules tailored accordingly. However, for now, the strengthened governance arrangements, which we support, do not appear to have been fully taken into account when determining the eligible investor base beyond the professional, DC and sophisticated retail investor categories.

We look forward to discussing these points further with you.

Yours sincerely,

Jonathan Lipkin
Director - Policy, Strategy & Research

THE INVESTMENT ASSOCIATION

Response to consultation

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

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 43% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

Our detailed response to the questions posed by the FCA reflects our strong support for the approach taken to the design of the LTAF as a standalone regime. The proposals are well-considered, and the governance and disclosure requirements reflect those we would expect from a fund available to a wider category of investors than the traditional institutional / professional market. Our main areas of disagreement are on the starting point to distribution, which appears at odds with the level of protection being proposed for the vehicle itself. We oppose NMPI as a starting point and would like to have further discussion on a more workable and inclusive regime to make distribution of the LTAF more achievable than distribution of the QIS. Our concern is that if this issue is not resolved, investment managers will not regard the LTAF market as viable.

Q2. Disclosure and governance rules

We are broadly supportive of the disclosure and governance rules, which build on existing requirements for fund value assessments.

Q3. Detailed requirements

We support the principles-based approach underpinning the LTAF but have observations on a number of specific requirements:

- *Purpose*. We are not convinced that the 50% threshold would be helpful from a practical perspective and also raises a challenge of definition regarding illiquidity and the balance between public and private assets within a portfolio.

- *Investment Powers*. We largely agree with the approach. While we welcome the proposals to be able to invest in other collective investment schemes, we do not think it is necessary or desirable to require second schemes to have a prudent spread of risk given the specialist nature of some of the exposures. We welcome the ability for LTAFs to originate loans but note that the detailed rules may prevent co-investment and other legitimate lending strategies.

- *Valuation*. We note concerns from depositaries about the nature of valuation requirements regarding assessment of AFM capabilities and believe this should be the responsibility of the AFM Board.

- *Reporting*. We support full transparency but do not believe a quarterly report should be mandatory, as it does not seem consistent with the long-term nature of an investment in an LTAF. We suggest providing such a report should be at the discretion of the AFM having regard to the information needs of the investors in the LTAF.

Q4. Wider observations

While our preferred starting point for structuring the LTAF would have been the NURS regime rather than the QIS, we welcome the creation of the LTAF as a separate chapter in the COLL sourcebook. We would encourage separation throughout the Handbook, not as a sub-definition of "qualified investor scheme", which might limit the perception of the LTAF to being that of a professional investment vehicle and does not give sufficient weight to the originality in the LTAF's requirements. We also suggest the safekeeping requirements for the LTAF should be aligned with the AIFMD requirements, given that the depositary's role as the registered owner of private market assets can have much broader implications than in respect of custodial assets.

Q5. LTAF as part of default arrangements

We support the approach being taken for the LTAF, with the inclusion also of guidance regarding concentration risk at the default level. However, we still see the permitted links rules complicating allocation decisions for unit-linked investment in illiquids more broadly. Additionally, as a wider comment, we note that there are a set of broader structural challenges faced by the DC market when allocating to illiquid assets, which the LTAF on its own cannot solve. It will be critical for policymakers and regulators to address these barriers in order for the use of illiquids in DC to become more commonplace.

Q6. Eligible assets for LTAFs in DC schemes

We do not have concerns about the specific asset classes that an LTAF could invest in from a DC investor perspective. The more relevant issues will be appropriate use of asset classes in a scheme's allocation over time.

Q7. Treatment of LTAF for distribution purposes.

We do not agree that the LTAF should initially be treated as a QIS for distribution purposes. The LTAF would have stricter levels of governance requirements and more investment restrictions, and yet is potentially restricted to the same group of investors as a QIS, significantly limiting its appeal. This asymmetric approach to customer protection and distribution rules is both wrong in principle with respect to facilitating customer choice and potentially very damaging to the commercial viability of the LTAF. Instead, we propose that the LTAF should be treated as a distinct fund type under the FCA's distribution rules.

Q8-9. Barriers within the existing NMPI rules

Feedback from distributors such as private wealth managers, advisers and platforms suggests that the NMPI is a very significant obstacle to effective distribution. There are a number of complex issues here concerning the exemption-based regime and different coverage / requirements. Our strong view is that having the LTAF fall under the NMPI banner will discourage distributors and hence manufacturers, resulting in a DC-focused market that may fail to gain significant traction. It would therefore be preferable to adopt a distribution model for the LTAF that sits outside the NMPI rules.

Q10-14. Alternative approaches to retail access

The rules in COBS 9A and COBS 10A on complex products would be the baseline for broader retail distribution of the LTAF but could be further supplemented to provide additional safeguards around LTAF access by retail investors. These safeguards would be built in particular on product governance requirements.

The non-readily realisable securities (NRRS) rules themselves are not a suitable approach to ensuring retail access to the LTAF given that they were not designed for funds. However, they do provide a template for useful objective tests for determining retail investor eligibility, particularly minimum capital thresholds.

The rules on NURS-FAIFs will require some minimal changes, particularly to the rules on eligible second schemes, to enable NURS-FAIFs to be managed with a portfolio of LTAFs, and we also suggest enabling a NURS to invest in an LTAF within the 20% limit for unapproved collective investment schemes.

Q15. The investor base beyond DC and retail

Although the LTAF has been designed primarily with the DC and retail markets in mind, it may also be a suitable vehicle for large institutional investors, including insurers and DB pension schemes, to use in accessing illiquid assets via a pooled open-ended vehicle. This can further help LTAFs achieve scale, to the benefit of all investors in the fund. We are not aware of any barriers faced by these investors that would prevent the LTAF being marketed to them. However, we note that, quite apart from the broader discussion on retail access, retail investors seeking to invest in an LTAF through a SIPP wrapper are likely to face barriers to doing so as a result of the capital requirements faced by SIPP providers in respect of Non-Standard Assets.

Q16-17. The broader use of the LTAF within the unit-linked environment

The question of the investor base also arises within the unit-linked environment, where the current proposal to restrict LTAF distribution to DC defaults is overly restrictive. Outside the DC default landscape, there are other balanced managed investment arrangements where the provider designs and governs the portfolio on the investor’s behalf. These look much like default arrangements but lack the formal designation of a default as a result of not being part of workplace pension products. Investors in these strategies (which could be found in non-workplace pension products, for example) could also benefit from exposure to LTAFs. More generally, where investors in a long-term unit-linked product have either professional support on fund selection or are guided through an appropriate choice architecture, they should be able to invest in an LTAF and the distribution rules should reflect this.

As a technical matter, while the FCA's proposals for the LTAF work well for unit-linked DC default arrangements, the 35% cap remains a significant constraint within the permitted links rules for structures other than LTAFs that seek to offer unit-linked investors illiquid exposures. A more coherent regulatory approach would treat all fund structures the same in this regard, and the proposals for the LTAF within the permitted links rules offer a way forward for other structures too.

ANSWERS TO SPECIFIC QUESTIONS

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.

We do not consider that these proposals raise any equality or diversity issues.

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 recognise that the principles-based approach taken in particular for the investment powers of the LTAF, and the importance of maintaining an appropriate liquidity management programme requires a robust governance structure around the LTAF. This is particularly important given the ambition for the LTAF to be accessed by DC schemes and professional investors, and we hope, by certain retail investors. We also recognise the need for key investor disclosures to be presented in clear, fair, and not misleading way and to be accessible for investors.

