# Illiquid assets and open-ended funds and feedback to Consultation Paper CP18/27

**Policy Statement**
PS19/24

September 2019

# This relates to

Consultation Paper 18/27
which is available on our website at
www.fca.org.uk/publications

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# Contents

# 1 Summary

1.1 This Policy Statement (PS) sets out our response to the feedback we received to Consultation Paper CP18/27 on illiquid assets and open-ended funds. It also details the final rules and guidance that we are introducing following the consultation.

1.2 Following the result of the UK referendum on EU membership in June 2016, dealing in a number of property funds was temporarily suspended, preventing investors from accessing their money. Dealing in all funds had resumed by the end of the year, but the event raised some questions. These related to how fund managers use different liquidity risk management tools and how to strike a fair balance between the interests of investors wishing to redeem their holdings and those wishing to remain invested in the fund under difficult market conditions.

1.3 We saw that the suspensions and other liquidity management tools generally worked as they were intended to, and prevented the problems that property funds were facing from causing any wider market disruption. However, lessons could be learned to inform specific improvements in some areas, for example on the use of certain liquidity management tools, contingency planning, oversight arrangements and disclosure to retail clients.

1.4 On this basis, we issued an illiquid assets and open-ended investment funds discussion paper in February 2017, DP17/1, and then a consultation paper, CP18/27, in October 2018 to which we have received feedback.

1.5 The policy work in CP18/27 and this PS, is focused on non-UCITS retail schemes (NURSs) investing in immovables such as commercial property. It was this type of fund that suspended in 2016 following the EU Referendum.

1.6 In June 2019, after this consultation closed, a high profile UCITS fund, the LF Woodford Equity Income Fund (the WEIF), suspended dealing. This led to renewed focus on illiquid assets held in open-ended funds. We postponed publication of this PS while we considered any potential read across to our proposed remedies for NURSs.

1.7 As a UCITS fund, the WEIF is prohibited from investing more than 10% of its property in assets that are unlisted, and thus usually more illiquid, securities. This is in contrast to NURSs, which can invest up to 20% of their scheme property in unlisted securities, and up to 100% of their scheme property in immovables, such as real estate.

1.8 While the remedies in this PS are focused on NURSs rather than UCITS funds, suspensions in both types of fund demonstrate the difficulties that may be experienced by open-ended funds which hold less liquid assets while also offering daily dealing. Had suspension tools not been used, it would have been very difficult to ensure investors remaining in the funds were treated equally and fairly when the liquidity problems arose.

1.9 There was significantly greater negative reaction to the WEIF suspension than following the suspension of commercial real estate NURSs in 2016. This likely in part reflects a greater level of awareness and understanding of the liquidity mismatch inherent in real estate funds compared with UCITS funds, the rules for which are intended to limit, but not prohibit, fund investment in less liquid assets. However, there are also UCITS funds which by design seek to offer investors exposure to less liquid assets, for example high yield bonds. Investors may choose to invest in funds which hold less liquid assets because of higher expected returns, or to diversify their portfolio. But this reinforces the need for clear disclosure to investors regarding the implications of investing in illiquid or less liquid assets through open-ended fund structures. It also raises important questions about the way funds investing in illiquid or less liquid assets manage liquidity mismatch, and whether they should be offering daily redemption.

**1.10** The issues highlighted by the WEIF raise the question of whether the measures in this PS should be applied more widely than NURSs, and also whether we should be exploring further remedies for UCITS funds, NURSs and for other types of fund. We are considering this further, as set out in Chapter 7.

**1.11** Our final rules in this PS reflect that we do not want to prohibit open-ended funds from investing in illiquid or less liquid assets where investors understand and are willing to accept the liquidity risk this can involve.

**1.12** We note that fund managers have several options for managing or avoiding this mismatch. For example, they may apply a dealing frequency in units of the fund that better reflects the typical time needed to liquidate the underlying assets, or choose to operate as a closed-ended and listed fund, such as a Real Estate Investment Trust (REIT). Investing in illiquid assets via investment trusts such as REITs, the shares of which may be sold by investors without triggering a need to sell underlying assets, offers an alternative way to invest in illiquid assets. The price at which shares can be sold will, however, also be affected by perceptions of the valuation of underlying assets and the liquidity of the market for these shares at the time of sale.

**1.13** Where a fundamental mismatch remains between the dealing frequency of fund units and the liquidity of underlying assets held by an open-ended fund, funds must have clear arrangements, and be clear to their customers, on how this mismatch will be managed. It is important that we have a clear framework within which fund managers and depositaries operate to ensure the fair treatment of investors. Our final rules for NURSs investing in inherently illiquid assets set specific requirements which seek to ensure this is achieved. These supplement existing guidance, applying to UCITS funds as well as NURSs, that an AFM needs to ensure that the fund's prospectus provides clarity on the arrangements for any suspension of dealing, and that any suspension needs to be consistent with the instrument constituting the fund and the prospectus.

**1.14** We are continuing with most of the proposals set out in our CP. This includes introducing a new category of 'funds investing in inherently illiquid assets' (FIIA) within our Handbook. NURSs that fall into this category will be subject to additional requirements, including enhanced depositary oversight, standard risk warnings on financial promotions, increased disclosure of liquidity management tools and liquidity risk contingency plans.

**1.15** We are also proceeding with a requirement that NURSs must suspend dealing in fund units where the standing independent valuer (SIV) expresses material uncertainty regarding the value of 20% of the scheme property. In stressed market conditions, less liquid assets can suffer from a high degree of valuation uncertainty and become harder to sell at the value which would be expected in normal market conditions. Following feedback, we will, however, allow an authorised fund manager (AFM) to continue to deal where they have agreed with the fund's depositary that this is in the fund investors' best interests. This change is being introduced to ensure that AFMs (in conjunction with depositaries) have the ultimate say in whether a fund suspends. This will reduce reliance upon the SIV, and protect consumers by avoiding suspension where this would not be in investors' interests.

**1.16** Following feedback, we will not proceed with two of our original proposals. This includes the requirement for a manager of a FIIA to add an 'identifier' to the name of the fund. We accept that, without a comprehensive arrangement to have identifiers related to other risk factors, for example credit risk or market risk, across the range of fund structures, this could lead to misinformed investor conclusions about relative risk. We remind fund managers, however, that fund names should be carefully chosen so that they do not mislead, as set out in COLL 6.9. We have also decided not to proceed with guidance relating to limiting the accumulation of large cash buffers within NURSs and UCITS funds. Otherwise, our final rules do not significantly differ from the rules included in our consultative draft.

**1.17** Under our new rules, where AFMs managing NURSs choose not to manage the liquidity mismatch directly, for example by adapting the redemption arrangements to be more similar to the liquidity of the underlying assets, the fund will have to be classified as a FIIA and become subject to the additional requirements this brings.

## Who this affects

**1.18** You should read this if you have an interest in open-ended investment funds that are likely to hold illiquid assets. This includes:

- operators and investment managers of these funds
- depositaries
- ancillary service providers
- intermediaries, such as platform service providers, or those, like wealth managers or financial advisers, whose retail clients invest in funds holding illiquid assets
- firms communicating financial promotions to retail clients for funds investing mainly in illiquid assets. These promotions will be subject to the new requirement in our Conduct of Business sourcebook (COBS) to include a standard risk warning
- investors, whether institutional, professional or retail, who have direct or indirect exposure to these funds

**1.19** Others may have a less direct interest in the issues raised but may also find the PS relevant:

- pension plan operators, for example those offering Self-invested personal pensions (SIPPs) and Small self-administered schemes (SSASs)
- managers of other types of fund, such as qualified investor schemes (QISs) or unauthorised funds, which may be affected to some extent by several of the measures (QISs by the categorisation of units in certain QISs as 'inherently illiquid assets', and by the updated references to the Royal Institution of Chartered Surveyors (RICS) Red Book)
- life assurance companies with exposure to illiquid assets such as property, either by direct investment or through holdings in investment funds

## The wider context of this policy statement

### Our consultation

1.20 In October 2018, we published a consultation paper (CP18/27), on illiquid assets and open-ended funds. This followed our discussion paper (DP17/1), 'Illiquid assets and open-ended investment funds' (February 2017).

1.21 In drafting our proposals, we have also considered the results of our supervisory review of property funds and liquidity risks in 2016. Additionally, we considered the updated Recommendations, published on 1 February 2018, by the International Organisation of Securities Commissions (IOSCO), revising its Recommendations on Liquidity Risk Management for Collective Investment Schemes (CISs) originally published in 2013.

1.22 The CP presented a package of remedies proposing changes in 3 broad areas:

- suspension of dealings in units
- improving the quality of liquidity risk management
- increased disclosure

The measures were focused on NURSs, as these are a key type of fund which can invest in illiquid assets, and in which retail investors can invest. Less liquid assets can also be held in some other types of fund. Chapter 7 explores the case for additional measures in respect of these other fund structures.

### How it links to our objectives

1.23 The new rules we are introducing support the consumer protection and market integrity objectives of the FCA.

1.24 The rules about disclosures, such as the standard risk warning and liquidity risk management tools, support our consumer protection objective. In addition to protecting consumers, the mandatory suspension rules also support our market integrity objective.

## What we are changing

1.25 We are changing our Handbook in 3 broad areas:

### Suspension of dealings in units (Chapter 3)

1.26 We are requiring NURSs holding property and other immovables to suspend dealing when there is 'material uncertainty' about the valuation of at least 20% of the scheme property. We will, however, allow an authorised fund manager (AFM) to continue to deal where they have agreed with the fund's depositary that to do so is in the best interests of investors.

### Improving the quality of liquidity risk management (Chapter 4)

**1.27** We are requiring managers of funds investing mainly in illiquid assets to produce contingency plans for dealing with liquidity risks. We are also giving depositaries a specific duty to oversee the processes used to manage the liquidity of the fund.

**1.28** We are making further specific guidance to clarify:

- The circumstances in which it may be appropriate to suspend dealing. For a fund investing mainly in illiquid assets, the fund manager may suspend dealing before running down the liquidity in the fund, if this is in unitholders' best interests.
- The process for arriving at a fair and reasonable value for an immovable, where it needs to be sold quickly to ensure that the fund can continue to meet redemption requests as they fall due.

### Increased disclosure (Chapter 5)

**1.29** We are requiring:

- Additional disclosure in a fund's prospectus of the details of their liquidity risk management strategies, including the tools they will use and the potential impact on investors.
- A standard risk warning to be given in financial promotions to retail clients for such funds. This will apply to all firms communicating a financial promotion, not just the fund manager.

