This decision notice has been referred to the Upper Tribunal to determine what (if any) the appropriate action is for the Authority to take, and remit the matter to the Authority with such directions as the Tribunal considers appropriate.

FINANCIAL CONDUCT AUTHORITY

12 Endeavour Square
London
E20 1JN

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

DECISION NOTICE

To:	**Woodford Investment Management Limited**
FRN:	**745433**
Address:	**Monomark House, 27 Old Gloucester Street, London WC1N 3AX**
Date:	**1 July 2025**

1. ACTION

1.1. For the reasons given in this Decision Notice, the Authority has decided to impose on Woodford Investment Management Limited ("WIM") a financial penalty of £40,000,000 pursuant to section 206 of the Financial Services and Markets Act 2000 (the "Act").

2. SUMMARY OF REASONS

2.1. The Authority considers that, between 31 July 2018 and 3 June 2019 ("the Relevant Period"), WIM failed to act with due skill, care and diligence in carrying out its role as investment manager of the LF Woodford Equity Income Fund ("the WEIF"). In particular, it: (i) failed to exercise its investment discretion to maintain a reasonable and appropriate liquidity profile for the WEIF; (ii) made unreasonable and inappropriate investment decisions; (iii) failed to implement the applicable liquidity risk framework effectively; (iv) used metrics and methodologies (including stress testing) to measure liquidity which were unreasonable and inappropriate; and (v) failed to respond reasonably or appropriately to warning signs regarding the fund's liquidity profile. WIM thereby breached Principle 2 (due skill, care and diligence) of the Authority's Principles for Businesses.

2.2. The WEIF was an open-ended undertaking for collective investment in transferable securities ("UCITS") fund, authorised by the Authority and opened in May 2014. WIM was the investment manager of the WEIF from September 2016, when it took over the role from WIM LLP which had been the investment manager from the inception of the fund, and Link Fund Solutions Ltd ("Link") was the WEIF's Authorised Corporate Director ("ACD"). As a UCITS fund, the WEIF was subject to a detailed regulatory framework designed to offer protection to unitholders. Investors should be able to have confidence that UCITS funds they invest in will be managed in accordance with the regulatory framework. That is particularly important where funds are marketed to a range of investors, including consumers who are investing for themselves and are often heavily reliant upon those funds being managed in an appropriate way.

2.3. The WEIF attracted a range of investors including consumers as well as professional investors. It held substantial investments and its Net Asset Value reached a peak value of just over £10.1 billion in May 2017. The previous month, in April 2017, following the UK's vote in June 2016 to leave the European Union, WIM refocused its investment strategy for the WEIF away from large global companies towards UK companies which were frequently smaller and less well capitalised. WIM made its investment decisions for the fund in accordance with this strategy, which led to a change in the balance of the WEIF's holdings away from highly liquid stocks to those which were less liquid. As a result, many of the assets held by the WEIF could not be liquidated within the short timeframe required to meet redemptions under the regulatory framework and the fund's terms and conditions. This gave rise to liquidity risk – the risk that, while a fund may hold assets of sufficient value to cover its liabilities (including redemption requests), it has insufficient liquid funds to meet these liabilities in the required timeframes.

2.4. Following a persistent trend of poor performance, investor redemptions and deteriorating liquidity as detailed below, the WEIF's value had fallen to around £3.6 billion by the time of the fund's suspension on 3 June 2019 (a decline of over £6.5 billion). The WEIF was subsequently put into liquidation without reopening, meaning that investors' holdings in the fund could not be redeemed at will in accordance with the applicable redemption policy and the requirements of the regulatory framework.

2.5. For funds where investors expect to be able to withdraw their investments at short notice, it is particularly important that liquidity is appropriately managed to ensure that this can occur. In particular, investors are entitled to expect that investment managers such as WIM will diligently manage liquidity to ensure that:

(a) redemptions can be serviced in accordance with the redemption policy applicable to the relevant fund;

(b) unitholders will be treated equally, and in particular that unitholders should not be subject to disadvantage for remaining in the fund, should other unitholders redeem; and

(c) there is a prudent spread of risk in the fund.

2.6. During the Relevant Period, WIM failed to exercise due skill, care and diligence in carrying out its responsibilities in respect of the liquidity of the WEIF as summarised in paragraph 2.1 above. In particular:

(a) The WEIF's liquidity profile was unreasonable and inappropriate in light of the regulatory framework and redemption policy in the fund prospectus which allowed investors to redeem their investment within 4 business days.

(b) WIM made unreasonable and inappropriate investment decisions in the face of ongoing redemptions and net outflows from the fund, which contributed towards a significant deterioration in the WEIF's liquidity.

(c) WIM failed to implement the applicable liquidity risk framework effectively.

(d) WIM's metrics and methodologies used to measure liquidity contemporaneously (including stress testing) were unreasonable and inappropriate.

(e) WIM failed to respond appropriately to the ongoing deterioration in the WEIF's liquidity, which was apparent even on the unreasonable and inappropriate metrics which it used. Further, WIM failed to pay due regard to (and effectively ignored) the warning signs (including the warnings received from Link) regarding the fund's liquidity profile and the impending crossing/breaches of the existing triggers/limits set by the applicable liquidity framework. Instead, WIM chose to change, or persuade Link to change, the liquidity framework.

2.7. The Authority considers that WIM's investment decisions and other failings outlined in this Notice resulted in the WEIF's liquidity profile and its associated liquidity framework becoming unreasonable and inappropriate. They materially increased the risk that suspension of the fund would be required, and thereby place those investors who did not redeem prior to the point of suspension at a disadvantage. The WEIF was ultimately suspended by Link on 3 June 2019 due to liquidity issues. This followed a request from Kent County Council ("KCC"), which at the time was the largest single investor in the WEIF, to redeem its holding in full. Since being suspended, the value of many of the assets held within the WEIF has reduced significantly, meaning that investors have received, or are entitled to receive, significantly less than the value of their investments at the point of suspension.

The WEIF's liquidity profile was unreasonable and inappropriate

2.8. The unreasonable and inappropriate liquidity profile of the WEIF maintained by WIM is illustrated by the following facts and matters:

(a) WIM applied certain triggers and limits in respect of the liquidity monitoring metrics that it used. If these liquidity thresholds were crossed/breached, WIM was required to take specified actions (which involved updating or invoking contingency plans) which sought to ensure that the WEIF's liquidity would not deteriorate any further. Under the monitoring metric used by WIM from October 2018 onwards (the "Revised Four Bucket Model"), one of the triggers applied by WIM was first crossed in April 2019. That metric was unreasonable and based on inappropriate assumptions. Had WIM instead used a reasonable monitoring metric based on appropriate assumptions, the same trigger would have been crossed continuously from July 2018 at the very latest.

(b) Even on WIM's own contemporary calculations, it was or ought to have been clear that the liquidity of the WEIF was deteriorating and imprudent. Indeed, within WIM it was recognised in August 2018 that it could be "*hard to argue we're meeting our COLL liquidity obligations*", if the fund's liquidity continued to deteriorate when assessed against one of WIM's principal liquidity metrics (the "Initial T+20 Metric" as further addressed below). Instead of taking appropriate action to improve the WEIF's liquidity, WIM unreasonably ceased to apply the triggers and limits in respect of this metric without an adequate replacement. Had WIM continued to apply this metric, there would have been a continuous crossing of the trigger and breach of the limit from August 2018 and September 2018 respectively, on WIM's own contemporaneous calculations.

(c) Other liquidity metrics which were not contemporaneously applied, but which the Authority has used as a cross-check, also show that the liquidity of the WEIF was deteriorating and imprudent.

(d) In the Authority's view, from September 2018 onwards, the WEIF would not have been able to continue to meet redemptions in extreme but plausible scenarios.

(e) The WEIF was an outlier among Comparator Funds. During the Relevant Period, it was less liquid than the least liquid of such Comparator Funds in a number of respects. By way of example, the proportion of the WEIF's securities that were able to be liquidated within 7 days was lower than all other Comparator Funds throughout the Relevant Period and deteriorated from 18% in July 2018 to 8% on 3 June 2019, which was significantly lower than the bottom ranked Comparator Fund.

2.9. Despite the above, and as summarised below, WIM failed to adopt a reasonable and appropriate liquidity framework and effectively ignored warning signs, including warnings received from Link, regarding the fund's deteriorating liquidity profile.

Failings in WIM's approach to its investment decisions

2.10. The liquidity of the WEIF was principally affected by the investment decisions as to which assets to buy, sell or hold. In the Relevant Period, the total amount of shares sold from the WEIF was approximately £2.2 billion and the total amount of shares purchased was approximately £0.9 billion, resulting in a total net outflow of approximately £1.3 billion. An analysis of WIM's investment activity during the Relevant Period shows that it did not adopt a balanced approach to its buying and selling activity as it sold a much greater amount and proportion of more liquid assets than it bought, and bought a greater amount and proportion of more illiquid assets than it sold. This resulted in an increase in the amount of less liquid assets being held by the fund relative to its more liquid assets and a significant deterioration in the fund's liquidity profile. In addition, urgent steps to rebalance the portfolio should have been undertaken to ensure fairness to all investors, not just those seeking to redeem. By 3 June 2019 only 8% of the WEIF was able to be sold within 7 days, which was neither prudent nor reflective of a "*medium*" risk appetite, in circumstances where investors were entitled to redeem their investment and be repaid within 4 business days.

2.11. Further, between January 2018 and February 2019, the listing of certain previously unquoted securities on the International Stock Exchange, a stock exchange headquartered in Guernsey ("TISE"), enabled WIM to increase the WEIF's holdings in those securities. This was despite the fact that the securities: (1) were classified as amongst the most illiquid securities held by the WEIF, and even after listing would remain as such; and (2) had the same characteristics in liquidity terms as unquoted securities (which were subject to a regulatory limit of 10% of the property of the WEIF). Moreover, the liquidity of the WEIF was deteriorating and continued to do so until the end of the Relevant Period. In making further investments in these securities during the Relevant Period in these circumstances, WIM failed to pay due regard to the need to ensure an appropriate liquidity profile for the WEIF.

Failure to implement the liquidity risk framework effectively

2.12. Throughout the Relevant Period, WIM's stated risk appetite for liquidity risk (including for the WEIF) was *"medium"*, which was said to reflect *"a moderate amount of liquidity risk"* while recognising the need to "*ensure that there is sufficient liquidity to meet investor redemptions at all times*". In fact, during the Relevant Period, the WEIF carried a significantly higher level of liquidity risk. As noted above, the WEIF was an outlier among Comparator Funds in terms of its liquidity and, after a sustained period of deterioration of the WEIF's liquidity, the fund was ultimately suspended and put into liquidation without reopening. Further, WIM should have conducted an annual risk appetite review in or around March/April 2019, but failed to do so, which was a particularly significant omission given that this fell within a critical period for the WEIF's liquidity (being three months before the fund was ultimately suspended).

Failings in WIM's metrics and methodologies used to measure liquidity

2.13. WIM's metrics and methodologies used to measure liquidity were unreasonable and inappropriate. In particular:

(a) WIM unreasonably decided to cease applying the triggers and limits in respect of the Initial T+20 Metric in September 2018 without any adequate replacement, and unreasonably failed to take any (or any adequate) action in light of the continuing deterioration in the Initial T+20 Metric thereafter.

(b) Subsequent to discontinuing the Initial T+20 Metric, WIM adopted a methodology, which was also used by Link, which applied a Participation

Rate of 100%. A 100% Participation Rate was unrealistically optimistic as it assumed that WIM could sell the entire holding of a security which was traded on a given day without materially affecting the price of that security. The use of a 100% Participation Rate was combined by Link and WIM with the adoption of the Full Allocation Approach, whereby a security was assigned to a liquidity bucket based upon the number of days it was expected to take to dispose of all shares held by the fund in that security. These two assumptions had first been adopted by Link in the belief that they offset each other. WIM did not test this belief or challenge it. In the Authority's view, the Full Allocation Approach did not fully offset the 100% Participation Rate and instead the combined assumptions created an unjustifiably positive impression of the WEIF's liquidity. Had a more reasonable and appropriate Participation Rate been adopted, even if combined with a Linear Allocation Approach (whereby a security was assigned to numerous liquidity buckets based upon the number of shares in the security that were expected to be disposed of each day), actions would have been triggered under liquidity thresholds.

(c) The liquidity thresholds were unreasonable and inappropriate in light of the WEIF's redemption policy and metrics adopted. They were set in such a way that action would only be required when it was already too late. Meeting the KCC redemption would have taken the WEIF only 1% over one of its liquidity limits. Link decided to suspend the WEIF when KCC redeemed and therefore by that stage had accepted that the contingency plans which had been developed were ineffective and could not adequately resolve the liquidity issues.

(d) When assessing liquidity, WIM calculated the average daily traded volumes of securities using a 12-month average, which smoothed out fluctuations in liquidity and led to potential inaccuracies in the depiction of the WEIF's liquidity.

(e) WIM did not adequately stress test the WEIF. In particular, it did not test for extreme but plausible scenarios. Had WIM done so, it would have realised that the WEIF lacked sufficient liquidity to withstand such scenarios.

2.14. WIM's failure properly to measure the liquidity of the WEIF exposed investors to unnecessary risk. In the Authority's view, had WIM properly measured the liquidity in the WEIF, the true scale of the liquidity problem summarised above would have been known (not least because thresholds would have been crossed/breached).

Further, had appropriate triggers and limits been adopted, action in relation to liquidity would have been triggered earlier. Because neither happened, the WEIF's liquidity was allowed to deteriorate, thereby materially increasing the risk that suspension would be required and placing investors who did not redeem prior to the point of suspension at a disadvantage.

WIM's failure to respond appropriately to warning signs

2.15. On WIM's own contemporary calculations, it was or ought to have been clear that the liquidity of the WEIF was deteriorating and imprudent, as set out in paragraph 2.8(b) above. The existing liquidity risk framework – as amended from time to time – showed a persistent trend of deteriorating liquidity and the crossing of the applicable triggers and, on occasion, breaches of the applicable limits. However, WIM failed to recognise the need to act in response to these warning signs and instead made investment decisions which exacerbated the liquidity difficulties faced by the fund.

2.16. Even if WIM had not appreciated the significance of these warning signs, Link communicated to WIM as early as November 2017 that the WEIF's liquidity profile was becoming unbalanced and that action needed to be taken. However, WIM did not heed Link's warnings and did not seek to change its investment decisions to rebalance the WEIF's liquidity profile, which continued to deteriorate.

2.17. Subsequently:

(a) Link imposed liquidity limits in May 2018 as a backstop position to prevent the liquidity profile from deteriorating any further. However, during the Relevant Period, those limits were treated (by both WIM and Link) as an acceptable framework within which the WEIF was to be run, without rebalancing the portfolio away from the inappropriate and unreasonable liquidity profile described above. WIM unreasonably treated the limits as definitive and exhaustive of its obligation to maintain an appropriate liquidity profile for the fund.

(b) In September 2018, WIM proposed (and Link approved) a change in the liquidity monitoring framework. That change was adopted despite the fact that:

(i) Triggers and limits which had previously been part of the monitoring framework and which were identifying, and were likely to continue (and did in fact continue) to identify, crossings/breaches of liquidity thresholds, were discontinued.

(ii) The new monitoring framework was less prudent (in the sense that it did not identify the liquidity profile as crossing/breaching triggers and limits, whereas the previous framework did), but the relevant thresholds were not adjusted downwards to take this into account.

(c) From September 2018 onwards, Link repeatedly communicated to WIM that there was a need to improve the overall liquidity profile of the WEIF. However, WIM disagreed with Link's view and failed to take appropriate steps in response. For example, Link told WIM that there was a *"need to improve the overall liquidity profile of the fund"* and for the *"fund to be rebalanced to a considerably more liquid profile"* (on 20 September 2018); it *"strongly* [urged] *WIM to bring the liquidity profile out of the trigger by month end"* (on 28 March 2019); and told WIM that the WEIF should be brought out of the trigger condition *"as soon as practicable"* (on 4 April 2019). However, WIM failed to respond reasonably or appropriately to Link's concerns: indeed, on 9 April 2019, it proposed to change the liquidity metrics to less prudent ones.

2.18. WIM's failure to take appropriate steps during the Relevant Period to ensure that liquidity in the WEIF was properly managed meant that the unreasonable and inappropriate liquidity profile of the WEIF was not addressed and continued to deteriorate until the WEIF was suspended by Link on 3 June 2019.

Sanction

2.19. The Authority's operational objectives include securing an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system. WIM's failings threatened these objectives, resulting in significant losses to investors and an adverse impact on confidence in the UK fund management sector. The Authority therefore has decided to impose a financial penalty on WIM in the amount of £40,000,000 pursuant to section 206 of the Act for breaches of Principle 2 (due skill, care and diligence).

3. DEFINITIONS

3.1. The definitions below are used in this Decision Notice:

"ACD" means an Authorised Corporate Director of a fund;

"the Act" means the Financial Services and Markets Act 2000;

"ADTV" means the Average Daily Traded Volume of a security, which is the average number of shares traded per day on an exchange over a certain period of time;

"AFM" means Authorised Fund Manager;

"ALR" means WIM's Action Learning Review process, which was a forum introduced in the first quarter of 2018 for the purpose of ensuring that its business operated within an agreed control framework, policies and procedures;

"AUM" means assets under management, which is a total value of a fund's assets;

"the Authority" means the Financial Conduct Authority;

"Benevolent" means Benevolent AI Limited;

"COLL" means the Collective Investment Schemes sourcebook, part of the Handbook;

"Comparator Funds" means 221 funds identified by the Authority with comparable characteristics to the WEIF in terms of the size and nature of the funds, their geographical market and the time period in which they operated;

"Corrected Four Bucket Model" means a liquidity model used by the Authority applying an alternative set of assumptions to those used in the Revised Four Bucket Model;

"DEPP" means the Decision Procedure and Penalties Manual, part of the Handbook;

"ENFG" means the Authority's Enforcement Guide;

"Four Bucket Model" means the Initial Four Bucket Model and Revised Four Bucket Model used by WIM and Link as described in this Notice;

"Full Allocation Approach" means a liquidity risk monitoring approach in which a security was assigned to a liquidity bucket based upon the number of days it was expected to take to dispose of all shares held by the fund in that security;

"FVP" means Fair Value Pricing, a means of estimating the value of an asset where no market value is readily ascertainable;

"Handbook" means the collection of regulatory rules, manuals and guidance issued by the Authority as in force during the Relevant Period;

"IMA" means the Investment Management Agreement between Capita Financial Managers Limited (which became Link on 6 November 2017) and WIM LLP (subsequently transferred to WIM on 19 September 2016) dated 30 May 2014;

"Industrial Heat" means Industrial Heat, LLC;

"Initial Four Bucket Model" means the liquidity model used by Link from January until October 2018 and monitored by WIM from May until October 2018, as described at paragraph 4.41 below;

"IOC" means WIM's Investment Oversight Committee;

"IOSCO" means the International Organization of Securities Commissions, an association of national securities and financial regulators from over 100 countries;

"KCC" means Kent County Council;

"KIID" means Key Investor Information Document;

"Linear Allocation Approach" means a liquidity risk monitoring approach in which a security was assigned to numerous liquidity buckets based upon the number of shares in the security that were expected to be disposed of each day;

"Link" means Link Fund Solutions Limited, known until 6 November 2017 as Capita Financial Managers Limited (FRN 119197);

"NAV" means Net Asset Value, the value of a fund's assets minus its liabilities;

"NEX" means the NEX Exchange Growth Market (which has since been renamed as Acquis Stock Exchange), a stock exchange headquartered in England;

"Ombu" means Ombu Group;

"Participation Rate" means an estimate of the percentage of ADTV of a security that the WEIF was able to sell without having a significant impact on the price of that security;

“Principle” means one of the Principles for Businesses, rules set out in the section of the Handbook entitled “Principles for Businesses” (PRIN);

“RCR” means the Redemption Coverage Ratio, a ratio based on WIM’s liquidity metrics which measured the ability of the WEIF to meet redemption requests;

"RDC” means the Regulatory Decisions Committee of the Authority (see further under Procedural Matters below);

“Relevant Factors” means the factors affecting a fund’s liquidity as identified by the Authority in **Annex A**;

“Revised Four Bucket Model” means the liquidity model used by WIM and Link from October 2018 until the WEIF’s suspension on 3 June 2019, as described at paragraph 4.46 below;

“the Relevant Period” means the period from 31 July 2018 to 3 June 2019;

“Sabina” means Sabina Estates Limited;

“the Statistical Model” means the statistical model used by the Authority to assess the liquidity of the WEIF, as described in paragraphs 4.135 to 4.136 and **Annex A** below;

“SYSC” means the part of the Handbook entitled Senior Management Arrangements, Systems and Controls;

“TISE” means the International Stock Exchange, a stock exchange headquartered in Guernsey;

“the TISE companies” mean Benevolent, Industrial Heat, Ombu and Sabina;

“the TISE securities” mean securities in the TISE companies;

“the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber);

“UCITS” means an undertaking for collective investment in transferable securities, as defined in section 236A of the Act;

“Unquoted Securities” means transferrable securities which are not listed and traded on an eligible market;

"the Warning Notice" means the Warning Notice dated 19 February 2024 given to WIM;

"the WEIF" or "the fund" means the LF Woodford Equity Income Fund (called the CF Woodford Equity Income Fund between May 2014 and November 2017, the LF Woodford Equity Income Fund between November 2017 and October 2019, and thereafter the LF Equity Income Fund) (FRN 635902);

"WIM" means Woodford Investment Management Limited (FRN 745433); and

"WIM LLP" means Woodford Investment Management LLP, which acted as the investment manager of the WEIF from its inception in May 2014 until September 2016 when the IMA was transferred from WIM LLP to WIM.

4. FACTS AND MATTERS

SECTION A: BACKGROUND

<u>A1: Relevant parties</u>

4.1. The WEIF is a sub-fund of the LF Woodford Investment Fund, an open-ended UCITS scheme authorised by the Authority and incorporated in May 2014. After its NAV reached a peak value of just over £10.1 billion in May 2017, the WEIF was the subject of a persistent pattern of poor performance, redemptions and deteriorating liquidity and was ultimately suspended by Link on 3 June 2019, as described further at paragraph 4.128 below.

4.2. WIM LLP was the initial corporate vehicle founded by Neil Woodford for the purpose of conducting his investment management business and acted as the investment manager of the WEIF from its inception in May 2014 until September 2016. The launch of WIM LLP was contemporaneously described in the press as a *"landmark moment in British fund management"* owing to Mr Woodford's status as a *"star of the fund management world"* based on the results and experience he had accumulated over 25 years in his previous role as a fund manager at Invesco Perpetual. Mr Woodford was one of only two members of WIM LLP. In September 2016, WIM LLP's management of the WEIF was transferred to WIM, which was a private limited company founded by Mr Woodford and another person in April 2016.

4.3. Mr Woodford was the majority owner of WIM and a central figure at WIM, due to his role not only as a director but as Head of Investment and the lead fund manager of the WEIF, and (from July 2017) the designated 'risk owner' in respect of investment risk, which included liquidity risk.

4.4. Link was the ACD of the WEIF from the fund's inception . The ACD's role was to manage and administer the WEIF in accordance with the functions set out in COLL 6.6.3R. Broadly, an ACD maintains regulatory documentation (including the fund's Prospectus and the KIID), maintains operational relationships with key stakeholders (including shareholders and the Authority), values and ensures accurate pricing of the fund's assets, and monitors relevant activities of the investment manager (which role Link had delegated to WIM). As the WEIF's ACD, Link had a regulatory responsibility for the management of the fund. Link monitored and oversaw the WEIF and was required to ensure that it acted in the interests of all investors. However, Link did not involve itself in deciding which particular investments were bought, held or sold. WIM was responsible for making (and did in fact make) those decisions.

A2: WIM's responsibilities in respect of liquidity risk

4.5. The ability of the WEIF's investors to redeem the value of their investments at short notice was of fundamental importance. This was reflected by the regulatory framework and the fund's terms and conditions, which provided that investors were entitled to redeem their investments and be repaid within 4 business days. However, as outlined in more detail below, a significant proportion of the assets held by the WEIF could not be liquidated in such a short timeframe or could only be liquidated at significantly reduced prices. This gave rise to liquidity risk – the risk that, while a fund may hold assets of sufficient value to cover its liabilities (including redemption requests), it has insufficient liquid funds to meet these liabilities in the required timeframes, to the detriment of investors.

4.6. In managing the WEIF's liquidity risks, WIM and Link were obliged to ensure that the fund complied with the Authority's rules, including those set out in Chapter 5 of COLL. These include specific threshold rules, for example that no more than 10% of the property of a UCITS scheme, such as the WEIF, may be invested in Unquoted Securities, but also qualitative rules such as that the UCITS scheme aims to provide a prudent spread of risk (which includes liquidity risk) and that the liquidity profile is appropriate to the fund's redemption policy.

4.7. WIM's responsibilities in respect of liquidity risk were set out (in the first instance) in the **IMA**. Under the terms of the IMA:

(a) WIM acknowledged and agreed that it would be responsible for ensuring that the fund was managed at all times in accordance with the Prospectus and the provisions of Chapter 5 of COLL (Clause 2.1);

(b) WIM was required to exercise its investment discretion compatibly with the provisions of Chapter 5 of COLL and with the standard of care that could reasonably be expected of a professional discretionary investment manager acting in good faith and with reasonable care and skill (Clause 2.2.1);

(c) WIM was further required to "*manage the liquidity of the [WEIF's] portfolio in a manner that [it] reasonably regards as being appropriate to the Fund. In particular, [WIM] shall consider, on an ongoing basis, the liquidity profile of the current and any proposed Assets of the Fund in relation to the Fund's overall liquidity requirements (and requirements in different market conditions)*" (Clause 2.2.3);

(d) WIM was required to "*regularly review the Fund's portfolio to ensure that the Fund is being managed in accordance with Clause 2.2*" (Clause 4.2.6);

(e) in performing its duties under the IMA, WIM was required, at all times, to *"follow a risk management process consistent with the FCA Rules and shall ensure that the Fund's investments are managed in a manner which shall enable each of the Fund and [Link] to comply at all times with the requirements of the Regulations, the Prospectus and the Instrument in relation to the redemption of Shares."* WIM was required to *"provide [Link] with details of its risk management process" and to "notify [Link] promptly if it proposes to change any aspect of such process"* (Clause 2.2.6).

4.8. WIM's responsibilities in respect of the WEIF's liquidity were further reflected in its policies and practice:

(a) WIM's Investment Risk Management Policy noted that WIM had a *"medium"* appetite for liquidity risk, which was intended to reflect *"a moderate amount of liquidity risk to meet our investment objectives and style"*. It stated that *"we will ensure that there is sufficient liquidity to meet investor redemptions at all times and have sufficient systems and controls to monitor liquidity levels"*.

(b) WIM's Investment Risk Management Procedures noted that *"our investment risk monitoring controls are designed to ensure that we are only exposing* *the funds to an acceptable level of risk from our investment approach"*, including in respect of liquidity risk.

(c) WIM periodically prepared Liquidity Contingency Planning Documents, the explicit purpose of which was to *"illustrate the liquidity management and monitoring undertaken by* [WIM]*"* and *"assist us in providing sufficient liquidity to all our clients in accordance with our regulatory and mandate obligations"*.

(d) Further, regarding the liquidity metrics applied by WIM as addressed in paragraphs 4.28 to 4.57 below: (a) WIM applied its own set of liquidity monitoring metrics up to September 2018 which differed from Link's metrics; and (b) even after the amendments made to WIM's metrics in October 2018, which effectively aligned the metrics applied by WIM and Link, WIM continued to conduct its own daily reporting and/or monitoring of all of these metrics.

A3: WIM's governance structure

4.9. WIM's governance structure comprised the following key bodies.

4.10. The **Management Board:**

(a) This Board met quarterly. It had a mandate to do the following (among other things):

(i) determine the appropriate risk appetite and tolerances for WIM (including in respect of liquidity risk);

(ii) provide support, guidance and insight regarding WIM's strategy;

(iii) provide forward-looking consideration of all relevant factors which could affect WIM's strategy including (for example) industry trends and competitor activity.

(b) The responsibilities of the members of the Management Board included:

(i) setting WIM's risk appetite (including in respect of liquidity risk);

(ii) annually reviewing and approving any proposed changes to WIM's risk appetite statements.

4.11. Separately, the **Oversight Board** served to provide an independent check on WIM's key controls (including risk and compliance controls) and its risk management framework.

4.12. The **Management Team** reported to the Oversight Board and (via a dotted reporting line) to the Management Board. As to the role and responsibilities of the Management Team:

(a) The Team met monthly and its purpose was to *"develop and deliver against business strategy, projects, medium-term plans and budgets"*.

(b) Its members each had the following specific accountabilities (among others):

(i) *"ensuring there is an effective management structure and organisation within the company which is consistent with the effective delivery of the company business plan"*;

(ii) *"ensuring the company maintains an effective internal control framework which is designed to: enable the company to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company strategic objectives"*;

(iii) *"maintaining an oversight of the activities of the Action Learning Review"* which was a successor committee to the IOC established in the first quarter of 2018 (as further described in paragraph 4.15 below).

4.13. In addition, the **IOC** was a further body which met quarterly until it was replaced in August 2018. As to the role and responsibilities of the IOC:

(a) The purpose of the IOC was to oversee investment risk across all of WIM's funds and mandates by providing:

(i) oversight of the daily investment risk monitoring process;

(ii) independent questioning of the investment approach and decisions taken by the Investment team in the previous quarter;

(iii) a review of the investment team's strategy for the following quarter.

(b) IOC meetings therefore served to discuss "*investment risk, performance and strategy"* including (for example) the following:

(i) construction and characteristics of the portfolio;

(ii) liquidity of individual securities (quoted and unquoted);

(iii) liquidity profile of the portfolio;

(iv) stress testing.

4.14. The **control functions** comprising the Risk function and the Compliance function:

(a) The Risk function was responsible for (among other things):

(i) providing an *"independent review"* of investment risks;

(ii) developing, managing and embedding WIM's risk management framework;

(iii) managing the complete, accurate and informative reporting and presentation of risk to relevant committees, boards, the ACD and oversight functions.

(b) The Compliance function was responsible for (among other things):

(i) developing, initiating, maintaining and revising policies and procedures to ensure compliance with all legal and regulatory requirements;

(ii) developing and maintaining an appropriate monitoring programme to ensure compliance with all policies and procedures;

(iii) providing an independent review and evaluation to ensure that compliance issues within WIM were being appropriately evaluated, investigated and resolved.

4.15. Further, members of the Risk and Compliance functions were members of the **Action Learning Review**, being a forum introduced in the first quarter of 2018 the purpose of which was to "*ensure the business is operating within the agreed control framework, policies and procedures*". This was supported by an **Event & Huddle** process, pursuant to which members of the ALR and other management as appropriate would convene to discuss events such as (for example) crossing a trigger or breaching a limit to discuss and agree actions in response, as well as perform a root cause analysis.

<u>A4: WIM's investment strategy and the WEIF's performance</u>

4.16. From its establishment in May 2014 to the end of June 2014, the total NAV of the WEIF reached nearly £1.7 billion. Substantial numbers of investors reportedly requested to move their investments to Mr Woodford's new fund, following his announcement that he was leaving Invesco Perpetual.

4.17. From June 2014 to May 2017, the WEIF continued to attract investors and the fund's NAV grew to a peak of just over £10.1 billion by May 2017. Between 2 June 2014 and 31 May 2017, the WEIF generally outperformed the FTSE All-Share Index. As at 31 May 2017, the WEIF was heavily weighted towards: (i) Healthcare (including holding AstraZeneca (8.87%)); Consumer Goods (including holding Imperial Brands (6.52%) and British American Tobacco (3.73%)); and (iii) Financials (including holding Legal & General (5.63%) and Provident Financial (5.51%)).

4.18. In April 2017, Mr Woodford decided to refocus the WEIF's investments from large global companies to UK-focused companies, which were frequently smaller, less well capitalised companies. The significance of this change in strategy on the WEIF's liquidity was two-fold:

(a) First, due to the nature of the companies targeted by Mr Woodford's revised strategy, the WEIF became invested in less liquid stocks:

(i) shortly before the announcement of his revised strategy, Mr Woodford himself described his investment approach in the press as a *"very extreme minority sport"* which involved *"investing in early stage, illiquid businesses"*;

(ii) WIM recognised in its liquidity contingency planning that the result of the *"change in investment strategy and the switch into UK securities that have a lower market cap"* was that there had been *"a change in the liquidity profile of the fund and the fund has moved towards the* [liquidity] *limits originally set out […]"*;

(iii) contemporaneous press commentary following the adoption of Mr Woodford's revised strategy in 2017 (and continuing through to 2019) noted that:

(i) "*(f)or funds such as Mr Woodford's, large investor redemptions can pose liquidity challenges because he holds significant positions in a relatively small number of companies*";

(ii) the WEIF "*now has a substantial exposure to small, illiquid companies*";

(iii) "*investors worry about the fund's high concentration in smaller, more volatile stocks, including private unlisted companies*" and "*(t)he fund is heavily positioned in smaller companies, including Aim [alternative investment market] stocks, which are typically illiquid*".

(b) Secondly, following the adoption of this strategy, the fund significantly underperformed the FTSE All-Share Index, which led to consistent outflows in the form of redemptions, as further set out below. The result of this sustained period of underperformance and redemptions was that WIM faced liquidity challenges that were unlikely to be resolved in the near to medium term, and WIM needed to recognise the likelihood of ongoing redemptions when managing the liquidity risks presented by the fund, especially in light of the change in Mr Woodford's investment strategy described above.

