

Financial Markets Law Committee (“FMLC”)

Asset Management Scoping Forum

Date: Thursday 12 December 2019

Time: 2.00pm to 3.30pm

Location: Simmons & Simmons, Citypoint, 1 Ropemaker Street, London, EC2Y 9SS



In Attendance:

Iain Cullen (Chair) Simmons & Simmons LLP

David Gasperow Orbis Investments

Kirsten Lapham Proskauer Rose LLP

Virgilio Diniz FMLC Secretariat

Katja Trela-Larsen FMLC Secretariat

Guest Speaker:

Chris Ormond Bryan Cave Leighton Paisner LLP

Regrets:

Phil Bartram Travers Smith LLP

Gregg Beechey Fried, Frank, Harris, Shriver & Jacobson (London) LLP

Richard Chapman AB Trading Advisors

Jonathan Gilmour Travers Smith LLP

Jon May Marshall Wace LLP

Neil Robson Katten Muchin Rosenman UK LLP

Jennifer Wood Alternative Investment Management Association (AIMA)

Registered Charity Number: 1164902.

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Minutes:

1. Introductions

- 1.1. Mr Cullen opened the meeting and invited attendees to introduce themselves.

2. Administration (Virgilio Diniz)

2.1. *The FMLC's Engagement with the Public Sector*

- 2.1.1. Mr Diniz delivered a short presentation providing an overview of the FMLC's engagement with public authorities.¹ He explained that FMLC is a charity which does not engage in lobbying; it does, however, interact closely with legislative and regulatory bodies in the U.K. and E.U. He provided examples of recent projects on which the FMLC had liaised with public authorities.

2.2. *2020 Forward Schedule*

- 2.2.1. Mr Diniz asked attendees to email the Secretariat should they have any comments on the draft Forward Schedule for 2020.

3. FCA Policy Statement on illiquid assets and open-ended funds (Chris Ormond)²

- 3.1. Ms Ormond explained this Policy Statement sets out the Financial Conduct Authority's ("FCA") response to the feedback received in relation to their Consultation Paper on illiquid assets and open-ended funds, and details the final rules and guidance, which will come into force on 30 September 2020. The rules and guidance aim to reduce the potential harm to investors in open-ended funds that hold illiquid assets, specifically non-UCITS retail schemes ("NURSS"), investing in immovables such as commercial property.

- 3.2. The LF Woodford Equity Income Fund ("WEIF") was suspended shortly after the Consultation closed in June 2019. This was an Undertaking for Collective Investment in Transferable Securities ("UCITS") investment fund. Ms Ormond noted that in the wake of the WEIF suspension work involving a broader consideration of the issues is underway at the Bank of England and FCA, which may result in additional consultation and/or changes to the rules and guidance in the future.

¹ Please see Appendix I

² Please see slides at Appendix II

- 3.3. Ms Ormond commented that the broad themes of the FCA final rules and guidance are improvements in the use of suspensions and other liquidity management tools, contingency planning, oversight arrangements, and more disclosure to investors.
- 3.4. Ms Ormond gave an overview of the rules' new definition of a Fund investing in inherently illiquid assets ("FIIA"), the new rules on suspension and liquidity management, the more explicit oversight function for depositaries and requirement for broader disclosure to investors set out in the Policy Statement.
- 3.5. Ms Ormond expressed her view that three takeaway points would be for fund managers to continue to explore the full spectrum of fund options that may fit their model, for fund managers to consider adopting some of the new rules before they become mandatory in a year's time and, on a wider industry level, this is an area in which to monitor developments.
- 3.6. A discussion followed on the FCA's decision not to proceed with guidance in the Consultation relating to limiting the accumulation of large cash buffers within NURs and how the FCA might revisit the rules and guidance following the recent announcement from M&G Investments that it was temporarily suspending dealing on its M&G Property Portfolio and M&G Feeder of Property Portfolio funds.

4. Any other business

- 4.1. No further business was raised at the meeting.

Did you know that although the FMLC is a charity and not a lobbying organisation...it has engaged significantly with public authorities?



Virgilio Diniz, Project Manager

Registered Charity Number: 1164902.

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The FMLC's charitable remit

According to its charitable remit, the FMLC has a tripartite mission:

- to *identify* relevant issues (the **radar** function);
- to *consider* such issues (the **research** function); and
- to *address* such issues (the **public education** function).

FMLC's engagement with public authorities

- The FMLC is NOT a lobbying organisation, but it has engaged significantly and effectively with public authorities;
- The engagement with public authorities is a natural adjunct to its radar, research and public education functions of identifying, considering and addressing issues of legal uncertainties;
- A few examples of topics on which the FMLC has corresponded with public authorities and has achieved effective outcomes and impact are set out in slides below.