In addition to the assessment of value that is required to be performed by AFM boards for all authorised funds, the FCA proposes a requirement for a further assessment to be performed by the AFM board on the investment valuations, the investment due diligence, conflicts of interest management and liquidity management of the LTAF (hereafter referred to as the "additional assessment"). We recognise the need for strong governance at the level of the AFM Board in ensuring investors are properly protected in these areas and believe that this additional assessment will greatly assist in giving investors confidence in the LTAF. The requirements given for the criteria of the additional assessment and reporting on these are high level. In this respect we note that firms may benefit from further guidance from the FCA on its expectations for the additional assessment by AFM Boards, who will be keen to ensure this is undertaken to the expected standard from the start.

We recognise the importance of full disclosure of charges, particularly to investors that are workplace pension schemes which have their own charge disclosure obligations, and in particular that trustees of DC default schemes in particular will require full visibility of charges given their requirement to comply with the charge cap. Performance fees play an important role in many private market investments, especially with private equity and venture capital investments, where managers typically play an active role in the management and improvement of the underlying investments. Performance fees can help to align the incentives of the manager with the interests of investors. As such, performance fees are likely to feature in many LTAFs, either at the level of the LTAF itself or at the level of the underlying investments. It is important that investors have a clear understanding of the rationale for a performance fee, how any performance fee charged by the LTAF will be calculated, and that this is explained in clear and accessible language, including with suitable illustrations of how this will be calculated. We also recognise that performance fees may need to be amortised over the life of the investment, to ensure they are fairly reflected in the valuation of the LTAF at each dealing point. Again, it is important that this is clearly stated in the fund prospectus.

The requirements around independent board representation reflect those in place for other authorised funds, and we agree with their inclusion here. Depending on client interest, these may also usefully be supplemented by Advisory Committees, although we suggest this should be at the discretion of each AFM.

These requirements go far beyond what would be required for a fund designed for professional investors. For the LTAF to succeed, there must be a corresponding broadening of the investor base that can access the fund. As discussed in our response to question 7, with the exception of the permitted links rules proposed for LTAF in COBS 21, the initial distribution rules as proposed will not offer any broader access than existing professional fund regimes, such as the QIS, which do not require the same level of governance or investor protections, and therefore will be more flexible and cost effective to launch. The LTAF regime is unlikely to gain significant traction if it imposes additional requirements without offering broader investment access than existing professional regimes.

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?

We support the principles-based approach that the FCA has taken with the LTAF requirements. Given the diversity of asset classes available for the LTAF and their illiquid nature, they do not readily lend themselves to hard risk limits of the types used in other authorised fund regimes, such as the UCITS and NURS regimes. Indeed, a more prescriptive approach has caused difficulties for the European ELTIF structure (now incorporated into the UK statute book as the LTIF Regulation).

In terms of the detailed proposals, we offer the following comments:

Purpose

We agree that the LTAF should have a high-level strategy to invest significantly in long-term illiquid assets. Our members have raised concerns regarding the "more than 50%" threshold stated in COLL 15.6.7 G, whether this should be viewed as a hard limit or whether this is indicative? For example, if a fund were to be following a hybrid strategy to meet a liquidity objective, e.g., with typically just over half of the assets in illiquid assets and the remaining half in listed or public securities, would a fund be in breach if it had less than 50% in illiquid assets? Such a scenario could arise due to large inflows, the maturity or redemption of a large illiquid position, a listing of a previously unlisted investment, or a change in the relative value of the liquid portion of the fund relative to the illiquid portion. While in such cases the manager would ultimately seek to rebalance the fund, the timescales for making allocations to illiquid assets can be long, due to the time required to identify suitable opportunities, the negotiation and due diligence that must be undertaken on such investments, the negotiation around legal contracts, etc. Therefore, it is likely that LTAFs operating hybrid strategies in particular may have periods where their allocations to illiquid investments may fall under a specified threshold, and it is important that managers of such funds understand what the regulatory implications of this would be.

In addition, some LTAFs will require a period in which the fund progressively increases its investments in private assets. In the initial and early stages of its life cycle, such a fund is likely to have a greater proportion of more liquid assets as opposed to the longer-term investments that will increasingly make over time. Specifying a threshold of 50%, even in guidance, is likely to be taken as a hard limit for the purposes of investment limit and risk monitoring, even though that does not appear to be the intention of COLL 15.6.7 G.

While we expect many LTAFs to have strategies that invest mostly or almost entirely in long-term investments, we understand that some asset managers are interested in offering hybrid strategies that have a significant allocation to long term investments that may be less than 50%, but over what could be achieved in other authorised funds. We suggest that instead of specifying a threshold, COLL 15.6.7 G refers to “significantly” instead of “mainly” and also that an LTAF should at a minimum seek to invest more in long-term investments than would be permitted in a NURS under COLL 5.6. This should achieve the objective of ensuring the LTAF is only used for funds that genuinely seek to make significant allocations to long-term investments, without overly restricting the investment strategies that the LTAF can be used for.

<u>Investment Powers</u>
We largely agree with the approach taken by the FCA for investment powers. The higher standard of a prudent spread of risk requirement is appropriate for the LTAF, given the ambition for this vehicle to be available to a broader investor base. We note that the prudential spread of risk requirement is not an absolute requirement, and therefore it will be important for the investment objective and policy of the LTAF to outline how this requirement will be achieved.

An initial period after the fund is launched where the rules on investment limits will not apply (typically referred to as a ramp-up period) will be critical for LTAF, accounting for a period of time both for the fund to reach scale and to develop a suitable investment pipeline. Given the highly illiquid nature of the assets proposed for the LTAF, 24 months is not likely to be a sufficient ramp-up period required for an LTAF – in the case of some asset classes, a much longer period is likely to be needed. We suggest that the ramp-up period of up to 5 years be permitted, matching that provided in the ELTIF Regulation, or that there at least be provision for the manager to apply for an extension of the original ramp-up period. It should be noted that some managers may not wish to permit redemptions during this ramp-up period as the LTAF builds scale, due to the need to commit to transactions.

We welcome the proposal for the LTAF to be able to invest in other collective investment schemes, including those structured as limited partnerships. The limited provision for ELTIFs to invest in other collective investment schemes, apart from small positions in other ELTIFs, EuSEF and EuVECA funds, was a significant barrier to the use of the ELTIF structure, noting that it is usual to wrap up private market assets in collective investment schemes. In particular we welcome that the proposed LTAF rules do not include a requirement for second schemes to have a limit on investing in other collective investment schemes, and agree with the approach for the manager to instead undertake sufficient due diligence through the structure to ensure there is unlikely to be any circular investment back to the LTAF.

We do not believe it is necessary or desirable to require second schemes to have a prudent spread of risk in order to be eligible investments for an LTAF. The collective investment schemes that the LTAF will invest in are likely to be unauthorised schemes that would not have this requirement, and moreover this would prevent the LTAF from investing in collective investment schemes that have been used to wrap a single asset, e.g., for tax or operational efficiency purposes – such arrangements are fairly typical in private markets. The requirement for second schemes to have a prudent spread of risk would therefore be a significant barrier to the LTAF investing in many schemes. The prudent spread of risk should be assessed at the level of the LTAF, not at the level of the underlying schemes. (We recognise that assessing whether a prudent spread of risk has been achieved at the level of the LTAF will require looking through to the underlying assets of the schemes that the LTAF invests in as part of the overall investment due diligence undertaken by the portfolio manager).

An issue arises in the drafting of COLL 15.6.2 R (1). This requires that where the LTAF invests in a feeder fund, the eligibility requirements of second schemes apply not to the master fund in which that feeder invests, but to any other scheme that the master fund invests in. This is one layer of look through more than is necessary or appropriate. The exposure of the LTAF through the feeder fund is to the master fund, and it is to this that the LTAF should look to ensure it complies with the rules on second schemes. We note that similar issues with this drafting also arise in the rules in COLL 5.7 (for NURS operating as FAIFs) and COLL 8.4 (for QIS).

