

Michael Collins
Financial Conduct Authority
12 Endeavour Square London E20 1JN

By email: cp20-15@fca.org.uk

2 November 2020

Subject: Response to CP20-15: Liquidity mismatch in authorised open-ended property funds

Dear Mr Collins,

INREV, the European Association for Investors in Non-Listed Real Estate Vehicles*, appreciates the opportunity to provide a few brief comments in response to this consultation. Our membership includes both investors and fund managers of open-end funds domiciled in the UK. Liquidity, transparency, fair treatment of all investors in open-end funds and economic stability are all important goals that we share with the FCA and with which we have long been concerned.

Executive summary

INREV welcomes this consultation and the opportunity to respond to the issues it addresses.

INREV has a unique role in representing institutional investors in UK and mainland European real estate funds. As indicated, our members include real estate fund management houses that operate in the UK and throughout Europe, some of whom also service retail/non-institutional as well as institutional investors.

INREV recognises the liquidity mismatch challenges associated with open-end funds holding underlying real estate and, in the of real estate funds serving institutional investors, has undertaken much work on identifying solutions to these and other challenges for such funds. For instance, INREV and the Association of Real Estate Funds (AREF) have focused on the operational issues and governance surrounding institutional open-end vehicle pricing and made practical recommendations that may be employed to make more informed decisions on the selection and effectiveness of pricing models. (see, e.g., Attachment 1: INREV-AREF Open-End Fund Pricing 2020 Consultation Paper, Phase 2, May 2020).

In addition, INREV has experience of other countries in Europe where the regulators looked to address these challenges for both retail/non-institutional as well as institutional investors.

For instance:

- INREV Guidelines (Attachment 2, pp. 10-17) which *inter alia* require that “overseeing the establishment of a fair liquidity mechanism and the disclosure of it to investors should be one of the objectives of a vehicles’ corporate governance activities”.
- The INREV study on “Pillars to Ensure Open End Fund Liquidity” updated in December 2018. (Attachment 3).
- INREV Report of June 2012 which focuses on the liquidity mismatch challenges for open-end real estate funds in Germany, recognising that Germany has since introduced reforms to address these challenges. (Attachment 4).
- INREV liquidity and pricing insights, liquidity considerations related to COVID-19, March 2020. (Attachment 5)

Although experience in other countries may not be within the scope of this consultation, INREV would welcome the opportunity to engage further with the FCA and provide more details on solutions adopted to address the challenges.

INREV recognises the merits of the principle of introducing notice periods in authorised open-end property funds, assuming the introduction of notice periods can be practically implemented and preserve the funds' current tax eligibilities.

On the issue of preserving the funds' current tax eligibilities, HMRC published a consultation on ISAs and authorised open-end property funds on 28 October. This consultation proposes permitting ISAs already invested in property funds to retain their investment should notice periods be introduced; however, new investment in these funds would not be permitted. INREV will respond to this consultation, proposing that new investment in such funds with notice periods be permitted.

Any policy change must be robust and neither jeopardise investor confidence nor result in other market stability risks materialising. For example, any resulting widespread disinvestment of pension funds and other institutional investors with commitments in open-end funds holding UK real estate investments would be highly undesirable.

Please note below our responses to the questions posed in the consultation.

Responses to questions

Question 1: Do you consider our proposals impact any groups with protected characteristics under the Equality Act 2010? Do you consider there are any issues which may be relevant to our obligations under the Equality Act (see paragraph 2.24)? If so, please provide details.

INREV does not express an opinion on this question.

Question 2: Do you agree with our proposal to introduce notice periods for UK authorised property funds? If not, what alternative proposal would you have to address the structural liquidity mismatch?

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In relation to scope, we suggest that 75% is an appropriate threshold for the definition of an FPIP that invests in immovables. Some investors are prepared to accept high cash levels in funds investing in property (and the reduction in resultant returns) in return for having the ability to redeem without a notice period. We propose that funds with less than 75% held in immovables would not have a notice period for redemptions: 25% or more held in liquid assets should address liquidity mismatch concerns.

Question 3: Do you agree that notice periods should be structured as described in this chapter? If not, why not and what alternative proposal would you suggest?

We agree that an irrevocable agreement is entered into at the commencement of the notice period, with the value being received by redeeming investors that is based on the price of the fund at the first valuation point after the expiry of the notice period.

We also agree that the manner in which funds accept subscriptions should not be changed; i.e., there should be no notice periods introduced for subscriptions.

Finally, we agree that AFMs should be required to provide appropriate warnings covering market risk which investors could be exposed to over the notice period, the length of the notice period and the irrevocable nature of the redemption requests.

Question 4: The instrument sets out two alternative notice periods with lengths of 90 days or 180 days in COLL 6.2.22AR(2)(e). Which of these is the best? If neither, what alternative length would you propose and for what reason?

