Michael Collins & Tom Bramhill
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Submitted via email to: cp21-12@fca.org.uk

25 June 2021

Dear Sirs

FCA Consultation Paper CP21/12: a new authorised fund regime for investing in long term assets (the "Consultation Paper")

BlackRock is pleased to have the opportunity to respond to the Consultation Paper.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We have been active contributors to the Productive Finance Working Group (PFWG) and welcome the opportunity to comment on the issues raised by the FCA in the Consultation Paper. We look forward to continuing to contribute to the thinking of the FCA on any issues that may assist in the final outcome.

The Long-Term Assets Fund (LTAF) offers the UK and UK savers significant opportunities:

- access to investments that can lead to better retirement outcomes for individuals from all walks of life;
- an important step towards the UK developing further advantages as a global centre for productive and sustainable finance, and
- an opportunity to modernise and resolve a number of imperfections in a somewhat outdated UK financial promotion regime, which have acted as barriers and disincentives to the democratisation of alternative funds in the past.

We encourage the FCA to ensure that all aspects of the authorised fund product and distribution regimes are explored (and if necessary changed) to ensure an optimal ecosystem for the success of the LTAF.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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CONSULTATION PAPER QUESTIONS & RESPONSES

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.

No issues identified.

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?

Yes. On the basis that the LTAF may be sold directly or indirectly to retail investors it is entirely appropriate that the existing authorised fund governance and disclosure framework should form the basis of requirements for the new LTAF regime. We feel that this will help ensure investor confidence, investor protection, and consistency of investor experience.

The enhanced requirements (regarding governance, reporting and disclosure) are not viewed as particularly onerous and indeed reflect current best practise among many asset managers.

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?

Yes, we broadly agree with the proposals with a few specific comments as follows:

- **Purpose**. We agree that the purpose of the LTAF is to facilitate investment in long term productive finance assets. On that basis an LTAF will be able to pursue a long-term investment strategy, meaning the asset allocation of the fund may vary over time and depend on investors' liquidity requirements. As the FCA acknowledges in para 3.14 of the Consultation Paper, it is helpful to avoid prescriptive requirements to avoid forced sales of fund assets. We are therefore concerned that the stated 'expectation' of a 50% allocation to long-term assets, may be difficult to define and may cause confusion, given there is no (and should be no) explicit requirement in the COLL rules themselves. We suggest replacing this with an expectation and related guidance that an LTAF should target long term investment outcomes and follow an investment strategy that is focused on long-term assets, but avoid numeric indicators which can become restrictive as a matter of product governance.

- **Investment powers**. We agree with the flexible "QIS style" regime proposed, however, we would question the need for an underlying, second scheme CIS to have a prudent spread of risk. Whilst we agree that this requirement should apply to commingled funds, there needs to be an acknowledgement that intermediate holding vehicles (which can be treated as funds) are not precluded from eligibility for LTAF investment. As already acknowledged by COLL in relation to real estate funds, the use of such vehicles in private market investing is widespread, so we suggest applying true fund designations to this requirement, rather than the CIS definition.

  More specifically on loan origination, where we understand there has been some discussion as to appropriateness, we would encourage the FCA to allow the LTAF to invest in this asset class given its benefits for investment diversification in multi-asset alternative portfolios. We note the 2017 rule changes in relation to the Irish qualifying investor alternative investment funds (QIAIF) regime which acknowledged the benefits of the asset class in this regard.

- **Valuation**. We question the practicalities of the proposed role of depositaries in determining whether or not an LTAF may perform valuations internally (particularly the 'without qualification' requirement). In practice this may result in the obligatory use of an external valuer, leading to

unnecessary expense and potentially less expertise, especially for more bespoke/esoteric strategies. AIFMD Level II is already very detailed on the verification of the valuation of assets, and we believe this already provides sufficient protection.

We agree with the proposal for valuations to be conducted at least monthly, but would note for transparency and clarificatory purposes that in the case of certain long-term assets which cannot (for cost and practical reasons) be subject to full, formal 'bottom-up' valuations as regularly as this (which creates a mismatch of timing between the desired liquidity and availability of valuations and price delivery) these valuations will be indicative only and rely on "stale" financial data from earlier valuations. Such scenarios should be limited and risks mitigated (e.g. through indexing or fair valuation principles) where possible when designing liquidity/dealing cycles.