4.19. As contemporaneously explained by WIM to its investors, Mr Woodford's change in strategy was based on the fact that he was "*more bullish than consensus*" on the prospects of the UK economy following the UK's vote in June 2016 to leave the European Union:

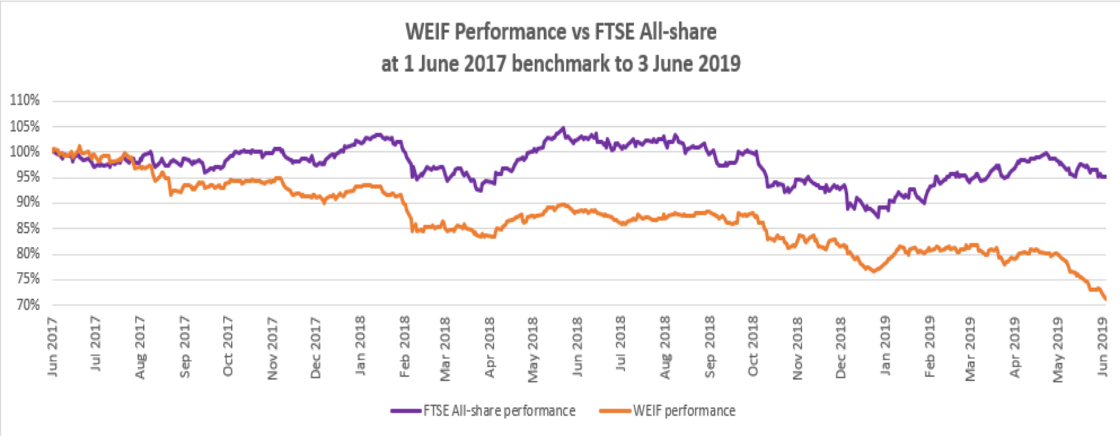
(a) As described by WIM to one of the fund's largest investors, KCC: "*In a nutshell, [Mr Woodford] is becoming more bullish than consensus on the UK economy. He thinks that people are too cautious post Brexit*".

(b) As set out in the blog that WIM published in May 2017 to explain its new UK-focused investment strategy: "*Neil has been keen to take advantage of what he sees as a compelling, contrarian opportunity in domestic stocks, which have become too cheap to ignore in the wake of the Brexit vote last year*".

(c) External commentators similarly recognised that Mr Woodford "*has been an outlier among UK equity investors since the referendum vote in 2016*" and *"has taken the opportunity to buy shares of companies that have fallen in value as a result of the market's fears about possible Brexit consequences"*.

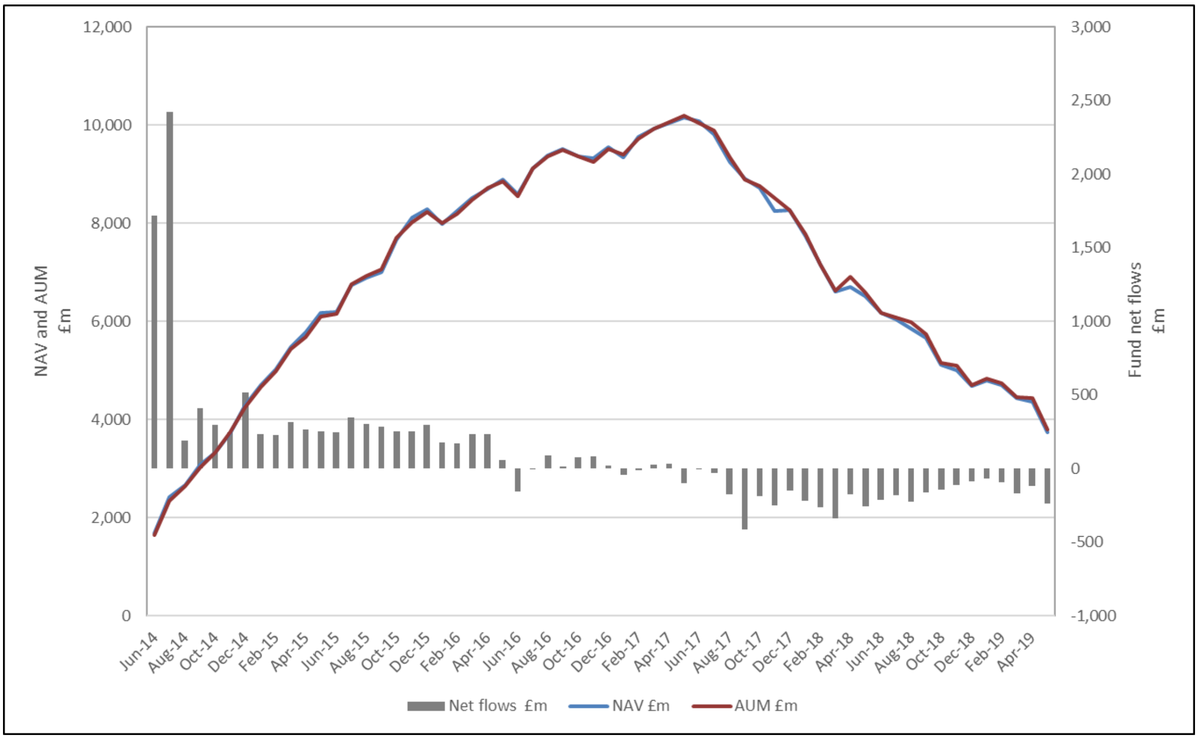
4.20. Following Mr Woodford's adoption of this UK-focused strategy, from June 2017 onwards, the WEIF generally underperformed against the FTSE All-Share index:

Figure 1: WEIF Performance vs FTSE All-Share



4.21. Owing to poor investment performance and persistent investor withdrawals, the WEIF's NAV dropped from just over £10.1 billion in May 2017 to around £6 billion in July 2018 and to around £3.6 billion by the time of its suspension on 3 June 2019, an overall decline of over £6.5 billion:

Figure 2: AUM, NAV and fund in/outflows of the WEIF from launch until its suspension



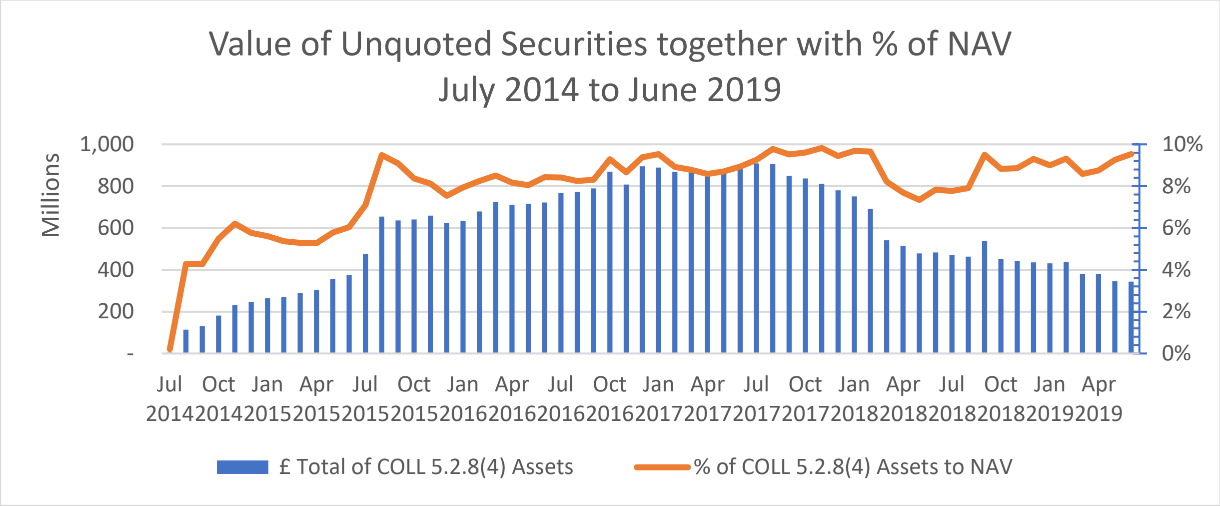
A5: WIM's investment in Unquoted Securities

4.22. The principal document that set out the WEIF's investment objective and remit was the Prospectus, accompanied by the KIID. Both the Prospectus and the KIID stated that the WEIF might invest in unlisted companies and overseas entities.

4.23. The WEIF made its first investment in Unquoted Securities in July 2014. The WEIF held investments in the Unquoted Securities of 64 different issuers during the lifetime of the fund. The maximum value of Unquoted Securities that is permitted in a UCITS fund is 10% of its NAV, as set out in COLL 5.2.8(4) which WIM was required to comply with through its contractual arrangements with Link. Some of the Unquoted Securities subsequently became listed, meaning that they were no longer classed as within the 10% unquoted limit by Link or WIM. These included the companies that became listed on TISE (see Section E below).

4.24. The chart below illustrates the proportion of the WEIF's NAV which comprised Unquoted Securities over its lifetime.

Chart 1



A6: Redemption by KCC and suspension of the WEIF

4.25. There was a wide range of types of investors in the WEIF, including very significant levels of retail investors, investing directly or more generally via platforms or being invested indirectly via pension funds. Whilst there were other investors with significant holdings in the WEIF, KCC was one of the largest investors in the WEIF during the period from June 2017 onwards. Its holding was valued at between £325 million (3.2% of NAV) in June 2017 and £237 million (6.5% of NAV) at the end of May 2019.

4.26. On 31 May 2019, KCC instructed WIM to redeem its entire position. Following this instruction being relayed to Link (as ACD), Link made the decision to suspend the WEIF from 3 June 2019, meaning that all remaining investors at that time (which included KCC) were unable to redeem their units at will in accordance with the applicable redemption policy and the requirements of the regulatory framework.

4.27. On 15 October 2019, Link wrote to investors in the WEIF that, having considered the future of the fund, it had decided not to re-open the fund and to wind it up as soon as practicable. It explained that this was with a view to returning cash to investors at the earliest opportunity. As at the date of this Notice, approximately £2.56 billion has been returned to investors by the WEIF's liquidators.

SECTION B: THE LIQUIDITY FRAMEWORK USED FOR THE WEIF

4.28. The framework used to monitor the WEIF's liquidity changed over time. In summary:

(a) From the fund's inception to September 2018, WIM applied "**T+ Metrics**" (in particular the Initial T+20 Metric): see Section B1 below.

(b) Further, from May 2018 to October 2018, WIM also monitored the "**Initial Four Bucket Model**" (alongside the Initial T+20 Metric until September 2018): see Section B2 below.

(c) From October 2018 to the suspension of the WEIF on 3 June 2019, WIM applied the "**Revised Four Bucket Model**": see Section B2 below.

(d) WIM also applied a number of additional liquidity metrics, including the "**Redemption Coverage Ratio**" (or "**RCR**") which applied from October 2018 onwards: see Section B3 below.

4.29. The time taken to liquidate a security without having a significant impact on its price was typically termed "T+" the relevant time period. For example, an asset that was expected to be able to be sold within one day would be categorised as "T+1".

4.30. One of the primary methods by which WIM and Link assessed the liquidity of the WEIF was by categorising assets by reference to the amount of time it was anticipated it would take to sell them. These categories were sometimes referred to as "liquidity buckets" and ranged from highly liquid (where the security could be sold relatively easily and quickly) to illiquid, frequently unlisted securities (where it would take a relatively long time to sell the security). The liquidity bucket in which a security was allocated was determined by the number of shares in that security which could be liquidated in one day. This was calculated as a product of:

(a) the ADTV of the security, which was the average number of shares traded per day on an exchange over a certain period of time; and

(b) the Participation Rate of the security, which reflected an estimate of the number of shares of that security that the WEIF could liquidate in one day, without having a significant impact on the price of that security.

4.31. The core features of each of these types of metric, and how they were altered by WIM and Link over time, are addressed in Sections B1-B3 below. These matters can be summarised as follows:

	Pre-October 2018 Period		Post-October 2018 Period
	From WEIF's Inception	**Introduced in Q1 2018**	
T+ Metrics			
Link WIM	N/A TTL Model, including the Initial T+20 Metric (used by WIM until mid-September 2018)		T+1, T+5 and T+20 Metrics
Liquidity Buckets			
Link WIM	Five Category Model N/A	Initial Four Bucket Model	Revised Four Bucket Model
Redemption Metrics			
Link WIM	Amivest Metric Various (addressed below)		Redemption Coverage Ratio (RCR)

4.32. As illustrated by this summary, WIM and Link originally applied different metrics and these were brought into alignment in a common set of metrics applied in the post-October 2018 period. The metrics relevant to WIM are as follows.

B1: T+ Metrics

Used by: WIM and Link	**Applied:** WIM: • The TTL Model, including the Initial T+20 Metric (from the inception of the fund until mid-September 2018) • The T+1, T+5 and T+20 Metrics (from October 2018 until 3 June 2019) Link: • The T+1, T+5 and T+20 Metrics (from October 2018 until 3 June 2019)

4.33. From the inception of the WEIF until mid-September 2018, WIM (or WIM LLP) used a *"Time to Liquidate"* model (the "**TTL Model**") to monitor the liquidity of the fund. The TTL Model categorised securities by reference to the time period within which they could be liquidated. These metrics are expressed as "T+" and a number of days, with T+5, for example, reflecting the proportion of the WEIF's NAV which could be liquidated within 5 days. In particular, WIM focused on the percentage of the WEIF's portfolio that could be liquidated within 20 days, expressed as a percentage of NAV (the "**Initial T+20 Metric**").

4.34. The Initial T+20 metric was calculated on a daily basis, assumed a 20% Participation Rate and used a Linear Allocation Approach. Originally the primary exchange data for ADTV was used, however at some point prior to September 2018 WIM extended this to include other trading venues. The ADTV was calculated using the preceding 6 months trading data.

4.35. WIM set an internal trigger on the Initial T+20 Metric (where the assets that could be liquidated in the 20 day period fell below 25% of NAV) and a limit (where the assets that could be liquidated fell below 20% of NAV). In the event of a trigger crossing, WIM was required to flag the crossing as an issue to the investment team; and in the event of a limit breach, to raise it as an issue to the IOC. After the IOC was replaced in August 2018, a trigger crossing or limit breach would be escalated as part of the Event & Huddle process.

4.36. WIM applied stress testing in respect of the T+ Metrics. This testing assessed the potential impact on the WEIF's liquidity of scenarios involving redemptions of 5%, 10%, 15%, 20%, 30% or 40%, and selling the most liquid assets first to meet those redemptions.

4.37. In September 2018, a few weeks before the adoption of the Revised Four Bucket Model in October 2018, WIM discontinued the Initial T+20 Metric. In particular, it ceased to apply any trigger or limit in respect of the Initial T+20 Metric, and removed it from Mr Woodford's daily update emails (which were sent to Mr Woodford by a risk analyst at the start of each working day). However, the metric continued to be calculated and displayed on WIM's electronic risk "*dashboards*". The Initial T+20 Metric (which continued to be calculated and displayed in the dashboard after September 2018) was not the same metric as the T+20 metric used by WIM for the purposes of stress testing after October 2018, which was based on different assumptions (e.g. a different Participation Rate and ADTV period) as described below.

4.38. From October 2018 onwards, WIM and Link used the T+1, T+5 and T+20 Metrics, which were introduced as a "*control mechanism*" to supplement the existing redemption monitoring procedures. These T+ Metrics used data from all exchanges, ADTV calculated as a 12-month rolling average, a 25% Participation Rate and a Linear Allocation Approach, which assigned a security to a T+ time period based on the amount that could be sold during that time period. This meant that the same security might appear in different T+ portions of the portfolio. The Redemption Coverage Ratios (see below) were produced using these outputs, and had specific triggers and limits associated with them. These metrics looked at the liquidity which was immediately available in the WEIF.

B2: The Liquidity Bucket methodologies

4.39. During the time that the WEIF was operational, WIM also used the following versions of liquidity bucketing to assess the fund's liquidity:

(a) the Initial Four Bucket Model (used by Link from January until October 2018 and monitored by WIM from May until October 2018); and

(b) the Revised Four Bucket Model (used by WIM and Link from October 2018 until the fund's suspension).

4.40. Each of these versions is addressed in turn below.

(i) *The Initial Four Bucket Model*

Used by: WIM and Link	**Applied:** Link - January 2018 until October 2018 WIM - May 2018 until October 2018

4.41. In January 2018, Link started to apply the Initial Four Bucket Model to the WEIF (replacing the model previously used by Link called the Five Category Model). The Initial Four Bucket Model was a "*bespoke control mechanism*" developed by Link which had previously used a similar model with 5 buckets for both the WEIF and the other funds (unrelated to WIM) for which Link was the ACD. The Initial Four Bucket Model was used in relation to the WEIF only and was intended to ensure that the WEIF's liquidity profile did not deteriorate further.

4.42. From May 2018 until October 2018, WIM monitored the Initial Four Bucket Model, concurrently with the TTL Model until it ceased to employ the latter in September 2018. The buckets were:

(a) Bucket 1: T+1 - T+7 (i.e. positions that could be liquidated in 7 days or fewer).

(b) Bucket 2: T+8 - T+30.

(c) Bucket 3: T+31 - T+180.

(d) Bucket 4: T+181 - T+365.

4.43. The Initial Four Bucket Model assumed a 100% Participation Rate and adopted a Full Allocation Approach. Link adopted these two assumptions in the belief that the

Full Allocation Approach and the 100% Participation Rate offset each other. WIM did not at any time test this belief or challenge it. The Initial Four Bucket Model considered ADTV data from the primary exchange on which the security was traded. It used the lower of the 5-day and 20-day average trading volume as at March 2017.

4.44. WIM monitored the Initial Four Bucket Model primarily by reference to a limit of 70% of NAV in Buckets 3 and 4 combined (although there was a disagreement between Link and WIM in May 2018 as to the significance of this limit, as further addressed in paragraph 4.88 below). In practice, WIM's monitoring was based upon Buckets 1 and 2 combined remaining above 30%, since this would mean that Buckets 3 and 4 were below 70%.

4.45. Notwithstanding its monitoring of the Initial Four Bucket Model, WIM continued stress testing in accordance with its TTL Model (as described in paragraph 4.36 above), and Link continued its own daily stress testing assessing the impact of a reduction in the ADTV of Large and Small Cap stocks by 20% and 40% respectively.

(ii) <u>The Revised Four Bucket Model</u>

Used by: WIM and Link	**Applied:** from mid-October 2018 until 3 June 2019 (i.e. the date the WEIF was suspended and the end of the Relevant Period)

4.46. As further set out in Section D3 below, WIM pressed for changes to the liquidity framework, prompted by Mr Woodford's concerns that the existing liquidity limits unduly constrained his investment strategy. Subsequently, on or around 15 October 2018, the Revised Four Bucket Model was adopted by WIM and Link as their primary method of monitoring the WEIF's liquidity.

4.47. The Revised Four Bucket Model's bucket composition and allocation remained the same as the Initial Four Bucket Model and included the 100% Participation Rate and Full Allocation Approach. It made two new adjustments:

(a) The ADTV period changed from the lower of 5 and 20-day ADTV at March 2017 to a 12-month rolling average.

(b) Under the revised methodology, ADTV was intended to capture trades from all exchanges where a security was traded, as opposed to the

Initial Four Bucket Model which only captured trades from the primary exchange.

4.48. The Revised Four Bucket Model applied further triggers and limits on the percentage of the WEIF's holdings in each bucket. In particular:

(a) The triggers applied if Bucket 4 increased above 30%, Buckets 3 and 4 combined increased above 65%, or Bucket 1 decreased below 8% of NAV. In the event of a trigger crossing, WIM was required to: (i) raise and address the crossing pursuant to the Event & Huddle procedure (described in paragraph 4.15 above); (ii) conduct a root cause analysis; and (iii) prepare or update its contingency plans as necessary.

(b) The limits applied if Bucket 4 increased above 35%, Bucket 3 and 4 combined increased above 70%, or if Bucket 1 decreased below 5% of NAV. WIM was required to address any breach of limit under its Event & Huddle procedure by invoking any applicable contingency plan and prioritising the steps needed for its execution.

4.49. For stress testing, WIM and Link tested the impact on the WEIF's liquidity of sudden 10%, 15% and 20% redemptions of the portfolio and selling the most liquid assets to meet those redemptions.

(iii) Summary of the assumptions underpinning the Initial T+20 Metric, Initial Four Bucket Model and Revised Four Bucket Model

4.50. The assumptions underpinning each of the metrics or models described above can therefore be summarised as follows.

Table 1- Summary of the assumptions underpinning the Initial T+20 Metric, Initial Four Bucket Model and Revised Four Bucket Model

Key inputs	**The Initial T+20 Metric**	**Initial Four Bucket Model**	**Revised Four Bucket Model**
	WIM	**Link & WIM**	**Link & WIM**
	Pre-October 2018	**Q1 2018 to October 2018**	**October 2018 onwards**
ADTV exchange data	Initially primary exchange; and subsequently all exchanges	Primary exchange	All exchanges
ADTV period	6 months of trading	Presented on two bases: (i) unspecified, described as "*the average daily market volume, as obtained from Bloomberg*" (referred to in the Link Liquidity Reports as the "*True data*"); and (ii) the lower of the 5 day and 20 day average volume as at March 2017 (referred to in the Link Liquidity Reports as the "*Adjusted Data*")	12 month rolling average
Participation Rate	20%	100%	100%
Allocation method	Linear Allocation approach	Full Allocation Approach	Full Allocation Approach

B3: Redemption Metrics

(i) 20 Day Net Flows Metric and redemption metrics

Used by: WIM	**Applied:** from the inception of the fund until October 2018

4.51. In the pre-October 2018 period, WIM assessed the rolling 20 day net flows for the WEIF (the "20 Day Net Flows Metric"). This metric was based on the actual historic redemptions of the fund.

4.52. WIM did not set triggers and limits in respect of the 20 Day Net Flows Metric. However, it set the following triggers and limits in respect of "*5-day redemptions*" (and after April 2018, to daily redemptions):

(a) Trigger: "*if 5-day redemptions exceed 1% of the portfolio, flag as an issue to Investment team*"; and

(b) Limit: "*if 5-day redemptions exceed 2% of the portfolio, flag as an issue to Investment Oversight Committee*".

(ii) Redemption Coverage Ratio (RCR)

Used by: WIM and Link	**Applied:** from October 2018 until 3 June 2019 (i.e. the end of the Relevant Period)

4.53. In October 2018, after adopting the Revised Four Bucket Model, WIM and Link monitored the RCR, which was based on WIM and Link's T+1, T+5 and T+20 Metrics and measured the ability of the WEIF to meet redemption requests.

4.54. The RCR served to measure the ability of the WEIF to meet redemption requests. It considered the proportion of the WEIF that could be liquidated in 1, 5 and 20 days, and was calculated by dividing the amount that could be liquidated in the period in question by the average daily redemptions based on the previous 10-day rolling average. For example, if £18 million could be liquidated in 1 day and the average daily redemptions over the previous 10 days were £2 million then the 1 Day RCR would be 9. As with the T+ Metrics, the RCR assumed a 25% Participation Rate, an ADTV of 12 months and captured trades from all exchanges.

4.55. WIM and Link set several additional triggers and limits based on the RCR. If a trigger was crossed, an event was required to be launched and a huddle convened under the Event & Huddle procedure to investigate the cause and update contingency plans. If a limit was breached, the liquidity contingency plan was required to be executed. The RCRs had the following limits and triggers:

(a) 1 Day RCR had a trigger of 8 and a limit of 5;

(b) 5 Day RCR had a trigger of 30 and a limit of 25; and

(c) 20 Day RCR had a trigger of 150 and a limit of 120.

4.56. The RCR was stress tested by WIM and Link in the same way as the T+ Metrics, by assessing the percentage of the WEIF's portfolio realisable in 1 day, 5 days and 20 days after modelling redemptions of 10%, 15% and 20%, assuming sales of the most liquid assets in order to meet those redemptions.

B4: Unquoted Securities Limits

4.57. WIM and Link also monitored the level of Unquoted Securities in the WEIF. WIM's analysis was contemporaneously reported in its Unquoted Securities Reports. There were two limits associated with this monitoring. The first limit was at 8.5%. Once this level was reached, no further investments in new Unquoted Securities were permitted. The second limit was at 9.5%. At this level, no further investments in Unquoted Securities were permitted.

SECTION C: WIM'S INVESTMENT DECISIONS

4.58. As investment manager of the WEIF, WIM was responsible through its employees for (among other things) deciding which assets to buy, sell or hold. During the Relevant Period, the total amount of shares sold from the WEIF was approximately £2.2 billion and the total amount of shares purchased was approximately £0.9 billion, resulting in a total net outflow of approximately £1.3 billion.

4.59. Liquidity risk will tend to be greater if a fund holds a significant proportion of less liquid assets – that is, those assets which take longer to liquidate – and may increase in the event of higher-than-expected or prolonged periods of net redemptions where redemptions (outflows) exceed investments (inflows). Accordingly, all else being equal, meeting redemption requests by selling more liquid assets without replacing them with assets of similar liquidity or buying more illiquid assets will generally lead to a deterioration in the liquidity profile of a fund (since this results in it holding a higher proportion of less liquid assets). This approach may lead to a position where the fund cannot meet redemption requests or can only do so by liquidating assets at significantly reduced values. This risks significant prejudice to those investors continuing to hold investments in the fund since they may be unable to access their funds at will and/or the value of their investments may reduce significantly.

4.60. During the Relevant Period, WIM could have adopted (but did not adopt) a balanced approach to its buying and selling activity, such that liquid and illiquid assets were bought and sold in amounts proportionate to the need to maintain a reasonable and appropriate liquidity profile for the WEIF. This would have prevented a disproportionate increase in the amount of illiquid assets held by the fund. Had WIM adopted a more balanced approach, the WEIF's liquidity would not have deteriorated in the manner in which it did.

4.61. Instead, as further set out below:

(a) WIM sold a much greater amount and proportion of more liquid assets than it bought, and bought a greater amount and proportion of more illiquid assets than it sold. This meant that the net outflows from Buckets 1 and 2 were far larger than the net outflows from Buckets 3 and 4, resulting in a deteriorating liquidity profile for the WEIF.

(b) In the circumstances, WIM's investment decisions failed to pay due regard to the need to maintain a reasonable and appropriate liquidity profile for the WEIF, and the approach it adopted was unreasonable. It resulted in the WEIF carrying a significantly higher level of liquidity risk and becoming an outlier among Comparator Funds. During the Relevant Period, the WEIF was less liquid than the least liquid Comparator Fund in a number of respects. By way of example, the proportion of the WEIF's securities that were able to be liquidated within 7 days (i.e. the proportion in Bucket 1) was lower than all other Comparator Funds throughout the Relevant Period and deteriorated from 16% in July 2018 to 8% on 3 June 2019, which was significantly lower than the bottom ranked Comparator Fund.

4.62. As contemporaneously recorded during the Relevant Period:

(a) During the 12 months ending on 31 July 2018, securities in Buckets 1 and 2 represented 87% of the assets sold, whereas securities in Buckets 3 and 4 represented only 13%.

(b) WIM's approach to selecting which assets to sell to meet redemptions was primarily based on the positions in which Mr Woodford had the least conviction in, rather than being based upon, or taking into account, the need to maintain an appropriate liquidity profile for the WEIF:

"Although the fund has had to sell to meet redemptions, the fund manager has chosen to liquidate those positions that he has the least conviction in"; and

"… the fund manager manages outflows as he does inflows, with decisions made from the perspective of investment conviction, not liquidity."

(c) In an investor meeting on 8 October 2018, Mr Woodford further described his approach. A note of that meeting prepared by the investor records:

"He looks through the portfolio and identifies what he loves the least […] he really likes everything in the portfolios, but will look to sell things with the least upside to fair value. He'll typically sell what he loves the least in totality before moving on in the same vein, but not always. The Equity Income fund has become more concentrated as a result of this and the positions remaining are bigger and more important."

4.63. Further, as set out in **Annex A**, the Authority has analysed the investment decisions made by WIM over the period from May 2017 to May 2019 and their impact on the composition of the fund. The analysis has been conducted by reference to the Revised Four Bucket Model as well as an alternative set of assumptions providing what the Authority considers to be a more accurate picture of the WEIF's liquidity (the Corrected Four Bucket Model). By reference to the Corrected Four Bucket Model, the analysis shows that during the Relevant Period:

(a) Mr Woodford sold a much greater amount and proportion of securities in Buckets 1 and 2 than he bought, resulting in a net reduction of £0.9 billion in the value of Buckets 1 and 2 over this period.

(b) Mr Woodford's buying and selling of securities in Buckets 3 and 4 was more balanced, resulting in a smaller net reduction of £0.4 billion in the value of Buckets 3 and 4.

(c) These investment decisions by Mr Woodford had the effect of significantly increasing the proportion of illiquid shares held by the WEIF. Over this period, by reference to the fund's NAV with percentages rounded:

(i) the proportion of securities in Bucket 1 fell by 8% (from 16% to 8%);

(ii) the combined proportion of securities in Buckets 1 and 2 fell by 9% (from 37% to 28%);

(iii) the proportion of securities in Bucket 4 increased by 8% (from 33% to 41%);

(iv) the combined proportion of securities in Buckets 3 and 4 increased by 11% (from 63% to 74%).

(d) These changes in the fund's composition were primarily driven by WIM's investment decisions and not by other factors (such as relative performance of the shares in each bucket or the movement of securities between buckets due to changing circumstances).

4.64. Still further, as set out in Section D below, WIM adopted this approach notwithstanding the clear and repeated warning signs that it received regarding the deteriorating liquidity of the WEIF. Its investment decisions served to exacerbate the deteriorating situation, and WIM continued to make investment decisions primarily based on the investment strategy Mr Woodford had adopted in April 2017 (as addressed in paragraphs 4.18 to 4.19 above) without paying due regard to considerations of liquidity.

SECTION D: WIM'S RESPONSE TO THE WEIF'S DETERIORATING LIQUIDITY

4.65. During the Relevant Period, WIM was aware that the WEIF's liquidity was deteriorating but failed to take appropriate action. WIM also adopted changes to the liquidity monitoring framework without reasonable justification. This section addresses in turn:

(a) WIM's early awareness of and response to liquidity problems (May 2017-April 2018) (Section D1);

(b) the changes to the liquidity framework made in May 2018 (Section D2);

(c) the ongoing deterioration in liquidity between May and September 2018 (Section D3);

(d) the changes to the liquidity framework made in September / October 2018 (Section D4);

(e) WIM's later awareness of and response to liquidity problems (October 2018 - June 2019) (Section D5).

4.66. Further, as set out in Section E below, WIM was aware that the WEIF held a high percentage of Unquoted Securities and assets that were valued using FVP, where the shares were not listed and traded on an exchange or there was no market price available. This issue was partially addressed by means of certain companies, in which the WEIF held Unquoted Securities, obtaining listings on TISE at WIM's suggestion. These listings did not, however, improve the liquidity of the securities in question (which were not subject to any arms' length trading, despite the listings). As particularised in Section E below, WIM: (a) was aware that the listing of the TISE companies did nothing to improve their liquidity; and (b) nonetheless chose to make further investments in the TISE securities during the Relevant Period which contributed to the overall deterioration of the WEIF's liquidity.

<u>D1: WIM's early awareness of and response to liquidity problems (May 2017 - April 2018)</u>

4.67. During the period from May 2017 to April 2018, as WIM was aware:

(a) the WEIF was subject to sustained redemptions which resulted in a net asset outflow of over £2.3 billion; and

(b) the WEIF's NAV fell by over £3.5 billion.

4.68. This sustained pattern of redemptions gave rise to a heightened level of liquidity risk (i.e. the risk that the WEIF might have insufficient liquidity to meet investor redemptions within the required timeframe), as is reflected in concerns regarding liquidity raised during this period as particularised below. These communications provide important context for further concerns raised by Link during the Relevant Period.

4.69. On **24 July 2017**, a WIM Risk Committee meeting was held. That meeting noted that the utilisation of the unquoted concentration was high, and that *"[p]ipeline suggests a breach in August 2017"*. WIM was aware of this and a number of contingencies to address the problem were considered. The Authority has seen no evidence that any of the discussed contingencies were adopted at this time.

4.70. On **17 August 2017**, Link wrote to WIM to check that *"WIM are carefully observing the current exposure to unquoted assets within WEIF and that your action plan, should it be required, is being maintained"*. WIM replied the next day, confirming that unquoted exposure was being closely monitored. Nonetheless, on **22 August 2017**, WIM's internal limit for unquoted assets was crossed.

4.71. In or before **October 2017**, Link proposed to WIM that it consider *"augmenting its liquidity testing by stress testing for the largest inflow over a period and ascertaining how similar-sized redemptions will be met and how the Fund would be rebalanced post redemption"*. WIM responded with reassurance as to the WEIF's *"effective liquidity management"* and agreed to *"nevertheless, consider your recommendation to augment our stress testing with contingency planning on how best to meet redemptions and to utilise, where necessary, the liquidity management tools described in the prospectus, notably in-specie redemptions, deferred redemptions and suspensions"*. On **30 October 2017**, a senior individual at Link wrote to WIM, asking it to reconsider this response. WIM did not however adopt Link's proposed changes to its stress testing in light of this exchange.

4.72. On **14 November 2017**, a discussion and meeting was held at WIM via Slack (an instant messaging system used within WIM) to discuss a request from Link that WIM indicate what action it was taking to mitigate any risk of crossing the unquoted concentration limit of 10%. Within the discussions the view was expressed that *"we can't really take action to avoid an inadvertent breach"*. Subsequently, no response having been sent to Link, a question was asked rhetorically, in respect of the 10% limit, *"if we are 9.9 who is concerned?"*.

4.73. On **27 November 2017**, Link shared a note with WIM which considered the WEIF's liquidity in light of the *"continuing trend of daily outflows from the Fund, averaging circa £10mn a day"*. That note concluded that the liquidity profile of the WEIF had deteriorated, as a result of increased exposure to assets in Liquidity Buckets 3 and 4 and a decrease in assets in Liquidity Buckets 1 and (more significantly) 2, which *"[did] require action to be taken",* including identifying the *"time it would take to bring the overall liquidity of the Fund to a more balanced position"*. On **29 November 2017**, a comment was made in the Slack chat that WIM was *"clearly concerned about the amount of redemption we have faced since August"*.

