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10 October 2022

Dear Adnan,

RE: FCA CP22/14 Broadening retail access to the Long-Term Asset Fund

The IA welcomes the consultation on broadening retail access to the Long-Term Asset Fund (LTAF). When the IA UK Funds Regime Working Group originally proposed the LTAF[1] in 2019, retail investors and Defined Contribution (DC) default arrangements were seen as the investor groups for whom the LTAF would bring the most benefit. For these investors, there are no other UK authorised fund structures that can bring the return and diversification benefits of a truly illiquid portfolio: while structures such as the NURS FAIF and the PAIF do allow for some illiquid exposures to retail and DC investors, they do not permit the breadth or level of illiquid exposure that the LTAF allows, due to their need to offer frequent redemptions.

It is therefore good news for retail investors that the FCA has put forward a set of proposals that we consider allows for broad distribution of LTAFs across the retail market but with appropriate protections. We support the proposals, both in terms of the overarching objective to permit greater retail exposure to private assets, and in relation to much of the detail, although we have some recommendations to strengthen the proposals further. These are set out in detail in our answers to the consultation questions, but the key points are as follows:

1.The importance of allowing LTAFs to be accessed via ISAs and SIPPs: For different reasons, some within the FCAs control, and some not, we consider that LTAFs will not currently be accessible through ISAs (at all) or SIPPs (infrequently). Given the importance of

[1] IA UK Funds Regime Working Group: Final report to HM Treasury Asset Management Taskforce, June 2019

these tax wrappers to retail investors, the issues impeding access to LTAFs through SIPPs and ISAs need to be addressed if true ‘democratisation’ of private assets is to be achieved.

2. The LTAF risk warnings and summaries need further calibration: While we are supportive of the need for risk warnings and risk summaries in order to alert investors to the risks involved in investing in LTAFs, we consider that the current proposals risk misinforming investors by labelling all LTAFs as high-risk investments. In particular the proposals conflate liquidity risk and portfolio risk, and we note that a lower level of liquidity at a fund level does not necessarily translate into a higher level of investment risk. For example, an LTAF could hold assets that are less risky than a daily-dealing listed equities technology fund.

We consider that risk warnings would be more useful to investors if they were instead to refer to the risk profile of the specific LTAF being marketed; and focus more on explaining the liquidity profile of the LTAF, which to our mind, is the distinguishing feature of the LTAF compared to other regulated funds.

3. The LTAF appropriateness test needs to better reflect the specific characteristics of the LTAF being marketed: Similar to the risk warnings, while we support the use of an appropriateness test, and broadly agree with the draft guidance on the matters to be covered in the test, some changes are needed to ensure the test is sufficiently specific to the LTAF being marketed. The current draft guidance assumes that all LTAFs will be high risk and unlikely to pay out income. As we explain in our response, this will not be the case for all LTAFs.

4. A a cap on NURS FAIFs investing in LTAFs is not needed, and NURS should also be able to invest up to 20% in LTAFs: We are of the view that the proposed extension of rules applying to retail funds such as UCITS and NURS in several key areas to LTAFs will offer enhanced investor protection without affecting the attractiveness of the LTAF regime, and therefore support those changes. We support the proposals to allow NURS FAIFs to invest up to 35% of their NAV in a single LTAF and the disapplication of the 15% restriction of second schemes and due diligence requirements, but we do not agree with the proposal for a 50% limit on aggregate investment into LTAFs. We also propose that NURS be allowed, within the 20% limit for unapproved collective investment schemes, to invest in LTAFs on the same basis as NURS FAIFs (ie. without the look-through or dealing frequency rules applying).

5. Distribution of the LTAF in the unit-linked market could be further improved: we support the proposals to expand LTAF distribution in the DC pensions market through permitting investments by self-select investors in qualifying workplace pension schemes, and through non-workplace pension products on an advised basis. However, these proposals could be improved by: (i) decoupling the LTAF investment limit for self-select investors in qualifying schemes from the default, instead setting it at the 10% RMMI level; and (ii) permitting non-advised investors to invest in unit-linked LTAFs outside of workplace pension schemes through the RMMI framework.