- **Borrowing**. For parity with the QIS regime 100% might be preferable for certain strategies, but we recognise that a 30% limit is sensible to ensure investor confidence and marketability.
- **Redemptions & Subscriptions**. We agree with the proposals.
- **Due diligence**. We agree with the proposals.
- **Knowledge, skills & experience**. We broadly agree with the proposals, but believe it would be helpful to have further clarification on the scope of this requirement as it relates to 'the activities of the LTAF' - presumably both experience of specific asset classes and of funds investing in private asset classes will be necessary to ensuring investor protection.

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

Retail Investors

Following our submissions made as part of the Productive Finance Working Group (PFWG) we were pleased to see that the FCA has acknowledged the importance of including retail investor eligibility in the LTAF regime. Whilst we understand the reasons Defined Contribution (DC) Pension Schemes have been identified as a priority investor group, it is equally important for the long-term success and competitiveness of the LTAF that the FCA ensures that informed retail investment (or private wealth, as it is commonly referred to) is permitted to access the LTAF. Furthermore, it has been widely noted that retail investors have been saving income during the COVID19 pandemic – the LTAF could present an ideal opportunity to mobilise those savings, benefiting both investors and the supply of productive finance.

Allowing a broader retail participation in the LTAF will help ensure that all investors (not just institutions or the wealthy) can benefit from access to long-term investments. The potential for higher returns offered by long dated assets, diversification, and investment exposures (which are not correlated as closely with public markets), are increasingly important for retirement outcomes.

Our strong recommendation is that the current momentum generated through the PFWG and Consultation Paper be used to conclude and confirm retail eligibility from the outset, rather than postpone the discussion for a later consultation. In our view, failing to make broader retail investment possible (of course with the appropriate safeguards) from the inception of the LTAF regime, will represent a lost opportunity that will compromise the ultimate success of the LTAF, as well as the benefits it can bring to UK savers and the attractiveness of the UK investment ecosystem.

Furthermore, as set out in our responses to Q7-9 below, we do not think the proposal to mirror the QIS distribution regime is appropriate, since this approach would not alter the current regulatory landscape and

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so the barriers to entry for retail investors will remain. It is important therefore that the LTAF is given its own framework as part of the new chapter in COLL, separate to the QIS regime, to ensure the imperfections of that regime are not inadvertently inherited (see Q8 below).

Tax

Whilst the objective of the Consultation Paper is to develop a new regulatory regime to support investment in productive finance assets, we note that five fund taxation regimes are in place in the UK, but none are completely suitable for the LTAF. As we communicated to HM Treasury in our response to its Review of the UK Funds Regime this something that will need to be addressed for the LTAF – and the authorised fund regime as a whole – to flourish.

Alternative Funds

The FCA has recognised in the Consultation Paper that the 20/35% cap on illiquid investment can restrict investment choice for DC schemes. We would encourage the FCA to consider applying the proposed relaxation of the requirement to other less liquid unauthorised fund types, not just the LTAF.

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?

Yes, we agree with the proposals, including the amendments to the COBS permitted links regime. However, we suggest the concept of 'default arrangements' include schemes which allow a limited degree of choice in relation to how contributions are invested (i.e. selecting a risk category).

As the FCA is aware, there are a number of operational and demand barriers that must be addressed, alongside the Sourcebook amendments, to ensure the LTAF regime is workable for DC default arrangements. These barriers most notably include:

- **Governance barriers.** Ensuring scheme trustees are supported and comfortable with investing in less liquid assets (e.g. through TPR and/or FCA guidance and training);
- **Cost barriers.** The focus should be on end investor outcomes and net of fees performance as a measure of success, rather than low costs. Also, consideration should be given to the real and perceived impact of the fee cap and how this prevents/dissuades investors from accessing long-term assets. Many legacy workplace pension schemes are priced at the costs cap, constraining the ability of the entire scheme to increase its costs. Performance fees specifically need to be accommodated as a common feature of private asset funds (as we highlighted in our responses to the recent DWP consultations); and
- **Operational/regulatory barriers.** Ensuring scheme providers have sufficient control of default strategies so that the consideration of older aged investors (for whom material exposure to long term assets might be less appropriate), and consolidation of pension pots (where holding more liquid assets makes this more viable) do not frustrate efforts to allocate scheme assets to the LTAF.