4.74. On **30 November 2017**, a discussion was held between Link and WIM, for which Link had produced a paper (sent to WIM on 28 November 2017), which set out actions required of WIM *"now"* in order to explain: (i) how WIM would meet a redemption of 5% of NAV or more in one day without *"further compromising the liquidity profile of the fund*"; and (ii) the time it would take to bring the overall liquidity profile of the WEIF into a more balanced position, such that the allocation to Liquidity Bucket 4 was reduced and the allocation to Liquidity Bucket 1 restored.

4.75. On **4 December 2017**, WIM wrote to Link raising a number of matters in respect of a liquidity recommendations paper that had recently been issued by IOSCO. WIM raised a number of questions with Link concerning how Link, as the *"responsible entity",* was dealing with issues raised in the IOSCO guidance.

4.76. On **5 December 2017**, Link shared a paper with WIM, the context for which was described in the background section as follows: *"[i]n response to a number of concerns raised with* [WIM] *by* [Link] *in respect of the liquidity structure of* [the WEIF]*, WIM have raised a number of matters in respect of the IOSCO paper"*. The Link paper set out its response to the questions raised by WIM and noted that failure to ensure adequate liquidity within a fund at its extreme could lead to a suspension and investors being unable to redeem their holdings, which in periods of volatility could *"cause capital erosion"*.

4.77. On **11 December 2017**, Link wrote to WIM referring to *"recent conversations and emails over the past ten days or so discussing the overall liquidity structure of WEIF, and your hope that you would be able to provide a report on this at the end of last week"*. WIM responded, proposing to send a draft contingency planning document in the next week. On **19 December 2017**, a WIM Liquidity Contingency Plan was issued which noted that the Fund *"has suffered redemptions since January 2017, with heightened redemptions since August 2017, and with September 2017 being the most stressful month since inception"*, and that *"further redemptions could compromise the fund's ability to meet its regulatory requirement, hence the need for a liquidity contingency plan"*.

4.78. In the event, the report described in the previous paragraph was submitted in early **January 2018**, after Link chased WIM for it. Around the same time, Link raised concerns with WIM about the WEIF's future ability to sell assets to meet redemption requests while not disadvantaging those investors who remained in the Fund. WIM responded by *"referring to events of September 2017 where there had been a high level of redemptions that had resulted in no material impact on investors"*. These points were reiterated to WIM at a meeting between Link and WIM on **18 January 2018**.

4.79. A Link liquidity analysis dated **18 January 2018**, shared with WIM, concluded that the circumstances *"could suggest that the redemption flow has been met by selling the more liquid assets and thereby increasing exposure to assets which will be more difficult to sell in volume",* and noted that the position required action to be taken.

4.80. On **1 February 2018**, Link sent an email to WIM, pointing out that the level of redemptions had risen recently and that a further meeting would be helpful to discuss next steps.

4.81. On **5 February 2018**, Link sent an email to WIM, asking it about its stress testing, and in particular *"the impact of a further decline in the market, combined with continuing outflow and the consequential position on the unquoted percentage"*.

4.82. On **8 February 2018**, a Link liquidity analysis sent to the Authority noted a deterioration in the overall liquidity profile of the WEIF over the period from January 2017 to January 2018. Reference was made to increased exposure to assets within Liquidity Buckets 3 and 4; a decrease in assets within Liquidity Bucket 1; and, *"more significantly",* a decrease in assets within Liquidity Bucket 2. The analysis referred to the position requiring *"action to be taken"* and needing further discussion. Link raised this at a meeting with WIM the next day.

4.83. On **6 March 2018**, the first weekly tripartite call was held between Link, WIM and the depository to the fund regarding the liquidity of the WEIF.

4.84. On **7 and 8 March 2018**, WIM employees discussed the need to enhance liquidity monitoring, *"especially when sustained redemption rates* [are] *as high as they currently are"*. On **8 March 2018**, it was agreed that WIM's control function *"need to surface the securities in WEIF into a liquidity bucket view for Neil [Woodford] and the team and not just viewed by FTSE and overseas categories"*. On **19 March 2018**, Mr Woodford's daily update emails started to include the fund's liquidity position by reference to the Initial T+20 Metric and to provide a link to the allocation of securities to buckets in the Initial Four Bucket Model (which had been in use by Link since January 2018, as described at paragraph 4.41 above). As explained at paragraph 4.43 above, the Initial Four Bucket Model adopted a 100% Participation Rate and Full Allocation Approach. Had a Participation Rate of 20% been adopted by Link (which would have been reasonable and appropriate, as set out at paragraphs 5.14 to 5.15 below, unlike the assumptions actually adopted), the Bucket 4 trigger that WIM contemporaneously set would immediately have been crossed, and would have remained so continuously until the WEIF was ultimately suspended in June 2019 (even assuming the use of a Linear Allocation Approach).

4.85. On **19 April 2018**, a WIM Oversight Board Meeting was held. At this meeting, the view was expressed that *"markets have become detached from reality"*. It was noted that *"[a] lot of work has been done on limits and concentration - everyone* *has worked hard to provide an environment"* in which the investment strategy could be maintained. This prioritisation of WIM's investment strategy, over the importance of the WEIF's deteriorating liquidity profile, persisted throughout the Relevant Period.

4.86. In **early May 2018**, there were negotiations between Link and WIM as to the position to be taken in regulatory correspondence with the Authority. WIM pushed for Link to change an original draft slide in order to remove references to a limit of 35% on Buckets 3 and 4 which Link had proposed be implemented. That change was adopted.

D2: Changes to the liquidity framework in May 2018

4.87. On or shortly after **17 May 2018**, Link raised the question with WIM as to whether it was necessary to impose new liquidity limits.

4.88. On **30 May 2018**, it appears that Link and WIM held a call on which they discussed Link's reporting to the Authority on the WEIF and changes to the Initial Four Bucket Model for the WEIF. Link's view of the call was that it and WIM had agreed a limit of 35% of NAV on Bucket 4 and a limit of 70% on Buckets 3 and 4 combined. However, Link and WIM appear to have had different understandings of what had been agreed. In particular, WIM understood that Link was reporting the limits to the Authority in the context of its own monitoring but did not accept that it had agreed to the limits; rather, it had understood that any breaches of limits would only lead to a discussion. In any event, it was by this point clear to WIM that Link had serious concerns about the liquidity profile of the WEIF.

D3: Ongoing deterioration in liquidity between May and September 2018

4.89. To WIM's knowledge, the WEIF continued to experience a persistent pattern of redemptions, net outflows and deteriorating liquidity between May and September 2018. In particular:

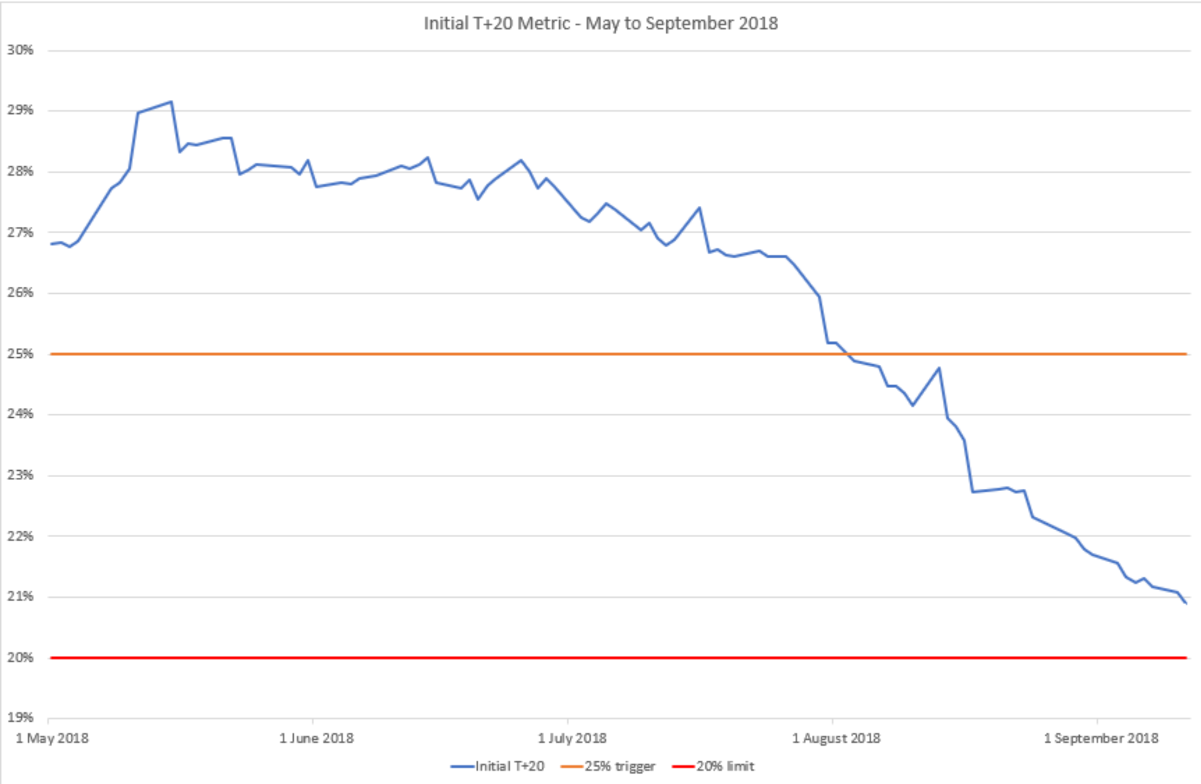
(a) During this period:

(i) the WEIF was subject to sustained redemptions which resulted in a net asset outflow of over £1 billion;

(ii) the WEIF's NAV fell by £888 million.

(b) Further, WIM's Initial T+20 Metric persistently deteriorated from early May 2018 onwards, such that from August 2018 onwards WIM's trigger of 25% was continuously crossed, and the WEIF was less than one percent away from breaching the limit of 20%, when WIM decided to discontinue this metric in mid-September 2018 (as described in paragraph 4.37 above). This can be illustrated graphically as follows:

Figure 3: Initial T+20 Metric- May to September 2018



(c) Still further, applying the Initial Four Bucket Model, the combined figure for Buckets 3 and 4 (as reported in WIM's daily update emails by reference to Buckets 1 and 2) increased by so much that it continuously breached the 70% limit from mid-September 2018 until WIM ceased to monitor the Initial Four Bucket Model in mid-October 2018. This can be illustrated graphically as follows:

Figure 4: Combined Buckets 3 & 4 – May to October 2018

4.90. Despite the clear deterioration in the WEIF's liquidity that was evident from the metrics that were contemporaneously reported within WIM on a daily basis, by reference to the Revised Four Bucket Model, between May 2018 and September 2018:

(i) Mr Woodford was selling proportionately more of the fund's most liquid assets, resulting in a net reduction of over £0.8 billion in Buckets 1 and 2, with a much smaller net reduction of £0.26 billion in Buckets 3 and 4;

(ii) the greatest proportion of the shares sold on average each month by Mr Woodford (by reference to their total value) was from Bucket 1 (55.2%) and the smallest proportion was from Bucket 4 (7.1%);

(iii) the proportion of shares bought were, relatively speaking, more weighted towards less liquid stocks, with Bucket 1 representing 46.3% and Bucket 4 13.2%;

(iv) as there was a net asset outflow of over £1.0 billion in this period, the liquidity of the fund was significantly more impacted by the selling decisions rather than the buying decisions;

(v) this selling and buying activity had the effect of reducing the liquidity of the fund.

4.91. On **16 July 2018**, the liquidity of the WEIF was raised at a meeting involving Link and WIM. WIM questioned Link about the rationale for the limits in the Initial Four Bucket Model, and sought clarity from it as to when the limits applied and what was required if the WEIF approached these limits.

4.92. On **3 August 2018**, the WEIF's liquidity fell below the trigger of 25% for the Initial T+20 Metric. The crossing of this threshold was reported to Mr Woodford. On the same day, an employee from WIM's Risk department notified Mr Woodford that the proportion of assets that were able to be liquidated within 20 days had fallen below 25% and asked for his *"planned mitigating actions to prevent a worsening of the position"*.

4.93. Mr Woodford responded on **6 August 2018**, stating that he was "*reluctant to take any mitigating action at the moment*", but would do so if told by WIM's Risk function that he was required to. This response was discussed amongst a number of WIM employees, with one individual in WIM's Risk department noting that in the absence of any remedial actions WIM could be at risk of breaching its COLL obligations: *"while there's no requirement to get back above 25%, I would rather not see a worsening liquidity profile as viewed by this metric with no remedial actions in place. Would be hard to argue we're meeting our COLL liquidity obligations in that case. We should try to get back above 25% but certainly not drop below 20% without liquidity becoming the main consideration in investment decisions"*.

4.94. On **14 August 2018**, a member of WIM's Risk function informed the individual acting as administrator for liquidity risks on behalf of Mr Woodford that he proposed changing the risk rating for liquidity risk from *"probable"* (meaning the risk may occur, with a range of probability at 0.11-0.49) to *"likely"* (meaning the risk is expected to occur, with a range of probability at 0.5-0.9).

4.95. As set out in paragraph 4.89 above, to WIM's knowledge, the liquidity position continued to deteriorate thereafter:

(a) The Initial T+20 Metric continued to show a deterioration in the WEIF's liquidity as described at paragraph 4.89(b) above.

(b) Further, under the Initial Four Bucket Model, the combined figure for Buckets 3 and 4 continued to show a deterioration in the WEIF's liquidity:

(i) the combined figure for Buckets 3 and 4 increased to the point that it was close to the 70% limit from late June 2018 onwards, and an employee from WIM's Risk department confirmed that the limit would have been breached at this stage, had it not been for the change in bucket classification of one particular stock held by the WEIF;

(ii) the figure continued to increase thereafter and continuously breached the 70% limit from mid-September 2018 until WIM ceased to monitor the Initial Four Bucket Model in mid-October 2018.

D4: Changes to the liquidity framework in September 2018

4.96. Despite being aware of the clear deterioration in the fund's liquidity (as set out in paragraph 4.92 above), rather than reduce liquidity risk, WIM sought to challenge the liquidity framework on the basis that it was unduly constraining Mr Woodford's pursuit of his long-term investment strategy.

4.97. On **6 September 2018**, it was noted in Slack messages that Mr Woodford "*believes that some of the investment decisions he is being forced to make currently are not in the best long-term interests of investors in the fund*" due to the applicable liquidity limits. A member of WIM's Risk function considered that Mr Woodford's concerns were "*worthy of a huddle especially as WEIF's 20-day liquidity approaches the 20% mark*". As a result of this huddle, it was decided: (a) to remove the Initial T+20 Metric from Mr Woodford's daily update emails, notwithstanding that one month earlier the individual from the Risk function had taken the view that non-compliance with the limits imposed on this metric could make it "*hard to argue we're meeting our COLL liquidity obligations*", as set out in paragraph 4.93 above; and (b) to raise with Link Mr Woodford's view that he was unduly constrained by the liquidity limits.

4.98. Accordingly, prompted by Mr Woodford's concerns that the liquidity limits unduly constrained his investment strategy, WIM discontinued the Initial T+20 Metric (by ceasing to apply a trigger and limit to this metric) and began to press for changes to be made to the liquidity framework, having previously questioned whether Link's use of only the primary trading venue was appropriate for volume data. After challenge from WIM, Link accepted that such changes should be made:

(a) On **11 September 2018**, WIM approached Link with a proposal to adjust the liquidity management framework, in light of Mr Woodford's concerns. Link responded that the proposal *"is one that we are not mindful to grant on a risk approach to the maintenance of an appropriate level of liquidity within the Fund"*. A member of WIM's Risk function responded, stating that Link had *"completely misunderstood [his] e-mail"* and emphasising that Mr Woodford had identified a *"course of action* [which] *would result in a more favourable performance outcome for investors over the medium-to-long term, but it is a course of action that cannot be pursued currently due to liquidity considerations"*.

(b) On **19 September 2018**, Link emailed WIM about a breach of the 35% limit on Bucket 4. WIM responded, disputing that there had been such a breach, and putting a series of questions to Link.

(c) On **20 September 2018**, Link held a call with WIM. There was an immediate dispute between Link and WIM as to whether it was agreed on this call that the WEIF's liquidity needed improving. Link's position, as set out in an email to WIM, was that there was a *"need to improve the overall liquidity profile of the fund"* and for the fund to be *"re-balanced to a considerably more liquid profile"*. WIM, however, objected: *"we have not agreed a need to improve the liquidity profile of the fund, just that we acknowledge that we need to manage it to the agreed limits, which we have been doing […] "once the fund has been re-balanced to a considerably more liquid profile" is not something we have agreed"*.

(d) On **24 September 2018**, Link accepted that it was *"useful to consider alternative calculations and measures for liquidity management",* but stated that the current monitoring framework should remain in place for now. Link *"continue[d] to press the need for a long term rebalancing of the portfolio to a more liquid overall profile as well as a reassessment and reformulation of an effective liquidity monitoring framework"*.

(e) On **25 September 2018** (at the latest), Link changed its position and agreed to change the monitoring framework to the Revised Four Bucket Model, as set out at paragraphs 4.46 to 4.48 above.

(f) On **26 September 2018**, Link recorded the change in an email and stated that WIM and Link needed to *"work together to formulate a* *proposal for a more refined liquidity management framework"* and *"acknowledge the need to rebalance the portfolio in the longer term (6m +) to a more balanced liquidity profile appropriate for a daily dealing UCITS fund".*

(g) On **27 September 2018**, WIM acknowledged the change in framework and accepted that there were limits that could not be breached. However, WIM also stated that it did not *"believe there is a need to rebalance the [WEIF's] profile to a more liquid one over the longer term"*.

4.99. WIM accordingly maintained throughout **September 2018** that it (WIM) did not need to improve the liquidity in the WEIF, notwithstanding Link's clear position that it did need to do so and the concerns expressed internally within WIM as to the possible consequences of being in breach of the Initial T+20 Metric. This was not a reasonable approach and, in reality, the liquidity in the fund had undergone a serious deterioration by this point, as set out in paragraph 4.89 above and further particularised in Section F below.

4.100. On **15 October 2018**, the Revised Four Bucket Model was implemented by WIM in place of the Initial Four Bucket Model. Its immediate impact was that the proportion of assets in combined Buckets 1 and 2 went from 24.36% to 34.36%, meaning combined Buckets 3 and 4 reduced from 75.64% to 65.64%. This enabled the WEIF to go from a breach of the 70% limit (as had been the case since 20 September 2018) to compliance with the limit, despite there being no change in the underlying assets held by the fund.

D5: Ongoing deterioration in liquidity (October 2018 – May 2019)

4.101. To WIM's knowledge, the WEIF continued to experience a persistent pattern of redemptions, net outflows and deteriorating liquidity between October 2018 and May 2019. In particular:

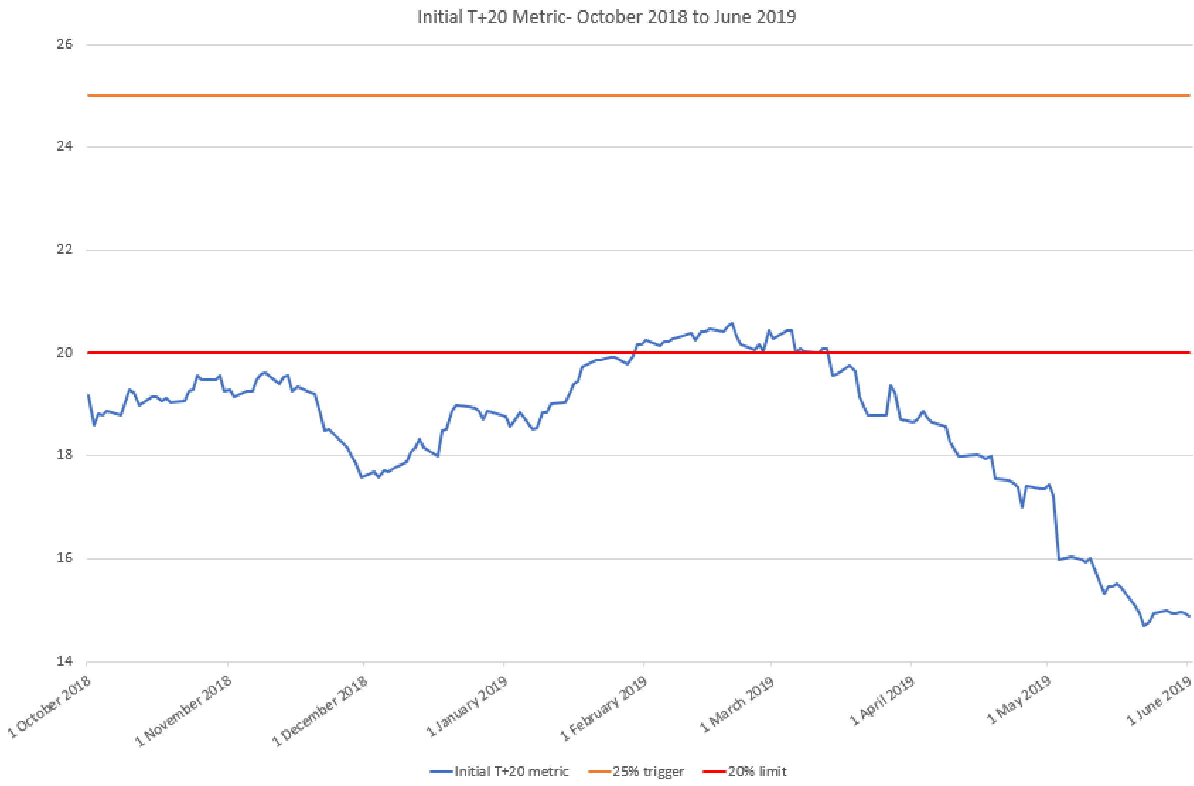
(a) During this period:

(i) the WEIF was subject to sustained redemptions which resulted in a net asset outflow of almost £1 billion;

(ii) the WEIF's NAV fell by over £1.935 billion.

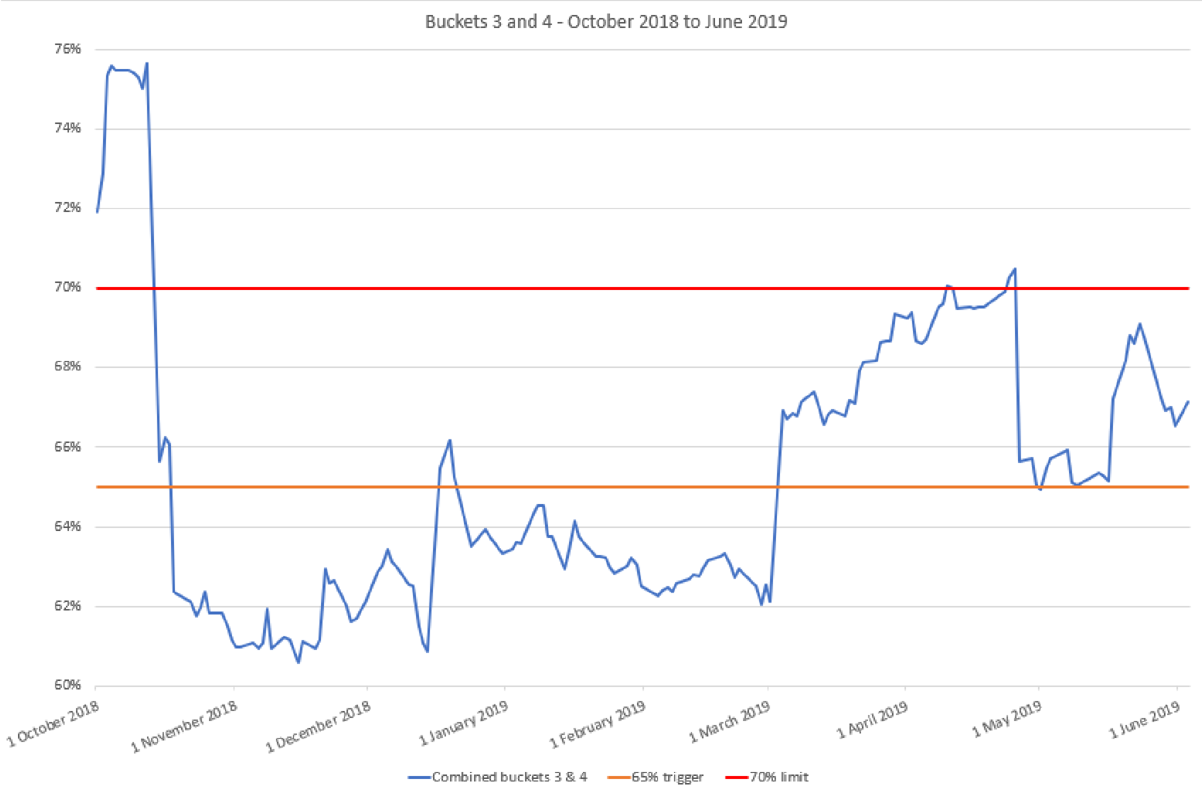
(b) Further, WIM's Initial T+20 Metric (which despite having been discontinued in mid-September 2018, continued to be displayed on WIM's dashboards) deteriorated significantly and was almost constantly in breach of the 20% limit that WIM had applied up to September 2018. This can be illustrated graphically as follows:

Figure 5: Initial T+20 Metric – October 2018 to June 2019



(c) Still further, the liquidity position continued to deteriorate under the Revised Four Bucket Model, with the WEIF crossing the 65% trigger for combined Buckets 3 and 4 almost constantly from March 2019 onwards. This can be illustrated graphically as follows:

Figure 6: Buckets 3 and 4 – October 2018 to June 2019



4.102. The clear deterioration in the WEIF's liquidity was evident from the metrics that were contemporaneously reported within WIM on a daily basis. These made plain the critical nature of this 8-month period (i.e. October 2018 to May 2019) for the fund's liquidity. However, despite this:

(a) WIM did not take adequate steps to rebalance the fund and instead made investment decisions which exacerbated the liquidity difficulties faced by the fund, as fully set out in **Annex A**. This was not a reasonable approach and did not pay due regard to the need to maintain an appropriate liquidity profile for the fund (see paragraphs 4.5 to 4.8 and 4.58 to 4.64 above). For example, by reference to the Revised Four Bucket Model, between October 2018 and May 2019:

(i) WIM continued to sell proportionately more liquid securities in Buckets 1 and 2, resulting in a net reduction of £0.63 billion in Buckets 1 and 2 and a smaller reduction of £0.31 billion for Buckets 3 and 4;

(ii) the greatest proportion of shares sold on average by WIM each month was for Bucket 1 (36.8%), and the smallest proportion was for Bucket 4 (9.7%);

(iii) the greatest proportion of shares bought on average each month by WIM (by reference to their total value) was for Bucket 2 (36.4%) and the smallest proportion was for Bucket 3 (16.5%);

(iv) as there was a net outflow of almost £1.0 billion in this period, the liquidity of the fund was significantly more impacted by the selling decisions than the buying decisions; and

(v) this selling and buying activity had the effect of reducing the liquidity of the fund.

(b) Further, the Joint Oversight and Management Board also failed to carry out the annual risk appetite review, which had last taken place in April 2018 and did not take place again at any point thereafter.

(c) Still further, WIM failed to take appropriate action in response, and instead advocated for yet further amendments to the liquidity framework which (had they been adopted) would (once again) have painted a more positive picture without altering the underlying reality of the fund's composition. These matters are addressed immediately below.

4.103. Between October 2018 and March 2019, as the liquidity position deteriorated, Link continued to raise concerns with WIM regarding liquidity and requested that prompt action be taken to address these concerns. For example, Link informed WIM on 10 December 2018 that *"[Link's] position is that we expect WIM to be undertaking prompt action to address both the valuation and liquidity concerns with the ultimate goal of bringing the hard to value assets down from 19% to less than 10% and for the portfolio to return to a more balanced position between the four liquidity buckets".*

4.104. On **4 March 2019**, WIM identified that the combined size of Buckets 3 and 4 had risen to 66.9%, as against a trigger threshold of 65%. On or around **8 March 2019**, WIM spoke with Link and agreed to update its liquidity contingency plans accordingly. WIM then discussed the possible options with Mr Woodford before updating its contingency plans and discussing them with Link, as set out in paragraph 4.109 below.

4.105. In a meeting with a large investor on **19 March 2019**, Mr Woodford stated that he could access liquidity more quickly than the liquidity risk framework (i.e. the Revised Four Bucket Model) suggested. The report of the meeting prepared by the large investor records Mr Woodford as stating that *"market liquidity is generally appalling at the moment but [he] does not run the portfolio based on liquidity"* and that *"the* [liquidity] *limits have been stretched"*.

4.106. At a Joint Oversight and Management Board meeting on **21 March 2019**, the minutes of the meeting recorded a Board member stating that *"From an oversight perspective from the strategy point of view is that we are working exceptionally hard to allow* [Mr Woodford] *to continue to maintain that strategy, because that strategy pushes us close to all of our limits, so to the extent that we can we accept the reality of that, it would be easy to capitulate and say you have got to get you liquidity levels up, you have exit this, sell some of that etc. At the moment we are at a point where we need to maintain what we believe in, which means we are going to be close to all of our limits. The governance and this oversight of this is our primary focus… We use every leaver* [sic] *and control mechanism we have to allow* [Mr Woodford] *to execute his strategy and its important that we get out and say that to clients rather than they believe that we are out of control, which couldn't be further than the truth. We have document contingency plans which have been well thought out and in train for over 2 years."* Mr Woodford stated at the meeting that he had *"never been more right* [in] *a strategy in my career"*. There was no minuted discussion of the fact that the WEIF was now above the trigger of 65% for combined Buckets 3 and 4. This approach was not compatible with WIM's *"medium"* risk appetite for liquidity risks and its low tolerance for adverse outcomes against its risks. The statements made at this meeting are indicative of WIM's prioritisation of Mr Woodford's ability to pursue his investment strategy over addressing the underlying liquidity issues faced by the WEIF.

4.107. The Joint Oversight and Management Board also failed to carry out the annual risk appetite review, a process that should have directly involved Mr Woodford as the designated risk owner for liquidity risk (see paragraph 4.3 above). The purpose of the risk appetite review was to *"ensure that both the quantitative and qualitative* [risk appetite] *statements are still appropriate for each risk category"*, involving the risk owner (i.e. Mr Woodford) reviewing *"the risk appetite* [for liquidity risk] *as well as the triggers and limits relating to each risk appetite measure, taking into consideration current risks facing the firm"*. This review should have been performed in or around March/April 2019, and had it taken place then, it should have identified that the WEIF had exceeded WIM's *"medium"* risk appetite for liquidity risk and that the triggers and limits being applied to the WEIF were not appropriate, taking into consideration the significant deterioration in the WEIF's liquidity profile over time and the level of ongoing net redemptions. This should have prompted immediate action to bring the WEIF back within its risk appetite and adjustments to the applicable triggers and limits to reflect the need to meet likely future net redemptions.

4.108. On or around **25 March 2019**, a call was held between WIM and Link to explain the updated liquidity contingency plans. On **28 March 2019**, Link wrote to WIM, making it clear that, having read the latest liquidity contingency plan, it was not satisfied with WIM's proposed actions to improve the WEIF's liquidity. It required WIM to identify *"concrete actions that have been or will be taken to improve the combined buckets 3 and 4 metric, particularly if the 70% limit is breached",* and noted that Link *"continues strongly to urge WIM to bring the liquidity profile out of the trigger by month end"*.

4.109. WIM responded the next day, resisting the need to restore the WEIF's position to below the trigger, and arguing that the liquidity buckets did not reflect the WEIF's true liquidity (notwithstanding the fact it had agreed with Link to adopt the applicable metrics in September 2018). WIM also noted that such a request was not in accordance with the limit framework plan that Link had approved, namely that, when a trigger was crossed, WIM should prepare contingency plans which would then be enacted if the limit was breached. WIM's response further stated that "*(o)ur view is that we will achieve a better price on sales in a post-Brexit outcome and there will be more liquidity. Immediate actions are not in the best interests of investors unless we cross red limits and deem it necessary*". In this way WIM was, once again, prioritising Mr Woodford's ability to pursue his investment strategy at the expense of promptly taking appropriate action to address the liquidity concerns raised by Link.

4.110. On **29 March 2019**, Mr Woodford emailed WIM's Risk and Compliance functions expressing his dissatisfaction with the Revised Four Bucket Model applied to the WEIF (notwithstanding the fact that WIM had itself proposed and agreed the revisions to this model in September 2018 as set out above). As at the date of his email, to Mr Woodford's knowledge, the combined figure for Buckets 3 and 4 stood at 69.33% and was therefore well over the trigger of 65% and less than one percent away from breaching the limit of 70%. Further, this was part of a consistent pattern of deterioration and breach over this period as set out in paragraphs 4.101 and 4.102 above. It was in this context that Mr Woodford challenged the existing framework:

(a) Mr Woodford began his email by noting that he had a "*big problem"* with the existing framework:

> "*Gentleman, You know I have a big problem with the methodology used in the liquidity bucket calculation. Equally, I understand now is not the time to challenge that methodology with Link or NT. Having said that I am still completely bamboozled by the categorisation of stocks and the measurement of daily liquidity*".

(b) Mr Woodford then gave a number of examples which he regarded as unsatisfactory classifications of securities produced by the Revised Four Bucket Method and said the following:

> *"We are in danger of bumping into limits, Link and regulatory concerns, which has and will affect my investment behaviour and our clients' outcomes based on data that just doesn't stand up to any scrutiny. I appreciate you are calculating these liquidity numbers to a methodology but it appears to me to be profoundly flawed."*

(c) Mr Woodford concluded his email as follows:

> *"I know of course that we are where we are because of my actions but I am very eager to avoid doing the wrong thing here (which of course I know we all are).*
>
> *Can you help me understand why we can't challenge this madness."*

(d) As Mr Woodford knew:

(i) The feature of the liquidity framework that he now sought to challenge (i.e. the use of the Full Allocation Approach) had been part of the liquidity framework since WIM had started monitoring the Initial Four Bucket Model in May 2018 (see paragraph 4.42 above), was part of the Revised Four Bucket Model adopted by WIM in October 2018 (as addressed in paragraph 4.48 above) and was used in conjunction with an assumed Participation Rate of 100%.

