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By email: cp18-27@fca.org.uk

25 January 2019

Dear Mike

Response to CP18/27: Consultation on illiquid assets and open-ended funds

We, the Association of Real Estate Funds[1] (AREF), welcome the opportunity to respond to this consultation. It is always a good idea after significant events, such as the suspension of dealing in some open-ended authorised property funds after the Referendum in 2016, to reflect on the actions taken and see if there are any lessons to be learnt and, where necessary, improve processes and regulations.

AREF has a diverse range of members with open-ended and closed-ended funds based in the UK, Channel Islands, Eire and Luxembourg with various dealing periods. Obviously we believe there should be a wide range of different property funds available to meet the varying needs of investors. Due to the subject matter, our members that are daily dealing open-ended NURS have led on our response. However, we have considered and included views on the proposals in the consultation paper from a wide representation of our members. Also, we have encouraged our members to provide their own individual response to the consultation. Where there has not been consensus across our members who have contributed to our response we have reflected the majority view. Where we disagree with a proposal we have tried to provide an alternative solution for the FCA to consider. One area where we would like to recommend some changes but need further clarifications before we can is the proposed risk warning. We would welcome a meeting with the FCA, after the consultation closes, to discuss this and our other responses in detail and assist where possible.

We feel that the actions taken by AFMs of open-ended authorised property funds after the Referendum in 2016 were taken in the best interest of their clients. Although, the actions varied between funds, we feel this was appropriate as what is suitable for one fund is not necessarily right for another. The diversity of approach demonstrated flexibility and assisted in all funds speedily reopening, quickly providing stability. However, we have suggested that the industry

[1] The Association of Real Estate Funds represents the UK real estate funds industry and has around 60 member funds with a collective net asset value of more than £72 billion under management on behalf of their investors, including £18 billion on behalf of retail investors in the UK. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Quarterly Property Funds Index and the AREF/IPD Property Fund Vision Handbook.

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consider the experience of funds that have used fair value pricing and update industry guidance on this which may lead to more consistency when fair valuing a fund in the future.

We appreciate that some investors did not understand why some funds acted differently to others and therefore we would support improvements in communications with investors to help them better understand these potentially different outcomes. We do not agree that there should be one solution for all authorised funds investing in inherently illiquid assets. That is one of the reasons why most of our members have not supported the proposal for there to be mandatory suspensions for funds holding more than 20% in properties when the SIVs have declared material uncertainty in the property market.

'Material uncertainty' is not a defined term in the Red Book. The Red Book advises SIVs to expressly draw attention to and comment on any issues resulting in material uncertainty in the valuation they provide. **A 'material uncertainty' clause does not mean the SIVs are unable to value the assets**, just that the degree of certainty around the valuation is less than normal. The fact material uncertainty has been declared is considered by the AFM when pricing the fund under normal fair value pricing procedures. Also, they may take other actions such as valuing the fund more frequently than normal to ensure investors receive a price as close to market values as possible. If no values can be attributed to some of the assets held by a particular fund or the AFM feels that the degree of uncertainty in the values being provided is such that they cannot provide a true value for the fund the AFM may decide that suspending the fund is in the best interest of investors. Automatic suspension across all funds is a severe resolution, especially where there are no liquidity concerns and when other actions and disclosure to investors may work much better. To introduce a mandatary rule for suspension appears detrimental to the aims of providing investors access to their investments and reduces investors' investment options. It has the possibility of leaving investors locked into a fund in a falling market and importantly appears to undermine the aim of maintaining wider financial stability.

It is fairly easy for SIVs to identify when an economic or political shock has occurred and therefore are likely to be consistent on when declaring material uncertainty. However, identifying a return to 'normal' trading conditions can be more subjective. This could lead to some inconsistency between SIVs removing the material uncertainty clause and affect when funds would be able to re-open after the mandatory suspension proposed in the consultation paper.