We welcome the provision in COLL 15.6.8 R (2) for the LTAF to be able to hold interests in loans originated or participated by the LTAF. This will greatly improve the potential utilisation of the LTAF in alternative credit strategies. We are concerned though that the drafting of the detailed provisions, intended to prevent inappropriate loans being made solely for the benefit of the AFM, its associates, or their directors/employees (the intention of which we support), are likely to also prevent legitimate loan strategies, in particular those that are part of co-investment strategies. We outline below some of the provisions that are likely to prove problematic:

COLL 15.6.8R(2)(a)(ii) – This rule would prevent any loans being made to "a fund". A "fund" includes an AIF or a CIS. Investments in a fund (e.g., a limited partnership) may be structured as an equity/loan split (which cannot be negotiated with the GP/manager of the underlying fund). As such, this rule would prevent the LTAF from participating in a large number of private equity transactions which are often structured using limited partnerships and a loan/capital split.

COLL 15.6.8R(2)(a)(iii) – This rule would essentially prevent any loans being made to a regulated firm. We would like to understand the intention behind this restriction, and why there is a concern on the part of the FCA about making loans to regulated firms. This could limit the ability of LTAFs to provide funding to innovative parts of the financial services sector. By way of example, if an LTAF were to make an investment in a fintech company, that investment may be structured as part equity and part loan. Based on this rule, an LTAF could participate in such investment financed as a loan only up until the fintech company became FCA regulated and would need to disinvest at that point in order not to breach this rule. This would not be a desirable outcome.

COLL 15.6.8R(2)(a)(iv) – similar to COLL 15.6.8R(2)(a)(iii), this would prevent an LTAF making a loan to any entity in any group that includes a regulated business, so this casts a very wide net over entities to which an LTAF cannot originate loans. This would likely prevent an LTAF making a loan to the same company in a group even if the loan has nothing to do with the business conducted by the regulated firm because of this rule (iv).

COLL 15.6.8 R(2)(a)(v) – our concern is that this rule appears to prevent funding acquisition vehicles that are set up to facilitate the LTAF investments. If the LTAF invests in the holding company, the holding company will want to make an acquisition (i.e., "use the credit for the purpose of investing in a security") and the holding company may request financing by way of a shareholder loan.

COLL 15.6.8R(2)(b) says that "the investment in the loan does not give rise to any conflict of interest". We recognise the need for any conflicts of interest that arise to be properly managed in the interests of investors. But preventing the origination of any loans on the basis that a conflict may arise, rather than simply requiring that any such conflicts arising are properly managed, would significantly restrict the ability for LTAFs to make loans. It is already the case that managers operating authorised funds invest in assets which give rise to a conflict of interest which they try to prevent or manage and, as a last resort, disclose to investors. Hence the need for allocation policies. For example, if a manager managed an LTAF, another authorised fund, and a segregated account, and all three of those funds/accounts participate in a loan then there is a potential conflict of interests, and potential for the interests of those three clients to diverge. Avoiding any loans that give potential for such conflicts would deprive LTAFs of investment opportunities. Providing conflicts of interests can be properly managed, such as through clear allocation policies, we do not believe the LTAF should be prevented in all cases from originating loans due to the possibility of a conflict of interest arising.

COLL 15.6.8R(2)(c) lists a number of persons who must not have a commercial interest in the loan, including the AFM, relevant persons, persons providing services to the AFM and any affiliated company or associates of these. The AFM necessarily has a commercial interest in the loan performing well given its obligation in managing the LTAF and therefore wanting the loan to perform well. We agree that the origination of loans *for the benefit of the AFM* should be restricted, but it must be the case that all AFMs of an LTAF necessarily have a commercial interest in loans originated from the LTAF they manage, for it to perform well. It may also be the case that relevant persons (such as directors or employees of the AFM or its delegate) join the board of a company in which the LTAF has invested in a capital/loan split as part of the management strategy for that asset – such appointments should not be prevented by these rules, although any such appointments and interests should be fully disclosed.

The consultation appears to suggest that the LTAF should not be subject to additional restrictions on loans, although the effect appears to go further than the rules that apply to the QIS. For instance, the current drafting calls into question whether you can invest in a Private Equity fund where the commitment is structured as a loan/capital split under COLL 15.6.8R(2)(a)(ii), and these investments are likely to be a key target for some LTAF strategies. Fund managers are likely to want the LTAF to invest alongside other investment products and for those parallel investments to be pooled through a holding vehicle, and for the holding vehicle to be funded by way of loans. The LTAF loans money to the vehicle, and the vehicle then makes the investment. This arrangement might fall foul of COLL 15.6.8R(2)(a) (v) and (iv), and also COLL 15.6.8R(2(c)(iv) – the holding company could be affiliate or associate, and obviously has a commercial interest.

The rules on loan origination should not prevent legitimate investment structuring and use. We suggest that the FCA reconsiders the drafting of these rules to ensure that these do not prevent legitimate loan origination investments for the benefit of the LTAF and its investors. The IA is willing to work with the FCA on alternative drafting that would ensure the interests of investors are protected while allowing LTAFs to engage in legitimate loan origination strategies.

Borrowing

Our 2020 Position Paper on the LTAF suggested that borrowing at the LTAF level be limited to 30-50%, without a look through to borrowing at the level of the underlying assets, noting that borrowing at the level of the LTAF would primarily be used for working capital purposes, such as bridging settlement payments. A borrowing facility would also give comfort to the seller when a fund enters into a transaction to purchase an asset – private market transactions can take several months to complete, and the availability of credit can give comfort to sellers.

Feedback from IA members suggest that a borrowing limit of 30% would be sufficient for an LTAF for working capital purposes. They note that this would not be high enough to deploy any meaningful leverage strategies using borrowing. However, IA members generally anticipate that any such borrowing deployed for such purposes would be used at the level of the underlying assets rather than at the level of the LTAF. We note that the consultation states that the proposed borrowing limit will not require the manager to look through to any borrowing in the underlying investments of the LTAF, which we welcome. We suggest that for the avoidance of doubt, guidance be added after COLL 15.6.17R(2) to clarify that this borrowing limit applies at the level of the LTAF only, and not in respect of any underlying assets that the LTAF invests in.

Valuation

Given the range of assets that will be available to the LTAF, we agree that a principles-based regulatory approach is appropriate, rather than prescriptive regulatory requirements which might work for some types of assets and not others. We note that managers of LTAFs will be required to set out in detail their processes and methodologies for performing valuations, and will be expected to follow any industry guidance or best practice for valuing the assets the LTAF invests in.

We welcome the flexibility in the draft regulations for the AFM to either appoint an external valuer to perform the valuation or to elect to perform the valuation itself, where it possesses the knowledge, skills, and experience necessary to be able to carry out a proper and independent valuation of the assets and types of assets that the LTAF will be investing in. We recognise such knowledge, skills and experience will be a pre-requisite for an AFM electing to carry out the valuation itself as opposed to appointing an external valuer.