Despite the welcome progress now being made on the regulatory regime, we would underline a residual concern. Some managers have stated their reluctance to launch LTAFs, which require notice periods, due to the lack of ability or willingness of key parts of the intermediation structure, particularly platforms, to host or distribute non-daily products, particularly those with notice periods. While some platforms have developed, or are developing the capability to offer non-daily dealing products including those that use notice periods, the regulator, HM Treasury and the industry need to work together to achieve the adaptation of the broader infrastructure to accommodate a greater range of products with differing redemption terms.

We look forward to discussing these points further with you.

Yours sincerely,

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THE INVESTMENT ASSOCIATION

Response to consultation

FCA CP22/14: Broadening retail access to the long-term asset fund

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 members range from small, independent UK investment firms to Europe-wide and global players. Collectively, they manage over £9.4 trillion of assets on behalf of their clients in the UK and around the world. That is 13% of the £75 trillion global assets under management. We act as their voice and represent their interests to policymakers and regulators and help explain to the wider world what the industry does.

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

As we set out in our cover letter, we are very supportive of the FCA's proposal, subject to some points of detail that are discussed further below, and we agree with the FCA's assessment of the likely effects of the reforms set out in the consultation paper. There are however, two areas where the current proposals may result in unintended consequences.

The first relates to the effect of the LTAF not being a qualifying investment for an ISA. The FCA acknowledges that some market participants consider ISA eligibility could facilitate widening access to the LTAF, but that this is a matter for HMT and HMRC. While we do recognise this point, it is worth emphasising that ISA eligibility is critical for true 'democratisation' of access to private assets. For those retail investors whose capacity to invest is fully covered by their ISA and pension allowances, the incentive to invest in products outside of these wrappers is significantly reduced by the loss of tax benefits. This is likely to result in lower LTAF allocations than would be the case were they available through ISAs. We recommend that HMT and HMRC address this point in order to allow for LTAFs to be sold broadly across the retail market. We consider that the FCA's proposals permit this to happen in a safe and controlled manner, and there is no reason to delay ISA eligibility for the LTAF.

The second area relates to the position in respect of advised customers seeking to invest in LTAFs. We fully support the ability of advised customers to invest in LTAFs without limit, where they have received a personal recommendation relating to the investment. However, we think the proposals could be strengthened by giving advisers some specific guidance both around assessing suitability of LTAFs for clients, as well as the factors that may guide decisions around the level of allocations. Given that LTAFs will be new products, whose features are not necessarily familiar to all advisers, our concern is that advisers may be reluctant to make LTAF allocations without further guidance from the FCA. The effect would be that retail LTAF investment may be lower than expected. We recommend that the FCA work with the adviser community in order to develop the appropriate guidance on suitability.

Q2: 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.

Q3: Do you agree that the LTAF should be recategorised as a RMMI (as per PS 22/10), from its previous category as NMPI, thus broadening retail access to include restricted investors?

We agree that the LTAF should be recategorised as a Restricted Mass Market Investment (RMMI) as this should permit controlled distribution of the LTAF to a broad range of retail investors. We have previously argued against the LTAF's initial classification as a NMPI[2] on the grounds that distributors would not make LTAFs available to eligible retail investors under the exemptions available in those rules – largely due to the perceived regulatory risk of the NMPI framework.

We agree with the FCA that the RMMI category is a more appropriate categorisation for the LTAF, given its authorised status and the high levels of customer protection and governance built into the regime. This sets it clearly apart from many categories of high-risk investment. The proposed categorisation better recognises the LTAF for what it is: an expansion of the regulated funds universe.

Our understanding is that this change would not prevent an AFM from restricting the availability of a particular LTAF to certain investor groups if they believe it appropriate, such as only to professional investors or only to those investors (eg. certified sophisticated investors) who are able to access NMPI products, if the AFM believes this appropriate for that LTAF. It would be helpful for this to be clarified in the policy statement.

