Woodford's plight and property funds

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Extensive coverage of the issues at Neil Woodford's fund and the resulting suspension of redemptions has again cast a light on open-ended funds investing in "illiquid" assets.

Since 2016, there has been considerable attention paid to open-ended property funds following the suspension of redemptions by a number of them. The Woodford suspension highlights an important point that numerous submissions to the FCA have made – that investors understand property is a less liquid investment asset, but that there may be greater problems with investments in assets that are, in theory, more liquid, but in practice are not.

The Woodford suspension prompted FCA chief executive Andrew Bailey to write that a thriving economy needs more, not less, investment in illiquid assets. This is reflected in a number of current FCA initiatives to find ways to encourage investment in "patient capital" investments.

If investment in illiquid assets is to be encouraged rather than discouraged, then the rules to protect investors need to be appropriate to the fund, the underlying investments, the type of investor, and the distribution channels through which those investors are accessed.

My major disappointment with the initial FCA reaction to the suspension of open-ended property funds following the EU referendum was its apparent eagerness to replace an existing "one size fits all" model with an alternative, but arguably even more imperfect, "one size fits all" model.

Even for retail investors, more choice should be available. Those who want to invest in a fully open-ended fund that offers daily redemptions should be able to, but need to recognise that this comes at a cost. Equally, those who are happy to risk locking in their money for longer in return for better performance should be able to do so, too.

Retail investors are able to understand the difference between a bank current account and a bank deposit account. It is a significant structural failing that they do not have the same choice when investing in property.

Shared responsibility

In my report for the Association of Real Estate Funds, looking at the behaviour of open-ended property funds after the EU referendum result, I suggested a straightforward change to the regulation of fund for retail investors. The change would allow the development of funds that offered investors potentially better returns in return for reduced liquidity. So far, the FCA have not taken this forward, but hopefully will in its forthcoming response to the previous round of consultation. This is apparently imminent.

Although much of the focus is on retail investors, the same challenges around liquidity arise for defined contribution pension schemes and unit linked insurance products. Relying on an investment model that only works for defined benefit pension schemes and traditional, on balance sheet life insurance investment is not viable in the long-term. Worse still, the UK's "one size fits all", or possibly to be slightly more generous "two sizes fits all", approach does not work very well for funds for these traditional, institutional investors either – they simply find it easier to work around the regulatory obstacles by using offshore vehicles such as Jersey Property Unit Trusts.

Bailey says that the use of platforms by investors has grown rapidly in recent years, and that it is important that platforms should exercise their responsibilities thoroughly and in a timely fashion. This is a key point, but not just one for the platforms.

Investors come into property investment through a diverse and complex range of distribution channels. Everyone in that chain should take responsibility for understanding the products they are recommending, and advising investors of the consequences. The primary focus of attention should be in improving transparency.

It is also important to recognise that the limitations in current platform architecture would be an impediment to many retail investors accessing a broader range of funds if they are developed, just as they are an impediment to retail investors accessing the tax benefits that are, in theory, a key feature of current funds.

From the largest institutional investor to the smallest retail investor, the UK provides a lack of choice for indirect investment in illiquid assets.

Given a greater selection of listed and unlisted vehicles with different characteristics, investors would be able to construct portfolios that are better suited to their long-term investment requirements.