## Outcome we are seeking

**1.30** We are seeking to reduce the potential for harm to investors in funds that hold illiquid assets, particularly under stressed market conditions. Our measures should:

- Help investors understand better any restrictions on access to their investments and the circumstances in which these restrictions will be placed on the funds.
- In the case of funds investing in immovables, reduce the potential for some investors to gain at the expense of others because units have been incorrectly priced, due to uncertainty about the value of assets held in the fund.
- Reduce the likelihood of a run, which could substantially reduce the value of investments for those left in the fund and possibly destabilise the market more widely.

## Measuring success

**1.31** If successful, we should see fewer complaints from retail investors in funds about perceived unfair treatment. Some fund managers may choose to adjust redemption terms to better match the liquidity of underlying assets, or to choose different types of fund when focusing on investment in illiquid assets. We do not consider the frequency with which funds investing in illiquid assets are suspended to be a measure of success, as whether suspension is in the interests of investors will depend on the circumstances. In particular, in circumstances of extreme market volatility or uncertain valuation suspension may be the appropriate way to protect investors, and we do not wish to discourage the use of the suspension tool when it is in investors' interests. However, clear disclosure of liquidity risks, leading to improved investor understanding, should dissuade investors unwilling to take liquidity risk from investing in illiquid assets through open-ended fund structures.

## Summary of feedback and our response

1.32 We received 43 responses to our CP. A full list of non-confidential respondents is in Annex 1.

1.33 Respondents were broadly in favour of many of our proposals, including:

- our proposed definition of assets that are inherently illiquid
- the application of most of the remedies to NURSs
- the introduction of liquidity risk contingency plans
- guidance clarifying the mechanism for reducing the price of an immovable to allow it to be sold more quickly to meet redemption demand
- the extension of depositaries' duties to include oversight of FIIAs' liquidity management processes
- a standard risk warning to be included in financial promotions of FIIAs
- the additional disclosure obligations in relation to liquidity management tools within the prospectus of FIIAs

1.34 Respondents broadly disagreed with a small number of our proposals, including:

- the introduction of a new category of 'fund investing in inherently illiquid assets'
- an identifier to be included in the name of a FIIA
- mandatory suspension of dealing in units of a fund in certain circumstances
- guidance stipulating that funds should not be holding large speculative cash buffers

1.35 Further detail on the feedback and our response is set out in the following chapters.

## Equality and diversity considerations

1.36 We have considered the equality and diversity issues that may arise from the final rules and guidance in this PS. Overall, we do not consider that they adversely impact any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment. No respondents to CP18/27 raised any concerns about equality and diversity considerations.

## Next steps

1.37 We set out the final Handbook text in Appendix 1. The new Handbook rules and guidance will come into force on 30 September 2020. This will allow firms to use scheduled annual reviews of fund documentation to make the necessary changes.

**1.38** The standard risk warning that we will require firms to include in financial promotions to clients (see Chapter 5) will apply to firms' MiFID business. MiFID II enables us to apply requirements that go beyond the scope of MiFID II in the area of investor protection where they can be shown to be justified and proportionate. EU Member States must notify such requirements to the European Commission, which then has to make public an opinion on whether it thinks the requirements are justified. We think that the additional risk warning requirements will help to promote investor protection by explaining in simple language the risks of investing in funds that invest in inherently illiquid assets. This will help achieve the investor protection objectives of MiFID II.

# 2 Scope

**2.1** In this chapter, we summarise the feedback received and provide our response on our CP proposals for funds that should be categorised as FIIAs and the definition of 'inherently illiquid assets'.

## Thresholds for classification as a FIIA

**2.2** We proposed to apply many of our remedies to a new category within our Handbook of 'funds investing in inherently illiquid assets'. A fund would be classed as a FIIA in one of two circumstances:

1. NURSs which have disclosed to their investors that they are aiming to invest at least 50% of their scheme property in inherently illiquid assets.
2. NURSs which have invested at least 50% of the value of their scheme property in inherently illiquid assets for at least 3 continuous months in the past 12 months, whether or not they have disclosed their intention to do so.

**2.3** We asked:

**Q1:** ***Is 50% the right threshold to set for a NURS to be classified as a FIIA? If not, please explain where you would set the threshold, and why.***

**Q2:** ***Do you agree that NURSs which have invested at least 50% of their scheme property in illiquid assets for at least 3 continuous months in the last 12 months should be classified as FIIAs, even if this is not their stated investment aim?***

**2.4** There was broad industry opposition to the proposal to create a new fund category. This was mainly on the grounds that retail consumers already have a significant number of acronyms to navigate and there was concern that this particular category would not be easily understood. Respondents expressed a preference for greater disclosure in fund documentation. They felt that this alternative would mitigate the risk of managers running their fund slightly below the threshold to avoid being categorised as a FIIA.

**2.5** Respondents raised specific concerns about the category threshold. Some respondents deemed the proportion of illiquid assets that constitute a FIIA (50%) to be too low and inconsistent with other relevant thresholds, for example, the 60% minimum for a fund to be categorised for tax purposes as a Property Authorised Investment Fund (PAIF).

**2.6** Many respondents disagreed with the application of the FIIA classification to NURSs which have invested at least 50% of their scheme property in illiquid assets for at least 3 continuous months in the past 12 months, even if this is not their stated investment aim. Some stated that this would lead to certain funds dropping in and out of the classification, which could result in confusion for investors. Others repeated their preference for additional disclosures instead of a numerical threshold. A small number of respondents suggested that the threshold could result in the 'fire sale' of assets as funds approach the threshold.

### Our response

As set out in Chapter 5 of this PS, the requirement for FIIAs to include the identifier 'a fund investing in inherently illiquid assets' within their name no longer forms part of the final rules. Given this change, the identifier will not be in consumer-facing literature and respondents' concern that retail investors would not understand the term falls away.

We continue to think that the 50% threshold sets an appropriate line between mixed funds, that are likely to hold substantially fewer inherently illiquid assets, and specialist funds, that will almost certainly hold more. The 50% threshold has the effect of capturing all funds that invest 'mainly' in inherently illiquid assets. We see no need to align the rules with the 60% threshold for PAIFs. The latter threshold has been defined for tax purposes. The 60% threshold is calculated in a different manner from the 50% threshold and is one of a number of conditions to be met under the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) (as amended). Further, the FIIA categorisation will include NURSs investing in all types of inherently illiquid assets, not just real estate.

We also continue to think that NURSs which have invested at least 50% of the value of their scheme property in inherently illiquid assets for at least 3 continuous months in the past 12 months, whether or not they have disclosed their intention to do so, should be classed as FIIAs. We think that 3 months is sufficient time for funds approaching the 50% threshold to sell illiquid assets if they do not wish to be classified as a FIIA. This should avoid funds dropping in and out of classification as a FIIA.

## Limited redemption arrangements

2.7 We proposed that NURSs that apply limited redemption arrangements should be excluded from the new requirements that we propose to apply to FIIAs. We also proposed to exclude such funds from the definition of a FIIA.

2.8 We asked:

**Q3:** ***Do you agree that a NURS that applies limited redemption arrangements that reflect the typical time taken to liquidate assets should be excluded from the definition of a FIIA?***

2.9 Many industry respondents objected to the exclusion of NURSs that apply limited redemption arrangements from the definition of a FIIA. They argued that the dealing cycle had no impact on the market liquidity of the asset portfolio, and that this distinction would not be clear to investors when comparing similar products. They contended that the application of the category should be governed exclusively by the proportion of illiquid assets in the fund.

### Our response

It remains our view that reduced dealing frequency helps to mitigate the liquidity mismatch in these funds. If a NURS applies limited redemption arrangements that reflect the typical time needed to dispose of its assets, the fund will be less exposed to liquidity issues at times of market turbulence than is the case for funds that deal more frequently. The additional measures associated with classification as a FIIA (ie enhanced disclosure and liquidity management) are not necessary for funds which already have limited redemption arrangements. This is because they have already taken steps to mitigate the liquidity mismatch that poses a risk to investors.

The inclusion of this exemption for funds that tackle the liquidity mismatch through reduced dealing frequency is in line with IOSCO's February 2018 recommendations on liquidity management in open-ended funds. These include a recommendation that, in setting the dealing arrangements during the fund design process, fund managers should consider the liquidity of the underlying assets.

## Feeder funds, multi-asset funds and funds of funds

**2.10** In the CP, we proposed a definition of inherently illiquid assets. The definition included units in other FIIAs and in any QISs or unregulated schemes that have substantially similar features to a FIIA. This meant that some feeder funds, multi asset funds or funds of funds would meet the proposed definition of a FIIA, due to their holdings in other funds.

**2.11** We asked:

**Q4:** ***Do you agree that feeder funds, multi asset funds and funds of funds with at least 50% of their scheme property invested in FIIAs, other similar funds and/or other inherently illiquid assets, should also be classified as FIIAs?***

**2.12** Respondents broadly supported this proposal. They said that funds with comparable indirect exposure to illiquid assets should be subject to the same requirements as funds investing directly. A small number of respondents raised the point that funds of funds that invest in FIIAs should be assessed on a look-through basis (ie having regard for the individual assets in which the FIIAs are invested), although most respondents did not share this view.

### Our response

We agree with the majority of responses received and are continuing with our original proposal. We agree with most respondents that funds that invest in FIIAs should not need to make assessments of the underlying assets on a look-through basis for reasons set out under our response to Q10.

## Defining inherently illiquid assets

2.13 We proposed a definition of 'inherently illiquid assets' within the FCA glossary, in summary:

- an immovable
- an investment in an infrastructure project
- a transferable security that is not a readily realisable security
- any other security or asset that is not listed or traded on an eligible market and has particular features that make the process of buying or selling difficult or timeconsuming
- a unit in a FIIA or another fund with substantially similar features

2.14 We asked:

**Q5:** ***Do the proposed new rule and guidance adequately define existing and potential future assets that are inherently illiquid?***

2.15 Many respondents were comfortable with the definition of illiquid assets and the examples given. However, a large number stated that the list should not be considered exhaustive or prescriptive given market conditions and liquidity can change over time.

### Our response

We agree with respondents that there are other assets which may become illiquid due to certain market conditions. However, the definition seeks to cover only those assets which are inherently illiquid.[1] We are keeping the definition substantially the same as originally drafted, albeit with a small amendment to address a potential inconsistency between paragraphs (3) and (4) as consulted upon, so that both are now linked to the concept of investments that are listed or traded on 'eligible markets'.

There are some illiquid securities and assets that would not be caught by this definition, for example a security that is listed on an EEA exchange but cannot readily be traded because in practice there is no market for that security. Managers of NURSs that do not fall within the definition of a FIIA but which invest in assets of this type should ensure they have properly disclosed the liquidity risk of the fund's portfolio to current and prospective investors.

We will be giving further consideration to the definition of liquid and illiquid assets in respect of a range of fund types – as set out in paragraph 7.14. As part of that review, we will consider the most appropriate rules and guidance around those listed securities that are less liquid in practice because there is not also an active market in the securities.