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

We have a number of comments on the risk warnings and summaries. Our answer focuses on the wording in the draft COBS 4.12A.11 R(1)(c) but also applies to the shorter form risk warnings and the risk summary, which contain similar language and concepts.

"This is a high risk investment..."

The 'high-risk investment' language has been primarily designed to describe RMMIs such as cryptoasset investments, which are unregulated and inherently volatile. As such, we are concerned the description of LTAFs as a "high-risk" investment is too blunt and not always appropriate. It would be preferable to specify the particular risks that the investor will be exposed to, rather than a broad statement that may not be accurate in all cases.

As the consultation paper (paragraph 2.5) notes *"there is a vast range of illiquid assets, with varying risk profiles".* Some LTAFs, investing in asset classes such as Venture Capital or

[2] See the IA response to CP21/12 'A new authorised fund regime for investing in long term assets'

some forms of Private Equity, may indeed be described as high risk due to the high likelihood of some investments not being successful. Equally, LTAFs investing in say, real estate, private credit or infrastructure debt, may be less risky investments.

A similar comment can be made when comparing assets of a different maturity. For example, investing in an LTAF that is intended to fund the building of new infrastructure or real estate will have a different risk profile to LTAFs invested in existing pieces of infrastructure or real estate that are already generating steady income streams.

Unfortunately, the risk warnings and associated risk summaries do not recognise the likely diversity in risk profile of LTAFs. Rather than describe all LTAFs as high risk, the risk warning and summary should instead be better aligned to the risk profile of the specific LTAF being marketed.

"…and you do not have protection against poor performance."

With the language around high-risk investments and the lack of protection against poor performance, the risk warnings appear to conflate the liquidity risk and investment risk of an LTAF portfolio[3]. A lack of protection against poor performance is true of any investment product and not specific to the LTAF. Furthermore, conflating these concepts suggests that the ability to redeem in a more liquid product somehow acts as 'protection' against poor performance, which is clearly not the case. As such, we do not see what benefit this language brings in the risk warning and would suggest deleting it.

"*Only invest if you're prepared to wait to get your money back. Assets in this fund take a long time to buy and sell"*

What distinguishes the LTAF from other regulated UK funds, and leads to its inclusion in the RMMI category, is the lack of liquidity of the product, rather than the investment risk of the portfolio. The risk warnings would therefore be better focused on the lack of liquidity available in LTAFs, and the length of time it takes to realise the proceeds of a redemption. This approach would better inform the investor that the LTAF is not a short-term investment. The wording could even be strengthened here by adding *"This is an illiquid investment"* as an additional sentence before the wording about being prepared to wait to get your money back, and clarify that the investor may not get their money back.

"It will take several years to make any money on your investment."

Our view on this wording links back to our comment about LTAFs being described as a high-risk investment: the approach here is too blunt and the wording should instead reflect the time horizon over which the investment might be expected to be profitable. As with the risk profile, the expected time horizon to profitability will be different for different LTAFs.

The only additional point we wish to make on the risk summary is that we disagree with the statement *"LTAFs will rarely make payments of income. You should not expect to get*

[3] We note the differing language on this point in the consultation document compared to the draft rules: when introducing the risk summary in the consultation document (p16), the language used is *"Due to the illiquidity of the LTAF fund structure, the Financial Conduct Authority (FCA) considers this investment to be high risk".* However, in the draft rules (4 Annex R1) the risk summary contains the wording *"Due to the potential for losses, the Financial Conduct Authority (FCA) considers this investment to be high risk."*

your money back this way". Some LTAFs, such as those invested in private credit, will often be immediately income generating and may make regular payments of income. Other LTAFs may be more in line with the wording in the risk summary. The key point is that the wording around payments of income should be consistent with the investment strategy that the LTAF is following.

