Feedback Statement

FS23/7

# Long-Term Asset Funds (LTAFs) – Financial Services Compensation Scheme Coverage Feedback Statement

October 2023

# Contents





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## Chapter 1

# Summary

**1.1** In Policy Statement PS23/7, we set out new rules to enable a broader range of retail investors and pension schemes to appropriately access Long-Term Asset Funds (LTAFs) whilst ensuring understanding of the risks involved.

**1.2** We also asked for views on whether it might be appropriate to remove Financial Services Compensation Scheme (FSCS) cover for regulated activities relating to LTAFs, as a first step toward change with a broader consideration of FSCS coverage for non-standard assets to follow.

**1.3** It was our view that the question of FSCS cover should be raised at this early stage because the products were not yet being marketed to retail investors. We set out in the chapter the arguments both in favour of, and against, removing FSCS coverage.

**1.4** We stated that, following the consultation, if we decided to exclude LTAFs from FSCS coverage, we would consult on detailed rules later in 2023. The consultation closed on 10 August, and we received 17 responses.

**1.5** We have considered the position carefully, in light of the feedback received, and have decided not to take forward the proposal to exclude FSCS cover for regulated activities relating to LTAFs at this time.

## Chapter 2

# Who this affects

**2.1** This feedback statement will primarily be of interest to:

- consumers
- groups representing consumers' interests
- asset managers with experience of managing illiquid, long-term assets
- depositaries
- potential investors in long term asset funds, like pension providers and trustees of DC or hybrid pension schemes, and sophisticated or wealthy investors
- investment advisers and private wealth managers
- insurers who write unit linked long term insurance contracts
- fund distributors

Chapter 3

# The wider context of this feedback statement

## Our consultation

**3.1** In Policy Statement PS23/7, we set out new rules to enable a broader range of retail investors and pension schemes to appropriately access LTAFs.

**3.2** This was a follow up to CP22/14 which consulted on proposals to treat the LTAF as a Restricted Mass Market Investment (RMMI), in line with our approach for high-risk investments.

**3.3** As the LTAF is inherently a higher risk product than is typically distributed to retail investors, the RMMI regime offers additional protections including risk warnings and restricting the amount that retail investors can invest compared to the LTAFs previous distribution rules.

**3.4** The new rules therefore enable a broader range of retail investors and pension schemes to appropriately access the LTAF whilst ensuring they understand the risks involved.

**3.5** As it stands, unless we amend existing rules on FSCS coverage, regulated activities relating to LTAFs such as advice to invest in an LTAF, arranging the sale of units in an LTAF (e.g. by a platform), managing an LTAF, or acting as the depositary of an LTAF are within the scope of FSCS. This is because FSCS coverage links to the regulated activities which a firm carries out in relation to products (such as providing advice) rather than the type of product.

**3.6** Therefore, PS23/7 also contained a consultation chapter on potentially excluding FSCS cover for activities relating to LTAFs.

**3.7** The chapter explored arguments in favour of removing FSCS coverage:

- Providing FSCS protection in circumstances where investors seek higher investment risk might be said to create a moral hazard by providing additional protections for an inherently risky product.
- When appropriately sold with risk warnings and an appropriateness assessment, an unadvised investor should be able to understand those risks and only invest if within risk and liquidity appetite.
- Where LTAFs are sold on an advised basis, advisers are required to have undertaken a suitability exercise, which involves the adviser determining the investor has the necessary knowledge and experience to understand the risks involved in buying units in an LTAF.

We set out these arguments in the context of high FSCS levies on industry in recent years, noting both that the scope of our UK compensation scheme in retail investment markets is more extensive than other comparable jurisdictions, and our commitment to bring the levy down. In particular, we are conscious that PS23/7 extended the scope of products which retail investors can invest in, and we wanted to ensure any corresponding risk in this leading to potential increased FSCS liabilities in the future is approached in a mindful way.

**3.8** The chapter also acknowledged some potential arguments against removing cover for activities connected with LTAFs:

- Removing FSCS protection in relation to advice about LTAFs might be considered unfair in some circumstances, for example, where the investor may not have received adequate information and advice about risks associated with the LTAF from the advising firm but could no longer make a claim against them. The advising firm may have misrepresented the suitability of the investment for the investor's needs.
- We should not take a piecemeal approach to excluding individual activities or products from FSCS protection.
- Removing FSCS cover in these circumstances might inappropriately deter some investors from investing in LTAFs, especially as it would be the only investment product excluded from FSCS coverage in this way.

**3.9** We had said previously in FS22/5, our Compensation Framework Review Feedback Statement, that we were open to exploring opportunities to restrict the scope of protection by excluding regulated activities carried out in relation to particular product types from the FSCS where there is currently cover, in particular in relation to non-standard or high risk investments.

**3.10** In DP21/5, we discussed that excluding protection for certain investment products may complement one of the objectives of our Consumer Investments Strategy by creating the right environment for consumers to invest, whilst encouraging firms to help consumers to identify and access investments that are suited to their circumstances and attitude to risk.

