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17 December 2018

Via email to cp18-27@fca.org.uk;

To Mike Bolton,
Financial Conduct Authority,
12 Endeavour Square,
London E20 1JN

Re: Illiquid Assets Consultation cp18-27

This is a joint response from UKSA and ShareSoc on behalf of individual investors.

UKSA and ShareSoc represent the 5 million people who own shares and have investment accounts with platforms in the UK. We represent the individual investors who own 12% of the UK stock market: they own 30%, if you include their investments via funds, pensions, etc.

Our view is that better labelling of these products is needed.

We believe that open ended funds investing in illiquid assets are a really bad idea and it makes for sense for such illiquid investments to be constrained to be only in closed ended funds.

Such an OEIC may offer the illusion of offering liquidity to its investors whilst, in truth, it may well need to close to redemptions at times of market dislocations, as realising (i.e. liquidating) assets at such times would be hugely value destructive to all its investors.

Not only do such OEIC mislead investors, but they can also exacerbate market disruption, if forced to dump assets into a market that is already oversupplied with such assets – and hence they can pose a systemic risk.

Our view is summed up by this comment from one of our members "*I personally have a number of investments in illiquid assets, including real-estate, private equity and debt instruments. I will only invest in such assets via closed ended investment companies that I know will not be forced to sell at the worst possible times (for that reason I am also wary of such companies using much leverage).*"

We also note we are starting to see complex and structured offerings in the ETF area, and the regulator should be thinking about some form of product labelling mechanism. (e.g. see Tabula's offering https://www.tabulaim.com/wp-content/uploads/2018/11/TCEP-factsheet-NOV18.pdf

. This product has a significant exposure to sub investment grade credit, and when combined with the 3 times leverage it will employ, means that it could suffer significant price volatility, including a large gap down in value in a distressed market. We note that in a strict sense, only 20% of the exposure (and therefore somewhat more of the risk) is in sub investment grade bonds. Put in plain English, what this means is that this most likely will someday - maybe not for a while, but someday - end in tears)

The proposals seem sensible and we could support them, except they have an ongoing cost of £5.3million pa. and a £1.53m one off cost.

However, the consultation document has not scaled the problem. How big are the AUM in this area of activity? How many basis points does this extra charge represent?

We note the FCA in their consultation say.

> *Which funds are we targeting?*
> *The package of remedies will have cost implications which could ultimately be borne by investors. We have considered carefully which funds should be in scope and which level of protection is appropriate for different types of investors. We want to avoid imposing requirements which are not justified in terms of the improved outcomes they achieve for consumers, against the costs they impose.*

If the FCA have indeed considered carefully which funds should be in scope, they should be able to tell us pretty quickly how much AUM is involved. We have asked for this information, but the FCA have not supplied it.

Much of the proposals/consultation is all a bit 'nanny state'. Any retail investor who invests in this type of investment surely should know about the potential problems of liquidity. Ten minutes on Google would inform him/her. **We are not convinced this extra regulation is necessary.** Better labelling may be a simpler and cheaper solution. Better labelling may well encourage the market to solve the problem without loads of extra regulation and so remove the need for our recommendation on banning illiquid investments from open ended funds.

The problem with regulators is that they tend to recommend more regulation. This may be a case in point.

Answers to the 25 specific questions.

We have no comments on the specific 25 questions - other than Q23, together with our general comments above.

Q1. Is 50% the right threshold to set for a NURS to be classified as a FIIA? If not, please explain where you would set the threshold, and why.

Q2: Do you agree that NURSs which have invested at least 50% of their scheme property in illiquid assets for at least 3 consecutive months in the last 12 months should be classified as FIIAs, even if this is not their stated investment aim?

Q3: Do you agree that a NURS that applies limited redemption arrangements that reflect the typical time taken to liquidate assets should be excluded from the definition of a FIIA?

Q4: Do you agree that feeder funds, multi-asset funds and funds-of-funds with at least 50% of their scheme property invested in FIIAs, other similar funds and/or other inherently illiquid assets, should also be classified as FIIAs?

Q5: Do the proposed new rule and guidance adequately define existing and potential future assets that are inherently illiquid?

Q6: Do you agree that the potential harm we are trying to address lies mainly in NURSs and the remedies should be limited in scope to NURSs? Is there a case for extending some of our proposed remedies to QISs? If so, which measures do you think should also apply to QISs investing in inherently illiquid assets?

Q7: Do you agree that mandating suspension in these circumstances would be in the best interest of investors?

Q8: Do you agree that 20% of the scheme property is the right level at which to set the threshold for mandatory suspension? If not, please explain why a higher or lower threshold would be preferable.

Q9: Do you agree with the proposed guidance on the use of suspensions for funds investing in inherently illiquid assets? If not, how, if at all, do you think the existing guidance at COLL 7.2.2G should be amended in respect of FIIAs?

Q10: Do you agree that the threshold for suspension for a fund investing indirectly in immovables should not be calculated on a look through basis? If not, please explain how a calculation on a look through basis would work in practice.

Q11: Do you agree that fund managers should not need to gain the depositary's consent, but should simply notify the depositary before suspending?

Q12: Do you agree that fund managers should be required to resume dealing in units in a fund, with the approval of the depositary, as soon as reasonably practicable after the material uncertainty assessment applies to less than 20% of the scheme property?

Q13: Do you agree with our proposal to require contingency plans?

Q14: Are there other elements of FIIA managers' approach to managing liquidity risk that need to be included in the contingency plan?

Q15: Do you agree that the written agreement that we propose to require FIIA managers to obtain is the best way to ensure that fund managers can be confident that third parties will be able to play their part in implementing the contingency plan? If not, how do you think that we can gain this confidence?

Q16: Do you think that the proposed new guidance, clarifying the mechanism for reducing the price of an immovable to allow it to be sold more quickly to meet redemption demand, is helpful?

Q17: Do you agree that fund managers wanting to use this tool should be required to disclose their intention in the fund prospectus?

Q18: Do you agree the proposed guidance would discourage the speculative accumulation of large liquidity buffers and help to reduce first mover advantage in funds

investing in inherently illiquid assets? If not, is there a more appropriate way to achieve this?

Q19: Do you agree with the proposed guidance on the use
of suspensions for funds investing in inherently illiquid assets? If not, how, if at all, do you think the existing guidance at COLL 7.2.2G should be amended in respect of FIIAs?

Q20: Do you agree that it is appropriate to extend depositaries' duties to include oversight of FIIAs' liquidity management processes?

Q21: Do the proposed requirements cover all the aspects of liquidity management prescribed by the current framework of rules, that depositaries should oversee?

Q22: Do you agree that using an identifier would effectively highlight that FIIAs are fundamentally different in regard to liquidity than other authorised funds?

Q23: Do you agree that that the risk warning would contribute to better understanding of the risks by investors in FIIAs?

> Yes. Your suggestion *"This means that at certain times you may experience a significant delay and/or need to accept a discount when selling your investments."* is clear and adequate.

Q24: Do you think that our proposals relating to the prospectus are sufficient to provide investors and professionals who act on their behalf with sufficient information about liquidity risk management in FIIAs? If not, what additional information should be disclosed? And where and how would disclosure be most efficient?

Q25: Do you agree that our new requirements should come into force a year after we make our final rules? Are there any parts of the instrument that should take effect earlier?

Yours faithfully

Cliff Weight, Director, ShareSoc

Peter Parry, Policy Director, UKSA