Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

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By email: cp22-14@fca.org.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to FCA consultation on Broadening retail access to the long-term asset fund – CP22/14

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of financial services policy and regulation in the UK.

We welcome the opportunity to respond to this consultation on broadening access to long-term asset funds (LTAFs), covering both how LTAFs should be treated for financial promotions, as well as the rules governing their use within pensions. The Panel recognises that consumers could potentially benefit from investing in LTAFs. However, it notes that LTAFs are not only high risk, but are also highly illiquid. Understanding the risks associated with individual LTAFs may therefore be challenging for retail investors. This makes it important that effective protection is in place.

The Panel therefore supports the proposals within this consultation that focus on ensuring consumers are protected. For example, the Panel agrees that there should be a focus on ensuring there are effective risk warnings for LTAFs.

Where the Panel disagrees with proposals, it reflects concerns about the proposed level of protections provided. For example, the Panel considers that there would be benefits from retaining the cooling off period that apply to other forms of Restricted Mass Market Investments (RMMI).

In addition, the Panel proposes that the FCA should look at additional ways to protect potential investors, particularly in relation to the use of self-certification to determine if an investor is sophisticated. There is considerable evidence that too many investors are self-certifying in order to meet the criteria, when they are not sophisticated investors. There is a danger consumers see this as just another 'box ticking' exercise and do not understand the increased risk they are taking. This means that applying the current RMMI rules to LTAFs is likely to result in investment by consumers who either do not understand the risks or cannot afford to undertake the risks. The Panel therefore proposes that the FCA should apply its proposed approach to crypto assets to LTAFs, namely that the "self-certified sophisticated investor" exemption should not apply to the sale of LTAFs.

In general, the Panel considers it is important that the overarching regulatory regime governing retail investments, including financial promotion rules, provides a coherent approach to setting regulation that meets consumers' needs. Our response should be considered in the context of our vision for how the market should function, which is set out in our response to the FCA's call for input on consumer investments. The foundation of this vision is a correctly implemented and supervised Consumer Duty[1]. This would make the firm responsible for the appropriate distribution of high-risk investments including the marketing, labelling and comparability of different investment options, as well as consumers' overall suitability for and understanding of the products which they invest in. This would create a market where:

- more of the population with investible assets, and where the decision is right for them, make an active, informed choice to invest, with successful outcomes, maximising their returns and thereby supporting the economy;
- the information disclosed to potential investors is designed in a way that will allow them to make effective decisions, and to compare the risks and rewards not only of different options for a given product type, but also of different products;
- it is not possible to use regulatory arbitrage to circumvent rules designed to protect consumers;
- there is a common industry-wide definition of consumer segments (such as 'high net worth', 'novice' or 'able to sustain losses'), which is used to inform product design, set purchasing channels, target marketing and ongoing engagement;
- the use of client self-certification is removed;
- information, education, guidance and advice is readily available and tailored to the consumer to ensure they are supported in taking decisions both pre-investment and on an ongoing basis. This will require the re-engineering of current thinking to better integrate these aspects together and blend them throughout the customer's investment life-cycle. Only in this way will trust be established and consumers supported through what is an inherently complex set of decisions;
- the use of guidance or advice should not be the gateway to anything other than a range of default-based, simple, tax-efficient investments;
- products must be better designed, labelled and described to enable consumers to better understand fully the opportunities, risks and costs involved and easily compare these across options; and
- when harm does occur, there must be easily accessible and efficient redress and compensation solutions.

Our responses to the questions posed in the consultation are included at Annex A below.

Yours sincerely,

Helen Charlton

Chair, Financial Services Consumer Panel

[1] For our comments on the FCA's proposed new Consumer Duty, please see here: https://www.fs-cp.org.uk/sites/default/files/final_fscp_response_cp21-36_a_new_consumer_duty_20220214.pdf

Annex A – responses to questions

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

This response should be read in conjunction with the Panel's response to CP21/12.

The Panel is supportive of proposals to create an effective regime governing long-term asset funds (LTAFs). It considers that an important part of this will be to ensure that there is a strong focus on consumer protection, whatever the sales channel, that is backed by clear, concise, easy-to-understand disclosure.

The Panel notes that LTAFs are highly illiquid and high risk investments. These risks will not necessarily be stable. For example, the recent shift to a high inflation, rising interest rate environment may impact the viability of some of the underlying investments permitted within LTAFs. Understanding the risks associated with individual LTAFs may therefore be challenging for retail investors. This makes it important that effective protection is in place.

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.

The Panel agrees that this proposal does not raise any diversity or equality 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?

The Panel agrees that LTAFs should be treated as Restricted Mass Market Investments (RMMIs), rather than Non-Mass Market Investments (NMMI).

However, the Panel notes that the FCA's proposals in its consultation CP22/2 also suggested treating crypto assets as RMMIs, but unlike for most RMMIs not allowing the use of self-certification for this asset class.