Following RDR the intermediated market, who manage model portfolios, became significant holders of the funds. The perception that there may be an increase in the frequency of suspensions, due to the proposals in the consultation paper, may lead to the intermediated market moving away from using open-ended funds. This may lead to a reduction in choice for consumers and a potential increase in volatility and less diversification as they seek to allocate to alternative, listed property vehicles that may be less suitable for the investor.

We welcome the FCA's support in removing the stigma previously associated with fund suspensions. Based upon feedback received after the 2016 suspensions, we believe that investors in our member funds are accepting of the use of suspension as a tool in exceptional circumstances when a fund has liquidity issues. However, we do not believe that investors wish for dealing to be suspended when it is difficult, but not impossible, to value a fund's assets.

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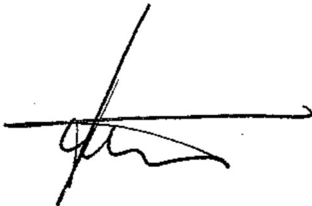
We note that the FCA are currently looking at ways to encourage investment by retail investors in patient capital through unit-linked funds. In CP18/40 you have clarified that where the rules say underlying funds should publish their prices regularly this should not be read as a need for them to price daily. We would like to highlight that the daily pricing model has worked well for many years; on the rare occasion when funds have not been able to provide daily dealing the situation has been managed in an orderly fashion by the funds. We do not believe that making it clear that regular dealing does not necessarily mean daily dealing will change the demand for underlying funds to price daily. Advisers and distributors' systems and processes are based on daily pricing and it is unlikely there will be appetite for spending money on changing this. We would point out that although PAIFs have now been in existence for many years and despite all the large retail property funds having now converted, there are a significant number of platforms who have yet to upgrade their systems to permit the income streaming required. Therefore investors, who wish to invest in authorised property funds via these platforms, cannot obtain the tax benefits afforded by PAIFs. We support the FCA's attempts to encourage retail investors to invest in a broader range of long-term assets and we would encourage the FCA to engage with advisers and distributors on how this can be achieved in the best interest of investors.

The FCA's DP18/10 Patient Capital and Authorised Funds explores whether it should be made easier for direct investment by authorised funds in patient capital assets. We believe that the pricing and liquidity issues identified in CP18/27 for NURS invested in inherently illiquid assets would also be similar for authorised funds investing directly in patient capital assets. We would encourage the FCA to consider the responses to DP18/10 and the outcome from CP18/40 before finalising any remedies from consultation CP18/27.

Our detailed responses to the questions in CP18/27 are set out in the annex that follows.

Yours sincerely



John Cartwright
Chief Executive
The Association of Real Estate Funds

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ANNEX: AREF's responses to the specific questions raised in CP18/27

Funds investing in inherently illiquid assets - FIIAs

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.

We strongly disagree that there is a need for a FIIA classification. Investors are already faced with a number of acronyms; NURS, OEIC, PAIF, AIF; adding another acronym is not necessarily going to increase investors understanding of the product.

FIIA or 'Funds that Invest in Inherently Illiquid Assets' would mean very little to a non-advised investor.

In the case of our own members, having "property" or "real estate" in the name of the fund discloses to investors the nature of the assets the fund is investing in. In most cases, investors would understand that it can take time to trade in properties and therefore there may be times the fund cannot easily provide liquidity. Compared to almost all other asset classes we would suggest that property is in fact one of the simplest asset class to understand to a lay person, given the personal experience most will have of buying, selling or renting a property.

Investors should be encouraged to read more about the products they plan to invest in. We believe there should be full disclosure to investors that in certain circumstances the assets held by the fund may take longer than normal to sell in order to return the investment made. This should be included in the objectives and investment policy for the fund as well as wider documentation and marketing material.

We appreciate that there is an argument that investors do not read fund documentation such as prospectuses, KIIDs or indeed factsheets. We question whether an investor, who is not interested in reading fund documentation, would know and ask what FIIA means.