We do, however, note concerns within the depositary community on the proposed requirement in COLL 15.2.6 R (2) for the depositary to perform an assessment and make a determination that the AFM has the necessary knowledge, skills, and experience to perform an independent valuation of the asset classes concerned. The requirement that this determination be made “without qualification” is of particular concern to depositaries. This appears to go beyond the existing requirements for depositaries to oversee the processes and controls relating to the valuation, and it is not clear whether depositaries, who do not themselves perform valuations, will themselves have the required capabilities to assess and provide a determination of the AFM’s capabilities to this standard. It is therefore possible that many depositaries may refuse to undertake to make such a determination, requiring an AFM to appoint an external valuer even though it possesses the appropriate capabilities to perform the valuation. Those depositaries willing to provide the determination will likely have to hire this experience or deploy specialists from elsewhere within their organisations, which is likely to impact on the depositary fees charged to the LTAF. If only a limited number if depositaries are willing to work within these parameters, this would likely lead to a limited and concentrated market for depositary services for LTAFs, limiting competition for depositary services. The consequent impact on costs for the LTAF would be undesirable, given a key target market identified for the LTAF is DC default schemes, which are subject to a charge cap and therefore very cost sensitive.

We suggest it should be the responsibility of the AFM Board to determine that the AFM possesses the knowledge, skills, and experience to perform the valuations itself. If the FCA believes it necessary to require external assurance of these capabilities, this would be more appropriately performed by an independent expert possessing the necessary skills itself to perform the determination, rather than the depositary.

The valuation process for the LTAF should also consider the valuations undertaken on underlying investments made by the LTAF, particularly where the LTAF is investing in other collective investment schemes. If those collective investment schemes have themselves been subject to external valuations, requiring the LTAF itself to have an external valuation would be an unnecessary duplication of costs.

We also note that since the implementation of the AIFMD, external valuers have largely been unwilling to be appointed to AIFs due to the unlimited liability on valuers for negligence. Revisiting this unlimited liability provision, even to clarify that it only applies in the case of gross negligence, would remove a significant barrier to the use of external valuers.

Finally, we note that a valuation will be required on each dealing point and at least monthly. For many LTAFs, a monthly valuation is likely to be required, given not just their dealing frequencies but also that investors in LTAFs requiring daily price feeds will be using stale prices, and will not want these to be too infrequent. However, for some LTAFs with very limited dealing frequencies and that are particularly difficult to value, monthly valuations may not be required, adding unnecessarily to the costs of the LTAF. We suggest that this minimum requirement is reduced to once a quarter (in line with the AIFMD regulatory reporting frequency for most full scope AIFMs) but supplemented with a requirement for AFMs of LTAFs to have regard for the need of their investors when setting valuation frequencies, particularly when they are required to use regular price feeds.

Redemptions and Subscriptions

We agree with principles-based approach taken by the FCA, and the flexibility for the AFM to determine appropriate subscription and redemption cycles and the terms for these. We recognise that standardisation in the development of particular tools and practices is likely to be needed to ensure consistent operation of liquidity management tools, such as on the operation of notice periods. This will be important for administrators, transfer agents, platforms, and other stakeholders to develop systems and processes that are compatible with the wider ecosystem. We suggest, however, that these are developed collectively as industry standards rather than prescribed in regulation.

We envisage notice periods being a key tool for managing redemptions, and agree that the use of suspension of dealing, although an important tool to protect the interests of remaining investors in unforeseen circumstances, should not be relied on to manage liquidity in normal conditions. It is important for confidence in the LTAF that investors have predictable redemption terms, even if these involve infrequent redemption windows and lengthy notice periods. As a general matter, managers should seek to give investors a clear understanding of the fund's approach to liquidity risk management, including clear expectations about the use of tools such as gating and suspensions in exceptional circumstances. We do not envisage LTAFs offering daily dealing, given the inherent illiquidity of the types of assets that the LTAF will invest in.

Due diligence

We agree with the requirements set out by the FCA in respect of due diligence.

Knowledge, skills, and experience

We agree that only AFMs with the appropriate knowledge, skills and experience should be able to act as an AFM of an LTAF. It is important that an AFM possesses this knowledge, skills and experience itself, and is not reliant on the portfolio management entity for this. We also agree that only AFMs that are full-scope AIFMs should be able to act as AFMs of LTAFs, given the authorised nature of the LTAF, the specialist nature of the types of assets it will be investing in and the ambition for it to have a broader investor base. We also note that this mirrors the requirements in the ELTIF Regulation, which only permits an AIFM authorised under Directive 2011/61/EU to act as the AIFM of an ELTIF.

Reporting

We agree with the intention for transparency, but we do not support a mandatory requirement for a quarterly report. A quarterly reporting requirement does not seem consistent with the long-term investment commitment required for investing in the types of assets to be held in the LTAF. The IA and its members previously called for quarterly reporting by corporates to be abolished, noting this was a driver in short-termist behaviour in capital markets. We appreciate that quarterly reporting has been proposed to enable investors to monitor the activity of the LTAF and that the same frequency of reporting is common market practice for closed-ended / private equity funds. However, our concern is that a quarterly reporting requirement for a long-term vehicle such as the LTAF in respect of transactions undertaken in the previous quarterly reporting period both (i) introduces an unnecessary burden on the LTAF manager that may not be transacting frequently (or at all) during that period, given the long-term nature of the investments, and (ii) encourages short-termism on the part of the LTAF manager and its investors. Although both a closed-ended / private equity fund and the LTAF have long-term strategies, the open-ended nature of the LTAF and its associated redemption opportunities may encourage investors to withdraw from the fund on the basis of the three-month snapshot thereby undermining the long-term objectives of the LTAF. As well as the costs and administrative burden of quarterly reporting, LTAF managers would also need to ensure that the relevance of the quarterly reporting information in the context of the long-term objective is adequately explained to investors in order to counteract the risk of short-termism.

Information on transactions and activities undertaken by the LTAF will be provided to investors on a half-yearly basis in the annual and interim reports, and we propose that it should be at the discretion of the AFM whether to provide more frequent updates to investors such as in a quarterly report. AFMs will be expected to meet the information needs of their investors and can elect to provide more frequent updates if they deem these appropriate and desired by their investors.

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

To ensure that the LTAF would have distribution rules that would make it a viable and innovative product, the IA originally proposed that this should be a sub-set of the NURS regime. This remains the IA's preferred route for the implementation of the LTAF. The FCA opted to use the QIS regime as the starting point for the LTAF, which has some detrimental impacts on the LTAF as a product. We recognise there are institutional reasons for the FCA to start with the QIS rules rather than the NURS, and ultimately it is the end product, rather than the starting point, that is important. But given this starting point, for LTAF to reach its full potential as an innovative product that broadens investor access to private market investments, it is important that the LTAF is fully decoupled from the QIS regime and is a standalone fund regime. The proposal for the LTAF rules to be in a separate new chapter in the COLL Sourcebook (COLL 15) is helpful, but to ensure this separation the long-term asset fund definition should be used in its own right throughout the Handbook, not as a sub-definition of "qualified investor scheme" as is proposed in 15.1.2 G. We discuss later on in our response an approach to distribution which sits outside the NMPI rules, and which would allow the LTAF to be decoupled fully from the QIS.

COLL 15.7.2R (2)(c) will require the depositary to ensure any scheme property is registered in its name or that of its depositary or delegate. While mirroring the requirement in COLL 8.5.4 for QIS, it is more restrictive than the equivalent AIFMD rule in FUND 3.11.23R, which does not require non-custodial assets to be registered in the name of the depositary, but instead requires a depositary to ensure that for any non-custodial assets, the AIF, or the AIFM acting on behalf of the AIF, is the owner of the assets based on documents provided by the AIF or AIFM and where possible on external evidence. We note the challenges and impacts for depositaries that can arise from registering real assets in the name of the depositary that are highlighted by the Depositary and Trustee Association in its response, and we support its proposal that COLL 15.7.2R (2)(c) is aligned with FUND 3.11.23R. In particular, we note that registering certain assets in the name of the depositary rather than the name of the LTAF is likely to impact on the costs charged by the depositary (arising from their additional obligations in respect of the assets), and on the significant costs that would arise to the LTAF if it were to change depositary. Furthermore, in the case of some assets, in particular those structured as limited partnerships, such a transfer of ownership (from the old depositary to the new depositary) may not even be possible. This has implications for competitiveness in the market for depositary services – the costs and challenges of re-registering the assets of the LTAF are likely to be a barrier to changing depositaries and therefore reduce competition for depositaries providing their services to 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?