U.K. withdrawal from the E.U. based on a free trade agreement not covering financial services – evidence to the House of Lords E.U. Financial Affairs Sub-Committee

- As an extension of work conducted by an FMLC Working Group examining whether a withdrawal from the E.U. based on a free trade agreement not covering the provision of financial services would have any legal ramifications for existing financial contracts, Professor Hugh Beale (University of Warwick) and Simon Firth (Linklaters LLP) gave evidence on the topic of post-Brexit contractual continuity to the House of Lords E.U. Financial Affairs sub-committee.



Colloquium on crypto-assets with the Chief of Staff of the U.S. Securities and Exchange Commission

- On 21st June 2019, the FMLC was delighted to welcome Michael Gill, Chief of Staff and Chief Operating Officer of the U.S. Commodity Futures Trading Commission (the “CFTC”), as keynote speaker at a colloquium on regulating crypto-assets. In the U.S., regulation of crypto-assets has evolved into a multifaceted, multi-regulatory approach and oversight is split between several federal and state authorities. The CFTC has responsibility over crypto-assets used in derivatives contract, or if there is fraud or manipulation involving crypto-assets traded in interstate commerce. Mr. Gill provided an overview of the development of crypto-assets and of the approaches taken by U.S. regulators in evaluating them. He outlined the CFTC’s priorities in considering whether and how crypto-assets should be regulated.



Review of Brexit “onshoring” legislation

- In recent months, the FMLC has focused on reviewing statutory instruments published in draft by HM Treasury under the European Union (Withdrawal) Act 2018. These instruments incorporate and amend (i.e., “**onshore**”) the E.U.’s legal and regulatory framework for financial services.
- The FMLC Secretariat was invited by HM Treasury to review draft versions of this legislation and, to facilitate a quick response to such secondary legislation, the Secretariat has organised meetings amongst leading organisations in the City, comprising representatives from the Brexit Law Committee, (the legal wing of the IRSG), the CLLS Financial and Regulatory Law Committees and the Law Society, to discuss coordinated responses.
- The FMLC has also published papers on the statutory instruments onshoring regulations relating to bank recovery and resolution, investment funds and their managers, markets in financial instruments, corporate insolvency, securitisation and the Benchmark regulation.

ESMA update on its Q&A on MAR in response to a letter from the FMLC

- On 5 September 2017, the FMLC received a response from the Financial Conduct Authority (“**FCA**”) on its paper that explores uncertainties as to the financial instruments that fall within the scope of the Market Abuse Regulation (“**MAR**”). The letter states that the FMLC’s analysis and recommendations stemming from this paper were circulated to the FCA policy team, who works with the European Securities and Markets Authority (“**ESMA**”) in its development of its MAR guidance materials. The letter flags that ESMA has updated its Q&A on MAR on 1 September 2017 to include a new Q&A 9 on market soundings, which seeks to provide guidance on some of the issues highlighted in the FMLC paper.

Summary and Conclusion

- The FMLC seeks to accomplish its radar, research and public education remits while also engaging with public authorities;
- Although the FMLC is NOT a lobbying organisation, it has charitable remits which are aligned with engagement with public authorities; engagement which serves to accomplish the charity's objectives of radar, research and public education.

Proposed 2020 Forward Schedule

- Tuesday 10 March 2.00pm to 3.30pm (U.K.)
- Monday 15 June 2.00pm to 3.30pm (U.K.)
- Tuesday 8 September 2.00pm to 3.30pm (U.K.)
- Monday 30 November 2.00pm to 3.30pm (U.K.)





Illiquid assets and open-ended funds: FCA final rules

FMLC Forum 12 December 2019

Chris Ormond, Associate Director KDL, BCLP

FCA Policy Statement PS19/24 on illiquid assets and open-ended funds; feedback to CP18/27

- Aim to reduce the potential harm to investors in funds that hold illiquid assets, particularly under stressed market conditions
- Relate to Non-UCITS Retail Schemes (NURS)
 - Not to be extended to Qualified Investor Schemes (QIS), with more knowledgeable investors
- BUT: in wake of June 2019 Woodford suspension, broader consideration by FCA and BoE underway
 - Depending on outcome of this work, additional changes may be consulted on in the future