Alternative proposal

Mandate additional disclosure in all the objectives and investment policy for the fund as well as wider documentation and marketing material.

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?

As we have stated above in our response to Question 1, we are not in agreement with classifying funds as FIIA.

If however, the FCA decides to go ahead with the use of this classification, our members have expressed a concern that the numerical definition is out of line with other classifications. To be classified as a PAIF at least 60% of a fund must be invested in direct property or REITs or similar. To be included in The IA's Property Sectors at least 70% of a fund's assets must be

invested directly in UK property or 80% in property securities or a mixture of direct property and property securities.

Also, the classification "funds investing in inherently illiquid assets" could give investors the impression that all funds that invest in inherently illiquid assets, not just ones that are NURS, would have this classification. If an investor is unlikely to read fund documentation they would not know that this refers to NURS which have invested at least 50% of their scheme property in inherently illiquid assets for at least 3 continuous months in the last 12 months.

Alternative proposals

- The investment objectives and policy should clearly state that in certain circumstances the assets held by the fund may take longer than normal to liquidate and the possible consequences of this for the investor.
- If the FCA decide to go ahead with the FIIA classification the percentage should be increased to 60% in line with existing legislation.

Treatment of professional investors

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?

No, we do not agree with this proposal. As we have noted in our response to Question 2, if the FCA goes ahead with using the classification FIIA, investors would expect all funds that invest in inherently illiquid assets to have this classification.

It would be perverse that a daily dealt fund, providing daily liquidity, would be labelled inherently illiquid when a limited redemption fund is not.

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?

We believe that feeder funds, multi-asset funds and funds-of-funds that invest in funds that hold significant levels of inherently illiquid assets should disclose this in the fund's objectives and investment policy. As mentioned previously we do not agree with the FIIA classification.

What do we mean by inherently illiquid assets?

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

We are generally in agreement with the definition of an inherently illiquid asset that is proposed to be included in the rules. Although, as we are not in agreement with the classification FIIA, we would change the last line of the definition to "a unit in a fund with a significant investment in inherently illiquid assets as defined above".

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We agree with the guidance on the type of asset that is inherently illiquid. You say that you expect market participants to decide whether new types of asset classes should be defined as inherently illiquid assets. Will there be a process for these to be added to the guidance?

Types of fund to which our proposals apply

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?

Most of our members agree that the remedies proposed in this consultation paper and the alternative solutions we have given should be focused on the requirements of retail investors.

We agree with the FCA that as investors in QISs are professional clients and sophisticated retail investors they do not require the higher level of protection the proposed remedies aim to provide. Although, it has been questioned by some of our members that if the FCA feels that a fund should suspend dealing when there is less certainty in the value of its assets shouldn't this be relevant for all types of funds and not just NURS?

Mandatory suspensions due to material uncertainty

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

Most of our members do not believe that mandating suspension in dealing when the SIVs have declared there is material uncertainty in property valuations is in the best interest of investors. This is for a number of reasons:

- The proposal seems a drastic response to there being increased uncertainty over the accuracy of valuations.

  To provide a valuation in accordance with the RICS Valuation Standards (The Red Book) SIVs require transactional evidence which in a normal market would enable them to accurately value within a small tolerance. When there are lower levels of transactions, usually combined with a wider economic event, SIVs are advised by the Red Book to qualify their valuations by indicating there is 'material uncertainty'. This just highlights the fact that they have limited or no evidence for the values they are providing and there may be a need to widen the tolerance around the given valuation; it does not mean that an assessment of value cannot be provided.

- The material uncertainty qualification is there to advise the AFM of increased uncertainty around the valuation not as a tool to trigger suspension of funds. The consultation proposal seeks to use a RICS qualification (which is undefined) for an entirely different and unconnected purpose.

Although, we do not agree with the mandatory suspension of funds when material uncertainty has been declared by SIVs, we do believe there should be more clarity around the term 'material uncertainty'. Therefore, we would support a working group being set up between RICS, SIVs and wider property market participants with regard to considering the definition of material uncertainty.