(ii) Further, the Revised Four Bucket Model had itself been adopted following challenge from WIM (as addressed in paragraph 4.98 above). Mr Woodford's challenge to it in late March 2019 arose in circumstances where he wished to adjust the liquidity framework to allow him to continue to pursue his investment strategy at a time when the fund was well over the trigger of 65% and less than one percent away from breaching the limit of 70%.

(e) In the circumstances, Mr Woodford's email was indicative of (and contributed to) WIM's inappropriate prioritisation of his ability to pursue his investment strategy over addressing the underlying deteriorating liquidity issues faced by the WEIF. This is further evident from the manner in which WIM's Risk function took up Mr Woodford's concerns and advocated for changes to the framework as addressed in paragraph 4.118 below.

4.111. A member of WIM's Risk function replied the same day (i.e. **29 March 2019**) noting (among other things) that: (i) the current approach had been set with WIM's involvement and took into account best practice guidance from the Authority and IOSCO; and (ii) the "*challenge*" from Mr Woodford as fund manager could potentially be brought to bear, but it would be preferable to do so in different circumstances (i.e. when WIM was in compliance with the existing limits). They summarised the position as follows:

> *"In summary, there are no detailed regulatory prescriptions, but there are regulatory best practice guidelines and recommendations we're expected to follow, with the oversight of our ACD. This does not mean we cannot challenge the assumptions based on your daily experience, although it would be better to do so when we are in compliance with the limits."*

4.112. Mr Woodford replied on **30 March 2019** saying as follows:

> *"There are so many nuances that* [a member of WIM's investment team] *and I experience every day it makes it very hard to see the real world validity of Link's methodology. Nevertheless we are where we are and I will do my utmost to steer us away from the limits."*

4.113. In the event, despite Mr Woodford's stated intention to *"steer* [the WEIF] *away from the limits"*, WIM breached the limit of 70% for the combined Buckets 3 and 4 figure three times in April 2019 and remained above the trigger of 65% almost continuously up to the point of the WEIF's suspension on 3 June 2019.

4.114. On **3 April 2019**, WIM breached one of its limits in respect of the Redemption Coverage Ratio (being one of the further liquidity metrics applied to the WEIF in addition to the Revised Four Bucket Model, as described in paragraphs 4.53 to 4.56 above). Later the same day a member of WIM's Risk function suggested in an internal WIM Slack that "*we should use this event* [i.e. the breach of the limit] *as an opportunity to recast the limits across the board in order to take into account market conditions*" and "*the actual experience of the fund manager*" (i.e. Mr Woodford). They outlined the proposed changes to the liquidity framework, which served to address the feature in respect of which Mr Woodford had been "*particularly critical*": namely, the allocation of securities to buckets based on the time taken to sell the entire holding (see paragraph 4.110 above). The effect of these and other proposed changes, if implemented, would have been to improve the assessment of liquidity in the fund by transferring proportions of securities held in Buckets 3 and 4 to Buckets 1 and 2, without altering the fund's composition (as further set out in paragraph 4.120 below). That WIM should use this breach as an opportunity to seek to recast the limits in this fashion is indicative of WIM's persistent inappropriate prioritisation of Mr Woodford's ability to pursue his investment strategy over addressing the underlying liquidity issues faced by the WEIF.

4.115. On **4 April 2019**, Link told WIM that the WEIF should be brought out of the trigger condition *"as soon as practicable"*, and that the Buckets 3 and 4 metric was *"concerning"*.

4.116. On **5 April 2019**, WIM responded to queries about its liquidity management from a large investor, stating that "*The portfolio continues to represent what Neil [Woodford] believes are the greatest valuation opportunities. As long as the portfolio continues to operate within the liquidity constraints set, we are comfortable and are not actively seeking to improve liquidity".*

4.117. On **8 April 2019**, a member of WIM's Compliance function prepared a draft message to Link to raise WIM's proposed revisions to the liquidity framework in light of Mr Woodford's invitation to "*challenge this madness*" as addressed in paragraphs 4.110 and 4.111 above. The draft noted that "*(w)e are aware your initial response may be that this has come up because we have crossed a threshold*".

4.118. On **9 April 2019**, a member of WIM's Risk function emailed Link proposing to review the applicable liquidity metrics and relaying the strong views that Mr Woodford had personally expressed in this regard. The email explained that:

(a) Mr Woodford (along with a member of the investment team) *"frequently express[es] strong views against a liquidity metric that provides the wrong incentives"*.

(b) WIM regarded one of the essential premises of the Four Bucket Model as a "*fundamental flaw*": namely, allocation of securities to particular buckets based on the time that would be taken to liquidate the entire holding in the security in question.

(c) Mr Woodford was "*categorical that being forced to manage money under such a non-sensical metric is not in the best interest of investors"*.

(d) Other proposed changes included using a 25% Participation Rate and *"more intuitive buckets"* based around the amount of value that could be generated per day, as opposed to a TTL model.

4.119. On **10 April 2019**, further to the discussions between Mr Woodford and WIM's Risk function as addressed in paragraphs 4.110 to 4.112 above, a member of WIM's Risk team sent details of the proposed revised liquidity bucket definitions to Link.

4.120. On **11 April 2019** Link responded to the proposed revisions, declining to replace the existing framework and agreeing only to run the new proposed framework in parallel with the existing model for a limited period as a test. Link emphasised that it was "*important that we continue with the current measures, and keep within the current boundaries"* and that it would not be appropriate "*to present a report* [to the Authority] *which could appear to 'soften' the limits"*. In the event, WIM's new proposed methodology never replaced the existing model: instead the two continued to run in parallel up until the suspension of the fund on 3 June 2019 (as addressed further below). This test period made clear that WIM's proposed revisions (had they been adopted) would have presented a significantly more positive picture of the WEIF's liquidity position up to and including the point of the fund's suspension.

4.121. On **26 April 2019**, Link identified a breach of the combined Buckets 3 and 4 limit, measuring those buckets as amounting to 70.01% of NAV, compared to the 70% limit. Link noted, in correspondence with WIM, that WIM had notified them of the upcoming expected breach of the limit and was already taking action to bring the metric back below the limit. A member of WIM's Risk function responded by setting out certain actions being taken and admonishing Link for using the word *"breach"* on the basis that the limits were not "*regulatory limits"*.

4.122. On **1 May 2019**, it was noted in the WIM Slack that there was a *"strong correlation"* between the risk of holding Unquoted Securities and liquidity risk.

4.123. On **22 May 2019**, Link told WIM on a call that it was very concerned about the level of FVP assets and the WEIF's liquidity profile. On **28 May 2019**, the WEIF's liquidity was again discussed at a meeting involving Link and WIM.

4.124. On **31 May 2019**, KCC made a request to redeem in full its holding in the WEIF. In the days following this request, Link liaised with WIM concerning options to meet the redemption, which was valued at £237 million (6.5% of NAV) at that time. After considering a number of options, on **3 June 2019**, Link concluded that immediate suspension was the appropriate response in order to protect the interests of investors in the WEIF.

SECTION E: UNQUOTED SECURITIES, LISTINGS ON THE INTERNATIONAL STOCK EXCHANGE AND FAIR VALUE PRICING

4.125. The WEIF invested in a number of Unquoted Securities whose shares were not listed and traded on an exchange. In these instances, as no market price was available, Link used FVP to value those assets. Link's FVP process comprised a number of steps, including a third-party service provider producing an initial valuation report. Input was sought from WIM and Link concerning relevant information, before the third-party provider produced a final valuation report. The final decision on the appropriate valuation was taken by Link.

4.126. Between October 2014 and December 2015, via the WEIF, WIM invested in Benevolent, Industrial Heat, Ombu and Sabina ("the TISE companies" or "the TISE securities"), which were all, when the investments were first made, Unquoted Securities:

	Initial investment Date
Benevolent	17 October 2014
Industrial Heat	13 May 2015
Ombu	28 October 2015
Sabina	17 December 2015

4.127. As a part of WIM's investment into the TISE companies, WIM made commitments to provide further funding to the TISE companies via future share subscriptions.

4.128. In August 2017, WIM entered into a voluntary moratorium on any further investments in Unquoted Securities, as the WEIF was approaching the 10% maximum permitted, which remained in place until the WEIF was suspended on 3 June 2019. By the end of November 2017, the percentage of Unquoted Securities held by the WEIF stood at 9.82%.

4.129. WIM notified each of the TISE companies in the first instance about the issues arising from the funding moratorium as well as the WEIF nearing the 10% limit on investments in Unquoted Securities. WIM was unable to provide further funding to the TISE companies unless the securities held by the WEIF became listed, meaning that they would no longer be covered by the 10% Unquoted Securities limit. Subsequently, each of these four companies listed shares in their companies on TISE, the listings occurring as set out below:

Company	**Date of listing**	**Stock exchange**
Sabina	28 December 2017	TISE
Ombu	15 June 2018	TISE
Industrial Heat	5 October 2018	TISE
Benevolent	21 March 2019	TISE

4.130. Notwithstanding their listing, prior to the suspension of the WEIF on 3 June 2019, there were no arm's length market dealings in any of the TISE securities, and only one trade recorded for any of the TISE securities, that being a trade involving Sabina shares with the WEIF acquiring shares from the Woodford Patient Capital Trust (another fund managed by WIM). In the absence of any market dealings in respect of the securities in the TISE companies, Link used FVP to value them at all stages (both before and after their listing).

4.131. The listing of these securities did nothing to improve the liquidity profile of the WEIF in circumstances where: (a) they would remain categorised as Bucket 4 securities even after listing; (b) they were likely to be, at most, thinly traded, if traded at all; and (c) other than in respect of Ombu, the only shares listed were those held by the WEIF.

4.132. Whilst, in the short term, the TISE listings had no adverse effect on the liquidity profile of the WEIF, on a longer-term basis the TISE listings enabled WIM to: (a) reduce pressure on the 10% Unquoted Securities limit; (b) increase the size of the securities which were either unquoted or otherwise subject to FVP; and (c) hold further securities which, in terms of liquidity, had the same characteristics as the Unquoted Securities. As a result, the listings contributed to the deteriorating liquidity profile of the WEIF.

4.133. The WEIF also held shares in a further Unquoted Security, Proton Partners (that subsequently became Rutherford Health), initially purchased in January 2015.

Subsequent to this, Proton Partners issued shares to the WEIF which were listed on the NEX exchange in February 2019. The issue of shares, and the subsequent listing, meant that the shares were removed from the WEIF's Unquoted Securities total. Although listed, there was no market for pricing purposes, and only one trade was ever made. Proton Partners continued to be valued by Link using FVP after it was listed on NEX.

4.134. As well as enabling the WEIF to continue to hold the Unquoted Securities noted above, the listings also enabled the further investment of the WEIF's funds into them during a period of time when the WEIF's liquidity was continuing to deteriorate:

(a) The WEIF made further investments into the following securities, totalling £82.99m:

(i) Ombu in June 2018 (£10.38m) and September 2018 (£10.38m);

(ii) Sabina in January 2018 (£8.94m), June 2018 (£8.82m) and November 2018 (£26.47m); and

(iii) Proton Partners in February 2019 (£18.00m).

(b) The proportion of the WEIF's portfolio that comprised securities that were valued using FVP (including all but 2 of the Unquoted Securities) increased significantly from 8.8% in May 2017 to 13.1% in July 2018 and up to 21.5% in May 2019. This contributed to the deterioration in the WEIF's overall liquidity.

SECTION F: THE AUTHORITY'S ANALYSIS OF THE WEIF'S LIQUIDITY BETWEEN 1 MAY 2017 AND 3 JUNE 2019

F1: Overview

4.135. The Authority has assessed the WEIF's liquidity over the period of 1 May 2017 to 3 June 2019 by reference to a statistical model based on the historical trading data for the securities in which the WEIF and peer funds invested (the "Statistical Model"). The Statistical Model uses data relating to the monthly composition of the funds, as well as data on the investments each fund held (the number of shares, their value, and their average daily trading volume), in order to ascertain:

(a) relevant liquidity metrics for the WEIF and the Comparator Funds;

(b) the effect of stressed scenarios on the WEIF; and

(c) the time it would take to liquidate various percentages of the portfolios held by the WEIF and Comparator Funds.

4.136. In summary, the Statistical Model shows:

(a) WIM (and Link)'s contemporary liquidity calculations during the Relevant Period were flawed. In particular, they inappropriately assumed a Participation Rate of 100% for the purpose of calculating liquidity buckets . Link believed that the 100% Participation Rate and the Full Allocation Approach would offset each other. However, the Authority considers that this was not the case and instead the combined assumptions led to an unjustifiably positive assessment of the WEIF's liquidity. WIM neither tested nor challenged Link's belief when proposing the adoption of the Revised Four Bucket Model.

(b) Liquidity in the WEIF was deteriorating by reference to the contemporary metrics of which WIM (and Link) were aware:

(i) Even on the results of WIM (and Link)'s contemporary calculations, it was clear that liquidity in the WEIF was deteriorating.

(ii) Had WIM (and Link) adopted appropriate assumptions in calculating those liquidity metrics, they would have identified that the liquidity profile of the WEIF deteriorated significantly during the Relevant Period.

(iii) This deterioration in liquidity came about as a result of WIM's investment decisions, in that it sold a much greater amount and proportion of more liquid assets than it bought, and bought a greater amount and proportion of more illiquid assets than it sold.

4.137. There were further indicators which WIM did not contemporaneously or actively monitor (the time it would have taken to liquidate certain proportions of the NAV and WIM's calculation of the Initial T+20 Metric after September 2018), which establish that the liquidity of the WEIF was deteriorating. Had WIM been in any doubt as to the deteriorating liquidity position (which it should not have been), these indicators would have confirmed the position.

4.138. The proportion of the WEIF invested in Unquoted Securities was generally within the 9.5% limit set by WIM and Link. While the proportion of the WEIF's portfolio that comprised Unquoted Securities remained broadly stable, that calculation excluded securities which were quoted but which were subject to FVP, and so did not capture the true amount of the WEIF assets which were not readily tradeable. The WEIF's securities which were subject to FVP were a driving factor in the deterioration of the WEIF's liquidity, and the proportion of the WEIF's portfolio that comprised such securities increased from 8.8% in May 2017 to 13.1% in July 2018 and up to 21.5% in May 2019.

4.139. The stress testing conducted by WIM (and Link) during the Relevant Period was inadequate. Had adequate stress testing been conducted, it would have become apparent that the WEIF was not able to withstand extreme but plausible scenarios.

4.140. The WEIF was an outlier in terms of its liquidity, and among the least liquid of the Comparable Funds, and on a number of metrics, the least liquid.

4.141. Each of these findings is addressed in more detail immediately below.

<u>F2: Inappropriate Assumptions and Data Issues</u>

4.142. The metrics used to measure the liquidity of the WEIF during the Relevant Period were not reasonable and relied upon inappropriate assumptions:

(a) First, the assumption of a 100% Participation Rate in the Revised Four Bucket Model to calculate liquidity buckets was not realistic, because it assumed that a single entity could access the entire liquidity in respect of a particular security without significantly impacting the price of that security. The 100% Participation Rate was combined with the Full Allocation Approach and Link believed that they offset each other. WIM did not test this belief or challenge it. In the Authority's view, the Full Allocation Approach did not fully offset the 100% Participation Rate and instead the combined assumptions created an unjustifiably positive impression of the WEIF's liquidity.

(b) Secondly, it was not appropriate to adopt a 12-month average ADTV (in respect of the Revised Four Bucket Model used by WIM from October 2018), as this period was too long, smoothed any fluctuations in liquidity and therefore would not reflect the true picture of the volume of shares traded on an exchange.

F3: Deterioration of the WEIF's liquidity

4.143. This section sets out the WEIF's liquidity position as assessed both contemporaneously and by reference to the Statistical Model. In respect of each metric, either (1) the contemporaneous calculation showed liquidity to be deteriorating, and once the inappropriate assumptions are corrected, that deterioration is shown to have been even worse; or (2) the contemporaneous calculation did not show liquidity to be deteriorating, but once the inappropriate assumptions are corrected, that is shown to have been incorrect.

The Liquidity Buckets

As calculated by WIM and Link

4.144. Based on the metrics set out in the WIM and Link liquidity reports, WIM and Link's own calculations demonstrated that the liquidity of the WEIF deteriorated significantly. Applying the Revised Four Bucket Model (used by WIM and Link from October 2018 onwards as described in paragraphs 4.47 to 4.49 above):

(a) Bucket 1 assets decreased from 14% to 8% of the WEIF's NAV between September 2018 and April 2019;

(b) Bucket 2 assets increased from 26% to 29% of the WEIF's NAV between September 2018 and April 2019;

(c) Bucket 3 assets decreased from 36% to 32% of the WEIF's NAV between September 2018 and April 2019; and

(d) Bucket 4 assets increased from 25% to 33% of the WEIF's NAV between September 2018 and April 2019.

4.145. This led to the crossing of applicable triggers and breaches of applicable limits (as contemporaneously monitored and calculated by WIM and Link), as follows:

(a) the WEIF crossed the 65% trigger for Buckets 3 and 4 combined in December 2018 and then almost constantly from March 2019;

(b) the WEIF crossed the 30% trigger for Bucket 4 almost constantly from April 2019; and

(c) the WEIF breached the 70% limit for Buckets 3 and 4 combined in April 2019.

The Four Bucket Model as re-calculated using the Statistical Model

4.146. If the Four Bucket Model is applied using appropriate assumptions, the WEIF's liquidity deterioration is even more acute.

4.147. First, using a 25% Participation Rate (even assuming the use of a Linear Allocation Approach):

a) During the period of 1 May 2017 to 3 June 2019:

(i) the proportion of the WEIF's holdings that were classified as Bucket 1 decreased from a high point of 27% in September 2017 to a low point of 8% in May 2019;

(ii) the proportion of the WEIF's holdings that were classified as Buckets 3 and 4 increased from a low point of 50% in May 2017 to a high point of 74% in May 2019; and

(iii) the proportion of the WEIF's holdings that were classified as Bucket 4 increased from a low point of 23% in May 2017 to a high point of 41% in May 2019.

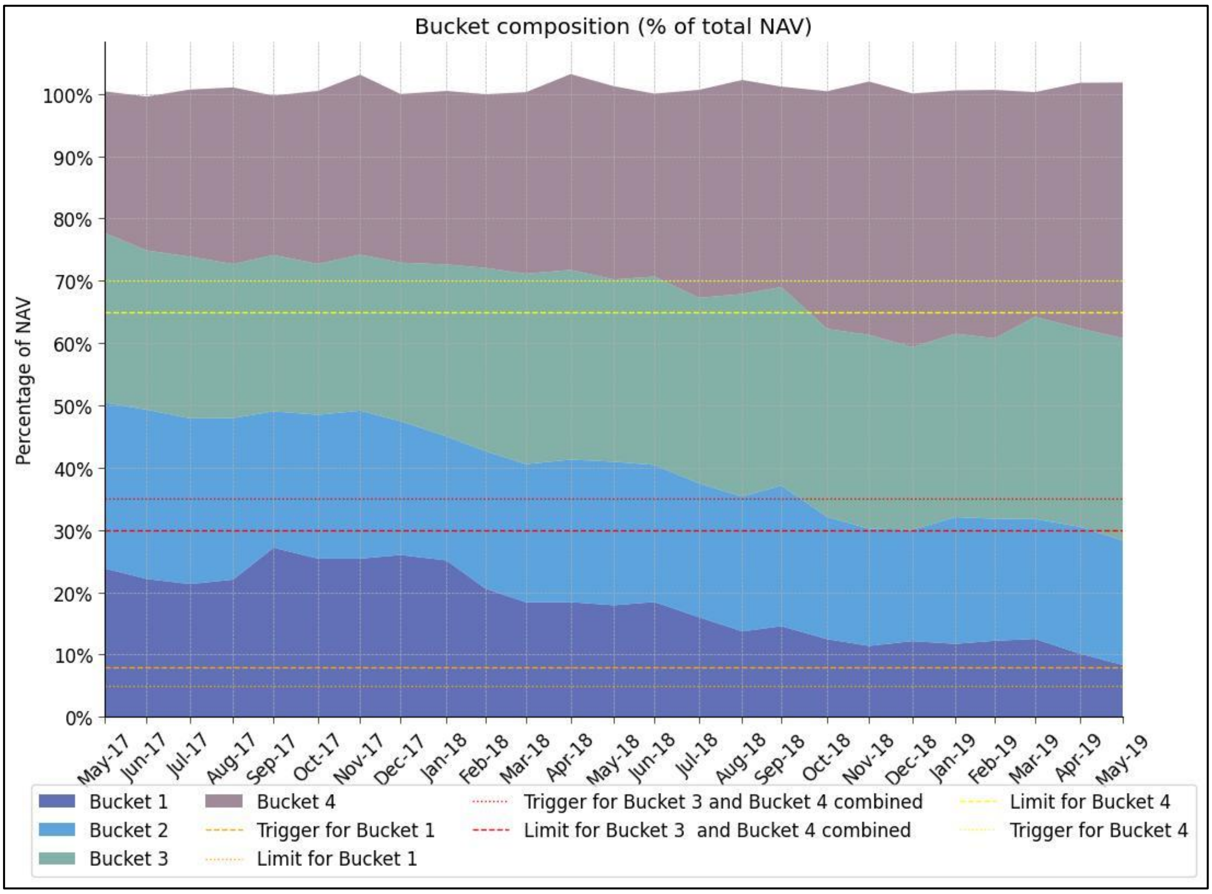
(b) Further, the thresholds set by Link (and monitored by both WIM and Link) in respect of the Liquidity Buckets were crossed/breached:

(i) In respect of Buckets 3 and 4, the trigger was continuously crossed from October 2018; and the limit was breached in November and December 2018, and in April and May 2019.

(ii) In respect of Bucket 4, the trigger was continuously crossed from July 2018, and the limit was continuously breached from October 2018.

(c) These points are illustrated in the diagram set out below:

<u>Chart 2</u>



4.148. Second, using a 20% Participation Rate (even assuming the use of a Linear Allocation Approach):

(a) During the period of 1 May 2017 to 3 June 2019:

(i) the proportion of the WEIF's holdings that were classified as Bucket 1 decreased from a high point of 23% in September 2017 to a low point of 7% in May 2019;

(ii) the proportion of the WEIF's holdings that were classified as Buckets 3 and 4 increased from a low point of 53% in September 2017 to a high point of 77% in May 2019; and

(iii) the proportion of the WEIF's holdings that were classified as Bucket 4 increased from a low point of 25% in May 2017 to a high point of 45% in December 2018.

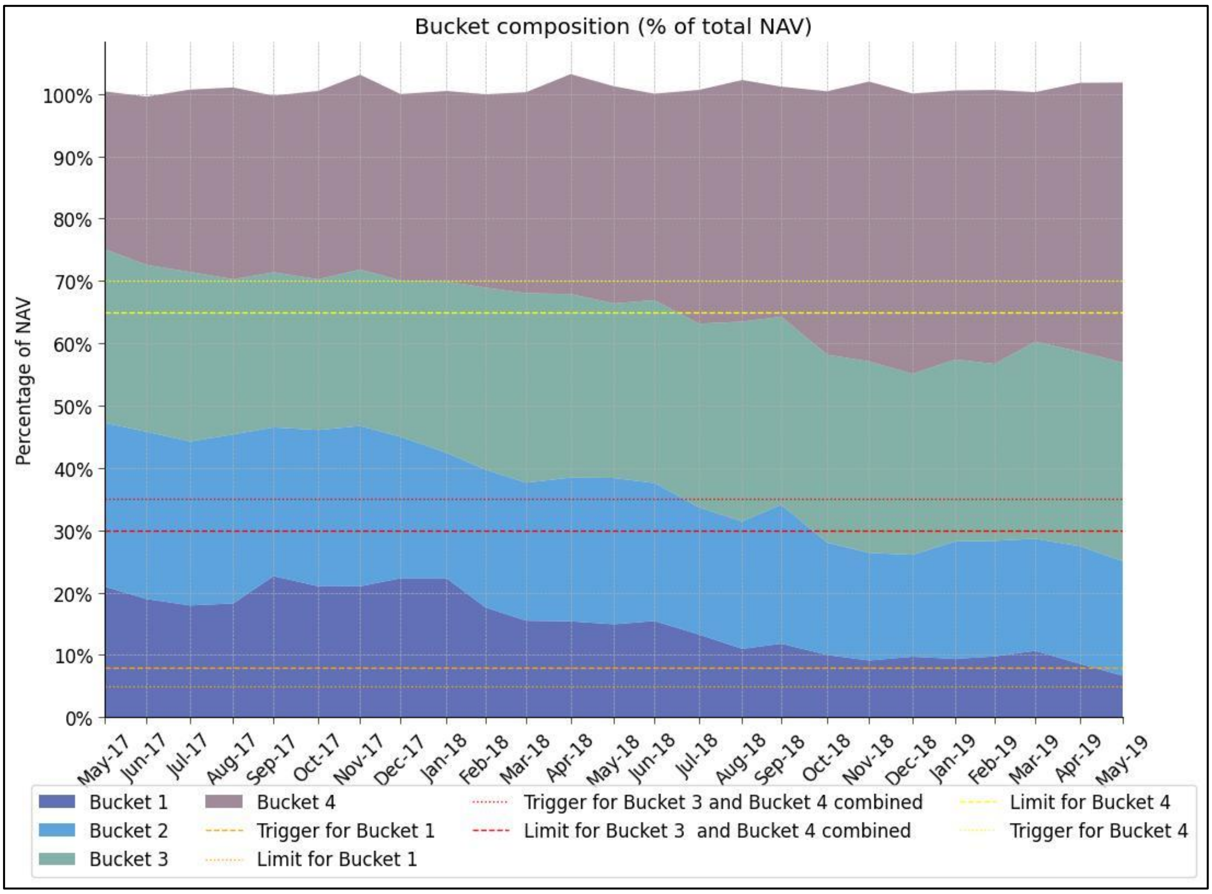
(b) Further, the thresholds set by Link (and monitored by both WIM and Link) in respect of the Liquidity Buckets were crossed/breached:

(i) In respect of Buckets 3 and 4, the trigger was continuously crossed from July 2018, and the limit was breached in August 2018 and then continuously from October 2018; and

(ii) In respect of Bucket 4, the trigger was crossed in August, October and November 2017, and then continuously from January 2018; while the limit was breached in April 2018 and then continuously from July 2018.

(c) These points are illustrated in the diagram set out below:

Chart 3



4.149. This deterioration in liquidity came about as a result of WIM's investment decisions, in that it sold a much greater amount and proportion of more liquid assets than it bought, and bought a greater amount and proportion of more illiquid assets than it sold. This meant it did not adopt a balanced approach from a liquidity perspective and the WEIF became increasingly illiquid, as further set out in Annex A below.

The T+ Metrics

4.150. The T+1, T+5 and T+20 Metrics (as applied by WIM and Link as described in paragraphs 4.50 and 4.52 above) remained broadly consistent throughout the period of 1 May 2017 to 3 June 2019.

4.151. Analysed through the Statistical Model, the true position was that each of the T+ Metrics assessed by WIM clearly followed a declining trend from January 2018 (at the latest) to the end of the Relevant Period, with the proportion of the WEIF's securities that were able to be liquidated, under the model used, within:

(a) 1 day decreasing from 5% in May 2017, to 2% in September 2018, to 1% in May 2019;

(b) 5 days decreasing from 20% in September 2017, to 11% in September 2018, to 6% in May 2019; and

(c) 20 days decreasing from 45% in September 2017, to 31% in September 2018, to 23% in May 2019.

The RCR

4.152. WIM and Link's calculation of the RCR (as described in paragraphs 4.53 to 4.56 above) was based on the average redemptions over the previous 10 days. This led to the RCR being a volatile metric.

4.153. Nonetheless, the RCR of the WEIF broadly declined over the period of 1 May 2017 to 3 June 2019 and first breached:

(a) the limit (and accordingly crossed the trigger) in May 2019 for the 1-day and 5-day RCR; and

(b) the limit (and accordingly crossed the trigger) in March 2019 for the 20-day RCR.

Conclusion

4.154. Accordingly, each of the metrics monitored by WIM (and Link) contemporaneously either showed a deterioration in liquidity or would have done so (or would have shown a more extensive deterioration), had liquidity been calculated appropriately.

4.155. In particular, if WIM (and Link) had used a Participation Rate of 25% (even assuming the use of a Linear Allocation Approach), the WEIF would have crossed/breached thresholds in respect of the liquidity buckets in April and May 2018, and continuously from July 2018.

Other indications of deteriorating liquidity

WIM's calculation of the T+20 Metric

4.156. Had the thresholds applicable to WIM's calculation of the Initial T+20 Metric been maintained throughout the Relevant Period, there would have been a continuous crossing of the trigger and breach of the limit from August 2018 and September 2018 respectively on WIM's own contemporaneous calculations. As set out above, it was in September 2018 that WIM decided to cease actively monitoring this trigger and limit.

Time to liquidate

4.157. Further, had WIM (and Link) considered the time which it would have taken to liquidate various portions of the WEIF (which would have been appropriate, given the level of redemption), they would have identified that, during the period of 1 May 2017 to 3 June 2019, the time it would have taken to liquidate portions of the portfolio (either 5%, 10% or 20%) increased significantly from August 2018. In particular, the WEIF would have taken:

(a) 2 days to liquidate 5% of its NAV between May 2017 and July 2018. This increased to 5 days by May 2019.

(b) 3 days to liquidate 10% of its NAV in May 2017. This increased to 9 days by May 2019.

(c) 6 days to liquidate 20% of its NAV in May 2017. This increased to 17 days by May 2019.

Unquoted Securities

4.158. The portfolio data for the WEIF provided by Link shows the proportion of the NAV that was invested in Unquoted Securities decreased between September 2017 and February 2019. However:

(a) The percentage of Unquoted Securities in the WEIF was more than 8.5% of the NAV (the initial limit monitored by WIM and Link as described in paragraph 4.57 above) for almost the entirety of the period of 1 May 2017 to 3 June 2019, except for March to August 2018.

(b) The percentage of Unquoted Securities in the WEIF also breached WIM and Link’s second internal limit (of 9.5%) in August to November 2017, January to February 2018, September 2018 and June 2019.

4.159. The proportion of the WEIF’s portfolio that comprised Unquoted Securities did in fact remain broadly stable during the period of 1 May 2017 to 3 June 2019, with the WEIF breaching the initial Link limit of 8.5% at month-end in 20 of 25 months during this period, and breaching the second limit of 9.5% at month-end in 8 of 25 months.

4.160. In addition to the breaches of WIM and Link’s internal limits for Unquoted Securities, the WEIF also breached the regulatory limit of 10% on three occasions. The three occasions were 21 November 2017, 2 February 2018 and 6 March 2018.

4.161. However, securities which were quoted but which were subject to FVP were excluded from the calculation of Unquoted Securities, and so the calculation did not capture the true amount of the WEIF’s assets which were not readily tradeable. In this respect:

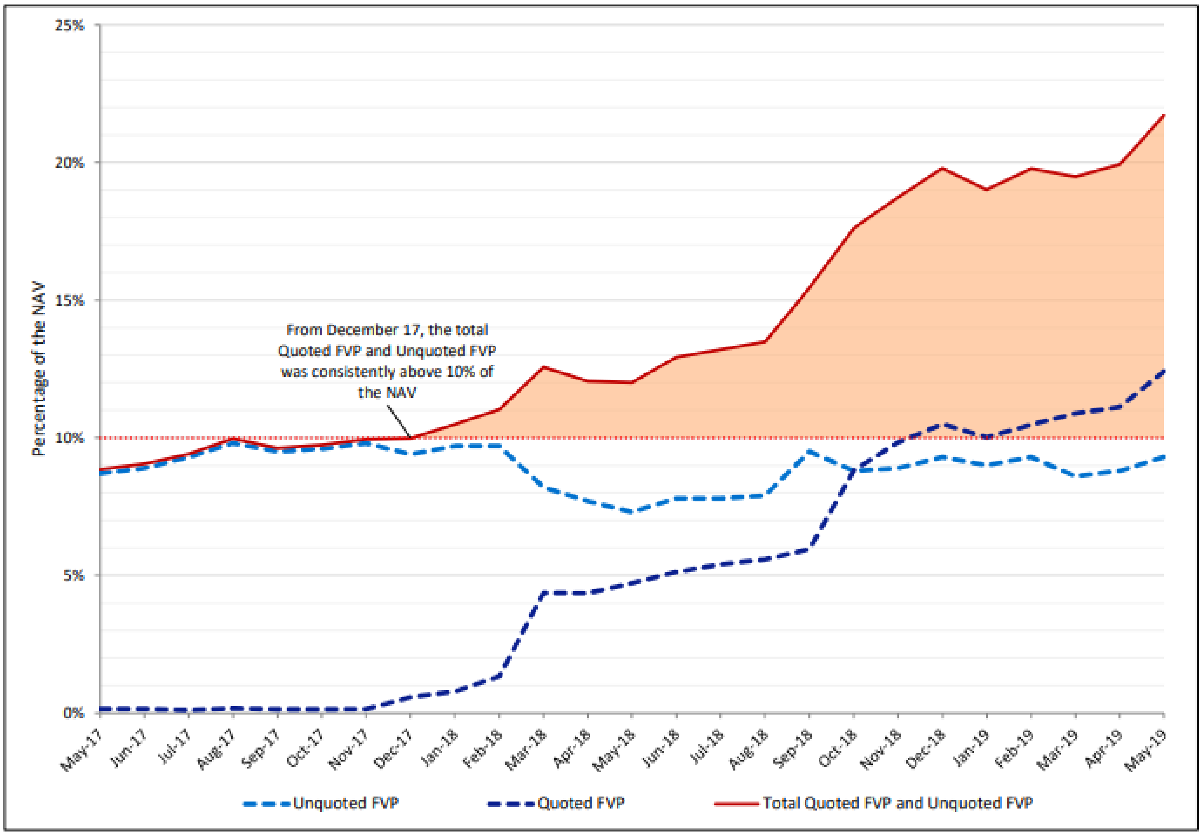
(a) The percentage of securities that were quoted, but were subject to FVP, increased significantly between May 2017 (when they represented 0.2% of the NAV) and May 2019 (when they represented 12.4% of the NAV).