1 We note that an asset that does not meet the criteria of an inherently illiquid asset is not by definition liquid.

## Types of funds to which our proposals apply

2.16 We proposed that our package of remedies would apply to NURSs, particularly those which invest substantially in illiquid assets, as these funds may be promoted to the general public. We proposed not to extend our remedies to QISs as investors in these funds are generally prepared to accept a higher degree of risk in their investments. They also generally have greater knowledge and experience than retail investors.

2.17 We asked:

> **Q6:** ***Do you agree that the potential harm we are trying to address lies mainly in NURSs and the remedies should be limited in scope to NURSs? Is there a case for extending some of our proposed remedies to QISs? If so, which measures do you think should also apply to QISs investing in inherently illiquid assets?***

2.18 A number of respondents agreed with our proposal as they thought that more experienced investors are sufficiently knowledgeable to understand the implications of investing in funds that invest in illiquid assets. A minority of responses suggested that all funds investing in illiquid assets should be covered by the remedies. They argued that the underlying portfolio (rather than the regulatory structure) is the driver for harm. Another respondent suggested that, if the remedies only applied to NURSs, consumers might perceive NURSs as more risky than other structures that invest in illiquid assets.

### Our response

We are proceeding with our initial proposal that the FIIA classification will only apply to NURSs. It remains our assessment that investors in QISs should be sufficiently knowledgeable not to require the additional disclosures that will be applied to FIIAs. We do not think there is sufficient reason to extend the new FIIA requirements to funds with more knowledgeable investors, who do not necessarily need the remedies that FIIA classification brings. As set out in Chapter 7, however, we are giving further consideration to additional safeguards that might be applied in respect of other fund types.

# 3 Suspension

3.1 In this chapter, we summarise the feedback received and provide our response on our CP proposals for mandatory suspension of dealing in extreme market conditions.

## Mandatory suspensions due to material uncertainty

3.2 As explained in CP18/27, open-ended funds must be priced correctly to ensure that investors are treated fairly and can have confidence in the product. If there is material uncertainty about the valuation of a significant proportion of the assets in an open-ended fund, there is potential for investors to be treated unfairly. The uncertainty in the value of the underlying assets may mean an investor exiting the fund receives a unit price significantly lower or higher than its underlying value. Those investors who remain invested in the fund might then see the value of their investments go up or down once the underlying value of the assets in the fund becomes clearer.

3.3 We proposed to introduce a new rule in COLL 7.2, that would require an AFM temporarily to suspend dealing in units of a NURS where the SIV has expressed material uncertainty about the value of immovables that account for at least 20% of the scheme property.

3.4 We asked:

**Q7:** ***Do you agree that mandating suspension in these circumstances would be in the best interest of investors?***

**Q8:** ***Do you agree that 20% of the scheme property is the right level at which to set the threshold for mandatory suspension? If not, please explain why a higher or lower threshold would be preferable.***

3.5 A small number of respondents agreed with this proposal. One suggested that mandatory suspension should apply where there was uncertainty about the value of other assets, not just immovables. However, overall there was strong opposition, not only from fund managers but from valuers. They were uneasy at the idea that their assessment of material uncertainty could become the trigger for automatic suspension.

3.6 The main arguments against the proposal were that the RICS Red Book did not define material uncertainty sufficiently clearly for the concept to be used as a basis for mandatory suspension. Additionally, respondents argued that fund managers were in a better position than SIVs to judge, based on all the facts, whether to suspend dealing in a fund at any particular time. Respondents made a number of other points:

- Mandatory suspension would lead to more frequent and unnecessary suspensions, potentially increasing systemic risks and driving investors out of open-ended funds.
- It would lock in customers who needed to sell units urgently.

- The resumption of dealing after a mandatory suspension risked triggering a run on some funds, possibly leading to a liquidity crisis where liquidity had not previously been an issue.
- There would be operational challenges, for example for intermediaries running model portfolios.
- The events following the EU referendum in 2016 showed that the current arrangements for liquidity management, including suspension, worked well and did not need to be changed.

**3.7** The proposal for a 20% threshold also received substantial negative feedback. Many respondents argued either that the figure should be higher, or that there should not be an automatic trigger for suspension at any particular threshold.

### Our response

We acknowledge the substantial resistance to the idea of applying a blanket suspension requirement under conditions of material uncertainty. We note the feedback that our proposal could shift the balance in the relationship between the fund manager and SIV in a way that might not be helpful, for example, if it led to valuers being unwilling to state that there was material uncertainty because of the potential consequences for the fund. We recognise that there might be some limited circumstances in which it could be in investors' interests for the fund to remain open, despite the existence of material uncertainty around the value of immovables. Our proposals as originally drafted would remove any discretion for fund managers not to suspend in those circumstances.

However, we continue to believe that we need to address the potential harm to investors from funds remaining open for dealing during market conditions in which the value of underlying assets, and hence the unit price, cannot be determined with a sufficient degree of confidence. In these circumstances, there is a risk that either those redeeming units or those remaining invested will be disadvantaged, depending on the unit price the fund manager sets. For example, a unit price that overstates the value of the underlying assets will mean that investors redeeming units will receive more cash than they should, at the expense of the remaining unitholders. The opposite applies where the unit price understates the value of the underlying assets.

So, we are proceeding with our original proposal, but introducing an amendment in the light of the feedback from the consultation exercise. Where material uncertainty applies to the value of immovables that constitute more than 20% of the scheme property, our rules will still require that a fund manager suspend dealing in a fund. However, a fund manager may continue to deal if they have a reasonable basis for determining that it is not in the best interests of investors to suspend. In these circumstances, the depositary must give agreement. The decision to continue dealing would need to be taken as soon as possible and in any event by the end of the second business day after the day on which material uncertainty applies to at least 20% of the scheme property.

This amendment will ensure that the fund manager has the opportunity to make a case for continuing to trade during a period of material uncertainty. However, we expect the circumstances in which it would be appropriate to do so would be limited. We would expect the fund manager to reach a decision on whether to suspend – and, in case of choosing to continue dealing, to obtain the depositary's agreement – quickly. This will minimise the risk of units being bought and sold at the wrong price. We will also require the fund manager to review any decision not to suspend during a period of material uncertainty at least every 2 weeks.

We are including a rule on the use of this discretion that makes it clear that setting a fair value price alone does not constitute a reasonable basis for keeping a fund open, because this adjustment does not address the uncertainty around the value of the assets which is where the potential for harm to consumers arises.

Open-ended funds which invest in illiquid assets but offer daily dealing need to be clear how they will protect remaining investors in the fund in the event of redemption requests which exceed the fund's ability to liquidate underlying assets at the value which would be expected in normal market conditions, or at times when they cannot establish a fair value for the fund's assets. This means suspension may be necessary in extreme market conditions. Failing to suspend when this is necessary to protect investors, or failing to explain clearly and effectively to investors the possibility of suspension, is likely to lead to poor consumer outcomes. Existing rules already require the prospectus to set out the circumstances in which redemptions in an authorised fund may be suspended. The risks of suspension can be reduced by better aligning redemption terms with the liquidity of assets – for example by avoiding offering daily dealing where this may not be sustainable without loss of value. If daily trading is considered important, another way of avoiding suspension risk is through choosing alternative – for example closed-ended – fund structures.

## Funds with indirect exposure to immovables

**3.8** We proposed to apply the mandatory suspension provision to funds with significant indirect exposure to immovables, such as multi-asset funds holding units in property funds, or feeder funds of property alternative investment funds (PAIFs).

**3.9** We asked:

**Q9:** ***Do you agree that 20% of the scheme property is the right level at which to set the threshold for mandatory suspension of funds investing indirectly in immovables? If not, please explain why a higher or lower threshold would be preferable.***

**Q10:** ***Do you agree that the threshold for suspension for a fund investing indirectly in immovables should not be calculated on a look through basis? If not, please explain how a calculation on a look through basis would work in practice.***

**3.10** There was significant opposition to the application of mandatory suspension to funds with indirect exposure to immovables, mainly for the same reasons given against suspending funds with direct holdings of immovables.

**3.11** A number of respondents agreed that applying the mandatory suspension proposal to funds with indirect exposure to immovables was straightforward, but trying to do so on a 'look-through' basis would pose significant difficulties. Others pointed out that our approach could lead to a fund having to suspend where it was only 4% exposed to assets, the value of which was subject to material uncertainty. Specifically, if that fund invested 20% of its assets in funds that were themselves suspended because the value of 20% of their scheme property was subject to material uncertainty. The respondents suggested that we should try to find some way of applying the rule on a look-through basis, for example, by requiring fund managers to publish the proportion of each of their funds that was subject to material uncertainty.

**Our response**

In the absence of any persuasive arguments in favour of an alternative approach, our final rules will apply mandatory suspension to funds with indirect holdings in immovables on the basis on which we consulted, and not on a look-through basis. Suspension on a look-through basis would require co-ordination between fund managers. This would take time during a period of potentially fast-moving markets and undermine the policy intention of avoiding the risk that investors are treated unfairly. The possibility of funds with as little as 4% exposure to immovables having to suspend is mitigated in appropriate circumstances by fund managers using the discretion that we are introducing to allow them to continue to deal, where suspension would not be in the interests of investors. In this case, fund managers could agree with the depositary that the material uncertainty affecting the value of a small part of the scheme property did not create an unacceptable margin of error around the unit price of the fund. So the fund should remain open.

## Role of depositary in suspensions

**3.12** We proposed that fund managers should not need to gain the depositary's consent, but simply to inform the depositary, in the case of a mandatory suspension due to material uncertainty. However, we proposed that the depositary's consent should be required to resume dealing following the lifting of a mandatory suspension.

**3.13** We asked:

**Q11:** ***Do you agree that fund managers should not need to gain the depositary's consent, but should simply notify the depositary before suspending?***

**Q12:** ***Do you agree that fund managers should be required to resume dealing in units in a fund, with the approval of the depositary, as soon as reasonably practicable after the material uncertainty assessment applies to less than 20% of the scheme property?***

**3.14** Most respondents agreed that, if we proceeded with our mandatory suspension proposal, a requirement to gain the depositary's consent would make little sense. However, some insisted that both the fund manager and the depositary should have to agree to suspensions under all circumstances, reiterating their opposition to mandatory suspension in general.

**3.15** Most respondents commenting on this point agreed that depositaries should have to agree to the resumption of dealing, following a mandatory suspension. However, a number stressed that fund managers should not be required to resume dealing straight away. For example, in case redemption demand had built up during the period of suspension and there was a need to rebuild cash buffers to be able to meet redemption requests and avoid the fund having to suspend again soon after resuming dealing. They asked for guidance on the meaning of the phrase 'as soon as reasonably practicable'.