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?

No, we believe full flexibility should be provided in the same way it is afforded to the QIS. In line with the enhanced governance requirements proposed by the FCA, product providers will assess the appropriateness of asset types based on the target market for each LTAF. The FCA will also review the model portfolio of LTAFs as part of the authorisation process.

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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?

No. The QIS and LTAF regimes are different and so a separate and different distribution regime is needed. The PFWG has concluded that there are product and distribution flaws inherent in the QIS, so after building a new product regime for the LTAF it would be remiss not to address the distribution regime at the same time.

As set out in the Consultation Paper, the LTAF will have stricter governance requirements, reporting requirements and investment restrictions, so it would be inappropriate for it to be restricted to the same group of investors as the QIS. Additionally, by automatically applying the QIS distribution regime the LTAF will inherit the NMPI imperfections discussed below.

We note that the introduction of the European Long Term Investment Fund (ELTIF) and European Venture Capital Fund (EuVECA) regimes into the FUND Sourcebook provides a precedent for the separation approach.

Alternative approaches

As discussed in the following questions, ensuring retail investor protection is critical to the success of the LTAF. We would encourage the FCA to work with distributors to create a new and bespoke “intelligent” financial promotion regime for the LTAF, one that is principles-based with investor understanding at its core, as opposed to the existing exemption based regime which is a complex and outdated approach to investor protection.

As an example, the PROD Sourcebook**,** Section 3.3 covers the “distribution of products and investment services”. This could be amended to apply a specific distribution regime for the LTAF which is based on assessments of target market and product complexity. A principles-based approach such as this would ensure that product manufacturers focus on the design and appropriateness of the LTAF for target investor groups. It would also lend itself to a tie-in with the SMCR framework the FCA proposes to specifically apply to the activities of the LTAF.

To answer the distribution related questions that follow, it may be helpful to draw comparisons with the ELTIF regime, forming part of both EU and UK law. The ELTIF Regulation requires distributors to provide investment advice and conduct suitability screening before an investment can be made. Whilst in our experience these obligations can be satisfied, they are often cited by our distribution partners as a reason they are reluctant to sell ELTIFs for fear of the risk, bureaucracy, and uncertainty a highly subjective test involves. Whether or not there is sympathy with this argument, the fact remains that it has acted as a disincentive for distributors of the ELTIF and could therefore do the same to the LTAF. For this reason, as part of the reform of the ELTIF regime, the European Commission is currently considering whether a move to MiFID suitability and appropriateness test principles would incentivise the take-up of ELTIFs.

In addition to the approaches discussed below (i.e. NMPI, NRRS, appropriateness, investment minima etc), other approaches either discussed in the industry or used in other countries include the RVECA regime and Luxembourg’s “well informed investor” - both might be helpful in considering the pros and cons of the different approaches available.

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.

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Yes. In our experience, distributors find the Non-Mainstream Pooled Investment (NMPI) regime to be a significant barrier to the effective distribution of funds.

The NMPI rules are complex (interpretation of the twelve categories of exemption often necessitate legal advice and therefore costs) and disincentivising, as in practice intermediaries can be reluctant to undertake the highly subjective assessments required and bear the perceived risk the NMPI label implies as compared to more traditional "mainstream" investments.

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. Allowing broader retail participation in the LTAF will help ensure that all investors (not just institutions or the wealthy) are able to access long-term investments. The potential for higher returns, diversification and investment exposures which are not correlated as closely with the public markets are highly important for retirement outcomes.

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

The appropriateness assessment is relied upon by distributors of financial products in other parts of the finance industry and so the same assessment could be used for the distribution of the LTAF. One important advantage this regime has (over NMPI, NRRS) is the qualitative determination of investor experience, knowledge and understanding of risk, as opposed to a simple exemption led assessment. Simple adjustment to the PROD Sourcebook as referred to above could be a way to introduce this.

As referenced above, we understand that for the ELTIF the European Commission is currently considering whether a move to MiFID suitability and appropriateness test principles is a suitable means of investor protection.

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?