(b) When the Unquoted Securities and quoted securities that were subject to FVP are combined, they increased significantly from 8.8% in May 2017 to 21.5% in May 2019. This appears to have been a driving factor in the deterioration of the WEIF’s liquidity.

(c) From December 2017, the quantity of securities classified both as unquoted, and quoted but subject to FVP, continuously exceeded 10% of the NAV.

4.162. The impact of the significant increase in securities subject to FVP is illustrated in the chart below (the 10% breaches noted in paragraph 4.160 above are intra month so do not appear on the chart):

Chart 4



F4: Inadequate Stress Testing

4.163. The stress testing conducted by WIM (and Link) from October 2018 onwards was inadequate. Had adequate stress testing been conducted, it would have become apparent that the WEIF was not able to withstand extreme but plausible scenarios.

Redemption Stress Rates

4.164. As set out in paragraph 4.56 above, after mid-October 2018, WIM and Link performed stress testing on the RCR by modelling the impact of redemptions of 10%, 15% and 20% of the portfolio. However, this stress testing (1) failed adequately to take into account the fact that redemption by KCC (and/or another large redemption) would be likely to result in an increased rate of redemption by other investors; and (2) failed to test the impact of redemption by KCC (and/or another large redemption) *alongside* an increased redemption rate, for example by testing on the basis that other redemptions might increase to the largest retail redemption rate over a preceding 5-day period since May 2017 (when the fund began to be affected by significant net outflows). Had such a stress test (or stress testing using similar appropriate parameters) been conducted, it would have shown that, from September 2018, the WEIF would have been unable to meet redemptions in these circumstances.

Combined Stresses on ADTV and Redemption Rate

4.165. During the Relevant Period, WIM failed (as did Link) to test for combined stresses on ADTV and the redemption rate. Had the stress testing been conducted for the plausible eventuality of combined stress on ADTV <u>and</u> the largest retail redemption rate over the preceding 5-day period, it would have revealed that the trigger set by Link (and monitored by both WIM and Link) in respect of the 5-day RCR was crossed throughout the Relevant Period under *all* of the scenarios analysed.

<u>F5: Comparison with other funds</u>

4.166. The WEIF was significantly less liquid than Comparator Funds. As set out below, on a number of metrics, it was the least liquid fund when compared against 221 Comparator Funds.

4.167. First, applying the Four Bucket Model using the Statistical Model to the Comparator Funds:

(a) Bucket 1: From July 2018 to the end of the Relevant Period, the proportion of the WEIF's securities that were allocated to Bucket 1 (and therefore able to be liquidated within 7 days) was lower than all other Comparator Funds throughout the Relevant Period and deteriorated from 18% to 8%, which was significantly lower than the bottom ranked fund.

(b) Buckets 1 and 2: From October 2017 onwards, the proportion of the WEIF's securities that were allocated to Buckets 1 and 2 (and therefore able to be liquidated within 30 days) were amongst the least liquid 5% of the Comparator Funds.

(c) Buckets 1, 2 and 3: From January 2018 onwards, the proportion of the WEIF's securities that were allocated to Buckets 1, 2 and 3 (and therefore able to be liquidated within 180 days) were amongst the least liquid 5% of the Comparator Funds.

4.168. Second, applying the T+ Metrics (which were applied by WIM and Link as described in paragraphs 4.50 and 4.54 above) to the Comparator Funds:

(a) T+5 Metric: From July 2018 to the end of the Relevant Period, the proportion of the WEIF's securities that were able to be liquidated in 5 days deteriorated from 12% to 6%, which was significantly lower than the bottom ranked Comparator Fund.

(b) T+10 Metric: From July 2018 to the end of the Relevant Period, the proportion of the WEIF's securities that were able to be liquidated in 10 days deteriorated from 22% to 12%, which was significantly lower than the bottom ranked Comparator Fund.

(c) T+20 Metric: From October 2018 to the end of the Relevant Period, the proportion of the WEIF's securities that were able to be liquidated in 20 days deteriorated from 25% to 22%, which meant that the WEIF was amongst the least liquid 5% of the Comparator Funds.

4.169. Third, the WEIF was also significantly less liquid than most Comparator Funds when assessed by reference to how long it would take to liquidate various percentages of the NAV of the WEIF:

(a) The WEIF would have taken significantly longer to liquidate 5% of its NAV than the Comparator Funds, with the position worsening from August 2018. For example, 95% of the Comparator Funds could liquidate 5% of their NAV within 1 day, whereas the WEIF would have taken between 2 and 5 days to liquidate 5% of its NAV.

(b) The WEIF would have taken longer to liquidate 10% of its NAV than the Comparator Funds, with the position worsening significantly from July 2018. For example, 95% of the Comparator Funds could liquidate at least 10% of their NAV within between 1 and 2 days, whereas the WEIF would have taken between 3 and 9 days to liquidate 10% of its NAV.

(c) The WEIF would have taken longer to liquidate 20% of its NAV than the Comparator Funds (being in the bottom 1% of such funds), with the position worsening significantly from July 2018.

(d) Accordingly:

(i) the time it would have taken to liquidate the WEIF's NAV was significantly longer than would have been the case for the Comparator Funds. At least 50% of those funds could liquidate up to 20% of their NAVs within 1 day, compared with between 5 and 18 days for the WEIF; and

(ii) from July 2018, the time it would have taken the WEIF to liquidate 5%, 10% and 20% of its NAV significantly increased and it consistently would have taken the WEIF significantly longer to liquidate 5% and 10% of its NAV than the bottom ranked Comparator Fund.

4.170. Fourth, during the period of 1 May 2017 to 3 June 2019, the WEIF experienced the worst performance of the least liquid Comparator Funds until September 2018, when its performance was in line with just one other fund. For that reason, compared to its peers, the WEIF had a heightened liquidity risk throughout this period.

F6: Impact on ability of investors to redeem

4.171. In the circumstances, the Authority considers that the WEIF's liquidity profile deteriorated significantly during the period of 1 May 2017 to 3 June 2019 and that WIM's failings during the Relevant Period (as particularised in the Failings section immediately below) materially increased the risk that suspension of the fund would be required, and thereby place those investors who did not redeem prior to the point of suspension at a disadvantage.

4.172. The *"first mover advantage"* for those redeeming earlier was exacerbated by the approach that WIM adopted in its investment decisions during the Relevant Period, by which it sold a far greater amount and proportion of more liquid assets than it bought, and bought a greater amount and proportion of more illiquid assets than it sold, leading to a significant deterioration in the fund's liquidity profile. As a result, WIM did not maintain a balanced approach to its buying and selling activity to ensure that there remained an appropriate spread of liquidity risk. Had it done so, the WEIF's liquidity would not have deteriorated in the manner in which it did. In addition, urgent steps to rebalance the portfolio should have been undertaken to ensure fairness to all investors, not just those seeking to redeem.

5. FAILINGS

5.1. The statutory and regulatory provisions relevant to this Notice are referred to in **Annex B**.

5.2. By reason of the facts and matters set out above, during the Relevant Period, WIM breached Principle 2 (skill, care and diligence). WIM's failings fall into the following categories:

(a) The unreasonable and inappropriate liquidity profile of the WEIF.

(b) WIM's failure, when making investment decisions, to pay due regard to the need to ensure an appropriate liquidity profile for the fund.

(c) WIM's failure to implement its risk framework effectively, in particular:

(i) by failing to manage the WEIF in accordance with WIM's stated risk appetite for liquidity risk which was *"medium"* (said to reflect *"a moderate amount of liquidity risk"* while recognising the need to *"ensure that there is sufficient liquidity to meet investor redemptions at all times"*); and

(ii) by failing to carry out the annual risk appetite review which ought to have taken place in or around March/April 2019.

(d) The unreasonable and inappropriate metrics and methodologies used by WIM to measure the WEIF's liquidity.

(e) WIM's failure to respond reasonably or appropriately to warning signs including:

(i) The persistent trend of deteriorating liquidity shown even by WIM's own metrics; and

(ii) The warnings given, and concerns expressed, by Link as the ACD of the Fund.

5.3. Each of these categories of failing is addressed in turn below.

<u>Failings in respect of the WEIF's liquidity profile</u>

5.4. As set out in paragraph 4.7 above, under the terms of the IMA:

(a) WIM acknowledged and agreed that it would be responsible for ensuring that the fund was managed at all times in accordance with the Prospectus and the provisions of Chapter 5 of COLL (Clause 2.1). This includes the requirement in COLL 5.2.3R to maintain a prudent spread of risk (including liquidity risk).

(b) WIM was required to exercise its investment discretion compatibly with the provisions of Chapter 5 of COLL and with the standard of care that could reasonably be expected of a professional discretionary investment manager acting in good faith and with reasonable care and skill (Clause 2.2.1);

(c) WIM was further required to maintain an appropriate liquidity profile for the WEIF having regard to the fund's overall liquidity requirements (and requirements in different market conditions) (Clause 2.2.3);

(d) WIM was required to regularly review the fund's portfolio to ensure that the fund was managed in accordance with Clause 2.2 (Clause 4.2.6); and

(e) WIM was required at all times to follow a risk management process consistent with the Authority's rules and to ensure that the fund's investments were managed in a manner which enabled each of the fund and Link to comply at all times with the requirements of regulations, the Prospectus and the IMA in relation to redemptions. WIM was also required to provide Link with details of its risk management process and to notify Link promptly if it proposed to change any aspect of such process (Clause 2.2.6).

5.5. During the Relevant Period, the WEIF's liquidity profile was unreasonable and inappropriate in light of the redemption policy in the fund Prospectus. In particular, as set out in Section F above:

(a) Had WIM not ceased to apply a trigger and limit to the T+20 metric in September 2018, there would have been a continuous crossing of that trigger and breach of that limit from August 2018 and September 2018 respectively until the end of the Relevant Period.

(b) Had WIM adopted, as it should have done, a more realistic Participation Rate (even assuming it also altered the allocation method), by reference to the Revised Four Bucket Model, at least one of the triggers which it had set for that metric would have been crossed: (1) from July 2018 (if WIM had used the 25% Participation Rate and Linear Allocation Approach it used for the T+ and Redemption Metrics); and (2) from January 2018 (if WIM had used the 20% Participation Rate, even assuming the use of a Linear Allocation Approach).

(c) There were other indications (in particular those set out at paragraphs 4.92 to 4.93 and 4.104 to 4.105 above) which WIM contemporaneously monitored and of which WIM was aware throughout the Relevant Period which clearly indicated that the liquidity of the WEIF was deteriorating and imprudent.

(d) There were further indications which WIM did not contemporaneously or actively monitor that establish that the liquidity of the WEIF was deteriorating and imprudent. Had WIM been in any doubt as to the deteriorating and imprudent liquidity position (which it should not have been), it should have conducted further investigations which would have identified these indications and confirmed the position beyond doubt.

(e) The stress testing conducted by WIM was inadequate. Had adequate stress testing been conducted, it would have become apparent that the WEIF was not able to withstand extreme but plausible scenarios. In particular, WIM's stress testing: (1) failed adequately to take into account the fact that redemption by KCC (and/or another large redemption) would be likely to result in an increased rate of redemption by other investors; and (2) failed to test the impact of redemption by KCC (and/or another large redemption) *alongside* an increased redemption rate, for example by testing on the basis that other redemptions might increase to the largest retail redemption rate over a preceding 5-day period since May 2017 (when the fund began to be affected by significant net outflows). Had that stress testing (or stress testing using similar appropriate parameters) been conducted, it would have shown that, from 1 September 2018, the WEIF would have been unable to meet its required redemptions in such plausible circumstances.

(f) The WEIF was an outlier and among the least liquid of the Comparator Funds:

(i) the proportion of the WEIF's securities that could easily be liquidated (i.e. within 7 days) was significantly lower than that of Comparator Funds throughout the Relevant Period; and

(ii) throughout the Relevant Period, the WEIF's liquidity was lower than the bottom ranked Comparator Fund in a number of respects.

(g) In all the circumstances, based on the indications that WIM contemporaneously monitored and the stress testing that it in fact carried out, together with the implications of sustained and significant diminution of NAV over an extended period of time, WIM should have appreciated that there were clear signs that liquidity was a significant issue in the context of the WEIF's redemption requirements and that urgent and significant action should have been taken to reduce the risks to remaining unitholders.

5.6. Given the continued trend of redemptions (outflows) exceeding subscriptions (inflows) and no obvious reason for this to change, it was apparent throughout the Relevant Period that redemptions would continue to be met by the sale of the more liquid assets, which as further set out in **Annex A** had been the pattern since at least May 2017. Urgent steps to rebalance the portfolio should have been taken to ensure fairness to all investors, not just those seeking to redeem.

5.7. The liquidity thresholds used by WIM (and Link) during the Relevant Period were inappropriate in light of the redemption policy and metrics adopted. They were set in such a way that action would only be required when it was already too late.

<u>Failings in WIM's approach to its investment decisions</u>

5.8. The first mover advantage created by the WEIF's poor liquidity was exacerbated by the failure of WIM to buy and sell assets proportionately across its buckets to maintain an appropriate liquidity profile. Had WIM done so, the WEIF's liquidity would not have deteriorated in the manner in which it did. Instead, WIM sold a much greater amount and proportion of more liquid assets than it bought, and bought a greater amount and proportion of more illiquid assets than it sold, leading to a significant deterioration in the WEIF's liquidity.

5.9. As set out in **Annex A**, the Authority has analysed the investment decisions made by WIM and their impact on the composition of the fund. By reference to the Corrected Four Bucket Model, the analysis shows that during the Relevant Period:

(a) WIM sold a much greater amount and proportion of securities in Buckets 1 and 2 than it bought, resulting in a net reduction of £0.9 billion in the value of Buckets 1 and 2 over this period.

(b) WIM's buying and selling of securities in Buckets 3 and 4 was more balanced, resulting in a smaller reduction of £0.4 billion in the value of Buckets 3 and 4.

(c) These investment decisions by WIM had the effect of increasing the proportion of illiquid shares held by the WEIF. Over this period (by reference to the fund's NAV with percentages rounded):

(i) The proportion of securities in Bucket 1 fell by 8% (from 16% to 8%);

(ii) The combined proportion of securities in Buckets 1 and 2 fell by 9% (from 37% to 28%);

(iii) The proportion of securities in Bucket 4 increased by 8% (from 33% to 41%);

(iv) The combined proportion of securities in Buckets 3 and 4 increased by 11% (from 63% to 74%).

(d) These changes in the fund's composition were primarily driven by WIM's investment decisions and not by other factors (such as relative performance of the shares in each bucket or the movement of securities between buckets due to changing circumstances).

5.10. In these circumstances, during the Relevant Period:

(a) WIM's investment decisions were not balanced from a liquidity perspective. It sold disproportionately more securities from Buckets 1 and 2 than it bought, in contrast to its more balanced approach to buying and selling for Buckets 3 and 4. This had a significant and direct impact on the liquidity of the WEIF, causing its liquidity to deteriorate.

(b) WIM's investment decisions failed to pay due regard to the need to ensure an appropriate liquidity profile for the WEIF and the approach it adopted was unreasonable. They resulted in the WEIF becoming an outlier in terms of liquidity among Comparator Funds with, for example, only 8% of its securities able to be sold within 7 days by 3 June 2019 (which was significantly lower than the bottom ranked Comparator Fund).

5.11. The listing of the TISE companies (addressed in Section E above) was used by WIM to take further steps which contributed to the deteriorating liquidity of the WEIF. In particular, WIM not only continued to hold the TISE securities once they had ceased to count towards the 10% regulatory limit on Unquoted Securities, but also increased the WEIF's holdings in certain of the TISE securities above the amount originally held. This was despite the fact that the TISE securities: (1) were classified as amongst the most illiquid securities held by the WEIF, and even after listing would remain as such; and (2) had the same characteristics in liquidity terms as Unquoted Securities. This resulted in the WEIF holding an increased proportion of assets which had the same characteristics in liquidity terms as Unquoted Securities. The TISE securities were among the Bucket 4 securities even after their listing (i.e. they remained in the least liquid bucket). As set out above, WIM's investment decisions during the Relevant Period, including its approach to the TISE securities, failed to pay due regard to the need to ensure a reasonable and appropriate liquidity profile for the WEIF and unreasonably sought to prioritise Mr Woodford's investment strategy without appropriately addressing the WEIF's deteriorating liquidity.

<u>Failure to implement risk framework effectively</u>

5.12. WIM failed to implement the applicable risk framework effectively:

(a) Throughout the Relevant Period, WIM's stated risk appetite for liquidity risk (including for the WEIF) was *"medium"*, which was said to reflect *"a moderate amount of liquidity risk"* while recognising the need to *"ensure that there is sufficient liquidity to meet investor redemptions at all times"*. In fact, the WEIF carried a significantly higher level of liquidity risk during the Relevant Period for all of the reasons set out in paragraphs 4.135 to 4.170 above and, after a sustained period of deterioration, the WEIF was ultimately suspended by Link and put into liquidation without reopening.

(b) Further, there ought to have been an annual risk appetite review in or around March/April 2019, including specifically reviewing the triggers and limits (see paragraph 4.10(b)(ii) above). But in fact there was no risk appetite review at any time after April 2018 (see paragraph 4.107 above).

<u>Failings in respect of WIM's Liquidity Framework and Analysis</u>

Unreasonable decision to discontinue the Initial T+20 Metric

5.13. A senior WIM employee recognised in early August 2018 that it would be "*hard to argue we're meeting our COLL liquidity obligations",* if the fund's liquidity continued to deteriorate when assessed against WIM's Initial T+20 Metric (see paragraph 4.92 above). Despite this, WIM:

(a) unreasonably decided to cease applying the triggers and limits in respect of the Initial T+20 Metric in September 2018 without any adequate replacement; and

(b) unreasonably failed to take any (or any adequate) action in light of the continuing deterioration in the Initial T+20 Metric, which continued to be displayed on WIM's dashboards (albeit not actively monitored) even after September 2018.

Inappropriate Participation Rates

5.14. Participation Rate: WIM adopted a 100% Participation Rate for the WEIF in respect of the Revised Four Bucket Model, however it adopted a Participation Rate of 25% in respect of its T+ and Redemption Metrics, and a 20% Participation Rate for the T+1 metric. The 100% Participation Rate was combined with the adoption of the Full Allocation Approach. These two assumptions had first been adopted by Link in the belief that they offset each other. WIM did not test this belief or challenge it. The 100% Participation Rate assumption is a highly significant one:

(a) Had WIM used a Participation Rate of 25% for the Revised Four Bucket Model (and assuming it had also altered the Full Allocation metric to a Linear Allocation metric), thereby mirroring its methodology for the T+ and RCR metrics, at least one of the triggers that WIM contemporaneously set against this model would have been crossed from July 2018.

(b) Had WIM used a Participation Rate of 20% for the Revised Four Bucket Model (and assuming it had also altered the Full Allocation metric to a Linear Allocation metric), at least one of the triggers that WIM contemporaneously set against this model would have been crossed from January 2018.

5.15. In the Authority's view, the 100% Participation Rate and the Full Allocation Approach did not fully offset each other and instead created an unjustifiably positive impression of the WEIF's liquidity.

Inappropriate liquidity limits

5.16. As set out in paragraph 4.41 and 4.47 above, WIM (and Link) adopted the following liquidity limits on the WEIF's NAV during 2018:

(a) Bucket 1 (T+1 – T+7) – no lower than 5% (trigger at 8%).

(b) Bucket 4 (T+181 – T+365+) – no higher than 35% (trigger at 30%).

(c) Buckets 3 and 4 (T+31 – T+365+) – no higher than 70% (trigger at 65%).

5.17. When the KCC redemption was modelled immediately before suspension, it took the WEIF 1% over the Bucket 3 and Bucket 4 limit. Link decided to suspend the fund at that stage and therefore had determined that the contingency plan was not the appropriate way to resolve the issues. The fact that Link decided to suspend the WEIF, rather than require implementation of contingency plans, is a further indication of the inappropriateness of the limits / triggers being: (a) set at the level they were; and/or (b) calculated in the manner that they were.

Inappropriate ADTV Period

5.18. Subsequent to October 2018, WIM used a rolling 12-month average period over which to calculate the ADTV for the Revised Four Bucket Model. The effect of this was that fluctuations in liquidity were smoothed out and did not reflect the true volume of shares traded. This led to potential inaccuracies in the assessment of the WEIF's liquidity.

Inadequate stress testing

5.19. For the reasons set out in Section F4 and paragraph 5.5(e) above, the stress testing conducted by WIM (and Link) was inadequate during the Relevant Period. WIM could not reasonably derive significant comfort from the tests conducted given the extreme but plausible scenarios that they omitted to cover. In particular:

(a) the redemptions stress tests carried out by WIM (and Link) were inadequate for the reasons set out in paragraph 4.164 above;

(b) the stress testing set out at paragraphs 4.164 and 4.165 above (or stress testing using similar appropriate parameters) should have been carried out. Had adequate stress testing been conducted, it would have become apparent that the WEIF would not have been able to withstand extreme but plausible scenarios.

5.20. Without other market factors in play, the redemption by KCC, albeit a significant investor, should not have led to an "extreme" scenario if the WEIF had an appropriate liquidity profile. It should not have taken the actual redemption request by KCC for WIM (and Link) to recognise that the liquidity profile had become inappropriate. The potential need for a suspension of the WEIF if KCC were to redeem its funds should, through adequate stress testing, have been appreciated well before the redemption occurred.

<u>Failure to respond reasonably or appropriately to warning signs</u>

5.21. As particularised in paragraphs 4.89 and 4.101 above, WIM was aware from its internal reporting of the persistent trend during the Relevant Period of: (i) redemptions resulting in net outflows from the WEIF; (ii) the deteriorating liquidity of the WEIF by reference to the metrics that WIM applied and/or monitored in its dashboards; and (iii) crossing and breaches of WIM's liquidity triggers and limits. Despite the clear deterioration in the WEIF's liquidity that was evident from the metrics that were contemporaneously reported within WIM on a daily basis, WIM did not take adequate steps to rebalance the fund and instead made investment decisions which exacerbated the liquidity difficulties faced by the fund, as addressed in paragraphs 5.8 to 5.11 above.

5.22. WIM further failed to respond reasonably or appropriately to the liquidity concerns that were repeatedly raised by Link with WIM during the Relevant Period. In particular:

(a) Link recognised and clearly communicated to WIM by its email of 20 September 2018 *"the need to improve the overall liquidity profile of the fund"* and for the *"fund to be rebalanced to a considerably more liquid profile"* (see paragraph 4.98(c) above). WIM unreasonably responded that it did not agree with and had not agreed with this conclusion.

(b) Link said on 24 September 2018 that it continued *"to press the need for a long term rebalancing of the portfolio to a more liquid overall profile as well as a reassessment and reformulation of an effective liquidity monitoring framework for* [the WEIF]*"* (see paragraph 4.98(d) above).

(c) Link again informed WIM, on 26 September 2008, that WIM and Link needed to *"work together to formulate a proposal for a more refined liquidity management framework"* and *"acknowledge the need to rebalance the portfolio in the longer term (6m +) to a more balanced liquidity profile appropriate for a daily dealing UCITS fund",* and required WIM to *"advise* [Link] *of their plan to achieve this"* (see paragraph 4.98(f) above). WIM unreasonably responded that it did not *"believe that there is a need to rebalance the portfolio to a more liquid one over the longer term"* (see paragraph 4.98(g) above).

(d) Link informed WIM on 10 December 2018 that *"[Link's] position is that we expect WIM to be undertaking prompt action to address both the valuation and liquidity concerns with the ultimate goal of bringing the hard to value assets down from 19% to less than 10% and for the portfolio to return to a more balanced position between the four liquidity buckets"* (see paragraph 4.103 above).

(e) Further, on 28 and 29 March 2019 and 4 April 2019, Link again required WIM to identify *"concrete actions that have been or will be taken to improve the combined buckets 3 and 4 metric, particularly if the 70% limit is breached"* (see paragraph 4.108 above). WIM unreasonably responded it did not agree with and had not agreed with this conclusion.

(f) In the circumstances, WIM failed to pay due regard to (and effectively ignored) the warnings received from Link regarding the fund's liquidity profile and the impending breaches of the existing rules and parameters set by the liquidity framework. This was an unreasonable approach.

5.23. During the Relevant Period, WIM failed to respond reasonably or appropriately to Link's concerns or take any adequate action in response to them in order to substantially rebalance the liquidity of the WEIF. Link had communicated to WIM as early as November 2017 that the WEIF's liquidity profile was becoming unbalanced with respect to Buckets 1 and 4 and that action needed to be taken such that the allocations to Bucket 4 could be reduced and Bucket 1 could be increased. However, the liquidity profile continued to deteriorate and WIM did not seek to change its investment decisions to rebalance the portfolio and improve liquidity. The subsequent limits adopted by Link in May 2018 were meant to be a backstop position that prevented the liquidity of the WEIF from deteriorating any further, since liquidity had continued to deteriorate in early 2018 as more liquid securities were sold to meet redemptions of just over £1 billion in the first four months of the year. Instead, the limits became the framework (both at WIM and Link) within which the WEIF operated. WIM unreasonably treated these limits as definitive and exhaustive of its obligation to maintain an adequate liquidity profile for the WEIF. They therefore became a key factor in preventing a fundamental rebalancing of the portfolio, and WIM failed to tackle the root cause of the issue.

Conclusion

5.24. By reason of the matters set out in paragraphs 5.4 to 5.23 above, during the Relevant Period, in breach of Principle 2, WIM failed to exercise due skill, care and diligence in: (i) maintaining an appropriate liquidity profile for the WEIF; (ii) ensuring that the fund was managed at all times in accordance with the provisions of Chapter 5 of COLL, including in particular the requirement to maintain a prudent spread of risk in COLL 5.2.3R; and (iii) ensuring that WIM's investment discretion was exercised compatibly with the provisions of Chapter 5 of COLL.

6. SANCTION

Financial penalty

6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

Step 1: Disgorgement

6.2. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breaches where it is practicable to quantify this.

6.3. The Authority has not identified any financial benefit that WIM derived directly from its breach of Principle 2. The Step 1 figure is therefore £0.

Step 2: The seriousness of the breaches

6.4. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breaches. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breaches may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.

6.5. The Authority considers that the revenue generated by WIM is an indicator of the harm or potential harm caused by its breaches. The Authority has therefore determined a figure based on a percentage of WIM's relevant revenue. WIM's relevant revenue is the revenue derived by it during the period of the breaches. The period of WIM's breaches was from 31 July 2018 to 3 June 2019. Where a breach lasts less than 12 months, the relevant revenue will be that derived by the firm in the 12 months preceding the end of the breach (DEPP 6.5A.2G(2)). The Authority accordingly considers WIM's relevant revenue to be £33,147,223.

6.6. In deciding on the percentage of the relevant revenue that forms the basis of the Step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 20%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on firms there are the following five levels:

Level 1 – 0%

Level 2 – 5%

Level 3 – 10%

Level 4 – 15%

Level 5 – 20%

6.7. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach, and whether it was committed deliberately or recklessly. DEPP 6.5A.2G(11) lists factors likely to be considered 'level 4 or 5 factors'. Of these, the Authority considers the following factors to be relevant:

(a) WIM's breaches materially contributed to a significant loss or risk of loss to a large number of individual consumers and investors, causing serious, or potentially serious, consequences and distress to those invested in the WEIF at the time of the suspension. Many of the holders of the around £3.6 billion NAV of the WEIF at that time were retail investors.

(b) WIM's breaches have had an adverse effect on confidence in financial services markets.

6.8. DEPP 6.5A.2G(12) lists factors likely to be considered 'level 1, 2 or 3 factors'. Of these, the Authority considers the following factors to be relevant:

(a) Little, or no, profits were made or losses avoided as a result of the breaches.

(b) WIM's breaches were committed negligently.

6.9. The nature and impact of WIM's breaches were extremely serious, in particular:

(a) the need to act with due skill, care and diligence when managing a fund's liquidity is of fundamental importance under the regulatory framework, especially where that fund has a significant number of retail investors;

(b) WIM's breaches directly involved its senior management in the person of Mr Woodford, who was its co-founder, its Head of Investment and one of only two executive directors on the Management Board;

(c) as above, WIM's breaches materially contributed to a significant loss or risk of loss to investors;

(d) WIM's breaches resulted in serious, or potentially serious, consequences and distress to those invested in the WEIF at the time of its suspension; and

(e) the failure of the WEIF has had an adverse effect on financial services markets, in particular by damaging consumer confidence in the UK fund management sector.

6.10. Taking all of these factors into account, the Authority considers the seriousness of WIM's breaches to be level 4 and so the Step 2 figure is 15% of £33,147,223.

6.11. Step 2 is therefore £4,972,084.

Step 3: Mitigating and aggravating factors

6.12. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breaches.

6.13. The Authority considers that there are no factors that aggravate or mitigate the breaches.

6.14. Having taken into account the lack of mitigating or aggravating factors, the Authority considers that the Step 2 figure should not be changed.

6.15. Step 3 is therefore £4,972,084.

Step 4: Adjustment for deterrence

6.16. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.

6.17. The Authority does not consider that the Step 3 figure of £4,972,084 represents a sufficient deterrent in the circumstances of this case, either generally or to WIM, which was a high-profile manager of a number of funds in addition to the WEIF.

6.18. WIM's serious failure to manage properly the liquidity of its most significant fund exposed many thousands of investors to the risk of significant detriment. This risk crystallised when the fund was suspended. It has also undermined public confidence in the funds industry. At the time of its suspension on 3 June 2019, the WEIF was valued at around £3.6 billion. Since then, the value of many of the WEIF's holdings have reduced significantly on realisation, meaning that investors (nearly three quarters of whom were retail investors) have received, or are entitled to receive, significantly less than the value of their investments at the point of suspension. At present there remains a shortfall of some £1 billion, or approximately 30% of the fund, from the WEIF's NAV at suspension. The losses were unfairly and disproportionately borne by those investors who did not redeem early and were left with a fund consisting of less liquid assets. The Authority has calculated the amount of investor losses at up to approximately £298 million. The Authority regards these circumstances as a matter of significant importance when considering the need for credible deterrence.

6.19. The scale of the investor losses increases the importance of deterring others managing big, high-profile funds with large numbers of retail investors, from taking the types of unreasonable liquidity risks that WIM took when pursuing its investment strategy. WIM prioritised its investment strategy at the expense of promptly taking appropriate action to address the liquidity concerns raised by Link. The need for credible deterrence in these circumstances is greater than a case where the risk to investors arising from the misconduct is much smaller; or where the investors are not as vulnerable as retail investors.

6.20. Accordingly, the Authority considers that in order to achieve its objective of credible deterrence, the Step 3 figure should be increased to £40,000,000.

6.21. Step 4 is therefore £40,000,000.

<u>Step 5: Settlement discount</u>

6.22. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6.23. There has been no settlement between the Authority and WIM and no discount applies to the Step 4 figure.

6.24. Step 5 is therefore £40,000,000.

Penalty

6.25. The Authority therefore has decided to impose a financial penalty of £40,000,000 on WIM for breaching Principle 2.

7. REPRESENTATIONS

7.1. Annex C contains a brief summary of the key representations made by WIM in response to the Warning Notice and how they have been dealt with. In making the decision which gave rise to the obligation to give this Notice, the Authority has taken account of all of the representations made by WIM, whether or not set out in Annex C.

8. PROCEDURAL MATTERS

8.1. This Notice is given to WIM under section 208 and in accordance with section 388 of the Act.

8.2. The following statutory rights are important.

Decision maker

8.3. The decision which gave rise to the obligation to give this Notice was made by the RDC. The RDC is a committee of the Authority which takes certain decisions on behalf of the Authority. The members of the RDC are separate to the Authority staff involved in conducting investigations and recommending action against firms and individuals. Further information about the RDC can be found on the Authority's website:

https://www.fca.org.uk/about/committee/regulatory-decisions-committee-rdc

The Tribunal

8.4. WIM has the right to refer the matter to which this Notice relates to the Tribunal. Under paragraph 2(2) of Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008, WIM has 28 days from the date on which this Notice is given to it to refer the matter to the Tribunal. A reference to the Tribunal is made by way of a signed reference notice (Form FTC3) filed with a copy of this Notice. The Tribunal's contact details are: Upper Tribunal, Tax and Chancery Chamber, Fifth Floor, Rolls Building, Fetter Lane, London EC4A 1NL (tel: 020 7612 9730; email: fs@hmcts.gov.uk).

8.5. Further information on the Tribunal, including guidance and the relevant forms to complete, can be found on the HM Courts and Tribunal Service website:

http://www.justice.gov.uk/forms/hmcts/tax-and-chancery-upper-tribunal

8.6. A copy of Form FTC3 must also be sent to the Authority at the same time as filing a reference with the Tribunal. A copy should be sent to Bob Beauchamp at the Financial Conduct Authority, 12 Endeavour Square, London E20 1JN.

8.7. Once any such referral is determined by the Tribunal and subject to that determination, or if the matter has not been referred to the Tribunal, the Authority will issue a Final Notice about the implementation of that decision.

Access to evidence

8.8. Section 394 of the Act applies to this Notice.

8.9. The person to whom this Notice is given has the right to access:

(a) the material upon which the Authority has relied in deciding to give this Notice; and

(b) the secondary material which, in the opinion of the Authority, might undermine that decision.

Third party rights

8.10. A copy of this Notice is being given to Link Fund Solutions Limited Under section 393(5) of the Act as a third party to whom the Warning Notice was copied. Link Fund Solutions Limited has similar rights to those mentioned in paragraphs 8.4 and 8.9 above in relation to the matter which identifies it.