We share the view that a normal time period for selling commercial property is between 60 and 90 days. We consider that in normal circumstances a 90-day notice period would be appropriate.

Question 5: Do you agree with our proposal regarding the interaction of notice periods and suspensions? If not, what alternative approach would you propose and why?

INREV shares the view that the introduction of notice periods would reduce the number of suspensions in open-end property funds for liquidity reasons. AFMs would have better insight of

forthcoming redemptions and ordinarily should be able to manage disposals of underlying assets to address redemption requests.

However, suspensions are still a valid liquidity tool. We assume that suspensions not invoked for liquidity reasons - for instance, when material uncertainty is declared over a material amount of a fund's assets - would not be affected by the FCA proposals.

Question 6: Do you agree that it is appropriate for FIIA rules to continue to apply to authorised property funds that operate notice periods?

INREV agrees that FIIA rules - for instance, the removal of the standard risk warning on financial promotions - should generally continue to apply.

Question 7: Do you agree that property fund NURS currently dealing no more frequently than monthly should not be classified as FPIPs, and so would not need to operate notice periods? Do you agree that all other property fund NURS dealing at monthly or quarterly intervals (whether existing funds moving to such dealing arrangements or newly authorised funds) should be classed as FPIPs and be required to operate notice periods?

INREV agrees there is a difference between the liquidity issues of daily dealing funds and those which accept deals less frequently. Funds servicing institutional investors commonly accept deals less frequently.

These funds should not be subject to a "one size fits all" policy given that the requirements of retail and institutional investors are different. This should be taken into account when determining whether a fund should be classified as an FPIP.

Question 8: Do you agree that we should introduce a transitional rule to avoid the potential of a step increase in the capital requirements of SIPP providers? If not, what alternative proposal would you make?

INREV does not express an opinion on this question.

Question 9: Do you agree that we have identified the other products and services that the change to notice periods would materially impact? If not, what other impacts should we consider?

INREV does not express an opinion on this question.

Question 10: What transitional arrangements do you think will be needed to implement the proposals in this paper? How quickly can they be brought into effect?

INREV strongly recommends that the proposals only be introduced if the introduction of notice periods can be practically implemented and preserve the funds' current tax eligibilities.

Question 11: Do you agree that the proposals in this paper for notice periods are preferable to placing other types of restrictions on funds that offer frequent dealing while investing in property assets (for example preventing them from future marketing to retail clients)? If not, what do you suggest?

INREV has experience of other countries in Europe where the regulators for looked to address the challenges relating to open-end funds holding underlying real estate for both retail/non-institutional as well as institutional investors.

Although experience in these countries may not be within the scope of this consultation, INREV would welcome the opportunity to engage further with the FCA and provide more details on solutions implemented in other countries which may be relevant to the challenges experienced in the UK.

Question 12: Do you think that other types of fund should be permitted to operate notice periods? If so, please explain which other funds and why.

INREV does not express an opinion on this question.

Question 13: Do you have any views on what further steps the FCA should take to accommodate long-term capital structures?

INREV represents institutional investors in UK and other European real estate funds, who are attracted to such funds as conduits for less liquid long-term growth capital. INREV supports the UK offering a transparent closed-ended or hybrid fund structure with unit trades not inhibited by transaction tax: the Professional Investor Fund (PIF) <https://www.aref.org.uk/resource/new-fund-vehicle-proposed.html>.

The PIF, which would be restricted to professional investors, would operate outside the authorised fund regime: for instance, not constrained by authorised fund requirements to offer tradeable units within a reasonable period at NAV. Other countries offer PIF-like structures and UK-based managers currently have to utilise such structures in the absence of an onshore alternative.

INREV hopes that the HM Treasury and the FCA will consider the merits of the PIF as part of the Government's review of the UK's funds regime, 11 March 2020 UK Budget announcement (2.208).

Question 14: Do you consider that there are any amendments to the fund rules (or other rules) which we should make to facilitate the development of a secondary market in units in property funds?

A small but growing secondary market for retail investors in open-end funds operates in Germany. INREV would welcome the opportunity to engage further with the FCA, and provide more details on the secondary markets operating in:

- Germany for retail investors; as well as
- the UK and elsewhere for institutional investors. INREV is actively involved in exploring transparency and other solutions which look to facilitate the operation of the secondary markets for institutional investors.

I hope with these comments that we are making a constructive contribution to this consultation.

Yours sincerely,

[signed]

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*INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe. INREV currently has 462 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in Europe.

Our fund manager members manage more than 500 European non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors. INREV's members represent almost all jurisdictions of the European Union's internal market and a range of underlying long-term investment vehicle structures, both CIVs and other non-listed real estate investment vehicles, the vast majority of which are Alternative Investment Funds ("AIFs") subject to regulation under the European Alternative Investment Fund Directive ("AIFMD").