### Our response

We are introducing the possibility for the fund manager to continue dealing in a fund, despite the existence of material uncertainty. However, we assume suspension will generally be the appropriate course of action in these circumstances. For the suspension to take place as quickly as possible, and in any event, within 2 business days of a fund being subject to material uncertainty, the fund manager will not need the depositary's agreement to suspend. However, if the fund manager wishes to continue dealing, we believe that, to ensure that this is in investors' interests, the depositary's consent should be required. Where the depositary disagrees with the fund manager's judgment, or fails to agree within the time limit, dealing in the fund must be suspended.

Regarding the timing of the resumption of dealing, we intended to align the requirement to seek depositary agreement to the resumption of trading following a mandatory suspension with the general requirement that exists following suspension. The wording 'as soon as practicable' is already contained in COLL 7.2R (4). It can be sufficiently broadly interpreted to allow a fund manager discretion, for example, to keep a fund closed for long enough to rebuild the liquidity position before commencing dealing again. In this way, the fund manager can ensure that the fund has enough cash to meet any anticipated redemption demands, to avoid having to suspend dealing again a short time after reopening.

# 4 Liquidity management

4.1 In this chapter, we summarise the feedback received and provide our response on our CP proposals for liquidity management. As described in DP17/1, sound liquidity management is an essential part of operating a collective investment scheme successfully. AIFMD prescribes detailed rules for liquidity management, although the assets of an AIF do not have to be inherently liquid. The UCITS Directive is less prescriptive about how the fund manager should carry out liquidity management, as the scheme's assets should (with limited exceptions) already be liquid to be eligible for investment. Sound liquidity management ensures that investors are treated fairly by enabling them to redeem their investments as expected and with certainty about the amount due to them.

## Liquidity contingency plans

4.2 Our rules currently require fund managers to have liquidity management systems and procedures, and to identify when these tools and arrangements may be used in both normal and exceptional circumstances. Our supervisory work in 2016 revealed shortcomings in some fund managers' contingency planning. To address this, we proposed to introduce a new rule in COLL 6.6.3CR to require managers of FIIAs to draw up and maintain contingency plans for exceptional circumstances with regards to their liquidity management.

4.3 The proposed contingency plans would:

- Describe how the fund manager will respond to a liquidity risk crystallising.
- Set out the range of liquidity tools and arrangements which they may deploy in such exceptional circumstances, any operational challenges associated with the use of such tools and the consequences for investors.
- Include communication arrangements for internal and external concerned parties and explain how the fund manager will work with the depositary, intermediate unitholders, third party administrators and others as necessary to implement the contingency plan.

4.4 We also proposed a specific requirement on FIIA managers in COLL 6.6.3ER to gain written confirmation from any third party, on which they rely to deliver the contingency plan, that they are able to place this reliance on them.

4.5 We asked:

**Q13:** ***Do you agree with our proposal to require contingency plans?***

**Q14:** ***Are there other elements of FIIA managers' approach to managing liquidity risk that need to be included in the contingency plan?***

**Q15:** ***Do you agree that the written agreement that we propose to require FIIA managers to obtain is the best way to ensure that fund managers can be confident that third parties will be able to play their part in implementing the contingency plan? If not, how do you think that we can gain this confidence?***

**4.6** A clear majority of respondents agreed that fund managers should have contingency plans for the liquidity management of FIIAs. No respondent wholly disagreed with these proposals. Some respondents believed that fund managers should already have such plans encapsulated in their liquidity and fair value pricing (FVP) policies, and so there was no need to require this to be documented separately.

**4.7** A limited number of respondents disagreed with a requirement for a written agreement to be put in place between fund managers and third parties on which they rely to deliver the contingency plan. One respondent commented that written agreements should only be required for third parties whose impact on the implementation of contingency plans was material.

### Our response

Given the positive feedback, we will include a requirement for FIIA managers to have contingency plans, and disclose these in each fund's prospectus, with an additional requirement to have relevant agreements with third parties in place. These requirements are additional to existing rules requiring the prospectus of an authorised fund to disclose the circumstances in which redemptions of units may be suspended.

While some fund managers may already comply with the new rules, we believe that providing clarity on how the current obligations may be fulfilled is helpful. Compliance with the proposed COLL 6.6.3CR may enable an authorised fund manager of a FIIA to meet some of its obligations under article 47(1)(e) of the AIFMD level 2 regulation.

We think that if fund managers distribute a significant number of units in FIIAs through platforms, those platforms must be able to implement contingency plans if and when needed. We remind fund managers that they should distribute their funds in a manner which allows them to implement their contingency plans when necessary.

Our new rules require fund managers to implement and maintain an 'adequate' liquidity management contingency plan for exceptional circumstances. The manager must also have written confirmation from any 'relevant' third parties identified in their contingency plans. This should address concerns raised about fund managers needing written agreements from third parties whose impact on the implementation of contingency plans would be immaterial.

In our rules, we have tried to strike an appropriate balance between providing a clear framework of requirements for firms, while avoiding being overly prescriptive. This should give firms enough flexibility to ensure the right outcomes for investors depending on the individual circumstances of each fund. We have reviewed the additional suggestions some respondents have put forward in this light. We have decided not to add to the requirements set out in the rules we consulted upon as we do not wish to include rules which might not be appropriate for all funds.

## Rapid sales and use of price reductions

**4.8** If daily dealing funds investing in illiquid assets experience significant redemption demand in a short time period, they might not hold sufficient amounts of cash to meet their obligations to redeeming investors. In these circumstances, rather than suspend dealing, some fund managers may choose to sell assets more quickly than normal, at less than the full open market value of the assets, and to apply a downward adjustment to the unit price of the fund accordingly.

**4.9** Given the impact that this type of adjustment could have on investors, we proposed a rule that would require fund managers wishing to have the option to undertake so-called 'fire sales' during difficult market conditions to disclose this intention to investors in the fund prospectus. We also proposed new guidance that, if a fund manager decides to sell an immovable quickly to meet redemption requests, it should consult and agree with the SIV a fair and reasonable price for the immovable.

**4.10** We asked:

**Q16:** ***Do you think that the proposed new guidance, clarifying the mechanism for reducing the price of an immovable to allow it to be sold more quickly to meet redemption demand, is helpful?***

**Q17:** ***Do you agree that fund managers wanting to use this tool should be required to disclose their intention in the fund prospectus?***

**4.11** A large proportion of respondents agreed with the proposed guidance and rule. Some respondents did raise specific issues about how pricing immovables in rapid sales situations would work in practice. Some were concerned that selling assets at fire sale prices, to meet demands of customers wishing to redeem their investments could negatively affect remaining investors.

**4.12** RICS have recommended deletion of the proposed (7B)(b) under COLL 6.3.6G(1). This provides for setting out a methodology with the standing independent valuer that establishes agreed guidelines for a rapid sale valuation, for example, applying a sliding scale of discounts that reflects the speed at which an immovable must be sold. RICS have submitted that there is no recognised methodology that would be capable of universal application. In particular, for immovables, there is generally no direct relationship between the timescale for a sale and the price that might be achieved, so the adoption of a 'sliding scale' is unlikely to be possible.

**4.13** RICS have also suggested replacing the reference to 'value' with 'price' in our proposed COLL 6.3.6G which reads that fund managers should 'consult and agree with the standing independent valuer a fair and reasonable value for the immovable to reflect a rapid sale'. This is because the price achieved in such a rapid sale may be less than it otherwise would. The proposed amendment would emphasise the difference between a valuation in line with our current rules and advice from the SIV on the price that might be achieved in a rapid sale, within the particular parameters set by the AFM.

**Our response**

We acknowledge that there may be difficulties in implementing a liquidity management tool which enables fund managers to sell immovables at a rapid pace when funds experience high levels of redemptions. However, we do not consider it is in the interests of investors to preclude fund managers from developing and implementing liquidity management tools, if they disclose this to investors and can do so in an appropriate manner. The requirement to consult the SIV will ensure that there is external input from a qualified professional into the price-setting process, when property is marketed to achieve a quick sale. This should mitigate some of the concerns about the impact of this tool on the interests of investors.

We intend to take the guidance and rule forward while adjusting it to reflect the points RICS raised. We will do this by replacing the reference to value with price. We are also removing the guidance in COLL 6.3.6.G(1)(7B)(b).

The proposed guidance together with mandatory disclosure should provide fund managers with the ability to develop a broader spectrum of liquidity management tools. It should also provide investors, and their advisors, with more options when considering which liquidity management style is most suitable for their individual needs.

## Accumulation of large liquidity buffers and use of cash to meet redemptions

**4.14** We proposed to clarify COLL 5.5.3R by introducing a guidance provision applying to NURSs and UCITS funds. This would have been to the effect that cash, and cash-like investments, retained in funds should not be accumulated or held for a significant duration in anticipation of unusually high and unpredictable volumes of redemption requests.

**4.15** The rationale behind this proposal was to ensure that fund managers meet investors' expectations. Large cash positions create a drag on yield, diminishing the fund's performance. This may disappoint investors, who expected to be more fully exposed to the risks and rewards associated with a particular asset class. The proposal also aimed to reduce a perceived first mover advantage in seeking to redeem units in FIIAs. This is where investors are incentivised to redeem before other investors, if they fear that the fund will suspend when cash levels are depleted and believe other investors might redeem soon.

**4.16** As we have noted elsewhere in this PS, there may be circumstances where suspension is in the best interests of investors. For example, where redemption demands cannot be met without significantly depleting the fund's liquidity and/or without selling off scheme property at a substantial discount. So, we proposed modifying our suspension guidance in COLL 7.2.2 to better reflect that FIIAs mainly hold illiquid assets such as real estate.

**4.17** We asked:

> **Q18:** ***Do you agree the proposed guidance would discourage the speculative accumulation of large liquidity buffers and help to reduce first mover advantage in funds investing in inherently illiquid assets? If not, is there a more appropriate way to achieve this?***
>
> **Q19:** ***Do you agree with the proposed guidance on the use of suspensions for funds investing in inherently illiquid assets? If not, how, if at all, do you think the existing guidance at COLL 7.2.2G should be amended in respect of FIIAs?***

**4.18** There was significant opposition to providing guidance on liquidity buffers and a large number of respondents believed that our proposition could be counterproductive to managing liquidity in FIIAs. Only a few respondents found the proposed guidance helpful.

**4.19** Generally, respondents did not see a need to modify our COLL sourcebook in this area. Respondents questioned whether guidance to this effect would remove any first mover advantage. Some believed the guidance could increase the incentive to redeem quickly, if funds were to hold less cash. Fund managers were particularly sceptical about how reducing their discretion to hold appropriate levels of cash would be helpful. They were concerned that a 'one-size fits all' approach might not work for all funds.