The Panel considers that the proposed ban on the use of self-certification should be extended to LTAFs that fall within the RMMI regime. LTAFs are highly illiquid, high risk investments and the risks that they pose are likely to be very idiosyncratic depending on the specific nature of the illiquid asset that an individual LTAF is invested in. The Panel notes that the FCA's own evidence shows that too many investors are self-certifying as meeting the criteria of being a sophisticated investor, when they do not actually meet this criteria. The Panel therefore considers it would be appropriate to ban the use of self-certification for LTAFs.

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.

The Panel considers that effective risk warnings are extremely important and welcomes the FCA's proposal to ensure that LTAFs will come with both a risk warning and a risk summary.

However, the Panel has significant concerns about the proposed risk warnings set out in Paragraphs 3.18 and 3.19 of this consultation. LTAFs are high risk investments and come with the risk of losing some or all of the invested funds. The Panel considers that this risk should be highlighted more explicitly and that consumer testing should be undertaken to ensure final proposals are effective.

- Potential alternative to para 3.18:

  "This is a high-risk investment, and you do not have protection against losing money. It will take several years to make any money on your investment. Assets in this fund take a long time to buy and sell. Only invest if you're prepared to wait a significant time to get your money back when you sell; and be aware you could not get your money back."

- Potential alternative to para 3.19:

  "This is a highly illiquid, high-risk investment. You can lose money and will need to wait to sell."

The Panel is broadly happy with the proposed risk summary template. However, again the Panel considers that it is important to make the risk of losing all your money explicit and suggests that this is added to the first bullet under section 1 of the proposed Risk summary template.

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?

No. The Panel considers that the illiquid nature of LTAFs makes it more, not less, important that investors are given a cooling off period. Just because the investment is illiquid does not mean that investors cannot make a rushed decision. For example, hype around a particular LTAF might encourage them to act quickly, without fully thinking through whether an illiquid investment is right for them.

The Panel considers that this is particularly important given self-certified investors sophisticated investors will be allowed to invest in LTAFs. The FCA's own evidence shows that too many investors are self-certifying in order to meet the criteria, when they do not fit the definition of a sophisticated investor. This means that the current rules are likely to result in investment by consumers who either do not understand the risks, or cannot afford to undertake the risks.

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

Yes.

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

The Panel considers that the LTAF regime should include a cooling off period.

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

Yes.

The Panel considers that it is very important that firms should assess whether the products they are selling are appropriate for individual clients.

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

The Panel considers that it is important that Funds of Alternative Investment Funds (FAIF) benefit from effective diversification benefits, as well as to be able to meet its redemption obligations. It is concerned that allowing a FAIF to invest up to 35% of its assets in a single LTAF could reduce the expected diversification benefits.

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?

The Panel agrees that there should be an upper limit on the amount a FAIF can invest in the LTAF sector, in order to ensure that it remains under the Funds with Inherently Illiquid Assets threshold.

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?

No. LTAFs are illiquid investments that will potentially change the performance characteristics of any FAIF that invests in them. Especially given that the FCA's proposals would allow a FAIF to invest up to 35% of its assets in a single LTAF, the Panel considers that it is important that a requirement for appropriate due diligence is retained.

There may be some scope for a FAIF to use information provided by the LTAF as part of this – for example where an independent auditor is used. However, the FAIF should still satisfy itself that the appropriate rules have been followed.

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

LTAFs are an illiquid, high-risk investment option. Even as part of a pension arrangement, investment in LTAFs will not be universally appropriate, given that someone who is approaching retirement will have different liquidity requirements to someone at a different stage in life/investment journey.

The Panel considers that broadening the distribution of LTAFs in qualifying pension schemes beyond the default arrangements to self-select options, should only take place where there is sufficient protection in place. The Panel agrees that insurers must satisfy themselves that investors are not over-exposing themselves to LTAF-linked funds. The Panel considers that this assessment should take account of an individual investor's circumstances and consider the likelihood of the chosen LTAF(s) generating returns by the time the individual will retire.

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?

The Panel agrees with the proposal to extend the distribution of LTAFS more widely, including to investors in non-workplace pensions and workplace pensions that are not qualifying schemes. Given LTAFs are high-risk, illiquid investments, the Panel agrees that this should only be possible in cases where an individual has received professional advice, and where the requirement for insurers to ensure the fund is suitable and redeemable for investors continues to apply.

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?

The Panel considers that giving other illiquid assets the same status as LTAFs should only be done where it is possible to ensure that the same level of consumer protection will be available.

The Panel notes that the FCA suggests that treating other form of illiquid investments in the same way as LTAFs in relation to the investment cap would create a more coherent regulatory approach. However, the FCA also states that LTAFs come with protections that are not available through other illiquid asset types.

The Panel considers that the focus on regulatory coherence should relate to consumer protections, rather than the investment cap. It is appropriate for access to be more restrictive, where consumer protection is less effective.

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

The Panel supports the FCA's proposal to treat LTAFs as non-standard products for SIPPs. It considers that the relatively illiquid nature of LTAFs means the associated capital surcharge is appropriate.