**3.11** We asked four questions in the consultation chapter:

*Q1: Do you consider that we should consult on removing FSCS protection for either (a) some activities relating to LTAF – in which case which ones; or (b) all activities? If not, why not.*

*Q2: If you support removal of LTAF from FSCS coverage, do you agree that steps should be taken to confirm the policy rules for this as soon as possible, so that these changes are made at this early stage in the process of LTAFs being distributed directly to retail investors?*

*Q3: If not, do you consider this should be kept under review as part of our wider work on FSCS cover for activities relating to investment products?*

*Q4: Are there other amendments to FCA rules, for example, on distribution and the operation of LTAFs, that you would make if FSCS coverage was limited, to enhance consumer protection?*

**3.12** We received 17 responses from: 3 private individuals, 3 firms, 7 trade bodies, 1 law firm, 2 FCA panels, and the FSCS.

**3.13** 16 out of the 17 responses to the consultation expressed significant concern about the removal of FSCS protection for activities linked to LTAFs in isolation of any wider scope reform. Of the 16 responses, 4 were against considering the removal of FSCS protection for LTAFs under any circumstances. The remainder, and majority of respondents, were in favour of considering the scope of FSCS protection for the retail investments landscape as part of a holistic review, including but not limited to LTAFs. Only one respondent, a trade body, was in favour of removal. It stated that the interest of its member firms in offering LTAFs to advised clients remains low and it only envisages direct exposure to LTAFs among High Net Worth (HNW) and Ultra HNW clients as part of a high value portfolio.

**3.14** **Three key themes** arose from the consultation feedback:

- **Respondents suggested that focusing solely on FSCS cover for LTAFs could undermine the work of developing LTAFs for retail, their potential success, and could impact consumer confidence, which is at odds with the aims of broadening access to retail customers**. The point was made that reclassifying LTAF as a RMMI is the culmination of work from industry, Government and the FCA to establish a new UK authorised fund structure for less liquid assets and ensure this can be distributed to an appropriate range of consumers. It has taken several years and ended up commanding broad industry support. However, despite the changes, respondents suggested that some 'barriers' remain to the distribution of LTAFs in practice: platforms need to invest in technology change; all firms need to apply their new Consumer Duty processes to the new products and distribution channels; and manufacturers need to invest in bringing forward LTAFs with a direct retail target market and seek approval for these from the FCA. Respondents suggested that removing only LTAFs from the scope of the FSCS would only add another material barrier to the distribution of LTAFs that may make take up unattractive.
- **The implication of singling out LTAF as a 'risky' product is seen by stakeholders as wrong as, whilst there are specific liquidity and valuation considerations, they consider it likely to have much greater diversification and lower volatility than other products covered by the FSCS**. Respondents suggested, by way of example, that advice to invest in the equity of a corporate, the value of which can irrevocably go to zero intra-day, might be considered 'riskier' than an investment in a fund including LTAFs required to diversify its holdings that has been authorised by the FCA and is managed by a heavily regulated manager. A further argument was made that this could also create arbitrage with other semi-liquid funds. For example, advice to invest in an open-ended property fund would remain covered by the scheme, when LTAFs would not.

- **Respondents suggested that considering FSCS protection on a product-by-product basis risks creating confusion and inconsistency**. However, most respondents stated support for considering the scope of FSCS protection 'in the round'.

## Chapter 4

# Our Response and Next steps

4.1 We have considered the position carefully and reflected on the feedback received. In light of this, we have decided not to take forward the option to exclude FSCS cover for regulated activities relating to LTAFs. We now propose to consider any changes to the scope of FSCS protection for retail investments in the round, rather than excluding activities relating to certain investment products in isolation.

4.2 There are currently various FCA initiatives impacting the consumer investments sector, including those implementing HM Treasury's Smarter Regulatory Framework (SRF). Our upcoming work is outlined in the Regulatory Initiatives Grid. As we stated in FS22/5, we remain open to exploring opportunities for changing the scope of FSCS protection in the future. We will therefore continue to consider this question as appropriate as part of these connected workstreams.

## Annex 1
# List of respondents

1. We are obliged to include a list of the names of respondents to our consultation who have consented to the publication of their name. That list is as follows:

Association of British Insurers (ABI)

Association of Investment Companies (AIC)

Association of Pension Lawyers (APL)

Association of Real Estate Funds (AREF)

BlackRock

Consumer Panel

Depositary & Trustee Association (DATA)

Financial Services Compensation Scheme (FSCS)

Hargreaves Lansdown

Investment Association (IA)

Lane Clark & Peacock LLP

Michael Crofts

Personal Investment Management & Financial Advice Association (PIMFA)

Practitioner Panel

Roger Lawson

Schroders

Scott Huggins

## Annex 2

# Abbreviations used in this paper

| Abbreviation | Description |
|---|---|
| **FCA** | Financial Conduct Authority |
| **FSCS** | Financial Services Compensation Scheme |
| **LTAFs** | Long-Term Asset Funds |
| **RMMI** | Restricted Mass Market Investment |

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