An alternative and more accurate way of describing the risks than an investor in an LTAF might be exposed to might be as follows:

"This fund is intended to be used only as a small component within a broadly diversified portfolio and should not make up a large part of your overall investment portfolio. As is the case for most investments into funds, an investment in this fund does not give you protection against poor performance. Furthermore, this fund does not give you frequent opportunities to exit and realise the value of your investment (unlike many other forms of authorised fund which offer such opportunities on a daily, weekly or bi-weekly basis). The fund prospectus provides detail on the timing of the redemption opportunities that you will have. Only invest if you're prepared to wait for those opportunities and will not need to use this investment to fund your immediate cash needs. This is, in part, because assets in this fund may take a long time to buy and sell. In some circumstances and market conditions it may take longer for you to exit and realise the value of your investment than the usual timing described in the prospectus. In these circumstances it can take years for you to realise the full value of your investment."

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

Yes, we agree with the policy to exclude LTAF investments from the 24-hour cooling off period for RMMIs, for the reasons described in the consultation paper: potential investors have plenty of time and information in the sales process to consider whether a particular LTAF is right for them. Requiring a cooling off period would be an unnecessary friction for no benefit.

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

In contrast with the statement in the question, we note that, as drafted in the proposed statutory instrument in Appendix 1, the majority of rules noted in paragraph 3.29 (with the exception of the rules on change event notification periods and payments) will apply to all LTAFs, not just those with retail investors. Nonetheless, we are of the view that these rules as drafted provide additional protections to retail investors and clarity to AFMs looking to establish LTAFs. We do not consider it likely that these additional requirements will have any material impact on the attractiveness of the LTAF for professional investors, noting in particular that AFMs will retain the flexibility to offer broader fee structures for LTAF share classes being marketed exclusively to professional investors. Indeed, we understand from our members that where they establish QIS, they usually adopt similar rules for change notifications, conduct of unitholder meetings, registration and fund suspension in the scheme documents as set out in the rules referenced in 3.29.

As such, the IA largely supports the proposed extension of the retail fund rules noted in paragraph 3.29 to the LTAF, as set out in the proposed statutory instrument. Furthermore, we note that these rules would likely have applied to the LTAF had the IA's original proposal, that the LTAF be a sub-set of the NURS, been adopted.

We do suggest that, as in the case of the proposed requirements in COLL 15.8.15AR to COLL 15.8.15PR, other requirements could potentially be softened or disapplied for LTAFs or share classes being marketed to professional investors only. For example, for a change event for an LTAF which only has professional investors, or a affecting only a share class in an LTAF which is only available to professional investors, we suggest there should be some discretion for the AFM to determine the appropriate treatment under the proposed rules in COLL 15.5.10R. For example, the AFM may not consider it necessary to give 60 days notice to these investors for a significant change, particularly if this has been discussed with all investors ahead of the notice being issued.

Q7: Should the LTAF regime have any other additional protections that are already available for mass-market retail fund regimes?

The IA does not consider there are any other additional protections already available for mass-market retail fund regimes need to be adopted by the LTAF regime.

We note, however, that in our response to CP21/12, we expressed concern that the rules in COLL 15.7.7 R requiring all scheme property to be registered in the name of the depositary, its nominee or its delegate, could cause material difficulties both for depositaries and the fund/its investors in respect of holding certain asset types, in particular real estate and limited partnerships. It remains the IA's view that this rule as drafted will continue to pose a barrier to the broader adoption and attractiveness of the LTAF regime, with little investor protection benefit. We understand that the FCA has been exploring with the Depositary and Trustee Association (DATA) alternative models for the registration of these asset classes. The IA supports and encourages the continued engagement between the FCA and DATA to find a solution that would allow real assets and limited partnerships to be registered in the name of the fund (or a structure owned by the fund) while satisfying the FCA that sufficient investor protections are in place. The IA is of the view that it is in the interests of all stakeholders, and the overall attractiveness the LTAF regime, that a solution on the registration of assets be found at the earliest opportunity and asks that sufficient focus is given to resolving this issue.

There are further features of the current LTAF rules that we recommend the FCA considers:

We understand that AREF and RICS have raised concerns with the FCA regarding how the asset valuation rules for the LTAF differ from the QIS. Valuers believe the LTAF rules, as they stand, could be construed as they should provide a "fire sale" valuation. We would encourage the FCA to engage with AREF and RICS in providing clarity on this matter, as we understand represents a barrier to AFMs progressing plans to launch LTAFs that will invest substantially in property.