Confidentiality and publicity

8.11. This Notice may contain confidential information and should not be disclosed to a third party (except for the purpose of obtaining advice on its contents). In accordance with section 391 of the Act, a person to whom this Notice is given or copied may not publish the Notice or any details concerning it unless the Authority has published the Notice or those details.

8.12. However, the Authority must publish such information about the matter to which a Decision Notice or Final Notice relates as it considers appropriate. The persons to whom this Notice is given or copied should therefore be aware that the facts and matters contained in this Notice may be made public.

Authority contacts

8.13. For more information concerning this matter generally, contact Bob Beauchamp at the Authority (direct line: 020 7066 5302/email: Bob.Beauchamp@fca.org.uk).

Edward Sparrow
Deputy Chair, Regulatory Decisions Committee

FINANCIAL CONDUCT AUTHORITY
12 Endeavour Square
London
E20 1JN
Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

ANNEX A – THE IMPACT OF WIM'S INVESTMENT DECISIONS ON THE WEIF'S LIQUIDITY PROFILE

1. Overview

1.1. The Authority has assessed the WEIF's liquidity between 1 May 2017 and 3 June 2019 by reference to a statistical model based on the historical trading data for the securities in which the WEIF and peer funds invested (the "Statistical Model"). The Statistical Model uses data relating to the monthly composition of the funds, as well as data on the investments each fund held (the number of shares, their value, and their average daily trading volume).

1.2. The Authority has used the Statistical Model to assess the impact of WIM's investment decisions on the liquidity profile of the fund by reference to (i) a liquidity model applying the same assumptions used by WIM in the Revised Four Bucket Model; and (ii) an alternative set of assumptions that provide a more accurate picture of the WEIF's liquidity (the "Corrected Four Bucket Model").

1.3. This analysis shows that the deterioration in the WEIF's liquidity profile was predominantly caused by WIM's investment decisions, both in the period between May 2017 and May 2019 and specifically in the Relevant Period. The same conclusion is reached whether liquidity is analysed using the Revised Four Bucket Model or the Corrected Four Bucket Model.

2. Factors affecting the WEIF's liquidity profile

2.1. A fund's liquidity is affected by the following factors (the "Relevant Factors"):

(1) investment decisions made by the fund manager concerning the buying and selling of securities for the fund;

(2) the share performance of securities held in the fund;

(3) changes in the ADTV of individual securities.

2.2. A fund manager's investment decisions have a direct impact upon a fund's liquidity as a result of the securities being bought and sold. The liquidity of a fund can typically be maintained through investment decisions if buying and selling activity is balanced. For example, selling a greater proportion of liquid shares (i.e. those that can be sold at best price within a short time period) to illiquid shares (i.e. requiring a longer timeframe to be sold at best price) would over time cause the fund's liquidity to deteriorate, assuming that any buying activity is neutral from a liquidity perspective. Similarly, buying a greater proportion of illiquid securities compared to liquid securities would also have the same effect if selling activity is neutral.

2.3. Further, a fund's liquidity may also be affected by the respective levels of selling and buying activity. Both in the period between May 2017 and May 2019 and in the Relevant Period, the value of shares sold was more than twice as much as the value of shares purchased. Between May 2017 and May 2019, the total amount of shares sold from the WEIF was approximately £7.4 billion and the total amount of shares purchased was approximately £3.6 billion, resulting in a net total outflow of approximately £3.8 billion. In the Relevant Period, the total amount of shares sold from the WEIF was approximately £2.2 billion and the total amount of shares purchased was approximately £0.9 billion, resulting in a total net outflow of approximately £1.3 billion. In these circumstances, unless the selling activity was relatively balanced from a liquidity perspective, the liquidity of the fund would have been significantly more impacted by the selling decisions than by the buying decisions.

2.4. The share performance of securities held by a fund may differ over time. This can lead to changes in the liquidity profile of the fund by reference to the relative value of the securities held compared to the total value of the fund.

2.5. The fund's liquidity may also be affected by changes in ADTV. A security's liquidity is typically assessed by reference to the length of time it would take to sell that security without adversely affecting its price. A critical component of that assessment is the ADTV, which is the average number of shares traded in that security each day. If the ADTV in a security increases, it would typically mean that a greater number of shares can be sold each day without adversely affecting price, allowing the fund's holding in that security to be sold more quickly at best price (i.e. the security would become more liquid). Conversely, a reduction in a security's ADTV would typically mean that the security was less liquid (i.e. would take longer to sell at best price).

2.6. By analysing the changes to a fund's liquidity profile, it is possible to identify the reasons for those changes by reference to one or more of the above factors. The

Authority has analysed changes in the WEIF's liquidity profile by reference to (i) the Revised Four Bucket Model used by WIM; and (ii) the Corrected Four Bucket Model.

3. The Revised Four Bucket Model

3.1. By reference to the Revised Four Bucket Model, the WEIF's liquidity profile deteriorated in the period between May 2017 and May 2019. For example, the proportion of securities classified by value as Bucket 1 declined from 35% in May 2017 to 12% by May 2019. Over the same period, the proportion held in Bucket 4 increased from 17% to 31%.

The period from May 2017 to May 2019

3.2. During this period, there was a net total outflow of nearly £3.8 billion. This consisted of a net outflow of £3.5 billion from Buckets 1 and 2, and a net outflow of over £0.2 billion from Buckets 3 and 4.

3.3. The shares sold by the WEIF came predominantly from Buckets 1 and 2 during this period. Between May 2017 and May 2019, 78% of shares sold by the WEIF by value came from Buckets 1 and 2, with 22% being sold from Buckets 3 and 4.

3.4. On average over this period, the WEIF bought shares in a relatively even split between Buckets 1 and 2 and Buckets 3 and 4, amounting to 57% and 43% respectively.

3.5. The net buying and selling activity on a month by month basis for each bucket can be illustrated in the following graphs, showing net selling activity as negative and net buying activity as positive:

Figure 7: Net buying and selling activity for securities classified as Bucket 1

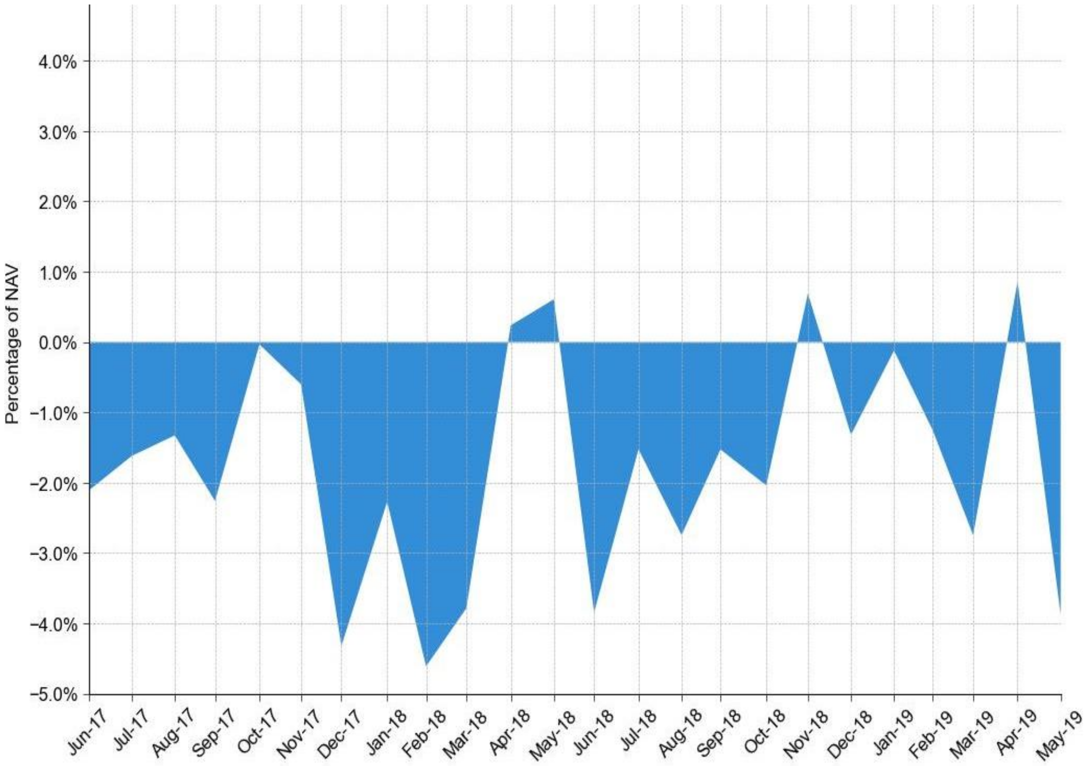


Figure 8: Net buying and selling activity for securities classified as Bucket 2

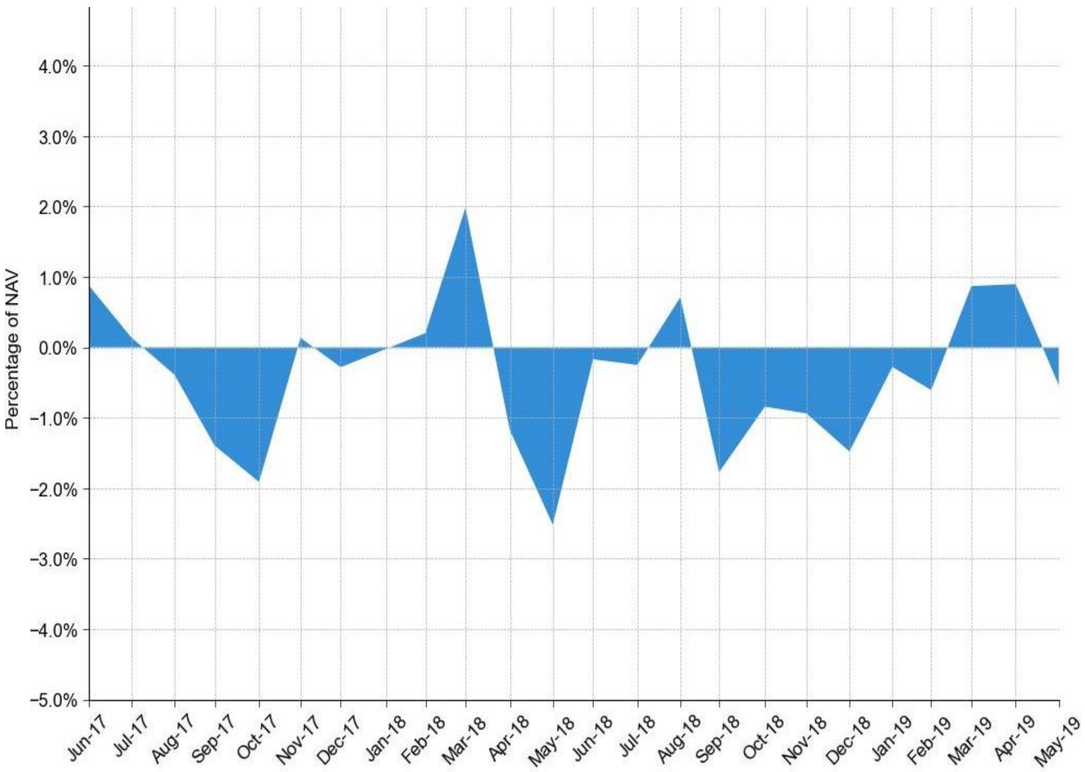


Figure 9: Net buying and selling activity for securities classified as Bucket 3

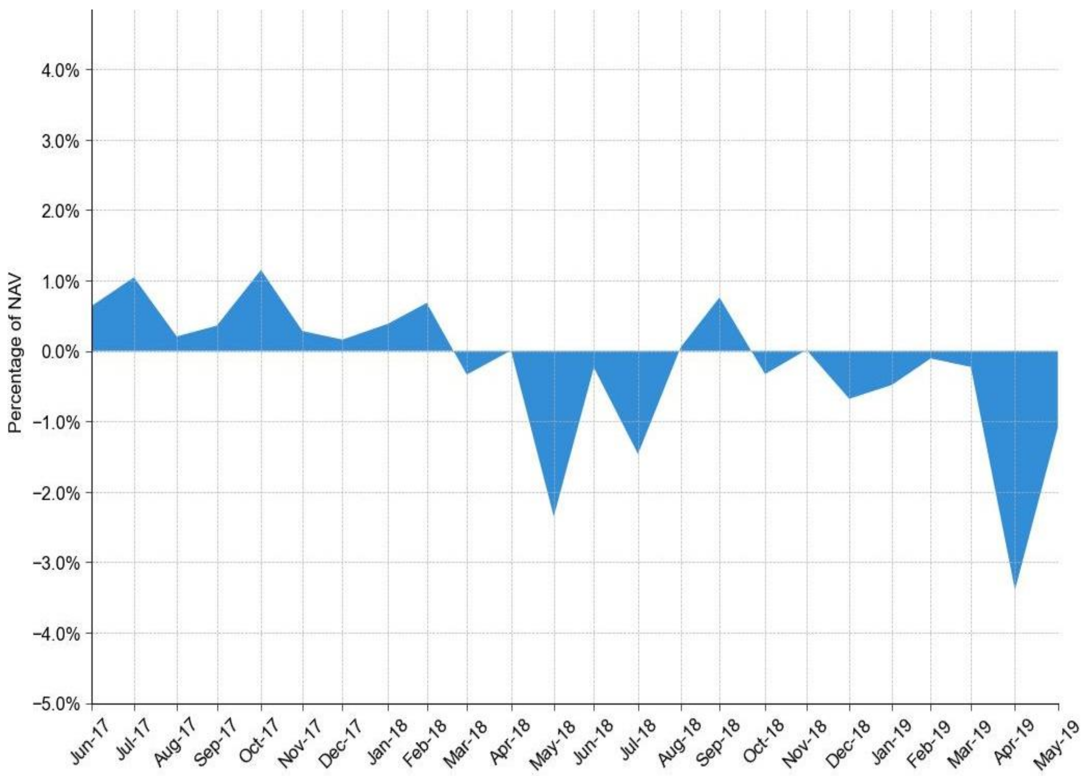
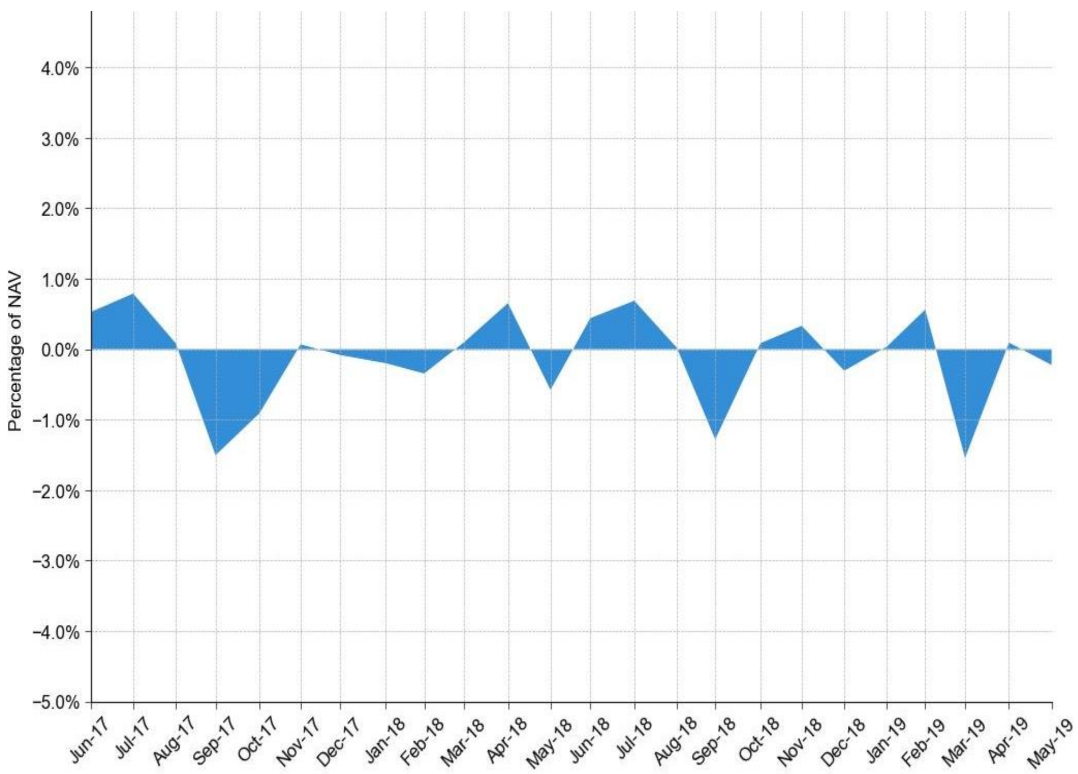


Figure 10: Net buying and selling activity for securities classified as Bucket 4



3.6. The above graphs show that the net buying and selling activity was predominantly:

(1) to sell shares from Buckets 1 and 2;

(2) to buy shares for Bucket 3 for the period to March 2018, and to sell shares thereafter; and

(3) a balance of buying and selling shares for Bucket 4.

3.7. The effect of this buying and selling activity had a negative impact on the WEIF's liquidity profile as a greater proportion of more liquid shares were sold and not replaced, resulting in the value of Buckets 1 and 2 decreasing compared to Buckets 3 and 4.

3.8. The Authority's analysis of the other factors impacting on liquidity (i.e. share price performance and ADTV changes) shows that they tended to have less impact on the WEIF's liquidity profile and exacerbated or failed to fully offset the overall deterioration in liquidity caused by WIM's investment decisions. This can be seen in the following graphs comparing the relative impact of Mr Woodford's buying and selling activity, share performance and ADTV changes on a cumulative basis. They also show that, where other factors contributed to the decline in liquidity, WIM did not adjust its buying and selling activity to compensate for this additional pressure on the WEIF's liquidity profile.

Figure 11: The cumulative impact of each of the Relevant Factors in respect of Bucket 1

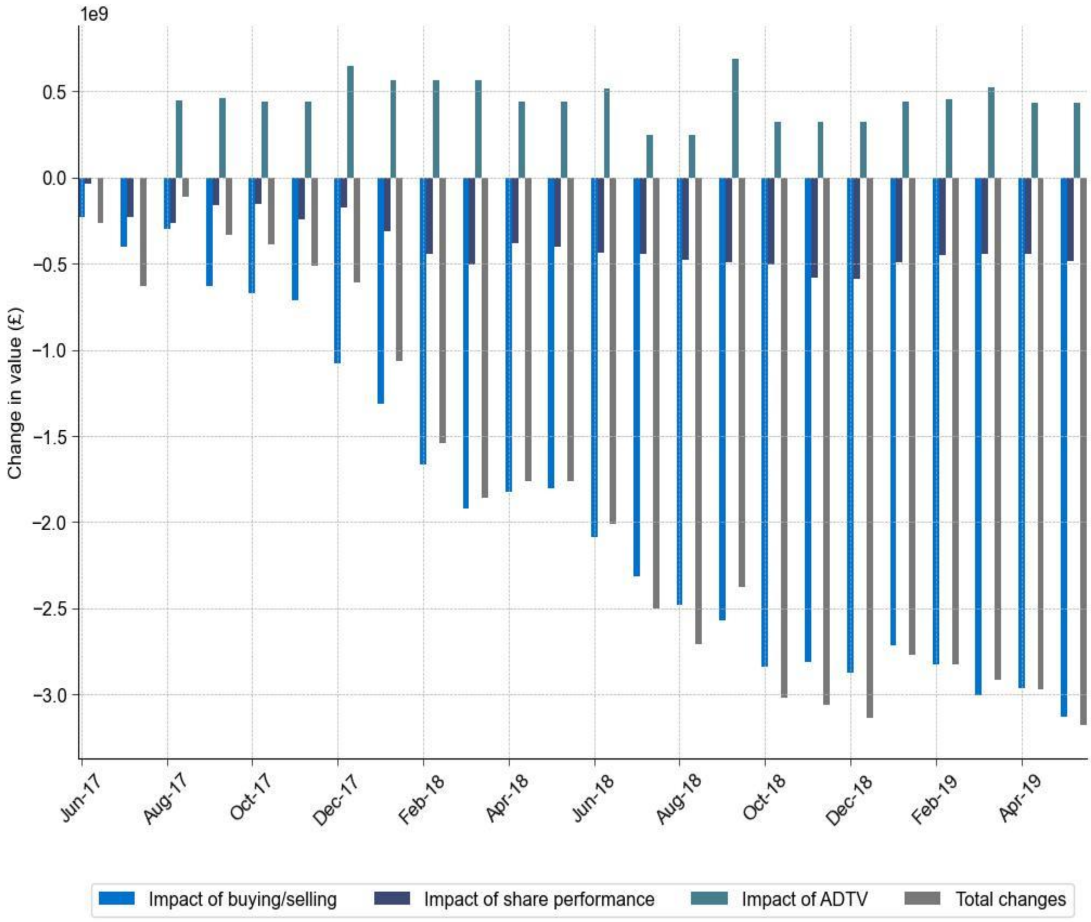


Figure 12: The cumulative impact of each of the Relevant Factors in respect of Bucket 2

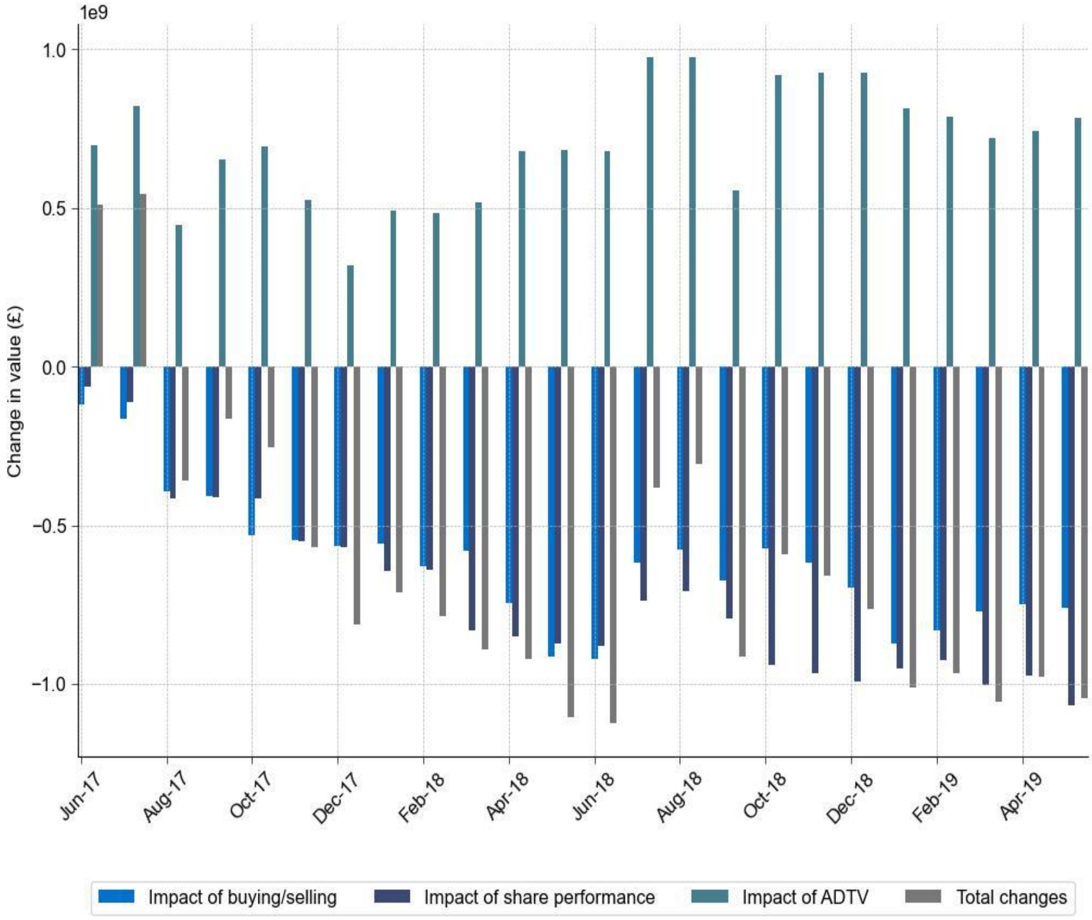


Figure 13: The cumulative impact of each of the Relevant Factors in respect of Bucket 3

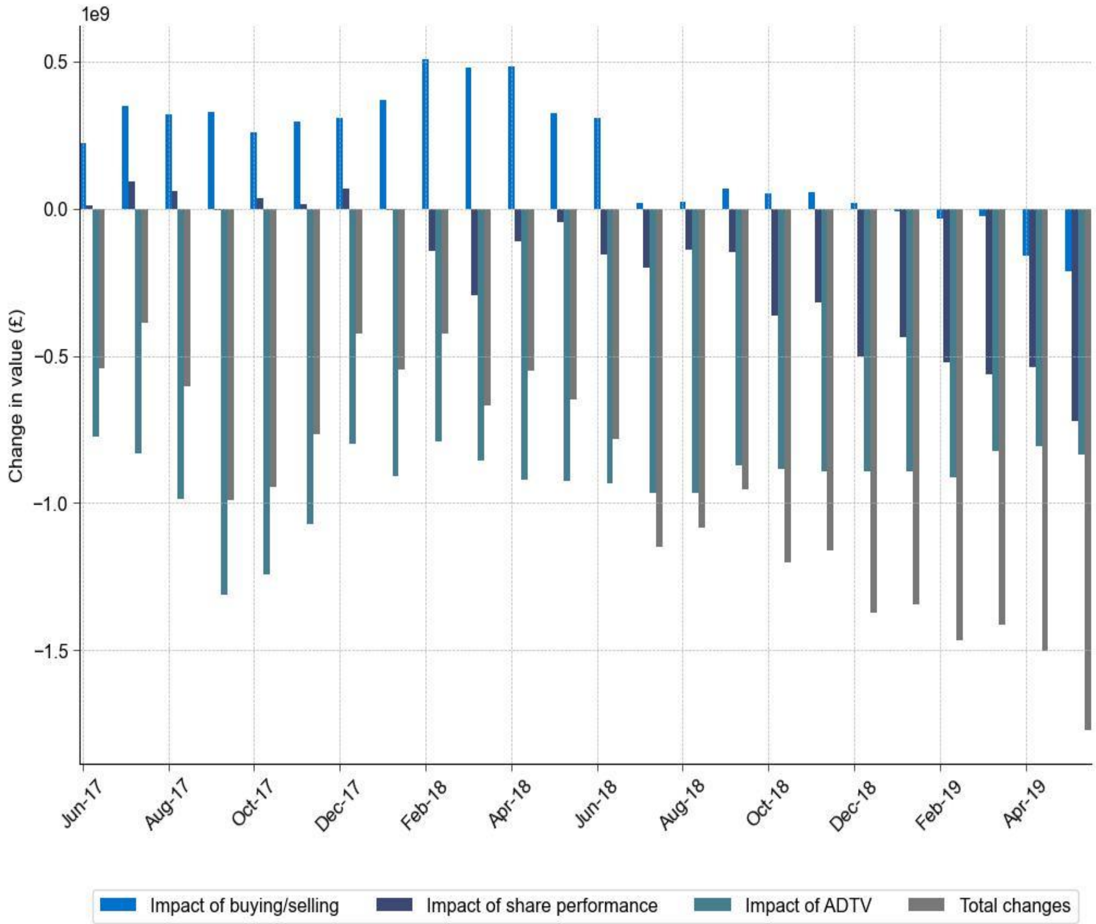
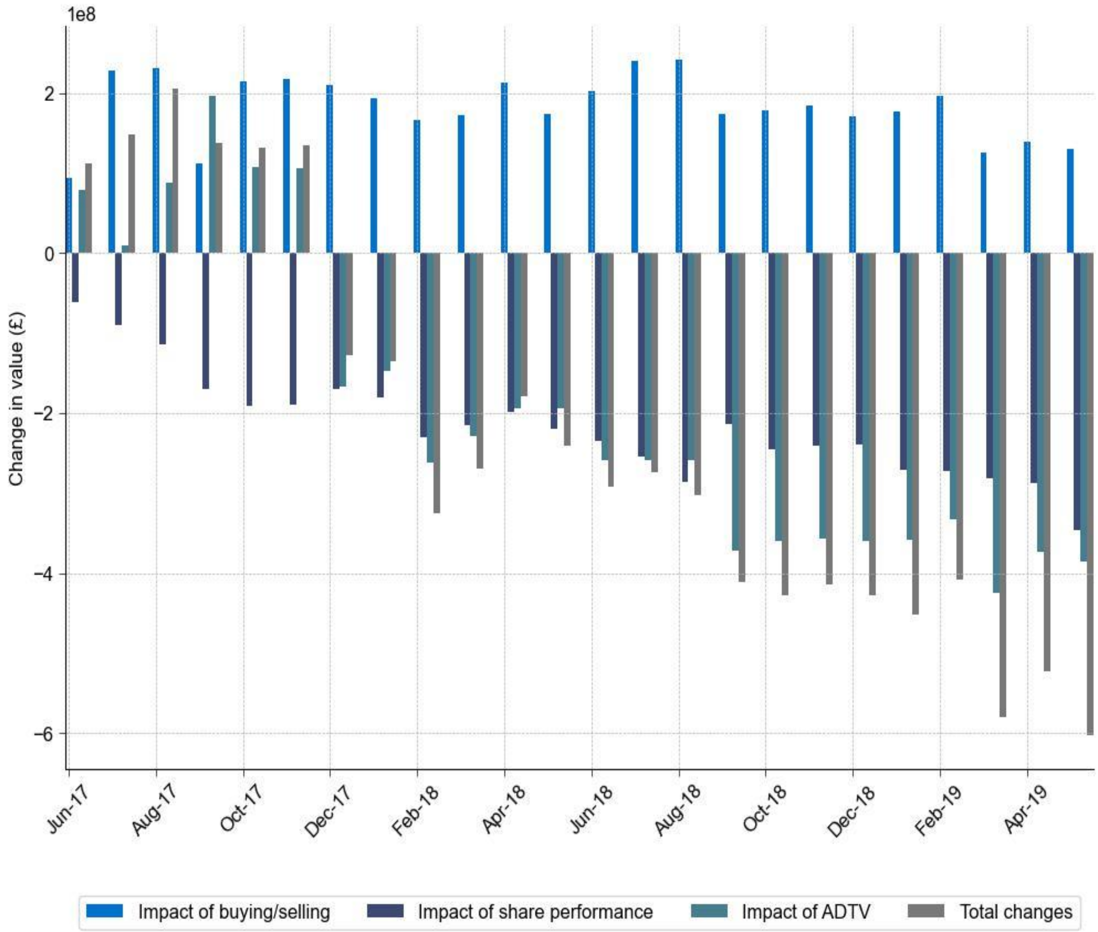


Figure 14: The cumulative impact of each of the Relevant Factors in respect of Bucket 4



<u>The Relevant Period</u>

3.9. The causes of the WEIF's deteriorating liquidity profile are broadly the same during the Relevant Period, in that the primary driver for the decline in the values of Buckets 1 and 2 relative to Buckets 3 and 4 during this shorter period was WIM's buying and selling activity.

3.10. During the Relevant Period, there was a net total ouflow of £1.3 billion. This consisted of a net outflow of nearly £0.95 billion from Buckets 1 and 2, and a net outflow of just over £0.35 billion from Buckets 3 and 4.

3.11. During the Relevant Period, on average 67% of shares sold each month by the WEIF came from Buckets 1 and 2, and only 54% of shares bought on average each month were allocated to those buckets. By contrast, 33% of shares sold each month came from Buckets 3 and 4, and 46% of shares bought were allocated to these buckets. As a consequence, the WEIF was, on a net basis, selling its most liquid assets.

3.12. Absent other factors (such as share performance or ADTV changes), this meant that WIM's buying and selling activity would inevitably cause the fund's liquidity profile to deteriorate over this period as Buckets 1 and 2 declined in value relative to Buckets 3 and 4. As can be seen at Figures 11 to 14 above, share performance and ADTV changes associated with Buckets 1 and 2 did not compensate for the deterioration in liquidity caused by WIM's investment decisions.

4. The Corrected Four Bucket Model

4.1. Unlike the Revised Four Bucket Model, the Corrected Four Bucket Model used by the Authority applies a Participation Rate of 25% and a Linear Allocation Approach. The Authority considers that these assumptions are more realistic than using the 100% Participation Rate and Full Allocation Approach used by WIM and Link in the Revised Four Bucket Model. In particular, the Authority does not consider it realistic to assume that (1) a single entity could access the entire daily liquidity in respect of a particular security without significantly impacting the price of that security (i.e. a 100% Participation Rate); or (2) the timeframe for liquidating a security depends upon when the entirety of the holding can be sold (i.e. the Full Allocation Approach). Further, the Authority does not agree with Link's belief that the two assumptions offset each other, and instead considers that the combined assumptions created an unjustifiably positive impression of the WEIF's liquidity.

4.2. By reference to the Corrected Four Bucket Model, the WEIF's liquidity profile deteriorated in the period between May 2017 and May 2019. For example, the proportion of shares classified as Bucket 1 declined from 24% in May 2017 to 8% by May 2019. Over the same period, the proportion held in Bucket 4 increased from 23% to 41%. These percentages are significantly lower for Bucket 1 and significantly higher for Bucket 4, compared to the Revised Four Bucket Model (see paragraph 3.1 above). This indicates that the Revised Four Bucket Model depicts an improved liquidity position compared to that revealed by the Corrected Four Bucket Model.

<u>The period from May 2017 to May 2019</u>

4.3. Similar to the position under the Revised Four Bucket Model, the shares sold by the WEIF during this period came predominantly from those classified as Buckets 1 and 2 in the Corrected Four Bucket Model. Between May 2017 and May 2019, 69% of shares sold by the WEIF by value came from Buckets 1 and 2, with 31% being sold from Buckets 3 and 4. This means that the WEIF was selling a disproportionate amount of its most liquid assets over this period.