- In COLL 6.3.2 (2) it says "An AFM is responsible for valuing the scheme property of the authorised fund it manages and for calculating the price of units in the authorised fund." The proposal for mandatory suspension takes this responsibility away from the AFM during periods of material uncertainty. We question if this is necessary especially as there is additional investor protection provided for authorised funds by depositaries having oversight of funds' activities. Also, investor protection will be enhanced when the requirement for independent directors on ACD boards is introduced later this year.

  When pricing the fund the AFM would take into consideration that material uncertainty has been declared and may implement their fair value pricing procedures. If no values can be attributed to some of the assets held by a particular fund or the AFM feels that the degree of uncertainty in the values being provided is such that they cannot provide a true value for the fund the AFM may decide that suspending the fund is in the best interests of investors. However, where material uncertainty has been declared other actions may be more suitable such as valuing funds more frequently than normal to ensure investors receive a price as close to market values as possible.

  When there was material uncertainty in property valuations in 2016, some AFMs used the existing tools within the regulations to fair price their funds to ensure that investors were receiving an accurate price for the funds given the information available.

  In fair valuing a fund's assets, there are a number of proxies the AFM uses. The process of fair valuing is not undertaken by the AFM alone, they would take input from as many qualified sources of information as they have at their disposal.

  Past history suggests the fair value process works well with the addition, where necessary, of increased valuation frequency being implemented to ensure accurate unit pricing. If funds were mandated to suspend dealing when the SIVs declared material uncertainty in valuing property in 2008 investors would have been locked into funds that were falling in value. This would have taken away the option for investors to sell their holdings in the funds if they wished.

- The proposal to adopt a very blunt tool of suspending dealing has many unintended consequences. As acknowledged in Chapter 2 of IOSCO 2012 Principles on Suspension of Redemptions, suspension in dealing potentially escalates wider financial instability and could cause the loss of investor confidence in authorised property funds. These funds provide investors with regular income and have typically lower volatility and lower correlation to other asset classes. This would lead to a loss of a valuable portfolio diversifier for investors.

  Suspension of dealing by a fund may spook investors and they may decide to leave the fund as soon as suspension is lifted even though the fund may still be a suitable investment for

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the investors. The increase in redemptions could lead to liquidity issues for the fund which may not have occurred if the fund had not been forced to suspend dealing.

- If investors believe an upcoming event may lead to uncertainty in property values and consequently to suspension of dealing in NURS holding property, they may decide to sell their holding prior to or just after the event happens so they are not stuck in the fund. Therefore, the proposal for mandatory suspensions when SIVs have declared material uncertainty could increase first mover issues.

- Automatic suspension creates significant issues both in entering suspension and in reopening a fund to trade, which appear not to have been considered or addressed in the consultation document.

  There is not a clear definition for material uncertainty and therefore it is a subjective decision by SIVs whether they declare there is material uncertainty in all or part of the property market. Although it is unlikely, has the FCA considered what would happen if all the SIVs do not agree that there is material uncertainty in property values? This could mean that some funds would have to suspend dealing and other similar funds would not, which again could unsettle the market. Material uncertainty is most likely to be declared on valuations for the whole property market due to a macro event but it is possible that there may be uncertainty in property values for one or more sectors of the market or even within sectors. For example there may be transactional evidence to value prime property but there may be a flat market for secondary property or there may have been recent transactions in small lots but no evidence of values for large lots. This would also lead to some funds suspending and others not.

  Funds may come out of suspension at different times depending upon the proportion of the fund held in property that cannot be valued with certainty and when material uncertainty around property values is lifted for each property sector. Also, as it is not always easy to identify when trading conditions have returned to ‘normal’, the SIVs may not agree when to lift material uncertainty on property values which could mean that some funds may come out of suspension earlier than others. This could lead to investors who wish to rebalance their holdings in property selling out of the fund that lifts the suspension in dealing first, potentially causing liquidity issues.

