ShareSoc
UK Individual Shareholders Society

Suite 34, 5 Liberty Square, Kings Hill,
West Malling, ME19 4AU
Phone: 0333-200-1595 Email: info@sharesoc.org
Web: www.sharesoc.org

Financial Conduct Authority

Via Email: dp17-01@fca.org.uk

02 May 2017

Response to Consultation on Illiquid Assets and Open-Ended Investment Funds

Dear Sirs,

This response to the above named consultation is submitted by ShareSoc, the UK Individual Shareholders Society. We are a not-for-profit organisation representing the interests of our members who are individual investors from across the United Kingdom.

Our answers to the questions in the Consultation Paper are as follows:

Q1: Do you have any comments on our description of the types of inherently illiquid assets that might be held in open-ended funds? Are there others you would consider inherently illiquid?

Answer: Your list of potentially illiquid assets appears to be a comprehensive one. We are not aware of any others.

Q2: Do you have any observations on our analysis of liquidity management tools? Are there other factors affecting the liquidity management of open-ended funds investing in illiquid assets that we should take into account?#

Answer: No comments.

Q3: What are your views on these, or other, possible approaches to the treatment of professional investors? Would these approaches be fair to retail investors in the same fund?

Answer: We are strongly opposed to differential treatment between professional and retail investors. As we made clear in our submission to the previous FCA consultation on its "Mission Statement", there seems to be a failure to recognise that individual investors participate directly in capital markets and we are opposed to any artificial distinction between one class of investor and another. In practice it can be very difficult to differentiate between them and there is no good reason to do so. To permit different classes of units for professional and retail investors as a matter of principle undermines what should be a level playing field in financial markets, even though we recognise that there may already be differentiation in terms of minimum investment size.

Q4: What are your views on these, or other, possible approaches to the portfolio structure of funds?

Answer: Requiring minimum holdings of liquid assets would have an impact on the performance of these funds as cash and other liquid assets usually return less than the illiquid assets over longer periods of time. Together with the other suggestions made about how to improve diversity in such funds and improve liquidity, these might result in very complex sets of rules that may not be widely known to investors. Complex rules tend to be easy to evade and add to costs. In general we think it is better to discourage the take up of investments in such funds other than by those who are aware of the risks of being unable to exit quickly.

Q5: What are your views on these, or other, possible approaches to the valuation of illiquid assets?

Answer: We agree it may be helpful to have some rules giving guidance to investment managers on asset valuation and anti-dilution measures although our preference would be for a single, simple set of rules that apply to all such funds with clarity about when they could be applied. It would then be clear to investors what might happen in certain circumstances in all such funds.

Q6: What are your views on these, or other, possible approaches to the fund manager's use of specific liquidity management tools?

Answer: We would be opposed to restrictions on redemption frequency or the use of notice periods as this would prejudice many investors. When investors wish to sell, they often need to do so urgently to meet other commitments.

Q7: Do you think our analysis of the possible benefits and risks of direct intervention by the regulator is correct? Do you think the FCA should be more proactive about directing the actions of fund managers in a stressed situation, and if so how?

Answer: Direct intervention in the market as regards the suspension or resumption of funds would imply that the regulator knows as much or more about the state of the market than the fund manager. This seems to be an unlikely hypothesis and hence we believe that decisions on such matters should be left to the manager.

Q8: What are your views on these, or other, possible approaches to requiring enhanced disclosure for funds investing in illiquid assets?

Answer: It is certainly clear that retail investors often do not understand the risks involved in investing in open ended investment funds such as property funds. And they are not adequately informed on these risks by IFAs, platform operators or other promoters of such funds to retail investors. We question whether such funds should be permitted to be sold at all when there are alternative closed-end funds with similar assets. However there may be some investors who prefer open-ended funds for various reasons so we suggest the problem be tackled by much stronger disclosure of the risks associated with such funds. Such "health warnings" should be so strongly worded as to deter all but the most knowledgeable investors or those who have clearly understood the risks and hence are willing to proceed with such investments regardless.

Q9: What is your view of the benefits and risks of a secondary market in the units of open-ended funds investing in illiquid assets? Should the FCA do more to encourage the development of such a market?

Answer: This is an interesting concept but it seems to ignore the complexity and delays associated with "in-specie" transfer of holdings in funds. And unless there is an active and liquid market in such units, the investor would still be faced with uncertainty on pricing and potential delays. It is difficult to see that this would be a viable proposition for most funds without a lot of investment in supporting systems.

Q10: Are there any other issues related to the subject matter of this paper that we should consider?

Answer: We have no other comments.

In conclusion, we would not be opposed to the banning of holding certain illiquid assets in open-ended funds (for example commercial property) although there are of course degrees of illiquidity in any market. However there is certainly a specific problem in certain funds that was demonstrated recently by the need to close redemptions of certain property funds.

We suggest the best way to tackle this issue is by strong health warnings to the purchasers of such funds as noted in our answer to Question 8 above.

Yours sincerely,

Roger Lawson
Deputy Chairman

Note to readers: the consultation document referred to is present here:
https://www.fca.org.uk/publication/discussion/dp17-01.pdf