4.4. Over the same time period, the shares bought by the WEIF were more heavily weighted towards those classified as Buckets 3 and 4. For example, on average:

(1) 8% of the monthly shares bought by the WEIF were classified as Bucket 1;

(2) 27% of the monthly shares bought by the WEIF were classified as Bucket 2;

(3) 29% of the monthly shares bought by the WEIF were classified as Bucket 3; and

(4) 36% of the monthly shares bought by the WEIF were classified as Bucket 4.

4.5. The result of WIM's investment activity was therefore that the WEIF was selling more of its more liquid shares and buying less liquid shares. This can be seen on a month by month basis in the following graphs for each bucket.

Figure 15: Net buying and selling activity for securities classified as Bucket 1

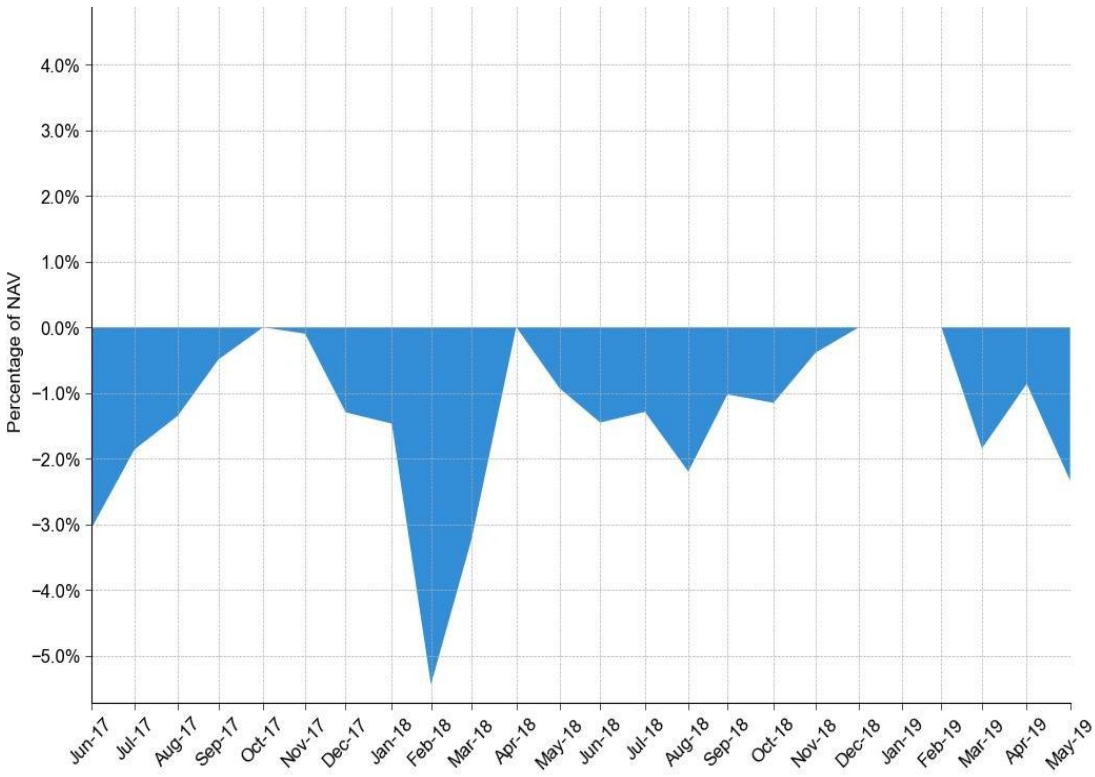


Figure 16: Net buying and selling activity for securities classified as Bucket 2

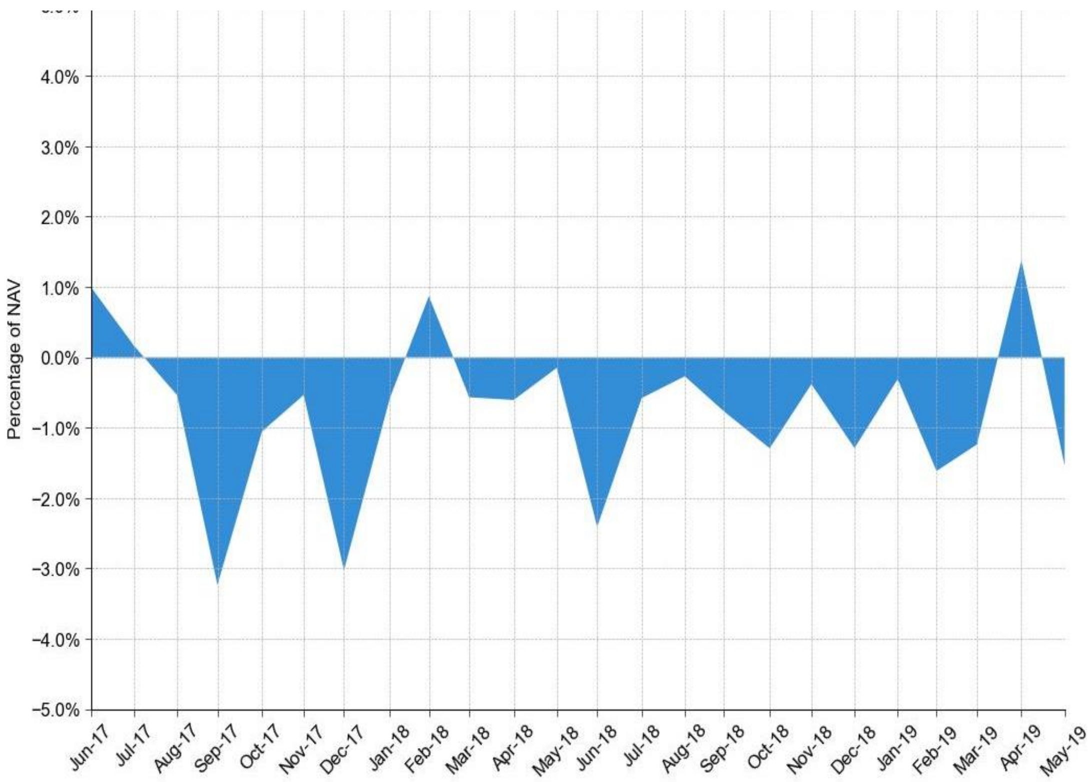


Figure 17: Net buying and selling activity for securities classified as Bucket 3

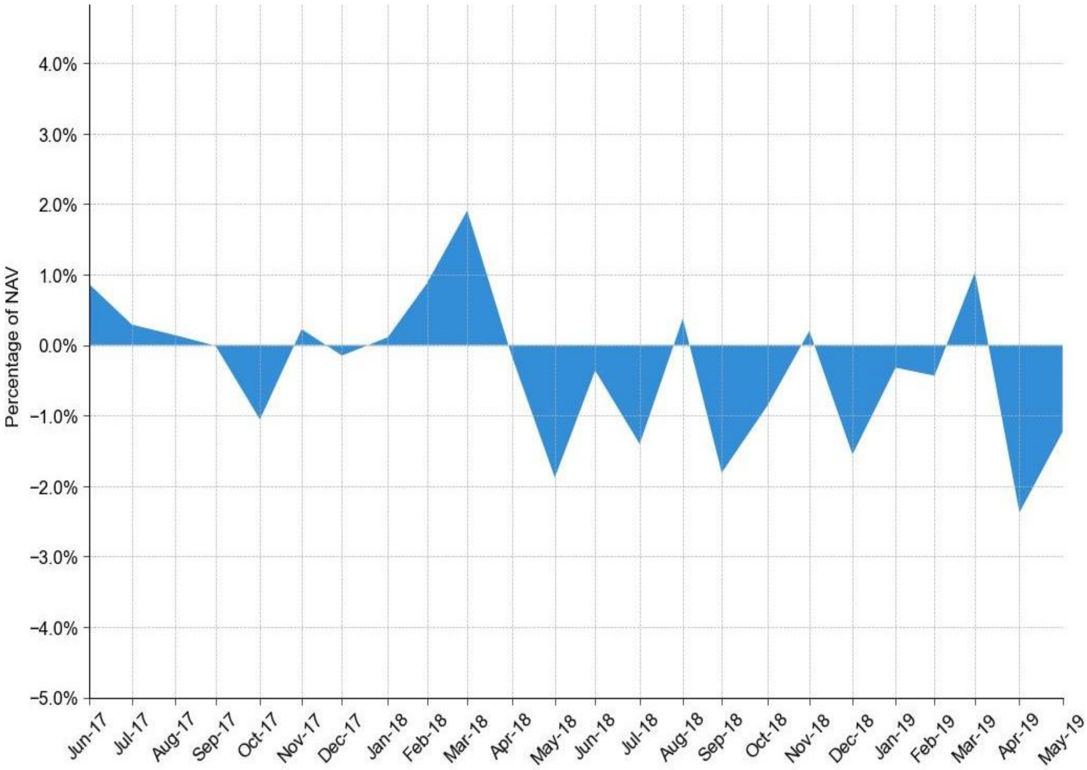
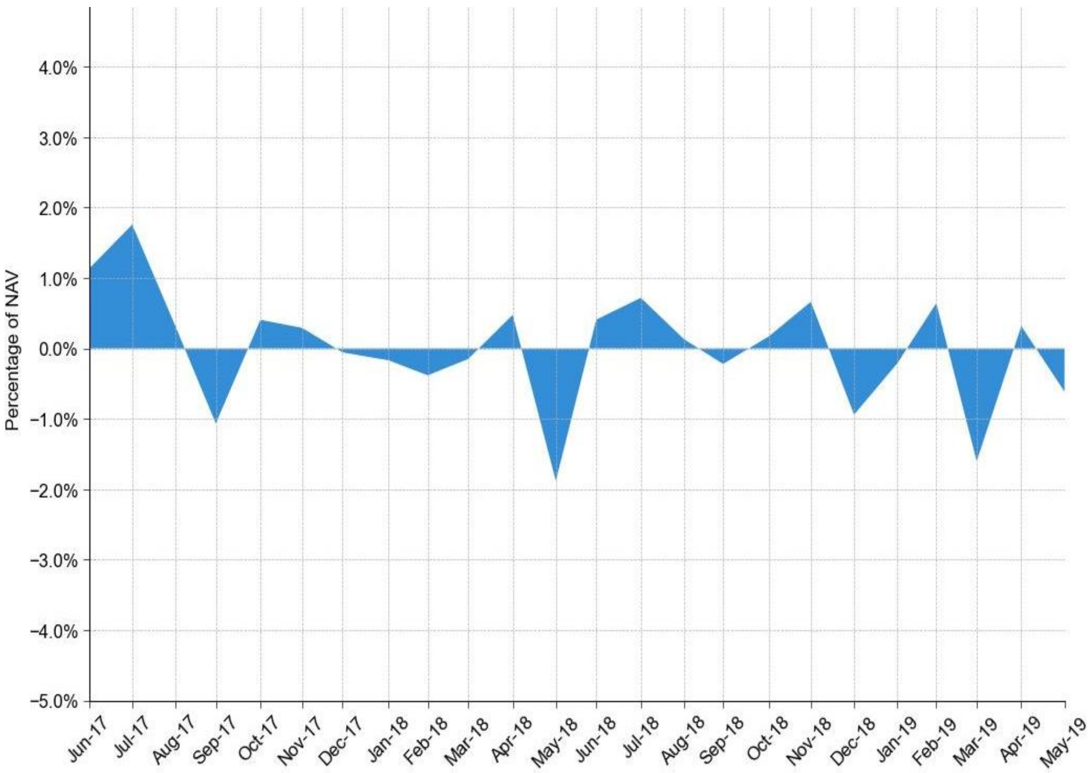


Figure 18: Net buying and selling activity for securities classified as Bucket 4



4.6. The above graphs show that WIM was selling shares from Buckets 1 and 2, buying shares for Bucket 3 up to April 2018 and predominantly selling shares thereafter, and more evenly buying and selling shares for Bucket 4. The net effect of this buying and selling activity was to reduce the liquidity of the WEIF as its more liquid shares were sold without being replaced through buying activity.

4.7. The graphs set out below illustrate that, by reference to the Corrected Four Bucket Model, WIM's buying and selling activity was the main factor behind the WEIF's deteriorating liquidity profile between May 2017 and May 2019, with the other factors (share performance and ADTV changes) generally having a less significant impact on liquidity. Where those other factors contributed to the decline in liquidity, WIM did not adjust its buying and selling to compensate for this deterioration.

Figure 19: The cumulative impact of each of the Relevant Factors in respect of Bucket 1

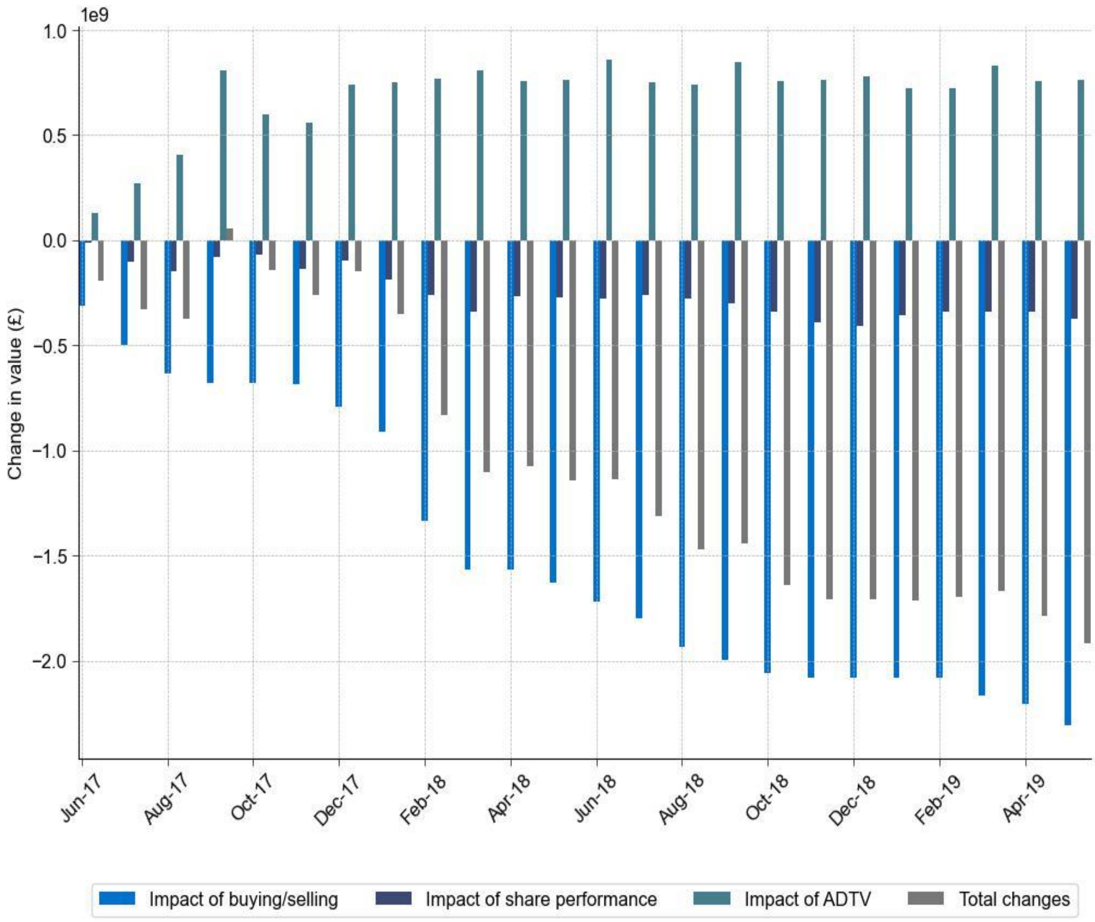


Figure 20: The cumulative impact of each of the Relevant Factors in respect of Bucket 2

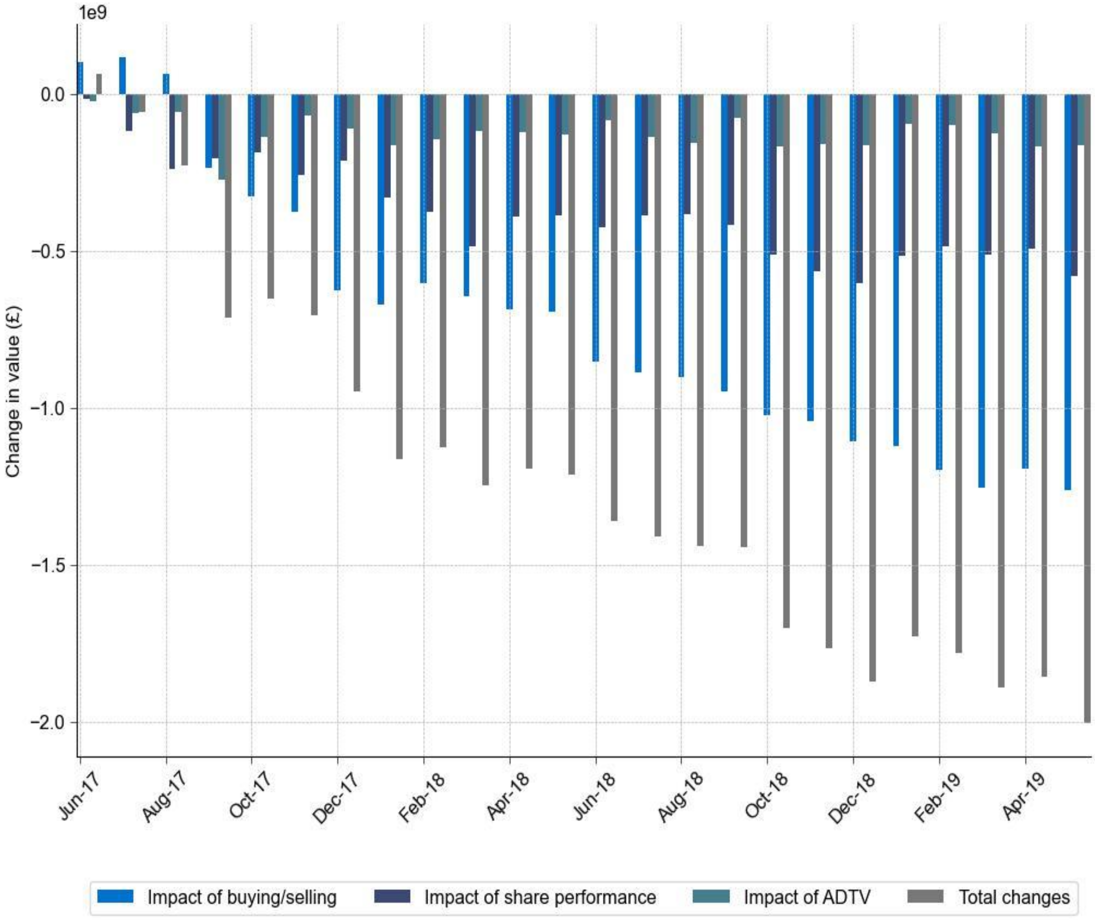


Figure 21: The cumulative impact of each of the Relevant Factors in respect of Bucket 3

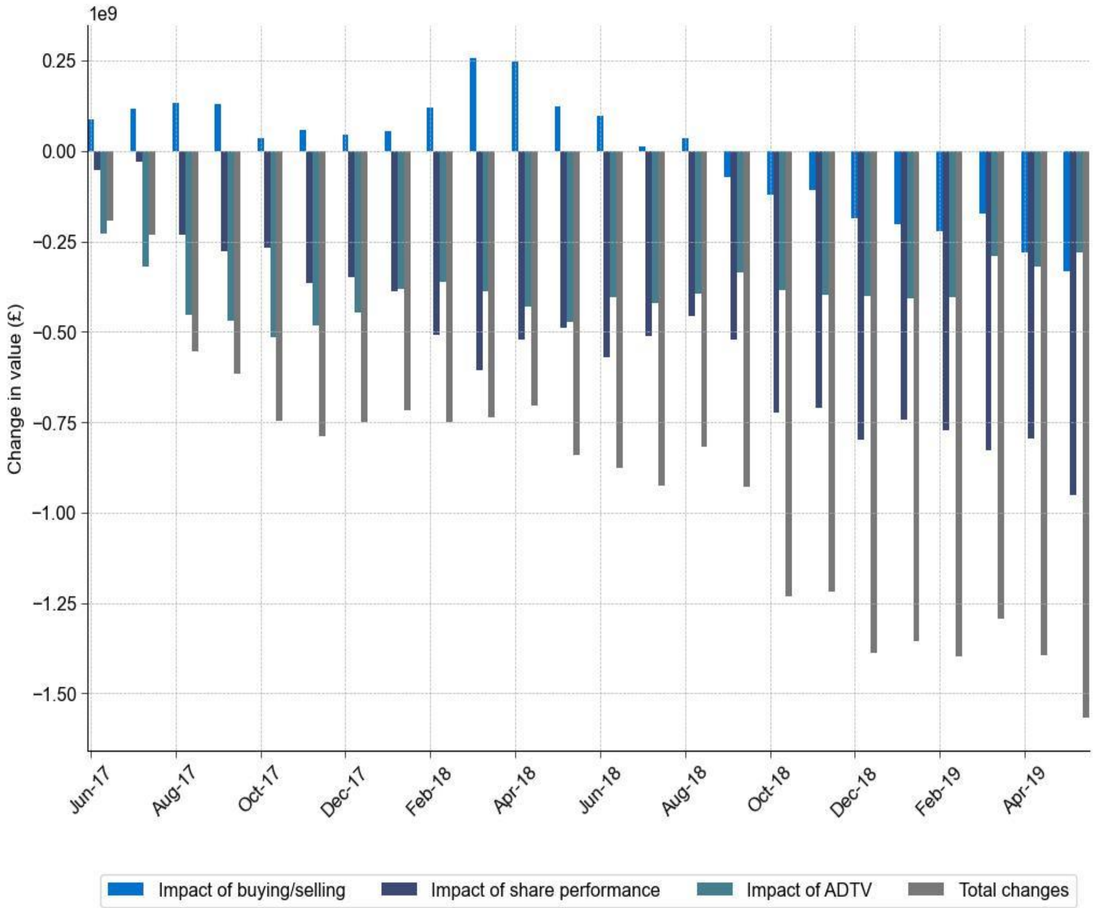
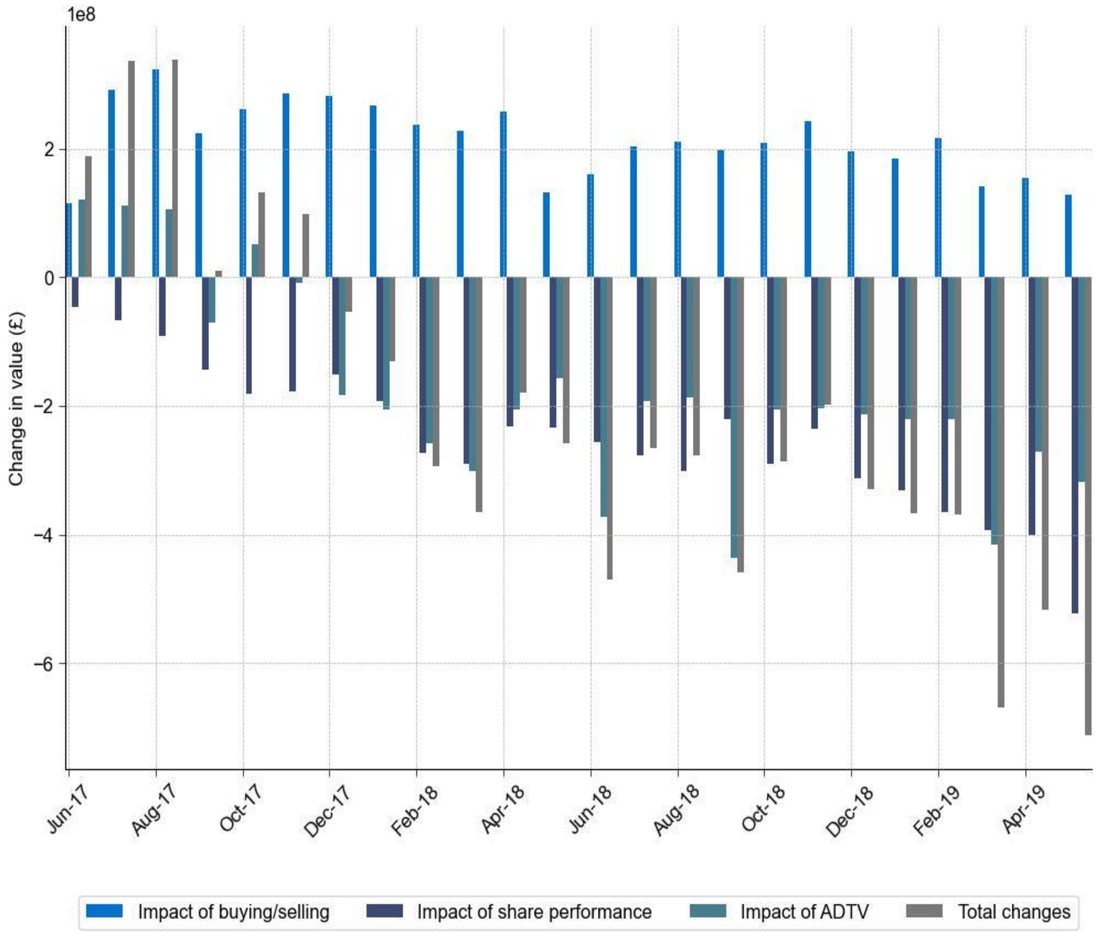


Figure 22: The cumulative impact of each of the Relevant Factors in respect of Bucket 4



The Relevant Period

4.8. The WEIF's liquidity deteriorated during this shorter period for the same reasons as above, namely because of a decline in the values of Buckets 1 and 2 relative to Buckets 3 and 4 largely due to Mr Woodford's buying and selling activity.

4.9. During the Relevant Period, the WEIF's share sales were relatively balanced across the four buckets, with the average monthly value of the shares sold from Buckets 1 and 2 and Buckets 3 and 4 amounting to 52% and 48% respectively.

4.10. Over the same time period, however, the shares bought by the WEIF were predominantly those classified as Buckets 3 and 4, to an even greater extent than was the case in the longer period between May 2017 and May 2019. For example, on average:

(1) 3% of the monthly shares bought by the WEIF were classified as Bucket 1;

(2) 20% of the monthly shares bought by the WEIF were classified as Bucket 2;

(3) 34% of the monthly shares bought by the WEIF were classified as Bucket 3; and

(4) 43% of the monthly shares bought by the WEIF were classified as Bucket 4.

4.11. This imbalance between WIM's buying and selling therefore caused the WEIF's liquidity to deteriorate during this period by increasing the amount of less liquid shares being held by the fund relative to its more liquid assets. This was the primary driver behind the deterioration in the WEIF's liquidity, with movements in share performance or ADTV changes having a more limited impact.

ANNEX B - RELEVANT STATUTORY AND REGULATORY PROVISIONS

RELEVANT STATUTORY PROVISIONS

1. Pursuant to sections 1B and 1D of the Act, one of the Authority's operational objectives is protecting and enhancing the integrity of the UK financial system.

2. Section 206 of the Act provides:

   "*If the relevant regulator considers that an authorised person has contravened a relevant requirement imposed on the person, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.*"

3. *"Relevant requirement"*, as defined by section 204A of the Act, includes a requirement imposed by or under the Act. As a requirement imposed by a rule made under the Act, this includes Principle 2.

RELEVANT REGULATORY PROVISIONS

4. In exercising its powers to impose a financial penalty, the Authority has had regard to the relevant regulatory provisions published in the Authority's Handbook. The main provisions that the Authority considers relevant are set out below.

   Principles for Business ("Principles")

5. The Principles are a general statement of the fundamental obligations of firms under the regulatory system and are set out in the Authority's Handbook.

6. Principle 2 provides:

   "*A firm must conduct its business with due skill, care and diligence.*"

   Decision Procedure and Penalties Manual ("DEPP")

7. Chapter 6 of DEPP, which forms part of the Authority's Handbook, sets out the Authority's statement of policy with respect to the imposition and amount of financial penalties under the Act. In particular, DEPP 6.5A sets out the five steps for penalties imposed on firms.

ANNEX C

WIM's Representations

1. A summary of the key representations made by WIM, and of the Authority's conclusions in respect of them (in bold type), is set out below.

<u>Responsibilities</u>

2. COLL applied to Link, as the fund's ACD, and in part to the depositary. COLL imposes specific rules and obligations in respect of liquidity on an ACD, including establishing and implementing procedures to enable the ACD to assess a fund's exposure to liquidity risk[1]. Chapter 5 of the COLL rules do not apply to the investment manager of a fund, and therefore did not apply to WIM. It is, therefore, the regulatory responsibility of the ACD to manage the liquidity risk, not the regulatory responsibility of the investment manager.

3. The IMA applied to WIM (which did not in itself impose regulatory responsibilities), and WIM states that the Authority's case against WIM rests upon the application of the IMA, and its contractual terms.

4. Whilst under the IMA WIM was contractually required to perform various delegated responsibilities in respect of liquidity management, the terms of the IMA make clear that the exercise of those contractual responsibilities was subject to Link's oversight and monitoring, and could be overridden by Link's instruction. This reflected the regulatory position that Link, as the ACD, retained regulatory responsibility and was responsible for overseeing the conduct of WIM, and was intended to ensure that the investment manager was undertaking activities in a way which did not conflict with COLL. The responsibilities that an ACD has before any contractual delegation remains unaffected, and an ACD remains fully responsible for discharging all of its obligations under the regulatory system if it outsources crucial or important operational functions or any relevant services and activities[2]. There is nothing in COLL to suggest that a delegate has an obligation to question and challenge its ACD. Rather, it is the ACD that holds the investment manager to account. WIM considers that the case of *Arch Financial Products LLP, Robin Farrell and Robert Addison v Financial Conduct Authority*[3] offers no material assistance to the matters being considered in this case, as its facts are materially distinct and can be distinguished.

5. In addition, Link's policies and procedures and its governance framework, reflected its understanding of its obligation and powers as an ACD, its relationship with its investment manager and its approach to risk management, in discharge of its COLL obligations, and made it clear that (1) Link did not delegate the related investment management activity of risk management, (2) Link accepted that it was ultimately responsible for the risk management of all of its funds, and (3) it retained overall regulatory responsibility for all the delegated activities of its funds. Link's understanding of the parties' obligations also reflects guidance issued by the Investment Association.

[1] For example: see COLL 6.12.5R; COLL 6.12.9R and COLL 6.12.11R.
[2] SYSC 8.1.6.
[3] [2015] UKUT 0013 (TCC).

6. Link exercised its ultimate control of (and responsibility for) the matters under COLL in a number of ways, including designing and applying the Four Bucket Models and imposing limits ("the Limits")[4] and triggers, and issuing instructions to WIM to enable Link to oversee and monitor WIM effectively. All the relevant parties understood that the Limits represented the parameters of an acceptable liquidity profile of the fund.

7. Link's involvement in decision-making about activities which had been contractually delegated, under the IMA, amounted to a withdrawal of delegation. WIM was required to manage the fund within the framework and limits set by Link, but beyond that Link had exercised its authority in imposing the measures and corresponding limits. WIM was not responsible for testing and challenging its ACD (who itself was tasked with overseeing and challenging the activities of WIM).

8. WIM was not merely entitled to, but required to, defer to its ACD on matters which fell within COLL, both under regulation and under contract. Link had itself highlighted that it was its decision, and not one for the fund manager, to adopt a particular approach, or change to a different approach. Link was a professional ACD, with 175 funds under its management during the Relevant Period, and WIM had been encouraged by the Authority to have Link as its ACD when applying to be authorised. WIM did not act unreasonably by adopting and applying the liquidity framework and limits set out by Link, and by complying with the contractual terms of the IMA. Given the relationship between Link and WIM, WIM should not, as a matter of principle, be liable for any alleged defects of that liquidity framework, and should not be sanctioned for having allegedly failed to challenge and oversee Link in respect of its implementation.

9. The Authority has referenced WIM's key responsibilities in respect of liquidity risk, as set out in the IMA, at paragraph 4.7 of the Decision Notice. Taken together, the provisions imposed very broad obligations on WIM in relation to liquidity management, including to: (1) exercise its investment discretion compatibly with the provisions of Chapter 5 of COLL, (2) manage liquidity in a manner that WIM (not Link) reasonably regarded as being appropriate to the WEIF and consider, on an ongoing basis the liquidity profile of the assets in the WEIF in relation to overall liquidity requirements, (3) maintain risk management processes which ensured that the WEIF was managed in a manner that enabled both the WEIF and Link to comply with regulatory requirements, and (4) regularly review the WEIF's portfolio to ensure that it was being managed in accordance with its contractual requirements in Clause 2.2 of the IMA. WIM had, therefore, under the IMA, been delegated substantial responsibility for the management of liquidity. The IMA had granted WIM the right, subject to certain restrictions, exclusively to buy, sell and deal in the investments forming the WEIF. WIM was the only party with the practical ability to execute the active steps necessary to affect the liquidity profile of the WEIF. Link had no ability itself to deal in the WEIF's assets.

10. Whilst it is accepted by the Authority that the IMA did not impose regulatory responsibilities on WIM itself, the Authority considers that the

[4] The Limits: (1) Initial Four Bucket Model: above 70% for Buckets 3 and 4 combined; and above 35% for Bucket 4; (2) Revised Four Bucket Model: above 70% for Buckets 3 and 4 combined; above 35% for Bucket 4; and below 5% for Bucket 1.

contract is of fundamental importance in assessing WIM's compliance with the standards set out in Principle 2. The Authority instructed an expert to opine on the duties and responsibilities of a fund manager ("Fund Management Expert"). The Fund Management Expert stated that "*it would not be reasonable or consistent with industry practice for the fund manager to make investment decisions solely by reference to liquidity triggers and limits*". He added that "*the fund manager was also obliged to ensure appropriate risk management, including the ongoing structure of the fund so that it could continue to meet its liquidity requirements into the future. In order to do so, the fund manager would need to take into account broader liquidity considerations*".