We agree with the FCA's proposals to allow DC default arrangements to invest in an LTAF subject to meeting the conditions around risk warnings and suitability.

There are two key elements of the FCA's proposals that are especially critical to ensuring the successful integration of the LTAF into the unit-linked DC default environment:

- **The identification of the LTAF as a permitted link in its' own right.** This makes it clear that an LTAF is a permitted investment for DC default arrangements and reduces the risk that the treatment of an LTAF as a QIS for retail distribution purposes contributes to a perception on the part of DC platforms that LTAFs are not suitable to be held by underlying DC investors.

- **The exemption of an LTAF held by a DC default from the 35% limit on an individual unit-linked fund's illiquid holdings**. Under the current rules, the 35% cap does not reflect the way that DC portfolios are constructed. The proposed change will better reflect the reality of DC portfolio construction.

There are three ways that an LTAF could be used in the unit-linked DC default environment: (i) as a building block in its' own right, used alongside other funds; (ii) as a holding by a single asset class fund alongside other funds e.g. a global equity fund that invests in an equity index fund and a private equity LTAF; (iii) as a holding by a multi-asset fund that invests in a number of funds.

Scenario (iii) would be expected to fit within the existing rules as a multi-asset fund would most likely be sufficiently diversified to ensure the limit did not bite. Scenario (ii) would be more constrained, with allocations between funds being made partly to meet the 35% limit rather than purely on investment grounds – the top-level fund would be limited to a 35% LTAF investment, which may not meet its investment objective. Scenario (iii) would not be permissible since it would require the underlying LTAF to hold no more than 35% of its assets in illiquids. This would be contradictory to the proposed guidance in COLL 15.1.3 G(2) that the FCA would generally expect more than 50% of the value of an LTAF's scheme property to consist of illiquid assets.

Our conversations with DC schemes suggest that all three approaches would be considered when structuring default portfolios to allocate to an LTAF. The rules in their current form would thus affect structuring decisions by DC schemes. Therefore, we support the exclusion of the LTAF from the 35% cap as it will give DC schemes maximum flexibility in choosing how to structure their default portfolios. Removal of such an impediment can only help speed up the adoption of LTAFs by DC schemes wishing to make such allocations.

Alongside these revisions, we support the inclusion of guidance clarifying that the insurer must consider the concentration risks at the default level associated with an LTAF allocation, as part of the ongoing suitability and appropriateness assessment of the default investment strategy required under COBS 21.16.3 R(2). This is an important protection for DC default investors with the removal of the cap and will ensure that illiquid exposures are kept at a level that is appropriate to the needs of members, while giving DC asset allocators sufficient flexibility over portfolio construction.

We note however, that while the proposed rules will work well for LTAFs in the DC default context, the 35% limit may continue to create challenges for unit-linked investment in illiquid assets through other structures and in products outside of DC defaults. We return to this issue in our response to Q17.

As a wider comment we continue to highlight the well-known structural features in the DC market[1] that will constrain DC schemes in making illiquid allocations. While a new fund structure will certainly benefit DC investors, on its own it will not be sufficient to overcome the barriers around charge structures, competition purely on price, a conflation of quality with low cost, and operational and governance challenges faced by DC trustees and platforms. We note that the Productive Finance Working Group is considering ways to help the DC market overcome these broader challenges and look forward to the output from that work. Solving these problems will be critical in increasing illiquid investment by the DC sector.

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?

We do not have concerns about the specific asset classes that an LTAF could hold, from the perspective of a DC investor. It is important to remember that LTAFs will be investing in high quality assets and the governance and disclosure requirements for the LTAF will further ensure a high degree of customer protection.

The more relevant issue for DC is about the appropriate use of asset classes in a scheme's asset allocation over time. DC schemes are ultra-long-term investors, with asset allocation changing over time, reflecting the changing balance of different risks and corresponding investment objectives. For example, typical DC asset allocations will start off very growth-oriented, with members having greater need and capacity to take risk when they are far from retirement, with many years of contributions ahead of them. As assets accumulate, the emphasis typically shifts to combining growth with downside protection, while in retirement the need will generally be to provide a stable and sustainable income. DC schemes' asset allocation must be compatible with this member lifecycle, and indeed such lifecycle-oriented investment strategies are the norm in the UK DC market.

LTAFs must fit within this lifecycle-driven investment approach, which will also need to include liquidity considerations, particularly once members can access their pension after the age of 55. This means that LTAF investments must be suitable and appropriate for members *over time.* For example, an LTAF offering Private Equity exposure will have a high risk-reward profile that could be well suited to the early part of the accumulation stage but would be unlikely to be appropriate in the years before retirement, when the investment focus is more weighted towards mitigating downside risk and volatility becomes a greater risk. Similarly, the liquidity profile of the scheme's asset allocation should match the scheme's cash flow needs, which will be heavily dependent on the member age profile and behaviour. This will require schemes to have a good handle on member behaviour based on past trends and future assumptions.

We consider that these issues should already be considered as part of the ongoing suitability and appropriateness assessment in COBS 21.16.3 R(2) and do not believe further rules are needed here.

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[1] These issues are discussed at length in the IA's response to the DWP's 2020 call for evidence on the charge cap. Available at https://www.theia.org/sites/default/files/2020-08/IA%20response%20DC%20charge%20cap%20review%20200820_1.pdf

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?

We do not agree. The LTAF will have more investment restrictions and stricter governance requirements than the QIS, which is designed primarily to be a product for professional clients. These additional requirements will provide for stronger investor protections than those of the QIS and should therefore enable a broader distribution than the QIS. Placing the same distribution requirements on the LTAF implies that it is no more suitable for a broader investment base than the QIS and, more significantly, unregulated funds. Indeed, it is notable that COBS 4.12.13G specifically limits QIS to sophisticated investors only, meaning that the exemption for certified high net worth investors is unlikely to be available. Adopting this same requirement for LTAF would make its distribution more limited than that of other unauthorised investment funds, such as Unauthorised Unit Trusts and Luxembourg RAIFs, which arguably have less investor protection than the QIS, let alone the LTAF.

Table 1 provides a high-level comparison of the distribution rules for the LTAF, QIS, NURS and unauthorised AIFs alongside the investor categories to whom these products can be marketed. It is clear from this that the distribution rules for the LTAF do not fully reflect the additional investor protections built into the structure.

Table 1: Investor protection and distribution rules for different fund structures

Rules	LTAF	QIS	NURS	Unauthorised/ offshore AIF
FCA Authorised	✓	✓	✓	X
Prudent Spread of Risk	✓	X	✓	X
Prescribed investment limits	X	X	✓	X
Annual Board Assessment of valuation, due diligence, conflicts, liquidity management	✓	X	X	X
Borrowing Limit	30%	100%	10%	N/A
Can be invested in by:				
Professional clients	✓	✓	✓	✓
All Retail clients	X	X	✓	X
Retail clients who are sophisticated investors	✓	✓	✓	✓
Retail exemptions under NMPI rules:			N/A	
Certified high net-worth investor	X	X	-	✓
Certified sophisticated investor	✓	✓	-	✓
Self-certified sophisticated investor	✓	✓	-	✓

Taking this approach runs the risk that the LTAF is seen to be a quasi-institutional product, rather than one that could potentially be accessed by retail investors. A critical issue here is for the FCA to be more precise about the risks that it sees retail investors being exposed to and why these entail such a high barrier to participation. In our view, the LTAF sits apart from the high-risk investments that the FCA seems most concerned with. The unifying feature of all LTAFs – illiquidity – should not be confused with greater risk to investors, and therefore result in a more restrictive distribution regime.