We believe that increased disclosure of the qualification of valuations to investors would be a far more proportional approach than wholesale forced suspension of funds.

We appreciate that in 2016 there were some differences between the methodology used by fund managers to provide a fair and reasonable value for their funds. We understand that some investors were concerned how the adjustments made to values differed between funds, although we are unaware of specific material complaints being received. We believe this could be remedied by greater disclosures to investors on the approaches which an AFM may use given a similar situation.

The IA and DATA produced a guide to Fair Value Pricing in 2008. We propose to consult with The IA and DATA on updating the guide using the experiences of AFMs who have used fair value pricing. This may lead to more consistency in the methodologies used for fair valuing

funds in future. Fair valuing assets enables funds to stay open and provides investors the option to sell their holdings or invest in the fund if they wish. Suspending dealing in the fund does not give the investors that option and should only be used if it is not possible for the AFM to provide a reasonable and fair price for the fund's units.

Alternative proposals:

- Enhanced disclosure should be provided to investors when valuations have been qualified, including advising investors of the approach and methodology the AFM will adopt when considering fair value pricing.

- A working group is set up between RICS, SIVs and wider property market participants with regard to considering the definition of material uncertainty.

- AREF works with The IA and DATA to update their best practice guide on fair value pricing for funds.

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.

20% seems a very low threshold and not a "significant proportion of assets". A fund may be able to reliably value nearly 80% of its scheme property and still have to suspend dealing. If the FCA decide to implement the rules on mandatory suspension we believe this threshold should be at least 50%.

However, as we have mentioned in our response to the previous question we believe that the decision to suspend dealing should be made by the AFM if they are unable to provide a fair and reasonable unit price for the fund. We do not agree with a threshold being set at which mandatory suspension in dealing is imposed.

Funds with indirect exposure to immovable

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.

Under the proposals, a fund would have to suspend dealing if 21% of the value of its scheme property was held in funds that have suspended because the SIV have declared material uncertainty in the market for, for example, 22% of the value of their scheme property. In this example a fund would have to suspend dealing because there is material uncertainty in valuing less than 5% (22% of 21%) of the value of its scheme property on a look through basis. Although, this is an extreme example, it could happen if the FCA's proposed rules were implemented.

As we have explained in our response to Questions 7 and 8, we do not agree with the proposal for mandatory suspension and therefore do not agree with any threshold being imposed. If the

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underlying fund is fair valuing property the fund investing in the underlying fund should not need to suspend dealing.

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.

Whilst performing the threshold test on a look through basis would, on the face of it, resolve the issue explained in our response to Question 9, we agree with your conclusion in the consultation that this would not be practical or maybe even impossible to do so. The information to allow such a look through calculation to be performed may not be available (e.g. where the fund has a number of indirect holdings, some or none of which in isolation meet the threshold and will not therefore be declaring/disclosing valuation uncertainty) and at the very least there is likely to be a lag between one fund and the other suspending creating the potential for first mover advantage.

Once again, this emphasises our concerns with the practicalities of mandatory suspension.

Role of Depositary in Suspensions

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

Where mandatory suspension is imposed due to a fund meeting certain criteria we agree there is no point in a fund obtaining agreement from the depositary prior to suspending dealing. However, we would like to think that the depositary is notified as soon as the SIV has indicated to the AFM that they may declare there is material uncertainty on property values. It is important that depositaries are involved in any decisions to suspend dealing given their role in providing investor protection.

If the proposal for mandatory suspension goes ahead we appreciate it is planned to add COLL 7.2.-1 to the rules which states that the depositary must be notified prior to mandatory suspension in dealing being imposed. In addition, we would ask that it is made clear in COLL 7.2.1 (1) that it is only when there is mandatory suspension that a depositary's agreement is not required and in all other circumstances where suspension in dealing may be required the depositary's agreement must be obtained.

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?