We also observe that managers would welcome further clarity on the FCA's expectations regarding the appointment and use of external valuers for an LTAF. An external valuer is an important investor protection tool but given the nature of the assets in the portfolio, their value may not regularly change, and therefore there is a balance to be struck to ensure investors are not over-paying for a service with limited benefit. In particular, COLL 15.2.6R (5) states that a manager need not appoint an external valuer if the scheme property of the LTAF is constituted solely of investments in other collective investment schemes which have an external valuer. However, in practice, the more likely scenario is that some, but not all, of the scheme property comprises collective investment schemes which have an external valuer, and it is not clear to what extent the manager can rely on the valuations of those external valuers in that context.

Finally, although we regard notice periods as a key feature of the LTAF, allowing redemption terms to align with the liquidity of the underlying assets, there is a continuing reluctance on the part of many firms to launch products with notice periods while the current market infrastructure is still based on daily dealing. This was initially identified by the IA as a challenge that would need to be addressed in its original proposal for the LTAF. While some platforms have developed, or are developing, the capabilities to host non-daily priced products including those with notice periods, more needs to be done to encourage broader adoption by intermediaries, especially platforms, to make the necessary changes for the potential of the LTAF to be realised. The IA remains willing to work with the government, the FCA and the wider intermediary community to realise this ambition.

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

The LTAF and Appropriateness tests

In our response to last year's consultation on the LTAF regime, we argued that the robust governance and investor protections built into the LTAF regulatory framework were sufficient to ensure that it should be possible to market the LTAF to retail 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.

An appropriateness assessment should help restrict the LTAF only to those investors that understand the risks and illiquid nature of the product and we are supportive of its use in the LTAF non-advised retail sales process. The appropriateness assessment is not needed for advised retail investors, who will be subject to a full suitability assessment by a regulated and qualified financial adviser.

We have reviewed the draft guidance on assessing appropriateness for an LTAF in COBS 10 Annex 3 and broadly agree that the matters covered in the guidance are the correct factors that should be considered as a minimum in an LTAF-specific appropriateness test.

The only points which we consider need modification relate to items 3 and 5 in the guidance:

- *(3) the possibility that it could take the client many years to make profit on the money they invest, and that payments of income may be limited or non-existent;*

- *(5) the risk of the LTAF's investments failing and the associated risk of the client losing all of the money invested;*

In line with our comments on the risk warnings and summaries in Q4, knowledge and understanding of a customer in these two areas should be assessed in line with the specific characteristics of the LTAF being marketed. The current guidance gives the impression that all LTAFs are high-risk and unlikely to pay income. As we have previously highlighted, this will not be the case. We recommend that the guidance allows scope for firms to cover these aspects in line with the risk and expected income profile of the specific LTAF being marketed.

Additional elements of the RMMI regime – allocation limit and client categorisation

Alongside the use of the appropriateness test, we support the imposition of the 10% of portfolio limit on restricted retail investors allocating to RMMIs. This is a sensible step to ensure controlled and safe distribution of LTAFs to the retail market. While the precise level of any limit is always somewhat arbitrary, we support 10% as striking a sensible balance between retail investors gaining some LTAF (and other RMMI) exposure but being sufficiently protected from over-exposure to these products.

For experienced retail investors who want a greater level of exposure to LTAFs and other RMMIs, we consider that the other client categories (High Net Worth Individual, Self-Certified Sophisticated Investor and Certified Sophisticated Investor) offer sufficient opportunity to achieve this, subject to investors being categorised as the appropriate investor type.

Finally, we agree with the position taken in the draft rules that categorisation as a restricted retail investor is on a self-certified basis. This is a pragmatic choice that should help deliver broad retail access to LTAFs. We note that some distributors may want to go beyond the regulatory requirements and seek objective information from the investor in order to test their restricted retail status. This choice is best left to distributors and the draft rules achieve this.