In particular, we would note that it is possible – and indeed comparatively straightforward – for retail investors to access through investment trusts similar underlying assets to those that LTAFs are likely to invest in. This is a positive feature of the investment market. The key question then becomes what the feature of the LTAF is, given the high degree of governance and customer protection, that makes regulators so cautious about initial extension beyond the DC market. If it is the use of notice periods, then we would welcome a discussion about the implications of this since we are also in an environment where FCA proposals call for retail property funds to be subject to notice periods of potentially up to six months. We also note that notice periods have been successfully used in retail fund regimes in other countries, such as Germany.

Our view remains that notice periods provide investors with a choice between the prospect of more immediate liquidity (albeit at a price and not necessarily guaranteed where listed vehicles are less frequently traded) through investment trusts and an alternative process in an LTAF where redemption would be NAV-based. We suggest that this choice is a positive one and continue to regard the debate that positions investment trusts against open-ended funds as counter productive. The investment trust is an extremely valuable vehicle, and one which both should continue to play a role in accessing long-term investment and could play a greater role still. It is not clear why this militates against the LTAF being more widely available.

Finally, the FCA might deem it worthwhile to consider similar examples in other jurisdictions. For example, the EU's EuVECA has eligibility for semi-professional investors, defined under the legislation as an individual with a minimum investible amount of €100,000 in the fund. It is worth noting that the EU's MiFID II reforms and the potential revamp of the ELTIF might introduce a similar semi-professional investor category on an EU-wide basis.

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.

Notwithstanding the outcome of the current FCA Discussion Paper on financial promotions of high-risk investments, yes, we do see the existing NMPI rules as being a barrier to LTAF distribution in the retail market. Feedback from distributors such as wealth managers, financial advisers, and platforms, indicates that the exemptions within the NMPI rules will not be sufficient for these firms to distribute LTAFs to the broader retail target market described in paragraph 5.4 of the consultation paper. These relate to existing concerns with the current NMPI exemptions. Designating the LTAF as a QIS would not solve these, but merely restrict LTAF distribution into the retail market. Given the high standards of customer protection being proposed for the LTAF, and the high quality of assets they will hold, relying on the NMPI exemptions for retail distribution purposes is overly restrictive.

There are a number of issues here, concerning the exemptions for certified high net worth investors, certified sophisticated investors, and self-certified sophisticated investors in COBS 4.12.4(5):

- Where the NMPI to be promoted is a QIS, the certified high net worth investor exemption is unlikely to be available as a result of the guidance in COBS 4.12.13. Designating the LTAF as a QIS for distribution purposes means that the effect of the guidance would be to imply that the FCA views LTAFs as being unsuitable for certified high net worth investors, even if the investors are using professional investment advisers to manage or advise on their investments. Further guidance in COBS 4.12.9(2) indicates that a person who qualifies as a certified high net worth investor but who would not qualify as a certified sophisticated investor "may be unable to properly understand and evaluate the risks" of the NMPI in question. Although this is not as clear as the QIS guidance, it is still an indicator from the FCA that firms should be cautious about relying on the certified high net worth investor exemption.

- The requirement, in each of the three exemptions, for the investor to be subjected to a suitability/knowledge assessment is a major disincentive for distributors to promote NMPIs when the starting point is that NMPIs should be heavily restricted for retail clients. Distributors are reluctant to undertake these assessments since they carry a significant risk of distributing products not suitable for the investor at least partly based on a judgement made by the intermediary and not solely reliant on the demonstration of an objective test. For certified high net worth investors in particular, simply having high levels of income or assets does not mean they are capable of understanding the risks of NMPIs. In that regard, the exemptions are not particularly well targeted.

- A related point is that the high-net-worth exemption thresholds have not been uprated and so stand at relatively modest levels of £250,000 in assets and annual income of more than £100,000. As these limits cover an increasing number of individuals over time, distributors are increasingly sensitive to the fact that there is not necessarily a direct link between wealth and investment knowledge and experience.

- The NMPI designation itself is perceived as problematic and means a reluctance by advisers and wealth managers to distribute NMPIs to their clients, given the perceived higher level of risk as compared to more traditional "mainstream" investments.

- As a secondary issue, operating the exemptions requires a complex record keeping exercise that can act as a disincentive to firms.

The net result is that distributors have very little appetite to promote NMPIs to their clients as they potentially increase those firms' exposure to liability, with little by way of upside. An alternative method of distribution that sits outside the NMPI rules may reduce any inherent reluctance on the part of distributors to distribute them. Some possible solutions are discussed in our answers to a number of the questions below.

We also note there is a potential ambiguity in the rules in COBS 4.12 in respect of marketing a CAIF that is an LTAF to small charities that would be regarded as retail investors. In addition to being authorised by the FCA, CAIFs are established as charities by the Charity Commission under Section 96 of the Charities Act 2011. COBS 4.12.4R (5) (3) allows a person who is eligible to participate or invest in an arrangement constituted under section 96 or 100 of the Charities Act 2011 to invest in a non-mainstream pooled investment that is established under such an arrangement. A CAIF can be established as a QIS and, it is proposed, could be established as an LTAF. But COBS 4.12.13G suggests that these should not be promoted to any retail investor that is not a sophisticated investor or a self-certified sophisticated investor. It is not clear the extent to which this will apply to a charity investing in a CAIF that is a QIS or an LTAF. We suggest that this should be clarified, so there is no ambiguity over whether a charity that is a retail investor can invest in a CAIF LTAF.

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, we think that there should be broader distribution of the LTAF to retail investors than is currently proposed through the reliance on the NMPI exemptions. As set out in our answer to the previous question, reliance on the NMPI rules alone will not be sufficient for appropriate retail investor access to LTAFs, which will instead come to be viewed as a quasi-institutional vehicle suitable only for DC defaults and other professional investors. This will limit the vehicle's success.

The term 'retail' itself is very broad and not necessarily helpful when describing the target market for LTAFs. Indeed, we note that while there appears to be broad agreement across the industry and regulatory and policy-making communities that LTAFs are appropriate for DC investors, there is far less comfort on the part of regulators and policymakers in relation to retail access to LTAF.

However, this distinction is arbitrary and ignores the fact that, to the extent that DC transfers investment risk to individuals, the DC market is not as different to the retail market as is often supposed. The key difference is time horizon and governance. Even here though, a parallel could be made between DC and retail investors with long time horizons and access to high quality professional support on asset allocation and fund selection, such as private wealth clients using discretionary fund managers. Indeed, the latter group are likely to be better able to bear investment risk than some DC scheme members, due to higher levels of wealth and thus capacity to take risk and bear losses.

Moreover, DC schemes might take time to increase their capital allocation to the LTAF, while many private wealth management clients have sufficient risk appetite to deploy capital to the LTAF immediately. Consequently, expanding wealth management clients' access to the LTAF, and doing so soon, is optimal to ensure that the LTAF is successful at the outset. As we have seen in relation to other fund types, a hampered beginning can fatally undermine the market's perceptions of an investment vehicle.