**4.20** Respondents were broadly positive about introducing guidance on the use of FIIA suspensions given the different nature of the liquidity of assets these funds hold compared with other authorised open-ended funds. Some fund managers thought the proposed guidance would be helpful in removing the stigma surrounding fund suspensions.

### Our response

We have decided not to take the proposal on limiting cash buffers forward. There was clear opposition to the proposed guidance on liquidity buffers and concerns about whether the guidance would be ineffective or even counter-productive. While cash levels do have an impact on a fund's performance, investors can acquire information on different funds' cash policies and holdings. This provides them with a choice as to which level of cash is optimal for their needs. Where a fund with illiquid assets needs to prepare for a large expected redemption, it may be necessary to accumulate cash in preparation, selling assets at the point of time when a favourable price can be achieved. Further, we consider that our rules governing suspension in the event of material uncertainty would reduce the incentive for fund managers to hold large amounts of cash where this is not the best way of protecting investors' interests. This is because holding cash would not enable a fund to continue dealing in uncertain market conditions, unless the authorised fund manager and depositary agreed that it was not in the best interests of investors to suspend. Where only a minority of investors want immediate liquidity, holding a large cash buffer to meet the needs of this minority is unlikely to be in the best interest of investors as a whole.

We will be implementing the additional guidance relating to suspensions in FIIAs, as we think our current guidance on suspensions, while appropriate for the vast majority of authorised funds, does not work well for FIIAs.

## Depositary oversight of liquidity management

**4.21** Authorised funds' depositaries are required to provide cash flow monitoring, oversight duties and safekeeping or verification of assets. But our rules do not prescribe their responsibilities in detail for ensuring that fund managers have robust systems in place to manage liquidity risk or monitor the liquidity profile of funds. So, we proposed new rules in COLL 6.6.4BR and 6.6.4CR (and amendments to the guidance in COLL 6.6.11G) to require depositaries of FIIAs to assess regularly the liquidity profile and liquidity risks presented by the fund's scheme property. In addition, we proposed to require depositaries to devise procedures for overseeing the liquidity management by the fund manager.

**4.22** We asked:

**Q20:** ***Do you agree that it is appropriate to extend depositaries' duties to include oversight of FIIAs' liquidity management processes?***

**Q21:** ***Do the proposed requirements cover all the aspects of liquidity management prescribed by the current framework of rules, that depositaries should oversee?***

4.23 Most respondents commenting on this point agreed that we should issue rules giving depositaries the duty to provide oversight of FIIAs' liquidity risk management processes. Some respondents warned against rules becoming overly prescriptive, and found the current rules sufficient.

## Our response

We have decided to be more explicit about our expectations of depositaries and, given the feedback, will take these proposals forward. We see an appropriate level of depositary oversight of fund managers' liquidity risk management processes in FIIAs, with clearly defined responsibilities, as one of the key remedies we consulted on. In our review of property funds and liquidity risks, following the fund suspensions in 2016, we found that the quality of liquidity monitoring and management varied between different property funds. We also found that depositaries appeared to provide an effective, independent check of fund managers' adherence to the COLL sourcebook under normal market conditions. However, they did not appear to have considered fully how they should fulfil their responsibilities under stressed market conditions. Our proposals aim to ensure appropriate liquidity risk management across managers of FIIAs and more consistency in depositaries' oversight practices.

# 5 Disclosure

**5.1** As mentioned in CP18/27, open-ended funds that invest in illiquid assets, but offer the opportunity to redeem frequently, often daily, represent a risk to retail investors under extreme market conditions that other funds, investing in more liquid assets, do not. Although the occasions when these liquidity risks may crystallise are rare and unpredictable, we consider it important that investors are aware of these risks. As a way of decreasing the likelihood that retail clients invest in funds unsuitable for their individual financial circumstances, we believe that improved disclosures are necessary.

**5.2** In this chapter, we summarise the feedback and provide our response on our CP proposals for increased disclosure.

## Addition of an identifier to fund names

**5.3** We proposed to introduce a new rule that would require a manager of a FIIA to add '- a fund investing in inherently illiquid assets' to the final part of the name of the fund in certain financial promotions.

**5.4** We asked:

> **Q22:** ***Do you agree that using an identifier would effectively highlight that FIIAs are fundamentally different in regard to liquidity from other authorised funds?***

**5.5** Many respondents felt the proposed identifier contained jargon and would not be easily understood by retail investors. They also argued the fund name was not the appropriate place for a risk warning. Some added that the identifier drew specific attention to liquidity risk, which could wrongly suggest funds with significant exposure to other risks, such as market or credit risk, were relatively safer. There were additional concerns that the identifier was too long. This could lead to operational difficulties associated with listing the funds on platforms, causing the identifier to become truncated to an acronym.

### Our response

We are not taking this proposal forward. We agree with some of the feedback, in particular that the identifier might not be easily understood by some retail investors, that it draws attention to one risk over others, and that the fund name is not necessarily the appropriate place for a risk warning. We think the prescribed risk warning and other disclosure requirements included in this PS are a more appropriate way to address the harm.

Removing the identifier from the fund name significantly reduces the concern that consumers would not understand the term, be inappropriately directed to one particular risk or conclude that liquidity risk existed only in this particular type of NURS. However, we think it necessary for a new fund category (as discussed in Chapter 2) to be introduced as a defined term within the Handbook. This will identify which funds will be subject to many of our new requirements, including additional disclosure requirements on liquidity risk.

## Standard risk warning

**5.6** We proposed to introduce new rules requiring the following risk warning to be given in financial promotions to retail clients: '[Name of fund] invests in inherently illiquid assets. This means that at certain times you may experience a significant delay and/or need to accept a discount when selling your investments. See the key information document and fund prospectus for more information.'

**5.7** We asked:

> **Q23:** ***Do you agree that the risk warning would contribute to better understanding of the risks by investors in FIIAs?***

**5.8** Respondents were broadly in favour of the introduction of a standard risk warning.

**5.9** A considerable number of respondents said that although they agreed with the additional disclosure, they thought that the wording could be improved to make it easier for retail consumers to understand. In particular, they highlighted that the phrase 'inherently illiquid' is unlikely to be understood and that 'discount' may have positive associations for some consumers.

**5.10** One respondent agreed with the introduction of a risk warning but commented that the proposed wording was unduly alarming. Others commented that, while liquidity risk is important, it shouldn't distract from other risks that can affect the capital value of investments. It was also commented that the wording should reflect that the circumstances in which an investor would face a delay in redeeming their investment are not a frequent occurrence.

### Our response

We are continuing with the proposal to introduce a standard risk warning. However, we acknowledge and agree with the comments that the wording could be improved to ensure it is clearly understood by retail investors, is not unduly alarming and does not highlight liquidity risk as necessarily being the most important risk an investor will face.

Our rules will say that FIIAs will need to include the following risk warning in certain financial promotions to retail clients: '[Name of fund] invests in assets that may at times be hard to sell. This means that there may be occasions when you experience a delay or receive less than you might otherwise expect when selling your investment. For more information on risks see the prospectus and key investor information document.'

We think that this updated wording takes account of the concerns raised by respondents while adequately disclosing the risks to consumers.

In some cases, the new standard risk warning will need to be used by firms in the course of their MiFID business. In line with MiFID and subject to the UK remaining subject to its provisions, we will notify the European Commission of this additional requirement (see Chapter 1 for more information).

## Disclosures in the prospectus

**5.11** We proposed to introduce a requirement for a FIIA's prospectus to disclose how the fund manager will manage the fund where liquidity issues arise. These are additional to existing rules requiring the prospectus to set out the circumstances in which the redemption of units in an authorised fund may be suspended. We aimed to help retail investors choose a product right for their needs, to help avoid a situation where a fund is managed differently from how investors expected and to help market participants and investors to understand why similar funds may be managed differently in response to the same market events. We proposed that the prospectus should include:

- an explanation of the risks associated with the scheme investing in inherently illiquid assets and how these might crystallise
- a description of the tools and arrangements the authorised fund manager would propose to use, including those that FCA rules require them to use to mitigate the risks referred to in the first bullet point
- details of the circumstances in which these tools and arrangements would typically be deployed and the likely consequences for investors

**5.12** We asked:

> **Q24:** ***Do you think that our proposals relating to the prospectus are sufficient to provide investors and professionals who act on their behalf with sufficient information about liquidity risk management in FIIAs? If not, what additional information should be disclosed? And where and how would disclosure be most efficient?***

**5.13** Most respondents agreed with our proposals. However, a number commented that the list of tools disclosed in the prospectus should not be presented as exhaustive, nor should they restrict the fund manager to a certain course of action.

### Our response

We are retaining the rules as originally drafted. We agree with the feedback and do not want fund managers to be tied into a course of action that may not, due to unforeseen future circumstances, be in the best interests of investors. However, we consider that the rules, as drafted, would not force a fund manager to take a particular course of action. Rather, they require a 'description of the tools and arrangements the authorised fund manager would **propose** using' [our emphasis].

# 6 Next steps

**6.1** We proposed that our new requirements would come into force a year after the final rules had been made.

**6.2** We asked:

> **Q25:** ***Do you agree that our new requirements should come into force a year after we make our final rules? Are there any parts of the instrument that should take effect earlier?***

**6.3** The majority of respondents were content with the proposed timescales for introduction of the new requirements. However, a number commented that 18 months may be more appropriate for the rules requiring updates to documents.

**6.4** One respondent commented that more time should be given for industry bodies and firms to do further work on 'material uncertainty'.

**Our response**

Our new rules will come into force on 30 September 2020. Most respondents agreed with our suggested timescales and we think that 12 months should be a sufficient amount of time to comply with the new rules.

Fund managers and depositaries may wish to consider whether it would be in customers' interests to adopt some of the measures, such as increased disclosure and improved liquidity management, ahead of the coming into force date, where these do not conflict with the rules applicable until that date.

# 7 Further considerations on open-ended funds investing in illiquid assets

**7.1** In June 2019, after the consultation described in this PS closed, the LF Woodford Equity Income Fund (the WEIF), an open-ended UCITS fund, suspended.

**7.2** While the proposals for new rules set out in CP18/27 and this PS are focused on NURSs, the WEIF suspension shows that similar issues can also arise with a UCITS fund if it invests in less liquid assets.

**7.3** So we delayed publishing this PS, originally due in Q2 2019, while we considered potential read across from and to the WEIF suspension.

**7.4** The WEIF suspension shows that liquidity considerations are not confined to those open-ended funds with exposure to property or other immovables. Liquidity issues can extend to other open-ended funds, including UCITS, where they have holdings of less liquid assets, even including investments in listed equities if there is not a liquid market in those equities. Similarly, some bonds may be listed without there being a liquid market for those securities.

**7.5** The WEIF events also indicated that many retail investors were not aware of, or did not appear to understand, the liquidity risk to which they were exposed and the impact this risk might have on their ability to realise their investments on demand.