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

We agree with the proposal to enable a NURS AIF to invest up to 35% into a single LTAF, in line with the limit in the NURS FAIF rules on investment in a single collective investment scheme. In practice, we expect investment by NURS FAIFs in a single LTAF to be considerably lower than this threshold in most cases, but this higher threshold will allow a NURS FAIF to make a meaningful allocation to a single LTAF while leaving “headroom” for continued compliance with the threshold should the value of the LTAF position change materially relative to the rest of the portfolio.

We are also of the view that a NURS should be permitted to invest in an LTAF on the same terms as a NURS-FAIF, but as part of the 20% limit for unapproved collective investment schemes and transferable securities, as outlined in our response to Q11.

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

We do not agree with the proposal to limit the value that a NURS FAIF can invest in aggregate across multiple LTAFs to 50% of the NURS FAIF’s NAV, nor do we understand the argument presented by the FCA in paragraph 3.40 for making this proposal. We do not believe that a limit on the aggregate investment across LTAFs is needed, provided the AFM of the NURS FAIF is confident that it will be able to meet its redemption commitments.

With the high degree of investor protection it offers, the LTAF will likely be amongst the most heavily regulated alternative investment funds that the NURS FAIF can invest in. Furthermore, a hard limit of 50% could present AFMs of NURS FAIFs with threshold challenges, since it will not readily be able to quickly dispose of units across the LTAFs if it comes close to or breaches the limit. To prevent this scenario arising, AFMs of NURS FAIFs are likely to restrict investment into LTAFs at a much lower level, limiting their ability to allocate investment into LTAFs even where this aligns with their investment strategies and liquidity commitments.

In paragraph 3.40, the FCA suggests that the aggregate 50% investment limit is needed for a NURS FAIF "to stay under the Funds with Inherently Illiquid Assets (FIIA) threshold". We do not understand this reasoning as a fund only becomes a FIIA if it allows regular redemptions. Since a NURS FAIF is permitted to have limited redemptions, it will not necessarily fall into the FIIA regime if it offers limited redemptions. We do not see why the AFM of a NURS FAIF needs to be protected from their fund becoming a FIIA – if the AFM elects to hold more than 50% of their fund in aggregate in LTAFs, they will recognise that the FIIA rules will apply and need to comply with these.

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

We agree that the rules in COLL 5.7.9R (1) and (2) should be switched off for NURS FAIFs that invest in LTAFs, given the LTAF regime already requires the schemes to comply with these requirements. We also welcome that the requirement in COLL 5.7.7R(2) (to be (2)(b) under the proposed rules) has not been extended to investment in LTAFs.

A NURS that is not a FAIF should also be permitted to invest in one of more LTAFs on the same basis as the proposed rules in COLL 5.7.7R(3), but within the 20% limit for unapproved collective investment schemes and transferable securities specified in COLL 5.6.10R (1)(e). In particular, the 15% limit on second schemes should be disapplied where the NURS is investing in an LTAF. Multi-asset funds are far more likely to be structured as NURS than NURS-FAIFs, noting that in the case of the latter it is intended for an advised retail audience per the non-Handbook Guidance issued by the then FSA when the NURS-FAIF was created. These are widely used by specialist managers for their clients, including private wealth managers, independent and restricted advisers and charity managers. The LTAF could be a valuable diversifier for NURS that are multi-asset funds or fund of funds, allowing them to make small allocations to private market assets but within their liquidity profiles, similar to what has been advocated for DC default schemes. We consider that permitting investment by NURS in LTAFs up to the 20% limit for unapproved collective investment schemes would be sufficient for the majority of multi-asset strategies within NURS, noting these are unlikely to seek large exposures, and would not change the nature and risk profile of the NURS product.

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

Yes, we support the proposal to extend distribution of LTAFs beyond defaults in qualifying workplace pension schemes. The ability for self-select DC members to diversify their portfolios through exposure to LTAFs is welcome.

