Institute and Faculty of Actuaries

CP18/40: Consultation on proposed amendment of COBS 21.3 permitted links rules

IFoA response to the Financial Conduct Authority

28 February 2019

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

We strive to act in the public interest by speaking out on issues where actuaries have the expertise to provide analysis and insight on public policy issues. To fulfil the requirements of our Charter, the IFoA maintains a Public Affairs function, which represents the views of the profession to Government, policymakers, regulators and other stakeholders, in order to shape public policy.

Actuarial science is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. Actuaries provide commercial, financial and prudential advice on the management of assets and liabilities, particularly over the long term, and this long term view is reflected in our approach to analysing policy developments. A rigorous examination system, programme of continuous professional development and a professional code of conduct supports high standards and reflects the significant role of the profession in society.

Q1: Do you agree with our proposal to allow investment in immovable structures or installations as above? If not, how could we change it?

Yes, subject to the following comments.

The FCA's consultation paper includes several comments about the long term investment horizon of pension investors being a potentially good match for patient capital investment. While it is true that the investment time period for an individual saving for their retirement may be long in total, this is likely to be made up of several shorter periods investing in a number of different funds e.g. as a result of changing jobs. There is therefore a constant movement of members into and out of funds, and this is what drives the desire for daily liquidity and – perhaps more importantly - daily valuation/pricing. However, it is common to offset money in and out of funds on a day to day basis, and if this results in a relatively stable cashflow position then daily liquidity may be less of an issue.

In addition, the cost of moving assets into and out of illiquid assets (compared to a similar number of holdings in liquid assets) can also create a potential barrier when schemes carry out bulk transfers of assets between providers or investment options, which could have a potentially negative impact on competition.

The charges typically associated with investing in illiquid assets can make them cost prohibitive in a charge cap environment. In general, this means that these assets can only make up a small proportion of a default investment solution. However, larger schemes with higher investment budgets may be able to make bigger allocations to these assets, since they can negotiate lower charges on administration due to economies of scale.

Q2: Do you agree with our proposal to remove, for firms that meet the conditions as above, the current 10% limit on the proportion of fund assets that may be held in land and property, relying instead on the overall limit on illiquid investments? If not, what percentage limit would you suggest is appropriate?

We suggest that the proposals should distinguish between the situation when the fund is being made available on a standalone basis for retail investors to self-select, or when the fund is being used as a component within a default investment solution. We agree with removing the limit in the latter case but we believe a percentage limit is still appropriate in the former.

Q3: Do you agree with our proposals only to allow additional investments if the conditions in paragraph 3.17 are satisfied?

Yes although the requirement for firms to ensure that the investments are suitable and appropriate for retail investors in the investment context in which they are being used may make it less likely that providers would be willing to make the funds available on a non-advised self-select basis as it is harder to 'prove' suitability.

Q4: Do you agree with our proposal to relax the requirement for unlisted securities to be 'realisable in the short term' and to replace this with a liquidity test at the level of the investment fund, as set out above? If not, how could we change it, if at all? Do you think either of the alternative asset-level restrictions would work better?

The test at a fund level would seem to make more sense. We do not think the other proposals would be effective as 'timeframe appropriate to the notice period of the investing fund' would typically mean daily liquidity, and 'timeframe consistent with the tenor of the unlisted security' would be impractical.

Q5: Do you agree with our proposal to remove, for firms meeting the investor protection conditions, the current 20% on holdings of assets through QIS/UCIS and instead rely on the overall limit of 50%? If not, how could we change it?

As we have stated in Q2, this depends on how the funds are being used and who they are being offered to. Removing the limit would not be appropriate if they are being offered directly to a retail investor but would be if offered to a provider/asset manager as a component of a multi-asset/managed fund.

Q6: Do you agree with our proposal to set an amalgamated overall threshold limit for firms meeting the conditions as above? If not, what could we change? Do you agree with the percentage level proposed, or if not, what should it be and why?

This proposal seems reasonable, especially in the context of the insurer's overall duty under PROD to ensure that the funds should be suitable for the consumers for whom they are being made available.

Q7: Do you agree that the obligation on firms to provide adequate risk warnings about liquidity and investment risk would contribute to better understanding of those risks by investors in unit-linked funds?

Providers already provide risk warnings in fund descriptions and fund guides – and should already be doing this under existing COBS disclosure requirements - but these are not necessarily well understood by customers. We would encourage the FCA to consider ways to increase the extent to which investors read risk warnings as well as their level of understanding.

Q8: Do you agree with our proposal to require provider firms to ensure that any unit-linked investment does not interfere with retail investors' rights to switch funds, take benefits or to withdraw or transfer funds? And our proposal that links to the new categories of investment are only offered/ taken up in suitable and appropriate investment contexts? If not, how would you change it?

We agree with the requirement for investors to be able to take contractual benefits. However, we note that policy terms and conditions typically allow providers to restrict certain transactions when an insured fund is in deferral e.g. fund switches or non-contractual withdrawals.