The AFM should be in regular contact with the depositary while there is suspension in dealing in a fund and both parties are required to review fund suspension every 28 days. We agree that the depositary should approve the lifting of suspension regardless whether the suspension was mandatory or not.

We would ask the FCA to provide more clarity around when they would expect a fund to resume dealing. We would suggest this takes the form of guidance on how the FCA expect the AFM and depositary to ensure dealing is resumed "as soon as reasonably practicable".

Better contingency planning

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

We agree that AFMs of funds with inherently illiquid assets should have liquidity management contingency plans as described in section 5.4 of CP18/27. We do not believe this should be a separate document but it should form part of the liquidity management policies the AFM already has in place. We would appreciate it if the FCA could make it clear whether the contingency plans could be within AFMs' liquidity management policies.

Although in the consultation you mention Recommendation 16 in IOSCO's Recommendations on Liquidity Risk Management for Collective Investment Schemes, there is nothing in the proposed rules saying that the AFM should periodically test their contingency plans. We would ask the FCA to clarify in the rules or guidance to the rules their expectations for AFMs to periodically test contingency plans.

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

We suggest that the contingency plans should be expanded to include how a fund should go back to "normal" dealing. This should include resuming dealing after suspension and how the use of any other liquidity tools would be withdrawn.

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?

We agree that in principle a written agreement with third parties is a good way of ensuring they are able to implement the contingency plan. In practice it may be more difficult to obtain this agreement from parties such as platforms. They may not have the systems in place to be able to implement easily processes such as suspending dealing.

Rapid sales of immovables

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?

We welcome the guidance on the use of rapid sales in exceptional circumstances. We agree that where there is a high level of redemptions, the AFM could look across the fund's portfolio of properties and decide if the best course of action would be to sell a property or properties quickly. As you say in the consultation paper, the fund's valuation would reflect the intention for

them to be sold more quickly than normal to ensure investors receive the appropriate price for a unit.

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

We agree that if this proposal is carried forward the process for fair valuing properties for rapid sales should be clearly disclosed to investors in the fund's prospectus.

Liquidity buffers and first mover advantage

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?

We believe that the guidance proposed would not reduce first mover advantage but actually encourage first mover advantage. Well-informed investors will just move quicker to leave the fund if they suspect there may be an event that could lead to an increase in redemptions. By not allowing AFMs to plan for possible increases in redemptions, the funds are more likely to have to suspend. This may discourage investors, who like to have daily liquidity, investing in the funds.

Some investors feel that it is prudent fund management for funds to be prepared for possible events by holding high levels of cash, whereas other investors prefer to be in funds that are nearly fully invested. The AFMs disclose the level of cash the fund holds on a regular basis to investors. It should be up to investors to decide if they would rather be in a fund with high or low levels of cash.

We do not believe that AFMs are being "speculative" by increasing the liquidity in their funds when there is a true concern that an event may occur that could lead to high levels of redemptions. COLL 5.5.3 says that funds should retain cash or near cash where it is necessary to meet redemption of units. In addition, we would like to highlight that this is not the only reason property funds hold large levels of cash. More commonly higher levels of cash are held due to the time and due diligence required to purchase property, the availability of suitable properties, matching the fund's investment criteria or simply increased inflows into the fund over a short period. Cash may also be held for tactical reasons in instances of a falling market where it is in the interest of the investors to not be fully allocated, plus a proportion of cash may be committed to future capital expenditure, thus exaggerating the apparent cash level.