**7.6** We consider that suspension of dealing remains an important tool for protecting investors in open-ended funds from material loss of value in extreme market conditions. It helps to avoid fire sale of assets to the detriment of investors and also ensures that investors are treated equally.

**7.7** We think an ability to suspend dealing in an open-ended fund in extreme market conditions is preferable to prohibiting open-ended funds from investing in illiquid assets. Such assets tend to offer a higher expected return than more liquid alternatives. An ability to access long-term finance is also important to supporting the wider economy. Preventing open-ended funds from providing such finance could damage prospects of economic growth.

**7.8** However, where open-ended funds invest in less liquid assets, they and their investors need to be clear about the extent of any mismatch between the ability to liquidate assets and redemption terms offered to investors, and how this will be managed. Investors who want exposure to illiquid assets, as well as certainty about their ability to sell on a daily basis, may choose alternative structures – such as closed-ended fund structures – where the need for the fund to sell illiquid assets in extreme market conditions is avoided. Even in this structure, investors selling shares in such funds at times of market stress may not be able to sell at as high a price as could be achieved in more normal market conditions.

**7.9** The events surrounding the suspension of the WEIF highlighted how the ability of a single large investor to redeem, or attempt to redeem, on a single day, a large investment in an open-ended fund can have significant consequences for both that investor and other investors that remain invested within the fund.

**7.10** In addition to issues about arrangements for investors holding a large proportion of a fund investing in illiquid assets, it again raises the question about the appropriateness of an open-ended fund that invests in illiquid or less liquid assets offering daily dealing.

**7.11** UCITS rules require holdings of transferable securities and money-market instruments to be mostly listed or admitted to trading on regulated markets that operate regularly and are open to the public. These rules are intended to place limits on investment in less liquid assets. However, these rules – as implemented in COLL – might not be as effective as they could be in achieving their intent.

**7.12** Some of these issues are essentially the same as those targeted by the remedies set out in this PS for NURSs, such as how to ensure effective investor disclosure and understanding, the need for effective liquidity management and the appropriate use of suspensions.

**7.13** We are therefore considering whether the remedies set out in this PS should apply more widely than NURSs, and also whether we should be exploring a wider range of potential remedies, both for NURSs and for other types of funds. We are working with the Bank of England's Financial Policy Committee to assess how funds' redemption terms might be better aligned with the liquidity of their assets to minimise financial stability risks without compromising the supply of productive finance (see the Financial Stability Report). We also think that an adequate understanding of the liquidity properties of funds investing in illiquid assets is important to protecting investors' interests.

**7.14** We intend to explore, amongst other issues:

- the potential for the use of notice periods and reduced dealing frequency as liquidity management tools for open-ended funds investing in illiquid or less liquid assets, particularly if these funds are offered to retail investors
- liquidity risk stress testing, potentially including quantitative stress limits and the appropriate regulatory implications for those funds that fail these tests. This will take account of the liquidity stress testing guidelines that ESMA has recently produced
- the definition of liquid and illiquid assets held in open-ended funds, including how this is accounted for in the UCITS Directive (as implemented in COLL)
- how funds manage liquidity risk arising from large individual holdings, and whether separate redemption conditions should apply to such investors
- investor understanding of the interaction between liquidity risk and the mutual nature of investments in open-ended funds, including the wider applicability of the remedies set out in this PS such as enhanced investor disclosures and risk warnings
- the role of intermediaries and product distribution channels in determining fund structuring decisions and in providing investors with appropriate risk information
- the importance of alternative product structures in managing the risks associated with illiquid underlying investments, including existing products, such as closed-ended funds, and possible future products such as the proposal from the Investment Association UK Funds Regime Working Group to HM Treasury Asset Management Taskforce to introduce a new 'Long Term Asset Fund'

- other international regulatory regimes relating to fund liquidity and how these might be applied to UK authorised funds

**7.15** If this work results in proposals to change our rules, we will consult on them as part of the usual process. We welcome engagement and comments from stakeholders on these and other potential enhancements as we undertake this work.

# Annex 1
# List of non-confidential respondents

Aberdeen Standard Investments

AEW UK

Association of Investment Companies

AJ Bell

Arca PRM

Association of Real Estate Funds

Aviva Investors

BlackRock

BMO Global Asset Management

Canada Life Investments

CBRE

CBRE Global Investors

CMS Cameron McKenna Nabarro Olswang LLP

Depositary and Trustee Association

Deloitte LLP

Duff & Phelps

Heathstone Investments

The Investment Association

INREV

Integrafin

Investment Property Forum

International Valuation Standards Council

Janus Henderson

Jones Lang LaSalle

Kames Capital

Knight Frank LLP

Legal & General Investment Management

M&G

Nationwide

Partners Group

PML Capital

ReAssure

Redmayne Bentley

Royal Institution of Chartered Surveyors

Royal London Asset Management

Schroders Investment Management

St James's Place

UK BioIndustry Association

UK Shareholders' Association

UK Individual Shareholders Society

Valuology

# Annex 2
# Abbreviations used in this paper

| | |
|---|---|
| **AFM** | Authorised Fund Manager |
| **AIF** | Alternative Investment Fund |
| **AIFMD** | Alternative Investment Fund Managers Directive |
| **AIM** | Alternative Investments Market |
| **CBA** | Cost-benefit analysis |
| **CIS** | Collective Investment Scheme |
| **COBS** | Conduct of Business sourcebook of the FCA Handbook |
| **COLL** | Collective Investment Schemes sourcebook of the FCA Handbook |
| **CP** | Consultation Paper |
| **CRE** | Commercial real estate |
| **DP** | Discussion Paper |
| **EEA** | European Economic Area |
| **EU** | European Union |
| **FCA** | Financial Conduct Authority |
| **FIIA** | Fund investing in inherently illiquid assets |
| **FSB** | Financial Stability Board |
| **FSMA** | Financial Services and Markets Act 2012 |
| **FUND** | Investment Funds sourcebook of the FCA Handbook |
| **FVP** | Fair value pricing |
| **IOSCO** | International Organisation of Securities Commissions |
| **KIID** | Key investor information document |
| **MiFID** | Markets in Financial Instruments Directive |

| | |
|---|---|
| **NAV** | Net asset value |
| **NURS** | Non-UCITS retail scheme |
| **PAIF** | Property authorised investment fund |
| **PRIIPs** | Packaged retail and insurance-based investment products |
| **PS** | Policy Statement |
| **QIS** | Qualified investor scheme |
| **REIT** | Real estate investment trust |
| **RICS** | Royal Institution of Chartered Surveyors |
| **SIPP** | Self-invested personal pension |
| **SIV** | Standing independent valuer |
| **SSAS** | Small self-administered scheme |
| **UCITS** | Undertakings for collective investment in transferable securities |
| **UK** | United Kingdom |
| **WEIF** | LF Woodford Equity Income Fund |

We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 7948 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN

# Appendix 1
# Made rules (legal instrument)

# NON-UCITS RETAIL SCHEMES INVESTING IN ILLIQUID ASSETS INSTRUMENT 2019

## Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions in or under:

(1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (The FCA's general rules);
(b) section 137D (FCA general rules: product intervention);
(c) section 137R (Financial promotion rules);
(d) section 137T (General supplementary powers);
(e) section 139A (Power of the FCA to give guidance);
(f) section 214 (General);
(g) section 247 (Trust scheme rules);
(h) section 248 (Scheme particulars rules);
(i) section 261I (Contractual scheme rules);
(j) section 261J (Contractual scheme particulars rules);

(2) regulation 6(1) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228); and

(3) the other rule and guidance making powers listed in Schedule 4 (Powers exercised) to the General Provisions of the FCA's Handbook.

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

## Commencement

C. This instrument comes into force on 30 September 2020.

## Amendments to the Handbook

D. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below.

| (1) | (2) |
|---|---|
| Glossary of definitions | Annex A |
| Conduct of Business sourcebook (COBS) | Annex B |
| Collective Investment Schemes sourcebook (COLL) | Annex C |

## Citation

E. This instrument may be cited as the Non-UCITS Retail Schemes Investing in Illiquid Assets Instrument 2019.

By order of the Board
26 September 2019

## Annex A

## Amendments to the Glossary of definitions

In this Annex, underlining indicates new text, unless indicated otherwise.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

| | |
|---|---|
| *FIIA* | a *fund investing in inherently illiquid assets.* |
| *fund investing in inherently illiquid assets* | a *non-UCITS retail scheme* which satisfies the conditions in (1), (2) and (3):<br><br>(1) either:<br><br>(a) the investment objectives and policy published in the *instrument constituting the fund* and the *prospectus* aim to invest at least 50% of the value of the *scheme property* in *inherently illiquid assets*; or<br><br>(b) at least 50% of the value of the *scheme property* has been invested in *inherently illiquid assets* for at least three continuous *months* in the last twelve *months*; and<br><br>(2) the *instrument constituting the fund* and the *prospectus* do not provide for *limited redemption arrangements* that reflect the time typically needed to sell, liquidate or close out the *inherently illiquid assets* in which the *non-UCITS retail scheme* invests; and<br><br>(3) the *scheme* is not in the process of winding up or termination. |
| *inherently illiquid asset* | an asset which is:<br><br>(1) an immovable;<br><br>(2) an *investment* in an infrastructure project;<br><br>(3) a *transferable security* (within paragraph (2) of that definition) that is neither:<br><br>(a) a *government and public security* denominated in the currency of the country of its *issuer*;<br><br>(b) a *security* which is listed or traded on an *eligible* market; nor |

(c) a newly issued *security* which can reasonably be expected to fall within (b) when it begins to be traded;

(4) any other *investment* which is not listed or traded on an *eligible* market and satisfies one or more of the following conditions:

(a) sale and purchase transactions are typically negotiated on a one-off basis;

(b) valuation for the purposes of agreeing a sale price is typically complex and may require the seller and/or buyer to obtain specialist advice;

(c) it may take significant time for one party in a proposed transaction to identify another party prior to sale and purchase negotiations commencing;

(d) once negotiations have commenced, transactions typically take significant time to complete;

(5) a *unit* in another *FIIA*;

(6) a *unit* in a *qualified investor scheme* where that *qualified investor scheme*:

(a) would itself meet condition (1) of the definition of a *FIIA* if it were a *non-UCITS retail scheme*;

(b) permits redemptions of *units* on timescales which do not reflect the time typically needed to sell, liquidate or close out the assets in which the *qualified investor scheme* invests, those assets being ones which fall within paragraphs (1) to (5) above or (7) below; and

(c) is not in the process of winding up or termination;

(7) a *unit* in an open-ended *unregulated collective investment scheme* where that *unregulated collective investment scheme*:

(a) aims to invest at least 50% of the value of the property of the *unregulated collective investment scheme* in assets falling within paragraphs (1) to (6) above;

(b) permits redemptions of *units* on timescales which do not reflect the time typically needed to sell, liquidate or close out those assets; and

(c) is not in the process of winding up or termination.