The NRRS regime could work in the same way that the NMPI regime works, but we don't think either is the optimal solution for democratisation of the LTAF. Both NMPI and NRRS regimes look to apply exemptions, however we feel a new qualitative and permissive regime is preferable and what is needed for the success of the LTAF.

As with NMPI, the NRRS regime involves a certification exemption but it also comes with a monitoring obligation (that the investor has no more than 10% of net assets in NRRS in the previous 12 months and will not do so for the following 12 months) which presents administrative burden (and therefore cost and risk) to the distributor community which can act as a disincentive.

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?

In our view the FCA should be looking to ensure investor protection through understanding rather than wealth/ability to bear loss (see Q10 above).

Whilst a higher investment minimum might demonstrate the underlying investor's wealth, it is not an intelligent means of investor protection. Furthermore, while auto-enrolment and increased savings habits mean more people are likely to retire with sizeable assets in their pension plan, this doesn't make them professional or sophisticated investors. Assuming the LTAF will be made eligible for retail investors, we suggest normal retail investment minima are applied, but that a limit on an investor's overall portfolio might be a workable protection measure.

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Any minimum level of investment must correlate to the underlying LTAF investment strategy, the level of expected subscriptions and how that capital can be employed – it is not a "one size fits all".

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

In order to ensure the widest possible flexibility for investment in LTAFs we believe that it would be desirable to relax the 15% limit in underlying collective investment schemes under COLL 5.7.7(2) as it relates to LTAFs.

"…(2) the second scheme is prohibited from investing more than 15% (50% in the case of a long term assets fund) in value of the property of that scheme in units in collective investment schemes or, if there is no such prohibition, the non-UCITS retail scheme's authorised fund manager is satisfied, on reasonable grounds and after making all reasonable enquiries, that no such investment will be made;…"

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

The LTAF should of course be treated as a long-term investment and it is imperative that retail investors are appropriately educated and advised that this is the case. There are existing long-term and limited access investment wrappers in the market, such as the Lifetime ISA (LISA) – which includes a deliberate financial penalty for early redemption - which might helpfully be used to promote retail investment into LTAFs. This would require amendment to the ISA Regulations, but the regime could be used to educate investors, incentivise long-term investing and improve the range of long-term investment solutions available. Any review should, we suggest, also remove the LISA eligibility restriction to investors aged over 40 years.

The current FCA review of the key investor information document regime could potentially include consideration of the inclusion of a liquidity indicator (alongside existing/modified risk and performance indicators) and other retail friendly graphics and disclosures as part of ensuring investor understanding of the risks involved in investing in an LTAF.

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?

By extension to Q13 on the NURS FAIF, we believe that there is benefit in permitting a UK UCITS and NURS (that is not a FAIF) to invest in the LTAF. This would of course need to be considered carefully to avoid damaging the liquidity profile on such retail fund wrappers, but we believe that a modest ability to invest in the LTAF (e.g. as part of a modified 10% unapproved securities limit) would promote the growth of the LTAF regime.

In addition, we believe this point is essential to maximise the success of the LTAF in the DC market segment. This is because many DC default strategies are wrapped entirely in a UCITS or NURS (often but not always a fund of funds). If these UCITS and NURS cannot access the LTAF then this will need to be done directly by the life company or life platform. Some may not be able to manage the liquidity challenges that come with non-daily dealing whereas often the asset managers who run UCITS and NURS will be better experienced and equipped with better liquidity and risk management systems to facilitate this. This will also help to avoid a split operational model allowing the liquidity, risk and other aspects of a default to be managed holistically which can bring benefits for providers and investors alike.

The LTAF will of course be widely available to DB Schemes, institutional investors, corporates and sovereign investors, and no restrictions should be placed on such investments.

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?

Yes. Insurance liabilities are necessarily long-term and so it is important that such schemes are able to access long-term investments which are most likely able to meet them. See further our response to the FCA's 2019 permitted links consultation.

The focus to date has been on the DC default but other pension arrangements, such as non-workplace pension schemes, should not be precluded from investing in the LTAF.

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

The FCA has recognised in the Consultation Paper how the 20/35% cap on illiquid investment can restrict investment choice for DC schemes. We would encourage the FCA to consider applying the relaxation of the requirement to other less liquid unauthorised fund types, not just the LTAF.

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

No comment.

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