A more nuanced approach to retail access is therefore necessary, recognising that LTAFs will be investing in high quality assets and will come with additional customer protections in respect of governance and disclosure. Rather than a starting point which assumes illiquidity is inherently risky and something that retail investors need protection from, a recognition that illiquid assets can bring long-term investors return and diversification benefits is needed. This would mean a wider target market for retail that encompasses investors ranging from those with sizeable portfolios and access to professional support in respect of asset allocation and fund selection, to those investors who can be guided by appropriate choice architecture to invest – potentially within limits – in an LTAF.

Our answers to the next few questions propose a way forward in terms of allowing for this broader retail access.

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

The MiFID rules in COBS 10A on determining whether a product is non-complex or complex are intended to ensure additional protections for investors when purchasing products with non-standard features. Together with the suitability rules in COBS 9A, these strike a balance between enabling retail investors to access products deemed complex, while ensuring they have received a suitability assessment from a qualified and regulated financial adviser, or if they have not received advice, they are subject to an appropriateness test by the product provider or the intermediary, and provided with a warning if the assessment concludes that the specific product is not appropriate for that investor or where the firm determines it lacks sufficient information to determine appropriateness.

Given the robust governance and investor protections built into the LTAF regulatory framework, we believe that it should be possible to market the LTAF to retail investors, although subject to restrictions to ensure only investors who: understand the long-term nature of the commitment, understand the limited redemption terms means that their capital will be locked up for long periods, understand the risks inherent in investing in the underlying asset classes, and are ultimately able to risk the capital that is committed to the LTAF. Under the existing framework the rules in COBS 10A would be the minimum requirements that would apply were LTAFs to be removed from the NMPI rules. Our understanding is that the LTAF would be deemed to be a complex instrument under these rules, given the infrequent opportunities to redeem, and therefore subject to an appropriateness assessment.

An appropriateness assessment would potentially help restrict the LTAF only to those investors that understand the risks and illiquid nature of the product. For advised clients, the requirements of COBS 9A would provide the same via the suitability assessment, whilst further confirming that retail investors have the capacity to risk their capital and tie this up over the long-term.

While it is certainly possible that the rules in COBS 9A and 10A could form the basis of the distribution of the LTAF to retail investors over the long term, we believe that they can be supplemented using an approach based on the existing product governance regime, combined with a series of objective thresholds, to provider further safeguards around broader retail access. We explore this in our answer to Q14.

We also propose that investing via discretionary portfolio management should not be subject to additional restrictions on the investor's ability to invest in the LTAF. In this instance, the investor has outsourced their investment decisions to a professional investor that meets the criteria for the LTAF, in much the same way that a DC scheme member outsources their investment decisions to the scheme and its trustees, who are professional investors. The investor via a discretionary portfolio manager, like the DC scheme member, is able to access the service subject to stringent investor protections and with the agreement of parameters for the purposes of investment.

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?

We do not believe that the non-readily realisable securities (NRRS) rules, which were not designed for and do not apply to funds, should be carried over in their application to the LTAF. However, the NRRS do provide a useful provision that could be applied to the LTAF in conjunction with other objective tests.

Specifically, the NRRS rules provide a useful threshold for the maximum capital that should be committed to such an investment by an investor who is not a sophisticated investor. Basing assessments on objective thresholds, such as limiting the overall investment to a percentage of the portfolio, is preferable to a subjective assessment such as for sophisticated retail investors, which requires the distributor to make a subjective judgement on whether an investor has the necessary knowledge to make such an investment.

The NRRS would provide a means of limiting the investment that an investor who is not a sophisticated retail investor could make in an LTAF, ensuring they do not commit too high a proportion of their available investments or savings to an LTAF. However, the NRRS relies on a self-declaration by the investor, which may not in all cases be accurate, and distributors may prefer to look at the portfolio the investor has under their management or advice to assess it is within the threshold. Moreover, some further thresholds may be necessary, as suggested in our response to Q14, to ensure investors have sufficient investments and savings to be able to make an allocation to an LTAF, as well as having been notified of the limited redemption terms and risks associated with such an investment.

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?

Pooling the investments of professional and retail clients is key to helping all investors in a fund to benefit from the economies of scale that pooled investments bring. For retail investors in particular, investment alongside professional clients may allow them to achieve the benefits of scale that they might otherwise struggle to achieve in the absence of professional clients.

While the FCA makes some interesting points about the scrutiny of professional clients acting as a form of Quality Assurance for retail investors, we do not believe a minimum level of professional investment in an LTAF is necessary or desirable in order to fulfil this Quality Assurance function. As the FCA notes, there may be instances where professional clients do not wish to co-mingle their investments with retail clients, and it is unfair to deny retail investors access because professional clients do not wish to invest alongside them. While some vehicles will be co-mingled, it is also likely that many LTAFs will be tailored to the specific needs of their investors, whether retail, institutional or specific DC schemes.

Rather, it is the robust customer protection regime built into the LTAF, centred on effective and high-quality governance and disclosure, that will signal to the market the LTAF's suitability for investment by retail investors.

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

The LTAF will have more flexible investment powers to invest in second schemes, and many LTAFs are likely to use collective investment schemes to access the target asset classes. In order for a NURS FAIF to be able to operate a portfolio of LTAFs, or a portfolio including LTAFs, COLL 5.7.7 R (2) would need to be amended to either remove the requirement for a second scheme to have a prohibition on investing no more than 15% of its value in other collective investment schemes (e.g. by using similar wording to align COLL 5.7.7 R (2) with the proposed rules in COLL 15.6.9 R (1)(b)(iii)), or to introduce a carve out for the LTAF from this requirement.

We also suggest that COLL 5.7.9 R (1)(b)(i) is amended to so that the second schemes are subject to the safekeeping requirements specified in FUND 3.11.21R, 3.11.22UK and 3.11.23R, noting our proposal in our response to Q4 that the registration of assets rules for depositaries be aligned with these requirements.

We also propose that similar amendments are made to COLL 5.6.10R to enable a NURS to invest in an LTAF within the 20% limit for unapproved collective investment schemes (as permitted in COLL 5.6.10R (1)(e). This would enable a NURS with a multi-asset strategy to make a small allocation to an LTAF, provided this does not compromise the overall liquidity management of the NURS.

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

In our July 2020 Position Paper on the Long-Term Asset fund, we proposed a robust approach to customer protection whereby features of the ELTIF distribution rules could be adapted for the LTAF. We suggested that certified high net worth individuals, certified sophisticated investors and self-certified sophisticated investors should be able to access the LTAF. We also suggested extending the eligibility criteria for marketing to retail investors:

- Investment advice required.
- Investment in the LTAF must not constitute more than a set percentage (e.g., 10%) of the investor's overall investment portfolio at point of subscription.
- A two-part test: The investor must be well-informed (or other appropriate label), which can be satisfied by a minimum investment size, or otherwise certification required from the investor's distributor/private bank that the investor is well-informed (e.g., understands the risks of the investment) (no minimum investment size if certified as such).

Since the development of that paper, we have given further consideration to this matter and think there is an opportunity to harness the existing product governance regime under

FCA PROD in order to safely distribute the LTAF to certain retail investors. PROD already provides a series of product governance obligations on both manufacturers and distributors of funds, including the obligation to provide each other with appropriate information on the target market of a product to enable each party to identify the target market of a product and act in the best interest of the investor. There are further safeguards in place with the ongoing obligation on both manufacturers and distributors to regularly review the products to assess whether the product remains compatible with the intended target market and whether the chosen distribution strategy remains appropriate.