Amend the following definition as shown.

| | |
|---|---|
| *eligible* | (in *COLL* <u>and in the definition of *inherently illiquid asset*</u>) (in relation to a *securities* or a *derivatives* market) a market that satisfies the requirements in *COLL* 5.2.10R (Eligible markets: requirements) in relation to schemes falling under *COLL* 5. |

## Annex B

## Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text.

### 4 Communicating with clients, including financial promotions

…

### 4.5 Communicating with retail clients (non-MiFID provisions)

…

Funds investing in inherently illiquid assets (FIIAs)

| | | | |
|---|---|---|---|
| 4.5.16 | R | (1) | This *rule* applies to any *financial promotion* relating to a *FIIA* except the *FIIA's prospectus*. |
| | | (2) | A *firm* must ensure that the following risk warning is given:<br><br>"[Name of fund] invests in assets that may at times be hard to sell. This means that there may be occasions when you experience a delay or receive less than you might otherwise expect when selling your investment. For more information on risks, see the prospectus and key investor information document." |
| | | (3) | If the *financial promotion* is a *non-real time financial promotion*, a *firm* must ensure that the risk warning is prominently placed in the *financial promotion* in a font size that is at least equal to the predominant font size used throughout the communication. |
| 4.5.17 | G | The *rules* in *COBS* 4.5 do not apply to the form or content of a *NURS-KII document* (see *COBS* 4.1.7AR (Modification relating to the KII Regulation)). | |

…

### 4.5A Communicating with clients (including past, simulated past and future performance) (MiFID provisions)

…

Funds investing in inherently illiquid assets (FIIAs)

| | | | |
|---|---|---|---|
| 4.5A.17 | R | (1) | This *rule* applies to any *financial promotion* relating to a *FIIA* that is addressed to, or disseminated in such a way that it is likely to be received by, a *retail client*, except the *FIIA's prospectus*. |

(2) A *firm* must ensure that the following risk warning is given:

> "[Name of fund] invests in assets that may at times be hard to sell. This means that there may be occasions when you experience a delay or receive less than you might otherwise expect when selling your investment. For more information on risks, see the prospectus and key investor information document."

(3) If the *financial promotion* is a *non-real time financial promotion*, the risk warning must be prominently placed in the *financial promotion* in a font size that is at least equal to the predominant font size used throughout the communication.

4.5A.18 G The *rules* in *COBS* 4.5A do not apply to the form or content of a *NURS-KII document* (see *COBS* 4.1.7AR (Modification relating to the KII Regulation)).

## Annex C

## Amendments to the Collective Investment Schemes sourcebook (COLL)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 4 Investor Relations

…

### 4.2 Pre-sale notifications

…

Table: contents of the prospectus

4.2.5 R This table belongs to *COLL* 4.2.2R (Publishing the prospectus).

| | | | |
|---|---|---|---|
| … | | | |
| **Investment objectives and policy** | | | |
| **3** | The following particulars of the investment objectives and policy of the *authorised fund*: | | |
| | … | | |
| | (pa) | for a *fund investing in inherently illiquid assets* at least the following (see *FUND* 3.2.2R(8) (Prior disclosure of information to investors)): | |
| | | (i) | an explanation of the risks associated with the *scheme* investing in *inherently illiquid assets* and how those risks might crystallise; |
| | | (ii) | a description of the tools and arrangements the *authorised fund manager* would propose using, including those required by *FCA rules*, to mitigate the risks referred to in (i); and |
| | | (iii) | an explanation of the circumstances in which those tools and arrangements would typically be deployed and the likely consequences for investors; |
| | … | | |
| … | | | |

…

Guidance on contents of the prospectus

4.2.6 G (1) …

(4A) In relation to *COLL* 4.2.5R(3)(pa)(ii) and (iii), the types of liquidity management tools and arrangements that should typically be described include:

(a) suspension of dealing under *COLL* 7.2.-3R, *COLL* 7.2.-2R, *COLL* 7.2.-1R and *COLL* 7.2.1R;

(b) fair value price adjustment (see *COLL* 6.3.3ER, and *COLL* 6.3.6G(1)(5) to *COLL* 6.3.6G(1)(7));

(c) fair and reasonable valuation of an immovable (see *COLL* 6.3.6G(1)(7A) and *COLL* 6.3.6G(1)(7B)); and

(d) measures to prevent dilution, such as applying a dilution levy (see *COLL* 6.3.8R).

…

…

**5 Investment and borrowing powers**

…

**5.6 Investment powers and borrowing limits for non-UCITS retail schemes**

…

Funds investing in inherently illiquid assets (FIIA)

5.6.5E G (1) The *Glossary* definition of a *fund investing in inherently illiquid assets* (or *FIIA*) includes conditions relating to, amongst other things, the investment objectives of such *non-UCITS retail schemes* and the proportion of *scheme property* which is invested in *inherently illiquid assets*.

(2) Examples of such assets include:

(a) property and real estate;

(b) *shares* in a *special purpose vehicle* investing in infrastructure projects;

(c) *shares* issued by a company that are not listed or admitted to trading; and

(d) *units* in a *property authorised investment fund*.

…

Standing independent valuer and valuation

5.6.20 R …

(3) The following requirements apply in relation to the functions of the *standing independent valuer*:

…

(f) any valuation by the *standing independent valuer* must be undertaken in accordance with ~~UKPS 2.3 of the RICS Valuation Standards (The Red Book) (9th edition published November 2013)~~ UKVPS 3 and 2.3 of UKVPGA of the RICS Valuation – Global Standards 2017, UK national supplement 2018 (the RICS Red Book) or, in the case of overseas immovables, on an appropriate basis but subject to *COLL* 6.3 (Valuation and pricing).

…

…

## 6 Operating duties and responsibilities

…

## 6.3 Valuation and pricing

…

Accounting procedures

…

6.3.3D R …

Valuation of an immovable

6.3.3E R An *authorised fund manager* may only agree a fair and reasonable price for an immovable to reflect a rapid sale if the *prospectus* states that it may do so, in accordance with *COLL* 4.2.5R(3)(pa)(ii).

…

Valuation and pricing guidance

6.3.6 G Table: this table belongs to *COLL* 6.3.2G(2)(a) and *COLL* 6.3.3R (Valuation).

| **Valuation and pricing** | | |
|---|---|---|
| **1** | **The valuation of scheme property** | |
| | … | |
| | (7A) | Where the *authorised fund manager*, the *depositary* or the *standing independent valuer* have reasonable grounds to believe that the most recent valuation of an immovable does not reflect the current value of that immovable, then, unless *COLL* 6.3.6G(1)(7B) applies, the *authorised fund manager* should consult and agree with the *standing independent valuer* a fair and reasonable value for the immovable. |
| | (7B) | Where the *authorised fund manager* decides that an immovable must be sold quickly to meet *redemption* requests as they fall due, it should consult and agree with the *standing independent valuer* a fair and reasonable price for the immovable to reflect a rapid sale, to extent that the *prospectus* states that it may do so. |
| | … | |
| … | | |

…

## 6.6 Powers and duties of the scheme, the authorised fund manager, and the depositary

…

Table of application

6.6.2 R This table belongs to *COLL* 6.6.1R.

| *Rule* | *ICVC* | *ACD* | Any other directors of an *ICVC* | Depositary of an *ICVC* | Authorised fund manager of an *AUT* or *ACS* | Depositary of an *AUT* or *ACS* |
|---|---|---|---|---|---|---|
| … | | | | | | |
| 6.6.3CR* | | x | | | x | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 6.6.3DG* | | x | | | x | |
| 6.6.3ER* | | x | | | x | |
| 6.6.3FR* | | x | | | x | |
| … | | | | | | |
| 6.6.4BR* | | | | x | | x |
| 6.6.4CR* | | | | x | | x |
| 6.6.4DG* | | | | x | | x |
| … | | | | | | |
| Notes: | … | | | | | |
| | (6) | *_COLL_ 6.6.3CR, _COLL_ 6.6.3DG, _COLL_ 6.6.3ER and _COLL_ 6.6.3FR apply only to the _authorised fund manager_ of a _FIIA_. | | | | |
| | (7) | *_COLL_ 6.6.4BR, _COLL_ 6.6.4CR, and _COLL_ 6.6.4DG apply only to the _depositary_ of a _FIIA_. | | | | |

…

Additional functions of an authorised fund manager of a FIIA

6.6.3C R The *authorised fund manager* of a *FIIA* must establish, implement and maintain an adequate liquidity management contingency plan for exceptional circumstances which sets out:

(1) how the *authorised fund manager* will respond to a liquidity risk crystallising;

(2) the range of liquidity tools and arrangements which it may deploy in such exceptional circumstances, any operational challenges associated with the use of such tools and the likely consequences for investors;

(3) the procedures for working with the *depositary* in the event the *authorised fund manager* must deploy these tools and arrangements;

(4) how the *authorised fund manager* will work with its delegates, such as third-party administrators, and other relevant third parties including *intermediate unitholders*, to:

(a) deploy the liquidity management tools and arrangements;

(b) communicate their use in a timely way to *unitholders*; and

(c) implement any other part of this contingency plan;

(5) any operational challenges likely to arise from working with relevant third parties identified at (4); and

(6) communication arrangements for internal and external concerned parties (including the *FCA*, investors and the media where necessary).

6.6.3D G Compliance with *COLL* 6.6.3CR may enable a *full-scope UK AIFM* that is an *authorised fund manager* of a *FIIA* to meet some of its obligations under article 47(1)(e) of the *AIFMD level 2 regulation*.

6.6.3E R (1) The *authorised fund manager* of a *FIIA* must obtain written confirmation from any relevant third party identified in the contingency plan under *COLL* 6.6.3CR(4) that the third party will be able to undertake the matters specified in (2) as soon as is reasonably practicable.

(2) The matters specified for the purpose of (1) are that the relevant third party will, where necessary, be able to:

(a) deploy any liquidity management tools and arrangements on which *the authorised fund manager* plans to rely as part of its contingency plan;

(b) in a timely way, communicate the *authorised fund manager's* use of any such tools and arrangements to *unitholders*; and

(c) carry out any other part of the contingency plan which the *authorised fund manager* has identified as requiring action by that third party.

6.6.3F R The *authorised fund manager* of a *FIIA* must provide the *depositary* on an ongoing basis with all relevant information it needs to comply with its obligations under *COLL* 6.6.4BR.

