FCA Delays Finalising UK Property Fund Reforms as it Launches Consultation on New Long-Term Asset Investment Regime

Direction of Travel Suggests Finance Watchdog Will Introduce Redemption Notice Periods For Investors

The FCA wants to prevent the issues that have led to open-end fund suspensions. (Getty Images)

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The Financial Conduct Authority has pushed back final publication of its proposed reforms of open-ended property funds as it begins formal consultation on the creation of a new fund regime for investing in long-term assets.

The finance watchdog launched its most recent consultation into open-ended UK funds, focused in particular on reducing the potential for harm to investors from the so-called "liquidity mismatch", in August of last year.

Notably among the proposed rules it is considering introducing is a requirement that investors give notice — potentially of up to 180 days — before their investment is redeemed.

At present investors in open-ended UK property funds — which were pretty much universally gated as the UK entered lockdown and valuers began to apply material valuation uncertainty clauses at the end of March last year — can buy and sell units on a frequent, often daily, basis. But the underlying property in which the funds invest cannot be bought and sold at the same frequency, creating the liquidity mismatch which the FCA is attempting to address. Most funds have reopened since RICS' recommendation of a general lifting of the material valuation uncertainty clauses last year.

Some experts have suggested the rules could see property funds excluded from ISAs and would place the asset class "off limits" to many private investors.

John Forbes of Forbes Consulting, a leading expert in the field, has also pointed out that the FCA proposals should not be misconstrued to imply the fund suspensions during the COVID crisis were due to a liquidity mismatch when the funds often had the liquidity but were reacting to valuation uncertainty and the application of a specific FCA policy to apply in such circumstances. "Notice periods do not help solve valuation uncertainty," Forbes said.

Today the FCA published an update saying a final decision on its policy position - initially promised for "as soon as possible" at the beginning of this year - will not be made until Q3 2021 at the earliest.

This includes the decision as to whether or not to require notice periods at all. Forbes says the tenor of the document suggests that this remains strongly the direction of travel though.

The FCA said: “Stakeholders raised concerns around the operational challenges for fund managers and other firms, in particular in relation to ensuring that the infrastructure to support purchase and sale of holdings by retail investors will work seamlessly with notice periods. Some of these operational challenges also need to be addressed to make progress on new options for a Long-Term Asset Fund (LTAF).”

LTAF is a new category of fund that the FCA is consulting on, designed to invest more efficiently in long-term illiquid assets. The delay until the third quarter at the earliest is partly so that it can take on board feedback to the LTAF consultation.

"There is a recognition of the operational challenges, particularly in respect of platform architecture, which needs to be addressed for property funds and the LTAF," Forbes added.

Separately then the FCA today launched its consultation on a new fund regime for investing in long term assets.

This consultation sets out more detailed proposals for the long-term asset fund (LTAF) covered in the recent "Call for Input" by HM Treasury for its review of the UK funds regime.

Forbes said: "We were very supportive of the LTAF proposal put forward by the Investment Association and it is therefore good news that this is progressing so rapidly. We do not see the LTAF as a vehicle particularly to invest directly in real estate, but rather as a conduit for investment into real estate funds, other real estate investment vehicles, infrastructure and debt.

"Although the immediate prize is facilitating greater investment by defined contribution pension schemes, we think it is important that the LTAF is open to other types of investor. We agree that it may not be appropriate to allow distribution of LTAFs to all retail investors and had therefore suggested in our response to the Call for Input that regarding the LTAF as a "complex" product under MiFID II / COBS 10A was the most appropriate approach to restricting access. We are therefore pleased that this is considered as an option under 5.17 of the consultation."

The FCA also says it will allow a suitable implementation period before any rules on open-ended funds come into force, to allow firms to make operational changes, noting feedback that 18 months to two years would be an appropriate period.

"We are pleased that the FCA are considering a change to the deferral rules / architecture as this is something that we have been banging on about since 2017," added Forbes.

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