With the advent of these product governance requirements, industry has developed technical solutions for setting and communicating Target Markets. For example, the LTAF could be designated as "informed investor" or "advanced investor" in the European MiFID Template (EMT) provided by product manufacturers to distributors. "Informed investor" essentially tells distributors that whilst the fund can be "in the shop", it should not be "in the shop window", such that platforms and other distributors should not be actively promoting to unadvised investors. "Advanced investor" goes further in restricting unadvised retail investors purchases.

And while these are not regulatory terms, other fields in the EMT can be set by the manufacturer to limit distribution in accordance with the regulatory classification of the investor (retail or professional) and by service (unadvised, advised and discretionary), with these restrictions being combinable (for example, the fund can be set to be distributable to discretionary retail clients, but not to unadvised retail clients, or only to the latter where an appropriateness assessment is conducted).

Making use of EMT categorisation would enable manufacturers to filter the LTAF to retail investors meeting these criteria (and potentially additional criteria designated by the distributor), whether discretionary, advised or even self-select.

We suggest the FCA consider the PROD framework as an alternative and preferred approach to the NMPI rules for LTAF distribution to the retail market. In so doing, manufacturers would naturally have regard to any guidance provided by the FCA as to its expectation on Target Markets. As an example, with its Specialist Fund Segment the London Stock Exchange states that funds listed on this segment are "targeting institutional, professional, professionally advised and knowledgeable investors". This results in the EMT fields being completed with these settings, with the benefit that distributors can automate the restrictions they apply to retail distribution through their firms and platforms.

Using the product governance framework, alongside one or more objective criteria, such as the requirement for advice, the cap on the proportion of a portfolio that may be invested in an LTAF, or a minimum investible amount has several benefits. First, it is simple, clear, and straightforward for advisers and supervisors to assess. Second, it provides a high-level of investor protection and greater parity in the treatment of investors than does a method that relies to a greater or lesser extent on an element of subjective judgement. Thirdly, it moves away from a broad restriction on distribution that is based on a treatment of the LTAF as vehicle which, by its designation as a QIS, is automatically deemed unsuitable for most retail investors, despite the high standards of customer protection already embedded in the vehicle.

In addition, it should not be necessary for a Private Client manager providing a discretionary fund management service to certify an investor as being a sophisticated retail investor or a self-certified sophisticated investor in order to then invest in an LTAF on behalf of their client. The client is outsourcing the management of their investments to the DFM, and as such is not taking the investment decisions themselves but is relying on the knowledge and experience of the DFM, a regulated investment professional, to make these decisions for them. DFMs meet regularly with their clients to understand their circumstances and requirements and to invest accordingly. Such clients have the full protection of the suitability rules under COBS 9A.

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?

Although the LTAF was specifically designed with DC and parts of the retail market in mind, there could be other types of investors who would benefit from the ability to access genuinely illiquid assets in a non-daily dealt open-ended fund. Indeed, any investor with a long time horizon and the appetite to tie up part of their capital[2] for a longer time period could benefit from the LTAF structure. In this regard we are thinking of institutional investors such as DB pension schemes, insurance companies, sovereign wealth funds and large charities. We are not aware of any barriers that would prevent these investors from having an LTAF marketed to them.

As an additional point, and apart from the broader discussion about retail access, we note that investors wishing to access the LTAF through a SIPP wrapper will face particular challenges. SIPP prudential rules now require a significant capital add-on for 'non-standard assets' (NSAs), broadly defined as assets that cannot be liquidated within 30 days. The effect of this is that SIPP providers mostly refuse to allow NSAs into their SIPPs, with the few that do charging extra for it. As a result, DFMs investing retail client portfolios in SIPPs will avoid NSAs, even where they may be suitable for client portfolios. The long-term investment horizon of SIPP investors means they would be particularly suited to investing in LTAFs and we recommend that the FCA considers a specific exemption from the NSA definition for the LTAF.

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?

We agree that DC default strategies are a core target market for the LTAF but think that restricting LTAF distribution to this single market is unnecessarily narrow. Default strategies are a special case of a provider-designed and governed multi-asset portfolio. They are special in the sense of having a unique legal identity in pensions law and COBS in the context of the UK's auto enrolment pension reforms. From a commercial perspective, they benefit from the scale in assets that comes from member inertia under auto enrolment, with membership of the default remaining very high.

However, from an investment perspective, in terms of objectives and customer outcomes, they are like any other provider-governed multi-asset investment portfolio. Such strategies

[2] It is important to note here that investors seeking income could feasibly hold LTAFs that invest in cash-generating assets. While the assets themselves may be illiquid, they may be generating significant sums of cash over the shorter term. Private Credit is an example of such an asset class.

may exist within workplace pension products (e.g., members opting out of the default and into another multi-asset strategy offered by the provider) or in other long-term savings products such as non-workplace pensions, where the concept of a default is not present, but the provider may nonetheless choose to offer a managed strategy as a pre-packaged solution. The key point here is that, like the workplace default, the provider designs the strategy and is responsible for ensuring its ongoing suitability for the customer, who themselves make no investment decisions. In such cases we think LTAFs could form a part of these strategies to the benefit of the customer and the proposed limit on distribution to DC defaults only seems unduly restrictive.

This being the case, we recommend that in the unit-linked market, the rules allow insurers to include the LTAF alongside other permitted links and conditional permitted links in constructing managed multi-asset portfolios where the investor is not required to make any investment decisions. As with the default in the proposed rules, such portfolios should not be constrained by the 35% illiquid asset cap but should be subject to the same rules on the insurer to consider ongoing suitability and concentration risk. The rules should cater for the use of LTAFs in such managed portfolios both within pension products (workplace and non-workplace) and other long-term contracts of insurance.

For the avoidance of doubt, we are not proposing LTAFs being made available for standalone investment in a unit-linked wrapper without access to any supporting guidance and choice architecture e.g., as a self-select fund option in a pension product (workplace or non-workplace). However, consistent with our wider position on LTAF distribution in the retail market, where investors in a long-term unit-linked product have either professional support on fund selection or are guided through an appropriate choice architecture, they should be able to invest in an LTAF. Given the degree of substitutability between authorised funds and unit-linked funds, the distribution rules that allow for LTAFs to be sold to retail investors should also allow for the distribution of unit-linked LTAFs to such investors.

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

As set out in our response to Q5, we believe the proposed changes to the permitted links rules will accommodate the LTAF within the unit-linked environment. In practice this means that wrapping an LTAF individually or in conjunction with other funds, may be the simplest way for unit-linked product providers to provide DC default investors with access to illiquid assets. Were the FCA to broaden the distribution rules for retail investors (including non-default DC) in the way suggested in our answer to Q16, LTAFs may also become the dominant way for these investors to gain illiquid exposure via unit-linked contracts.

Outside the LTAF, we continue to see the 35% cap as the main constraint on unit-linked manufacturers' ability to offer illiquid assets. It also means the LTAF has an advantage over other fund structures, in particular the QIS and directly invested unit-linked funds, because the cap would apply to these structures but not to a conditional permitted LTAF. A more coherent approach that treats all structures equally would be to scrap the cap entirely.[3] This can be justified by the proposed addition to the rules of COBS 21.3.18G(2), which clearly states that insurers must assess the *"total exposure of the default arrangement to conditional permitted LTAFs and other investments of similar risk profile to that of conditional permitted LTAFs"* as part of the ongoing suitability checks required for insurers

[3] We have previously argued for such an approach. See the IA's response to the FCA's CP18/40.

offering conditional permitted links. Applying this requirement outside the DC default will level the playing field for all investment structures seeking to offer illiquid exposure in a unit-linked environment.

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

We do not have any comments on the FCA's cost benefit analysis.