…

Specific duties of a depositary: oversight of the liquidity management of a FIIA

6.6.4B R The *depositary* of a *FIIA* must:

(1) regularly make its own assessment of the liquidity profile of the *FIIA* and the liquidity risks presented by the *scheme property* of a *FIIA*;

(2) take reasonable care to oversee the *authorised fund manager's* liquidity management systems and procedures on an ongoing basis, using the assessment it has made under (1), to ensure the *FIIA* is managed in accordance with the following *COLL rules* and, in the case of a *FIIA* managed by a *full-scope UK AIFM*, the following

*FUND rules* and provisions in the *AIFMD level 2 regulation*:

(a) *COLL* 4.2.5R(3)(pa);

(b) *COLL* 6.6.3CR and *COLL* 6.6.3ER;

(c) *FUND* 3.2.2R(8);

(d) *FUND* 3.2.5R;

(e) *FUND* 3.6.3R;

(f) article 44(1) and (2)(c) of the *AIFMD level 2 regulation*;

(g) articles 46 to 49 of the *AIFMD level 2 regulation*; and

(h) article 108 of the *AIFMD level 2 regulation*; and

(3) establish an escalation procedure when instances of potential non-compliance with the *rules* and provisions set out in paragraph (2) are identified, the details of which must be made available to the *FCA* upon request.

6.6.4C R The *depositary* of a *FIIA* managed by a *small authorised UK AIFM* must not delegate its functions under *COLL* 6.6.4BR to one or more third parties, except in relation to supporting administrative or technical tasks that are linked to these functions.

6.6.4D G Subject to certain specified exceptions, the *depositary* of a *FIIA* managed by a *full-scope UK AIFM* is generally prohibited from delegating its functions (see in particular, *FUND* 3.11.26R (Delegation: general prohibition) and *FUND* 3.11.28R (Delegation: safekeeping)).

…

Duty to inform the FCA

6.6.11 G *SUP* 15.3 (General notification requirements) contains *rules* and *guidance* on matters that should be notified to the *FCA*. Such matters include, but are not limited to, any circumstance that the *depositary* becomes aware of whilst undertaking its functions or duties in *COLL* 6.6.4R(1) (General duties of the depositary) and (where applicable) *COLL* 6.6.4BR (Specific duties of a depositary: oversight of the liquidity management of a FIIA), that the *FCA* would reasonably view as significant.

…

## 7 Suspension of dealings and termination of authorised funds

### 7.1 Introduction

…

Table of application

7.1.2 R This table belongs to *COLL* 7.1.1R.

| *Rule* | *ICVC* | *ACD* | Any other *directors* of an *ICVC* | *Depositary* of an *ICVC* | *Authorised fund manager* of an *AUT* or *ACS* | *Depositary* of an *AUT* or *ACS* |
|---|---|---|---|---|---|---|
| … | | | | | | |
| 7.2.-3* | | x | | x | x | x |
| 7.2.-2* | | x | | x | x | x |
| 7.2.-1* | | x | | x | x | x |
| … | | | | | | |
| Notes | … | | | | | |
| | (4) | *COLL* 7.2.-3R to 7.2.-1R apply only to the *authorised fund manager* and *depositary* of a *non-UCITS retail scheme.* | | | | |

Purpose

7.1.3 G (1) This chapter helps to achieve the *statutory objective* of protecting investors by ensuring ~~they do not buy~~ the *authorised fund manager* does not sell or *redeem units* at a *price* that cannot be calculated accurately. For instance, due to unforeseen circumstances, it may be impossible to value, or to dispose of and obtain payment for, all or some of the *scheme property* of an *authorised fund* or *sub-fund*. *COLL* 7.2.-3R, *COLL* 7.2.-2R, *COLL* 7.2.-1R, and *COLL* 7.2.1R ~~(Requirement) sets~~ set out the circumstances in which an *authorised fund manager* must or may suspend ~~dealings~~ *dealings* in *units* and the manner in which a suspension takes effect.

(2) …

## 7.2 Suspension and restart of dealings

Requirement

7.2.-3 R (1) This *rule* applies to the *authorised fund manager* of a *non-UCITS* *retail scheme* if at any time:

(a) a *standing independent valuer* has expressed material uncertainty in accordance with VPS 3 paragraph 2.2(o) and the guidance at VPGA10, RICS Valuation Global Standards 2017 (The Red Book) (effective from 1 July 2017), about the value of one or more immovables under management and that material uncertainty applies to at least 20% of the value of the *scheme property*; or

(b) the *authorised fund* invests at least 20% of the value of the *scheme property* in *units* of one or more other *authorised funds* for which *dealings* in *units* have been temporarily suspended under (2).

(2) As soon as possible and in any event by the end of the second *business day* after the day on which this *rule* starts to apply under (1), the *authorised fund manager* must temporarily suspend *dealings* in *units* in the *authorised fund* unless (3) applies.

(3) *Dealings* in *units* in the *authorised fund* may continue provided that:

(a) as soon as possible and in any event by the end of the second *business day* after the day on which this *rule* starts to apply under (1), the *authorised fund manager* and the *depositary* agree that *dealings* in *units* in the *authorised fund* should continue;

(b) the *authorised fund manager* and the *depositary* have a reasonable basis for determining that a temporary suspension of *dealings* in *units* would not be in the best interests of *unitholders* in the *authorised fund*; and

(c) the *authorised fund manager* and the *depositary* do not rely solely on a fair value price adjustment when making their determination under (b).

7.2.-2 R (1) This *rule* applies where the *authorised fund manager* of a *non-UCITS retail scheme* is required to temporarily suspend *dealings* in *units* in the *authorised fund* under *COLL* 7.2.-3R(2) or *COLL* 7.2.-1R(3).

(2) The *authorised fund manager* must notify the *depositary* before suspending *dealings* in *units* in the *authorised fund*.

(3) During the suspension, the *authorised fund manager* must follow the requirements set out in the following provisions, where applicable:

(a) *COLL* 7.2.1R(2);

(b) *COLL* 7.2.1R(2A);

(c) *COLL* 7.2.1R(2B);

(d) *COLL* 7.2.1R(2C);

(e) *COLL* 7.2.1R(3);

(f) *COLL* 7.2.1R(4A);

(g) *COLL* 7.2.1R(5); and

(h) *COLL* 7.2.1R(6).

(4) *Dealings* in *units* must restart as soon as reasonably practicable after:

(a) the *standing independent valuer's* material uncertainty assessment applies to less than 20% of the value of the *scheme property*; and

(b) the *scheme's depositary* gives its approval for the temporary suspension to be removed.

(5) If a *non-UCITS retail scheme* operates *limited redemption arrangements* and a suspension has prevented *dealings* in *units* at a *valuation point*, the *authorised fund manager* must declare an additional *valuation point* as soon as possible after the restart of *dealings* in *units*.

(6) This *rule* applies to a *sub-fund* as it applies to an *authorised fund*, and:

(a) references to the *units* of the *class* or *classes* relate to that *sub-fund* and to the *scheme property* attributable to the *sub-fund*; and

(b) this *rule* can only apply to one or more *classes* of *units* without being applied to other *classes* if the *authorised fund manager* considers that a suspension of *dealings* in *units* of some but not all *classes* of *units* is in the best interest of all the *unitholders* of that *authorised fund* or *sub-fund*.

7.2.-1 R (1) This *rule* applies where the *authorised fund manager* and the *depositary* agree that *dealings* in *units* in the *authorised fund* should continue under *COLL* 7.2.-3R(3) and, if relevant, following a review under this *rule*.

(2) During the period of material uncertainty (see (8) below), the *authorised fund manager* and the *depositary* must review their agreement not to suspend *dealings* in *units* in the *authorised fund*

at least every 14 *days*.

(3) Following such a review the *authorised fund manager* must temporarily suspend *dealings* in *units* in the *authorised fund* unless (4) applies.

(4) *Dealings* in *units* in the *authorised fund* may continue provided that:

(a) the *authorised fund manager* and the *depositary* agree that *dealings* in *units* in the *authorised fund* should continue;

(b) the *authorised fund manager* and the *depositary* have a reasonable basis for determining that a temporary suspension of *dealings* in *units* would not be in the best interests of *unitholders* in the *authorised fund*; and

(c) the *authorised fund manager* and the *depositary* do not rely solely on a fair value price adjustment when making their determination under (b).

(6) The *authorised fund manager* must inform the *FCA* of the results of each review.

(7) This *rule* applies to a *sub-fund* as it applies to an *authorised fund*, and:

(a) references to the *units* of the *class* or *classes* relate to that *sub-fund* and to the *scheme property* attributable to the *sub-fund*; and

(b) this *rule* can only apply to one or more *classes* of *units* without being applied to other *classes* if the *authorised fund manager* considers a suspension of *dealings* in *units* of some but not all classes of *units* is in the best interest of all the *unitholders* of that *authorised fund* or *sub-fund*.

(8) In this *rule*, a "period of material uncertainty" is any period during which one or both of *COLL* 7.2.-3R(1)(a) and (b) applies.

…

Guidance

7.2.2 G (-1) The *guidance* in (1), (1A) and (1B) does not apply in circumstances where an *authorised fund manager* is required to temporarily suspend *dealings* in *units* in an *authorised fund* under *COLL* 7.2.-3R or *COLL* 7.2.-1R.

(1) Suspension should be allowed only in exceptional cases where circumstances so require and suspension is justified having regard

to the interests of the *unitholders*.

(1A) Except in the case of *FIIAs* (for which see (1B) below), ~~Difficulties~~ difficulties in realising scheme assets or temporary shortfalls in liquidity may not on their own be sufficient justification for suspension. In such circumstances the *authorised fund manager* and *depositary* would need to be confident that suspension could be demonstrated genuinely to be in the best interests of the *unitholders*. Before an *authorised fund manager* and *depositary* ~~determines~~ determine that it is in the best interests of *unitholders* to suspend *dealing*, ~~it~~ they should ensure that any alternative courses of action have been discounted.

(1B) In the case of *FIIAs*, there may be circumstances where suspension is genuinely in the best interests of *unitholders*; for example, where orders received for *redemptions* of *units* at the next valuation period cannot be executed without significantly depleting the *scheme's* liquidity, and/or without selling *scheme property* at a substantial discount to its open market value.

…

…

**8 Qualified investor schemes**

…

**8.4 Investment and borrowing powers**

…

Standing independent valuer and valuation

8.4.13 R (1) …

(2) …

(f) any valuation by the *standing independent valuer* must be undertaken in accordance with ~~UKPS 2.3 of the RICS Valuation Standards (The Red Book) (9th edition published November 2013)~~ UKVPS 3 and 2.3 of UKVPGA 2 of the RICS Valuation – Global Standards 2017 UK national supplement 2018 (the RICS Red Book) or, in the case of overseas immovables, on an appropriate basis but subject to any provisions of the *instrument constituting the fund*.

…

…

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