Alternative proposal

In our response to DP17/1 we did ask for the range of liquidity tools to be extended to include deferrals of redemptions across multiple valuation points subject to a provision that investors must receive their proceeds within 185 days of their redemption request. This would give the AFM sufficient time to settle the sale of property held by the fund to enable the fund to meet the redemptions. Then, there would not be the need to hold cash to meet an expected increase in redemptions. Unlike full suspension this would enable funds to accept redemptions and give investors the certainty that they would receive their proceeds within 185 days. When dealing is

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suspended in a fund, investors do not know when they will be able to sell their units. When some funds suspended dealing in 2016, there were some investors asking to buy into the funds. With deferrals over an extended period, the AFM would be able to continue to issue units; an activity that would provide the much needed liquidity to mitigate redemption pressure and shorten, compared to full suspension, the delay in paying out redemptions. Another benefit of deferrals is that it would be possible for AFMs to monitor redemption levels and make the appropriate investment decisions. When a fund is suspended the AFM has no reliable way of knowing the expected level of redemptions when the fund reopens. Although, there is reference in paragraph 23 of Annex 4 of CP18/27 to the requests in DP17/1 to deferred redemptions and notice periods, there is no reason given why this has not been taken forward.

Guidance on the use of suspensions

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?

We welcome the assistance from the FCA to remove the perceived stigma of fund suspensions.

We agree with the proposed guidance, although as we do not agree with classifying funds as FIIAs would replace the beginning of the guidance 7.2.2G(1A) with "in the case of funds holding high levels of inherently illiquid assets,….".

Depositary oversight of liquidity risk management processes

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

We have no objections to the rules specifying that depositaries are expected to oversee AFMs' liquidity management systems and processes.

We would ask the FCA to clarify what is expected of depositaries to "provide an independent evaluation of the adequacy of the liquidity management arrangements". It is not clear if this is expecting depositaries to oversee liquidity management arrangements or give an opinion on them. If it is the latter this is straying into the investment decision process which is not the responsibility of the depositaries.

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

COLL 6.6.4BR seems to be overly prescriptive. We would prefer the rules just make it clear that it is the depositaries duty to oversee liquidity management arrangements and then guidance is provided to how depositaries should achieve this.

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Signposting liquidity risks

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

Has the FCA completed any research on whether investors understand what "inherently illiquid assets" mean? We do not believe this would meet the FCA's own challenge to reduce the amount of investment jargon used in investor facing documents or the Plain English Campaign's requirements.

We do not believe adding the proposed identifier to the name of the fund will better inform investors. As we have suggested in our response to Question 1 we believe it should be clear in the fund's objectives and investment policy that in certain circumstance the assets held by the fund may be harder to sell. It should be explained to investors the implications of this and that this would be in exceptional circumstances.

Also, there is the potential that the identifier would be shortened to fit into the number of characters on some systems which could mislead investors more.

Risk Warning

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

Firstly, as you will be aware, the fact that property funds differ in liquidity considerations to equity or fixed income funds and the different nature of the asset class is already factored into disclosure documents. However, we agree with highlighting in financial promotions, provided to retail clients, that "on rare occasions they may experience a delay when selling their investments" when there is insufficient liquidity in the fund to meet redemptions within the normal time frames. We feel that it should be made clear that this is likely to be a rare occurrence otherwise investors may believe the product is more risky than it is.

As we have mentioned previously we do not believe retail investors would understand the term "inherently illiquid" and therefore we do not agree it should be included in the risk warning. Also, we do not understand what the phase "need to accept a discount" exactly refers to and the use of "discount" may be misunderstood by investors.

We totally understand that a long explanation cannot be given within the warning as the FCA needs to take into consideration the limited space in KIDs for risk warnings and ensure the wording meets the requirements of the Plain English Campaign. However, we would like more clarity on what risks the warning is designed to highlight to investors. We would welcome meeting with the FCA to discuss this further and then we should be able to suggest alternative wording.

Disclosure in prospectus

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?

We believe that the proposed disclosures, to be included in the prospectus, would be sufficient to ensure investors and their advisers understand the liquidity risk management processes the fund could adopt.

Next Steps

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?

We believe that a year would be a sufficient period of time for firms to embed any new requirements.

We would appreciate guidance on the FCA's expectations around the amendment of fund documentation. Would this be expected to take place on one particular date or would it be phased in over the 12 months to coincide with the document review dates?