11. **The Authority also considers that the case of *Arch Financial Products LLP, Robin Farrell and Robert Addison v Financial Conduct Authority*[5] supports this expert opinion. The Tribunal stated that "*a reasonable fund manager would take into account the liquidity risk of his chosen investments as an aspect of investment risk*[6]" *and that the reasons for doing so were "obvious*[7]"*.* The risks deemed obvious by the Tribunal[8] were equally obvious in respect of the WEIF, including it being a very large, open-ended fund and predominantly beneficially owned by retail investors. Accordingly, the Authority considers that the decision in *Arch Financial Products LLP* is a relevant precedent for the requirement for investment managers, operating under a delegated mandate, to exercise due skill, care and diligence under Principle 2.**

12. **The Authority does not consider that Link's involvement in decision-making about activities (including designing and applying the Four Bucket Models and imposing the Limits) which has been contractually delegated to WIM, under the IMA, can possibly amount to a withdrawal of delegation as suggested by WIM. As a matter of contract, Link's instruction (such as it was) in May 2018 (regarding changes to the liquidity framework as set out in Section D2 of the Decision Notice) did not represent a "withdrawal of delegation" under the IMA or remove or otherwise alter WIM's responsibilities for managing the WEIF's liquidity. Any such proposed withdrawal would require, inter alia, a modification by agreement, specifying that a change to the relationship was being effected and what the consequent responsibilities would be. This did not happen and the contractual position did not change.**

13. **In addition, there is no evidence to suggest that this was either WIM's or Link's understanding of the position at the time. The communication between the parties during this period (shortly before the start of the Relevant Period) is indicative of WIM seeking to use its professional judgement with Link in a way which is not reflective of the suggested removal of WIM's responsibilities. In any event, in the opinion of the Fund Management Expert, there is nothing in the mere adoption of the Limits**

---

[5] [2015] UKUT 0013 (TCC). This case also involved the actions of an investment manager operating under an apparently similar delegated mandate.
[6] Paragraph 414.
[7] Paragraph 415.
[8] Paragraph 415: The reason was "*that The UK Funds offered daily redemptions with settlement in cash within four days so a degree of liquidity would be necessary to meet anticipated redemptions. In volatile markets, increased amounts of cash may be held until the markets settle. These requirements were expressed in the various prospectuses for the UK Funds during the Relevant Period*".

that would seek to exclude or withdraw WIM's responsibilities when making investment decisions within the Limits.

14. **The IMA therefore delegated the investment management of the WEIF to WIM and required WIM to meet the relevant regulatory requirements (including COLL) when managing the WEIF's investments. The delegation did not absolve Link of its regulatory responsibilities as the ACD of the fund; but neither did Link's retention of those responsibilities mean that WIM was freed from its own regulatory responsibilities when managing the WEIF pursuant to the IMA. Both Link and WIM were responsible for complying with their own respective regulatory responsibilities. WIM had its obligations and responsibilities under the IMA, which it had to discharge in accordance with Principle 2. WIM had independent responsibilities for liquidity aside from adhering to the Limits, and this is consistent and compatible with what the applicable IMA and policies and procedures state, together with the parties' understanding at the time.**

<u>The liquidity risk framework</u>

15. The liquidity risk framework had been designed by Link and had set and imposed corresponding limits on the fund's liquidity against those measures, namely, Buckets 3 and 4 securities were not permitted to be larger than 70% of net asset value and there was to be a specific cap on Bucket 4 of 35%. The Authority was informed that WIM had been instructed of these corresponding limits. Link and the Authority were engaged in frequent dialogue during, and after, the imposition of the Four Bucket Model and WIM was kept updated. It was reasonable for WIM to assume that the actions taken by the ACD were known and acceptable to the Authority.

16. The Revised Four Bucket Model's changes, namely, (1) changing the ADTV period from the lower of 5 and 20-day ADTV at March 2017 to a 12-month rolling average; and (2) capturing trades from all exchanges rather than the primary exchange only, represented an improvement on the accuracy of the measurement of liquidity. Neither WIM nor Mr Woodford sought to change the framework nor were they the proximate or direct cause of the changes. The changes to the framework arose following discussions between Link and the control function within WIM to understand the consequences of the fund crossing the Limits.

17. WIM observes that the Authority considers that the components used to measure the liquidity during the Relevant Period, namely, (1) the application of a 100% Participation Rate and the acceptance of Link's offsetting assumption ("the Offsetting Assumption")[9]; and (2) the use of the 12-month ADTV, were unreasonable. Whilst WIM accepts that it had responsibility in respect of the "day-to-day" management (i.e. measuring the fund against the particular model imposed and reacting to any crossing of the triggers and breach of the Limits) it was not required to test the model produced by its own ACD. The use of the 100% Participation Rate, and its justification by reference to the Offsetting Assumption, was Link's decision. It was not WIM's decision. Link had applied this feature across

[9] Link's Offsetting Assumption: the use of a 100% Participation Rate with the adoption of the Full Allocation Approach. Link adopted these two assumptions in the belief that the Full Allocation Approach and the 100% Participation Rate offset each other.

all of its 175 funds. Link's approach had been approved by its governance structures and committees, and WIM knew that the Authority and the fund's depository had full visibility of Link's approach and its use of a 100% Participation Rate, justified by the Offsetting Assumption.

18. The Offsetting Assumption was not so patently perverse as to have prompted the Authority to demand that Link either produce evidence to justify the assumption or otherwise stop applying a 100% rate. WIM was never made aware of any concerns that the Authority may have had with the approach. Link carried on using the 100% Participation Rate until at least the end of 2020/beginning of 2021. The depository, tasked with overseeing the ACD, and which was also subject to the COLL rules, did not question or challenge the approach.

19. The Authority instructed an expert to opine on the reasonableness of the liquidity profile of the WEIF during the Relevant Period ("the Liquidity Expert"). WIM was aware that Link, the Authority, and the depository all had far greater visibility of the risk management practices adopted over the industry at large, and WIM would not have been able to have carried out the comparison forensic analysis against other funds as has been undertaken by the Liquidity Risk Expert. In any event, if WIM had challenged Link about its use of a 100% Participation Rate, it is highly likely that Link would have sought to justify the measure in the same way it did to the Authority, by reference to the Offsetting Assumption, and the challenge would have had no effect. Accordingly, it was not unreasonable for WIM to decide to adopt Link's Offsetting Assumption and not to challenge or test it in the way the Authority has alleged.

20. The decision to adopt a 12-month ADTV period was Link's decision, not WIM's. No-one within Link, the Authority or the depository questioned the use of a 12-month period for calculating the ADTV. This approach was not inconsistent with any related regulatory guidance at the time. There has been no analysis by the Authority as to whether the use of a different metric would have affected the measurement of the fund's liquidity.

21. WIM did not expect or envisage that anyone would challenge Link's use of a 100% Participation Rate, test the Offsetting Assumption, or challenge the adoption of a 12-month ADTV period.

22. These models were Link's measures, and the 100% Participation Rate justified by the Offsetting Assumptions, was applied by Link to its funds before the start of the Relevant Period. The Limits were set by Link, clearly communicated to the Authority and imposed upon WIM. Whilst Link had delegated, under contract, its responsibilities for liquidity risk, it had the right to impose on WIM a set of liquidity metrics and measures. WIM was required to accept instructions from its ACD, who retained regulatory responsibility. WIM was not required to oversee the instructions of the institution whose function was to monitor and oversee it. There was nothing inherently wrong about where the Limits were set. The Limits that had been originally imposed, and which had been communicated to the Authority, continued to apply after aspects of the Four Bucket Model were modified. Those modifications, communicated to the Authority in October 2018, did not fundamentally change the model or how it operated. The Authority did not raise concerns with these changes at the time.

23. Everyone within WIM interpreted the Limits as an instruction from their ACD, and adopting the Limits was a reasonable means by which WIM was able to discharge its contractual duties under the IMA. WIM's control functions were communicating with Link about the liquidity framework including the Limits.

24. WIM believed that a reasonable and acceptable liquidity profile for the fund was represented by the Limits. It was reasonable to assume that the ACD would not have set Limits that were outside an acceptable liquidity profile. Believing that the Limits represented the parameters of an acceptable liquidity profile, it was reasonable for WIM to manage the sustained redemptions in a way that kept the fund within the Limits imposed by Link and WIM worked hard to do so. WIM considers that any investment decision making, regarding the selling and buying of securities, should be assumed as being reasonable, unless they resulted in the fund being outside the Limits set by the fund's ACD.

25. The Liquidity Expert provided clear, uncontested expert opinion evidence that the liquidity profile of the WEIF was unreasonable throughout the Relevant Period, and had been allowed to deteriorate significantly. WIM has not sought to demonstrate that the liquidity profile *was* reasonable or appropriate.

26. The Authority considers that it was wrong in principle for WIM to treat the Limits as the definitive benchmark of whether liquidity in the WEIF was reasonable and appropriate. The Fund Management Expert stated that it would not be reasonable or consistent with industry practice for the fund manager to make investment decisions solely by reference to existing liquidity triggers, limits and metrics. In addition, it was not reasonable for WIM to make the assumption that the applicable limits set by Link reflected an acceptable liquidity profile for the WEIF.

27. In any event and as a matter of fact, the parties did not treat compliance with the Limits as determinative of an acceptable liquidity profile during the Relevant Period. The Limits under the Four Bucket Model were considered by the parties at the time as being part of a broader and multi-faceted approach for managing the WEIF's liquidity including responding to periods of stress by taking action before the Limits were breached. They were not *the determinant* of an acceptable liquidity profile in the manner WIM suggests. The Authority observes that the Limits were initially proposed in May 2018, following discussion between Link and WIM, as an extraordinary measure to seek to ensure that the WEIF's liquidity did not deteriorate further.

28. WIM and Mr Woodford felt able and empowered to challenge and change the liquidity risk framework when it suited them. They did so in order to loosen the constraints on Mr Woodford, so that he could maintain his preferred investment strategy. WIM sought to revise the Limits demonstrating that it did not simply accept them passively as has now been suggested. Revision of the Limits was sought by WIM at the very point when those constraints were breached, or close to being breached.

29. The Authority observes that Link and WIM's relationship was clearly fractious during the Relevant Period, and this is demonstrated by the correspondence between the parties, in part because they disagreed about

liquidity management. The Authority considers that WIM's image of itself, as an investment manager dependent on the directions from its ACD, is not borne out by the facts. The Authority notes from the correspondence that whenever Link did attempt to communicate its concerns with WIM directly, it would frequently be met with intransigence or obstinacy.

30. The Authority refers to two particular examples of WIM's behaviour which demonstrate that WIM was not a purely passive recipient of the liquidity risk framework.

31. Firstly, the changes (instigated by WIM) from the Initial Four Bucket Model to the Revised Four Bucket Model in September 2018[10]: the effect of the changes, at a time of the WEIF's worsening liquidity profile and the consequent constraints of the liquidity framework upon Mr Woodford's investment decisions, was to significantly improve the appearance of the liquidity profile without any change in the underlying assets held by the WEIF. The deterioration in the WEIF's liquidity at this point should have put WIM on notice that it needed to address the fund's underlying liquidity. Rather than doing this, WIM preferred to push to make changes to the framework to paint a more favourable *appearance* of liquidity.

32. Secondly, in March/April 2019[11], at the same time as the WEIF was in breach of multiple triggers and limits under the liquidity risk framework and Link was pressing WIM to take urgent action to improve the WEIF's liquidity, WIM began to explore further changes to the liquidity risk framework. These were clearly prompted by Mr Woodford's desire to pursue and prioritise his investment strategy unconstrained by the liquidity concerns. WIM's proposed changes (which were not accepted by Link) would have once again improved the *appearance* of the WEIF's liquidity profile by moving it away from the Limits under the Revised Four Bucket Model, but without affecting the underlying liquidity of the assets.

33. Despite WIM having independent obligations in respect of liquidity there is no evidence of WIM ever seeking comfort from Link that the metrics being used were sufficiently cautious or prudent. WIM frequently challenged the metrics in order to release constraints; but there is no evidence of WIM ever asking whether the assumptions were sufficiently prudent. Even by reference to the Limits, there was clear cause for concern. The Authority notes the opinion of the Liquidity Expert: "*Link and WIM clearly reported a deteriorating liquidity position…yet many of the thresholds…were not consistently breached until 2019…which is a further indication that their thresholds were not set at appropriate levels*".

34. This was in the context of continual, and increasing, warning signs coming from Link and other parties. These warning signs were repeatedly ignored (see section below).

35. WIM knew that the Limits applied were based on a 100% Participation Rate (an imprudent assumption). This was not a reasonable assumption to make, and is implicitly recognised by the acknowledged need to "*offset*"

[10] See paragraph 4.46 of the Decision Notice.
[11] See paragraph 4.110 of the Decision Notice.

it with the Full Allocation Approach (a conservative assumption). The Liquidity Risk Expert opined that the 100% Participation Rate assumption was not reasonable, and that the Full Allocation Approach did not appear to be reasonable from a risk management perspective. The Liquidity Risk Expert also opined that, had WIM interrogated whether this offsetting worked, it would have identified that it would not have worked. No explanation has been advanced by WIM as to why it was appropriate to "*offset*" rather than simply make realistic assumptions in the first place. The unrealistic and imprudent assumption embodied in the 100% Participation Rate ought to have put WIM on notice that it could not place the faith in the Limits that it now asserts it was entitled to believe were reasonable and appropriate. The Authority considers that WIM knew, or should have known, that the 100% Participation Rate assumption was not reasonable at the time, and considers that realistic assumptions should have been made in the first place. In any event, the Liquidity Risk Expert opined that these assumptions did not (or did not sufficiently) offset each other.

36. The Authority considers that the assessment of the reasonableness of the WEIF's liquidity profile would not have needed the forensic exercise conducted by the Liquidity Risk Expert; WIM held itself out as an expert manager of investments, was headed by a highly experienced investment manager, and accepted monies from hundreds of thousands of retail customers on that basis. The Authority had queried the use of a 100% Participation Rate with Link before the Relevant Period but was reassured that the 100% Participation Rate was an initial calculation, and that additional liquidity analysis would be used. The Authority is unaware whether WIM was made aware of the concerns the Authority had conveyed to Link.

37. Accordingly, the Authority considers that the Limits were not determinative of an acceptable liquidity profile for the WEIF. To the extent that WIM treated them as such (which is not accepted by the Authority), they acted unreasonably and without due skill and care in simply assuming that they were set correctly and failed to satisfy themselves in accordance with their responsibilities.

<u>Investment Strategy and its impact</u>

38. The Authority instructed an expert to opine on the factors which caused the deterioration of the fund's liquidity during the Relevant Period ("the Investment Decisions Expert"). WIM notes that the Investment Decisions Expert's conclusion, namely, that the principal reason for the deterioration was due to the investment decisions of WIM and Mr Woodford (as opposed to, for example, the performance of the securities held by the fund across the buckets), was founded on the Investment Decisions Expert's analysis of the fund's buying and selling activity across the four buckets of securities.

39. In a number of the following categories of supposed "purchases" of securities, the details of the transactions indicated that there had been a significant incorrect inflation by the Investment Decisions Expert of Bucket 3 and Bucket 4 purchases during the Relevant Period: (1) "conversions/corporate actions" (where the

acquisition of securities did not involve an actual purchase, but came about through a conversion or a corporate action); (2) securities which were classified as Bucket 1 or 2 when purchased and subsequently became Bucket 3 or 4 securities (hence the Investment Decisions Expert's assessing in error the security as a Bucket 3 or 4 security); (3) cross trades to effect the winding up of another fund (the assets of this fund were absorbed into the WEIF giving rise to an incorrect calculation by the Investment Decisions Expert of Bucket 3 and 4 purchases); and (4) unaccounted inflation of a particular security due to the incorrect date of the assessment of its value. The total inflation for Bucket 3 and 4 purchases during the Relevant Period is around £280 million.

40. As a result of these errors in assessing the quantity of the "purchases"[12], the calculations by the Investment Decisions Expert reflecting the buying and selling activity by the fund are materially inaccurate and unreliable. These are not isolated errors by the Investment Decisions Expert and appear to be a product of a structural problem in the approach taken. As a result of these material inaccuracies, the Investment Decisions Expert's conclusion, that the principal reason for the deterioration of the fund's liquidity was due to the investment decisions, cannot be relied upon. The Authority's finding is therefore unsafe.

41. The Investment Decisions Expert's calculations do not provide any information about the reason for deciding whether to sell or purchase a security. Investment decisions may have been driven by liquidity and/or investor interests. In addition, no evidence has been provided by the Authority as to what "rebalancing" would have been possible, let alone reasonable.

42. Accordingly, the Investment Decisions Expert's opinion does not assist in determining whether WIM acted with due, skill and care when making investment decisions in response to redemptions.

43. The fund needed, on average, to meet daily redemptions of over £11 million. The scale of the redemptions was significant, and the outflow relentless. WIM had to meet those redemptions by selling assets. It was more difficult to generate cash by selling less liquid stocks, and the stocks categorised as Buckets 3 and 4 could not always be sold within the four-day window within which redemptions needed to be honoured. Evidence that WIM sold a higher proportion of liquid stocks does not, in the circumstances of this case, support the Authority's case that there was a failure to act with due skill, care and diligence. In addition, WIM needed both to maintain a portfolio that it believed would give investors a return on their investment and to consider the expectation of investors.

44. In any event, WIM did take liquidity into account when making investment decisions in the face of redemptions. However, there were many other considerations that the investment manager needed to consider, including the expectations of investors. It is incorrect for the Authority to suggest that WIM made investment decisions solely by reference to the Limits. WIM did not operate on the basis that the liquidity profile should be addressed only once a trigger or limit had been crossed. WIM did its utmost to steer the WEIF away from the Limits and took proactive steps in anticipation of continued redemptions. Its approach was reasonable at the time and should not be assessed with the benefit of hindsight.

[12] WIM stated that it had not been able to assess the "sales", and these would have been relevant in connection with assessing how the fund met redemptions.

45. The fact that there was a deterioration in the fund's liquidity is not in itself indicative that WIM failed to exercise due skill, care and diligence when making investment decisions.

46. The Investment Decisions Expert considered the three possible factors which impact on liquidity: (1) buying and selling activity, (2) share performance of assets from different buckets, and (3) ADTV. WIM has raised a number of categories where it submits the Investment Decisions Expert made errors in assessing the quantity of purchases which it asserts made the calculations materially inaccurate and unreliable. As explained below, the Investment Decisions Expert considered these points and remained of the view that, notwithstanding any isolated inaccuracies within the data set provided to it by Link, it is appropriate and proportionate to rely on it.

47. The Investment Decisions Expert considered WIM's four categories of concern and responded as follows: (1) "conversions/corporate actions": the calculations are based on the net buy/sell position, so if a conversion is mischaracterised it will inflate *both* buying and selling activity and this will have a minor impact on the overall analysis; (2) classification of buckets: WIM's allegation that certain securities were wrongly placed in buckets arises from a difference in ADTV source data, and the data source used by the Investment Decisions Expert is an unbiased and reliable one, and it was reasonable for this data source to be relied upon; (3) cross trades: that assets were transferred in from another WIM fund has no bearing on their impact on the WEIF's liquidity profile; and (4) unaccounted inflation: the Investment Decisions Expert's approach was consistent with the data set provided to it, and the use of the previous month-end price for its analysis.

48. The Investment Decisions Expert remained of the view that its calculations and conclusions are reliable. The Authority considers that it is appropriate and safe to rely on the opinion of the Investment Decisions Expert, namely, that the principal reason for the deterioration of the fund's liquidity was due to the investment decisions by WIM and Mr Woodford.

49. When considering possible reasons for investment decisions, the Authority has not seen any evidence to suggest that there had been a particular impediment which constrained WIM's ability to manage the liquidity of the fund in a manner that would otherwise have been appropriate. The management of less liquid assets, particularly in difficult circumstances, requires consideration of their sale well in advance of execution. This is the point of liquidity management. The Authority is conscious that the fund needed to meet significant daily redemptions. Whilst these redemptions may have made the task of managing the fund more challenging generally, the Authority has seen no evidence to suggest that they constricted WIM's ability to manage the overall liquidity profile of the fund. The sustained and prolonged nature of the redemptions (from over a year before the start of the Relevant Period) provided WIM with ample opportunity to embark upon, and should have acted as a clear indicator of the importance of, long-term liquidity management.

50. Mr Woodford took the view that WIM was not required to take into account liquidity when making investment decisions so long as WIM stayed within the Limits. His stated approach to selecting which assets to sell to meet redemptions was primarily focused on which assets he had the most conviction in. At a time when the fund was needing to meet significant daily redemptions, it was incumbent on WIM to effectively manage the WEIF's liquidity by making appropriate investment decisions in response to day-to-day investor redemptions. WIM was expected to take a pro-active and prudent approach to liquidity risk by appropriately balancing liquidity factors against investment returns when making investment decisions. WIM and Mr Woodford continued to implement an investment strategy which pushed WIM *"close to all our limits".* This was not an approach which was compatible for a daily dealing fund claiming to operate within a medium risk appetite.

51. WIM's investment strategy trumped liquidity risk management, in that WIM did not adopt a balanced approach to its buying and selling activity as it sold a much greater amount and proportion of more liquid assets than it bought, and bought a greater amount and proportion of more illiquid assets than it sold. The Authority considers that this was not a reasonable approach and directly contributed to the deterioration in the WEIF's liquidity profile.

52. The deterioration of the fund's liquidity was a predictable outcome of WIM's investment decisions, and the Authority considers (and it is not making this assessment with the benefit of hindsight) that WIM failed to exercise due skill, care and diligence when making investment decisions.

<u>Warning Signs</u>

53. WIM's responses to the asserted "warning signs", namely, (1) the outflows from the fund (i.e. redemptions), (2) the deteriorating liquidity of the fund, and (3) the comments made by Link as to rebalancing the liquidity of the portfolio, demonstrated a transparent, consistent and reasoned position.

54. WIM's responses focused on the primacy and importance of the Limits, in respect of the Revised Four Bucket Model, which had been set by Link. WIM made clear to Link, throughout the Relevant Period, that (1) it acknowledged that it had to manage the WEIF to the agreed limits, and the need to manage to those limits whilst in a period of ongoing redemptions, (2) the right measure was to be used which clearly set out the parameters which WIM could work within, and (3) the measures could not be crossed to ensure WIM could continue to meet redemptions if they were to continue. WIM was relying on the Limits and managing the fund to them. If Link considered that the Limits did not present an appropriate liquidity profile, it had the power to change them, and had a regulatory responsibility to do so.

55. In responding to matters raised by Link, WIM clearly expressed its collective understanding (including Mr Woodford's understanding) of how the liquidity framework applied. WIM stressed to Link throughout the Relevant Period that they had an agreed liquidity framework in place which indicated that (1) when a trigger was crossed, WIM would identify the contingency actions and update them in the

contingency plan, and (2) WIM would be ready to take action should a limit be breached. These contingency actions had previously been agreed between Link and WIM.

56. WIM consistently impressed upon Link that it would act within the framework that had been designed by its ACD. As the fund's ACD, and consistent with the terms of the IMA, Link was responsible for overseeing WIM. If Link believed that the Limits (which it had imposed) failed to reflect an acceptable liquidity profile, it should have changed the Limits and instructed WIM accordingly. No such action was taken. The importance of the Limits was repeatedly emphasised by WIM to Link. Assuming that the fund was within the Limits, WIM felt duty bound not to act in a way that harmed investors.

57. The contemporaneous communications and meetings between Link and WIM, demonstrated that Link had accepted, and been satisfied with, the steps taken by WIM in response to its comments.

58. WIM responded reasonably to the matters raised by Link.

59. WIM was faced with many warning signs that liquidity in the fund was deteriorating and needed to be improved as a matter of urgency. The warning signs reflected the persistent trend during the Relevant Period of: (1) redemptions resulting in net outflows from the WEIF, (2) the deteriorating liquidity of the WEIF by reference to the Limits, and (3) specific communications from Link to WIM during the Relevant Period. This was especially when viewed against the background of concerns about the WEIF's liquidity profile having been raised by Link well before the start of the Relevant Period, and the ongoing deterioration in the WEIF's liquidity after that point.

60. Any actions that WIM did take were totally inadequate when seen against the seriousness of the situation the fund was in. Link's concerns should have been taken extremely seriously by WIM, but were not. Link repeatedly pressed WIM to act more prudently, and was met at every point with obstruction and refusal. WIM pushed hard against Link's frequent suggestion that liquidity ought to be managed in a manner other than through the Limits alone. Link had wanted liquidity to have a central place in investment decision-making even when within the Limits, whilst WIM wanted to avoid the need to do so.

61. The Authority refers to two particular examples of WIM's behaviour which demonstrate that its actions were a patently inadequate response to such warning signs, and that Link had not been satisfied with these steps.

62. In December 2018[13], Link expected WIM to undertake prompt action to address the liquidity concerns with the ultimate goal, inter alia, for the portfolio to return to a more balanced position between the four liquidity buckets. This communication had followed a breach of the Limits. Whilst WIM took certain short-term actions, the Authority considers that it failed entirely to engage with, or to respond to, Link's clear warning about the need to re-balance the liquidity profile of the fund in the long run.

[13] See paragraph 4.103 of the Decision Notice.

63. In March 2019[14], following Link strongly urging WIM to improve the liquidity profile earlier in the month, Link indicated that it was not satisfied with WIM's proposed actions to improve the WEIF's liquidity. WIM responded strongly, resisting the need to restore the WEIF's position to below the Limits, referring to "*contingency actions*" that had already been taken by WIM which had clearly not been sufficient to address the problem of the deterioration in the WEIF's liquidity. That the liquidity position had worsened during March 2019, despite WIM's actions, was itself a warning sign that those actions had failed to improve matters. WIM needed to address the issue more urgently and substantively. A senior member of Link's team internally commented following WIM's response "*this is just Woodford all over. Give them an inch and they take a mile. They should have acted immediately to take it [illiquid holdings] down we never accepted their initial argument".*

64. The contemporaneous communications and meetings did not, as has been asserted by WIM, demonstrate that Link was comfortable with WIM's steps in reaction to its comments.

65. The Authority considers that the steps taken referenced above were not reasonable responses to the matters raised by Link.

Sanction: Prohibition and financial penalty

WIM's Financial Penalty

66. The Authority has failed to apply fairly the Step 2 factors which, as set out in DEPP 6.5A.2G.11, are likely to be considered 'level 4 factors' or 'level 5 factors'. It is not accepted by WIM that the alleged breach contributed to a significant loss or risk of loss to a large number of individual consumers. Link had not previously mentioned the possibility of suspending the fund and this meant that WIM was unable to implement its contingency plan in place to protect investors. WIM played no part in the sale of the assets. In assessing the seriousness of the misconduct, the Authority has not taken material account of the significance and impact of external factors, including the scale of redemptions which WIM had to constantly manage over the Relevant Period, and the involvement of others. Link's function as the ACD, together with the fact that it designed and implemented the liquidity framework, warrant the seriousness of WIM's breach to be distinguished from the seriousness of the breach that the Authority decided was committed by Link[15] (which the Authority assessed as being level 4)[16].

67. Although there may have been an adverse effect on the confidence of financial services markets, and consumer confidence, those events were complex and involved many other persons, and it is unfair for this to be a factor supporting a 'level 4 or 5' category of seriousness.

[14] See paragraph 4.104 of the Decision Notice.
[15] https://www.fca.org.uk/publication/final-notices/link-fund-solutions-limited-2024.pdf at pages 68-69.
[16] WIM's representation was made in the event the Authority determined there had been breaches of PRIN (which was not accepted by WIM).

68. WIM's alleged conduct was accepted by the Authority not to be deliberate, or lacking integrity. It is said by the Authority that the alleged breach is one of negligence. WIM's actions were guided by what it believed was in the best interests of investors. In addition, WIM has a clean disciplinary record. WIM considers that the alleged misconduct falls within the lower category of seriousness, and at level 3.

69. When considering the level of penalty which would act as a credible deterrent, the nature of the misconduct is critical. Lack of integrity, particularly misconduct performed for financial benefit, warrants a large penalty to achieve credible deterrence. WIM's conduct did not involve a lack of integrity. Conduct which amounts to a failure to act with due skill care and diligence is fundamentally different and how deterrence operates in such circumstances will be different. The alleged failure to act with due skill, care and diligence was committed in the context of retail investments and not for any financial benefit.

70. At Step 4, the Authority has proposed to increase the Step 3 figure from £4,972,084 to £40,000,000 on the grounds that the increase is required to create credible deterrence. The Authority has not substantiated its justification for such a significant uplift for credible deterrence and why a lower financial penalty would not achieve the same effect.

71. The Authority has failed to show why the figure at Step 3 would be insufficient to deter WIM or others from committing similar failings in the future. The nature of the conduct, the size of the penalty at Step 3, and the operation of the penalty framework all suggest that the figure at Step 3 is sufficient to achieve credible deterrence. It seems inherently improbable that such an amount of money at Step 3 would not serve to deter similar failures of negligence within the industry. Accordingly, WIM considers that the significant deterrence uplift is excessive and disproportionate to achieve credible deterrence.

72. DEPP 6.5A.2G is silent as to the weight which should be applied to the relevant factors at Step 2 of the penalty calculation. The assessment of seriousness requires a consideration of all relevant factors with such weight paid to any particular factor as is merited by the facts and nature of the particular case. The Authority considers that, of particular significance to the assessment of seriousness in this case, is the extreme impact of the breach. WIM's contravening actions materially increased the risk of the suspension of the WEIF, which did in fact transpire. A significant number of retail investors held underlying interests in £3.6 billion of assets in the WEIF at the time of suspension. Each has suffered significant financial losses, together with the serious, or potentially serious, consequences of being deprived access to their funds for a lengthy period. The Authority considers that the extent of the financial loss which it is appropriate to attribute (or which can be attributed) to the liquidity management failings, as opposed to other failings, such as investment performance or (as WIM has asserted) deficiencies in the liquidation of the WEIF after October 2019, may be difficult to quantify.

73. The widespread and profound impact of the breach has been reflected in extreme levels of public, press and parliamentary concern and has resulted, in the Authority's assessment, in damage to confidence in one of the most important financial markets for the general public, namely, that

of retail fund management. The impact has been extremely significant. Accordingly, the Authority considers that the contribution to the seriousness assessment of the impact of the breach puts it as the very highest level. The Authority accepts that WIM did not act with a lack of integrity. However, the fact that WIM was a firm holding an extremely prominent position in the fund management industry is significant when assessing the seriousness of the breach as breaches by such firms are more likely to cause widespread and serious harm and a loss of confidence in markets.

74. A subject's regulatory history is not one of the factors which DEPP 6.5A.2G provides should contribute to the seriousness of the breach[17].

75. Accordingly, taking into account: (1) the factors which are likely to be considered 'level 4 factors' or 'level 5 factors'[18], and (2) the factors which are likely to be considered 'level 1 factors', 'level 2 factors' or 'level 3 factors'[19], the Authority considers that the misconduct falls within seriousness level 4.

76. The basis for the Step 4 uplift is that the Step 3 figure is too small "*in relation to the breach*" to meet the objective of credible deterrence (DEPP 6.5A.4(1)(a)). It is not sufficient to focus almost exclusively on the fact that the breach relates to a failure to act with due skill, care and diligence (rather than a lack of integrity). The impact of a breach, including investor losses, is relevant to Step 4 because the need for credible deterrence increases commensurately with the risk of harm arising from a breach.

77. It is critical that, when managing other people's investments of this magnitude in such a high-profile fund, fund managers ensure that they act prudently and with proper regard for the associated risks, including liquidity risk. The consequences of failing to do so are potentially extremely damaging as reflected in WIM's case, not only for investors in the WEIF but also for confidence in the UK fund management sector. These matters are highly relevant to credible deterrence, illustrating what is potentially at stake if a fund such as the WEIF is mismanaged, and the importance of ensuring that risks, such as liquidity risks, are appropriately managed.

78. The scale of the investor losses increases the importance of deterring others managing big, high-profile funds with large numbers of retail investors, from taking the types of unreasonable liquidity risks that WIM took when pursuing its investment strategy. WIM prioritised its investment strategy at the expense of promptly taking appropriate action to address the liquidity concerns raised by the ACD. The need for credible deterrence in these circumstances is greater than a case where the risk to investors arising from the misconduct is much smaller; or where the investors are not as vulnerable as retail investors. It is in this context that

---

[17] It is generally taken account of, pursuant to DEPP 6.5A.3G at Step 3 in the penalty calculation (the assessment of aggravating and mitigating factors). The Authority does not consider that WIM's regulatory history is a mitigating factor at Step 3 in the penalty calculation.

[18] DEPP 6.5A.2G(11).

[19] DEPP 6.5A.2G(12).

the impact of the breach must be considered in assessing credible deterrence for WIM.

79. It is not possible to provide the evidence requested by WIM to show that the financial penalty at Step 3 would be insufficient to deter WIM or others from committing similar failings in the future, whilst another larger sum would do so. This is not practicable nor necessary for the purposes of assessing the need for an uplift at Step 4. The Authority considers that the figure reached at Step 3 of the penalty calculation is too small to meet its objective of credible deterrence, and it is appropriate and proportionate to apply a deterrence uplift.

80. The Authority does not consider that Link and WIM shared responsibility for WIM's regulatory breaches, thereby reducing the seriousness of WIM's breach or mitigating the need for credible deterrence. Both Link and WIM were subject to their own, separate regulatory obligations, and the Authority considers that Link's failures do not act to lessen the seriousness of WIM's regulatory breaches, nor are they relevant in determining the appropriate adjustment at Step 4 to achieve credible deterrence. It remains imperative that investment managers are acutely conscious of their obligations to manage the liquidity of retail funds appropriately, and this can be best achieved by the imposition of a penalty demonstrating the consequences to a firm if it fails to do so. Accordingly, the Authority considers that a penalty of £40 million is necessary to achieve this credible deterrence.