However, while we support the need for a limit on self-select allocations to an LTAF in order to protect against inappropriately high exposures, we do not agree with the limit effectively being imposed by the link to the default arrangement level of illiquid exposure as per the draft rule COBS 21.3.18A R. Default strategies are by their nature 'one size fits all' approaches, and the level of allocation to LTAFs or other illiquid assets reflects the need to design a strategy that is broadly suitable for all members rather than being tailored to any individual's preferences and circumstances. In addition, illiquid allocations in the DC default market are heavily driven by cost considerations rather than pure investment decisions: a scheme may have lower levels of illiquid allocations than would otherwise be the case in the absence of market-driven cost constraints.

Self-select investors will want something more tailored to their circumstances and it does not seem appropriate to impose the default strategy's cost and design constraints on them (as it would not be consistent with providing an option for those minded to self-select, that meets their likely investment intention i.e. they might as well have just invested in the default scheme with an LTAF allocation). A better way to protect self-select investors from overexposure to LTAFs would be to set a limit at 10% of their assets with the scheme at the point of making the investment. This has the advantage of being in line with the RMMI limit as well as being easily verifiable by the pension scheme.

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

Yes, we agree with the proposal and have previously supported such an extension in the unit-linked product market. The additional choice will be welcome for customers. However, in light of the proposals for direct investment in LTAFs by non-advised retail investors, we do not see why unit-linked distribution of LTAFs should be limited only to advised customers or those investing on a discretionary basis with a DFM. Under the current proposals, a non-advised retail investor could invest directly in an LTAF under the RMMI framework but would not be able to invest in an insurance-wrapped version of the same fund. This is inconsistent and it is difficult to understand why the FCA has taken this position.

It could be resolved by permitting distribution of unit-linked LTAFs under the RMMI framework, and we recommend the FCA permits this in the final rules.

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

Yes, we agree with the policy position set out in the consultation paper. It reflects that DC default arrangements may use multiple fund structures to access illiquids and that it makes little sense to apply a cap on illiquid assets in a unit-linked fund to some structures but not others. However, we are not sure that the policy intention to treat equally all illiquid asset funds in a DC default unit-linked context has been achieved in the draft rules, as the 35% cap has not been lifted. We assume that this is an oversight, and that the intention was to lift the cap in respect of default arrangements.

We would also welcome clarification on when the FCA would consider other illiquid investments as having a "similar liquidity profile" as the LTAFs. What considerations would an insurer need to take into account when working out whether the illiquid assets have a "similar liquidity profile" as the LTAFs? For example, would that mean the illiquid assets would have to necessarily be open-ended in the same way as an LTAF?

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

Yes, we do consider that the decision to categorise the LTAF as a non-standard asset (NSA) for SIPPs will have an unintended consequence: it will reduce the likelihood of LTAFs being sold through SIPP wrappers.

We have heard feedback that the additional capital costs arising from NSAs mean that SIPP providers mostly refuse to allow them into their SIPPs, with the few that do charging extra for it. Our expectation is that for the most part, LTAFs will therefore simply be unavailable through SIPPs. In those cases where SIPP providers do make NSAs available at additional cost, direct investors, advisers and DFMs investing retail client portfolios in SIPPs will face an additional cost in making LTAF allocations over and above the charges on the fund. This may act as a disincentive to invest, even where an LTAF may be suitable for inclusion in a portfolio.

As with ISAs (discussed in our answer to Q1) the importance of the SIPP in the retail market will vary according to which market segment firms are seeking to sell to. For wealthier investors with additional money to invest over and above their annual ISA and SIPP allowances, lack of access to the LTAF through these wrappers need not be a barrier to investing in an LTAF. However, for those retail investors whose capacity to invest is within their ISA and pension allowances, the incentive to invest in products outside of these wrappers is significantly reduced by the loss of tax benefits. This is likely to result in lower LTAF allocations than would be the case were they available through ISAs and SIPPs.

We recommend that the FCA re-consider the decision to treat LTAFs as non-standard assets in SIPPs, taking into consideration the significant investor protection regime that applies to LTAFs in comparison to most non-standard assets. It would be helpful to better understand the FCA's concerns in this area in order to see whether there are any solutions that can be devised by LTAF manufacturers and distributors to allay these concerns.