Broad themes of the FCA's final rules

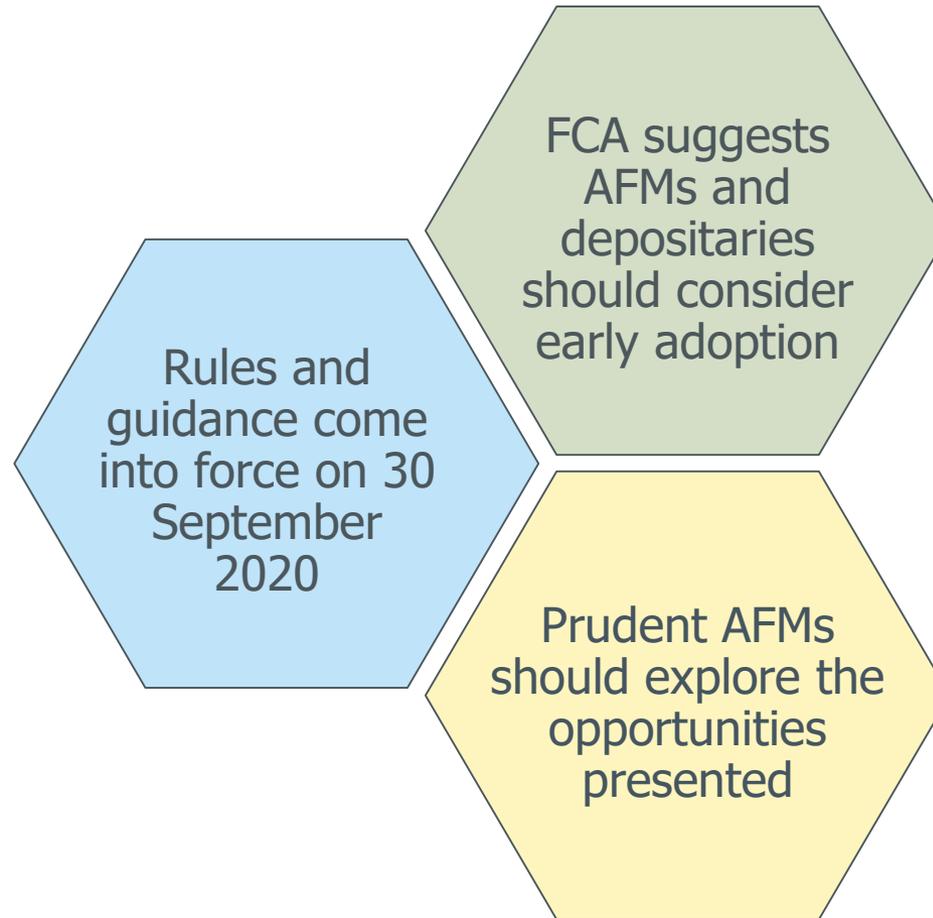
Improvements in use of suspensions
and other liquidity management tools

Contingency planning

Oversight arrangements

Disclosure to retail clients

Timing



Funds investing in inherently illiquid assets (FIIA)

New classification of FIIA

- A fund structured as a NURS
- Intends to invest at least 50% of its scheme property in inherently illiquid assets OR has in fact done so for at least 3 continuous months in the last 12 (whether or not their intention to do so was disclosed)
- Illiquid assets: real assets, transferable security not listed or traded on an eligible market; units in another FIIA or unregulated fund with similar features

NURS with limited redemption rights out of scope

- FIIA definition excludes NURS that invest in real estate/other immovables and where the prospectus/offering document provides for limited redemption (at least once every 6 months)
- Mandatory suspension rule will still apply

New rules on suspension

Mandatory suspension rule

- AFM of a NURS holding immovables must suspend the issue, cancellation, sale and redemption of units where there is 'material uncertainty' about the valuation of at least 20% of scheme property

Carve out to mandatory suspension

- AFM can continue to deal where it has agreed with the fund's depositary that this is in the fund investors' best interests
- Decision to be taken within 2 business days and reviewed every 2 weeks

Funds with indirect exposure still caught

- This rule still applies to NURS that have at least 20% of the value of their scheme property invested in one or more underlying funds
- Ensures fairer treatment of investors

Role of depositaries

- Depositary consent not needed for mandatory suspension
- AFM has to inform depositary of temporary suspension and agree any lifting of the suspension with it

New rules on liquidity management

Liquidity contingency plans

- To be produced (and disclosed in each fund's prospectus)
- Details to include: how an AFM will respond to a liquidity risk crystallising; range of tools and arrangements it may deploy; how it will communicate internally and to third parties; depositary liaison

Third party reliance to deliver contingency plans

- FIIA managers will have to obtain written confirmation from any third party on which they rely to deliver a contingency plan that they are able to place this reliance on them

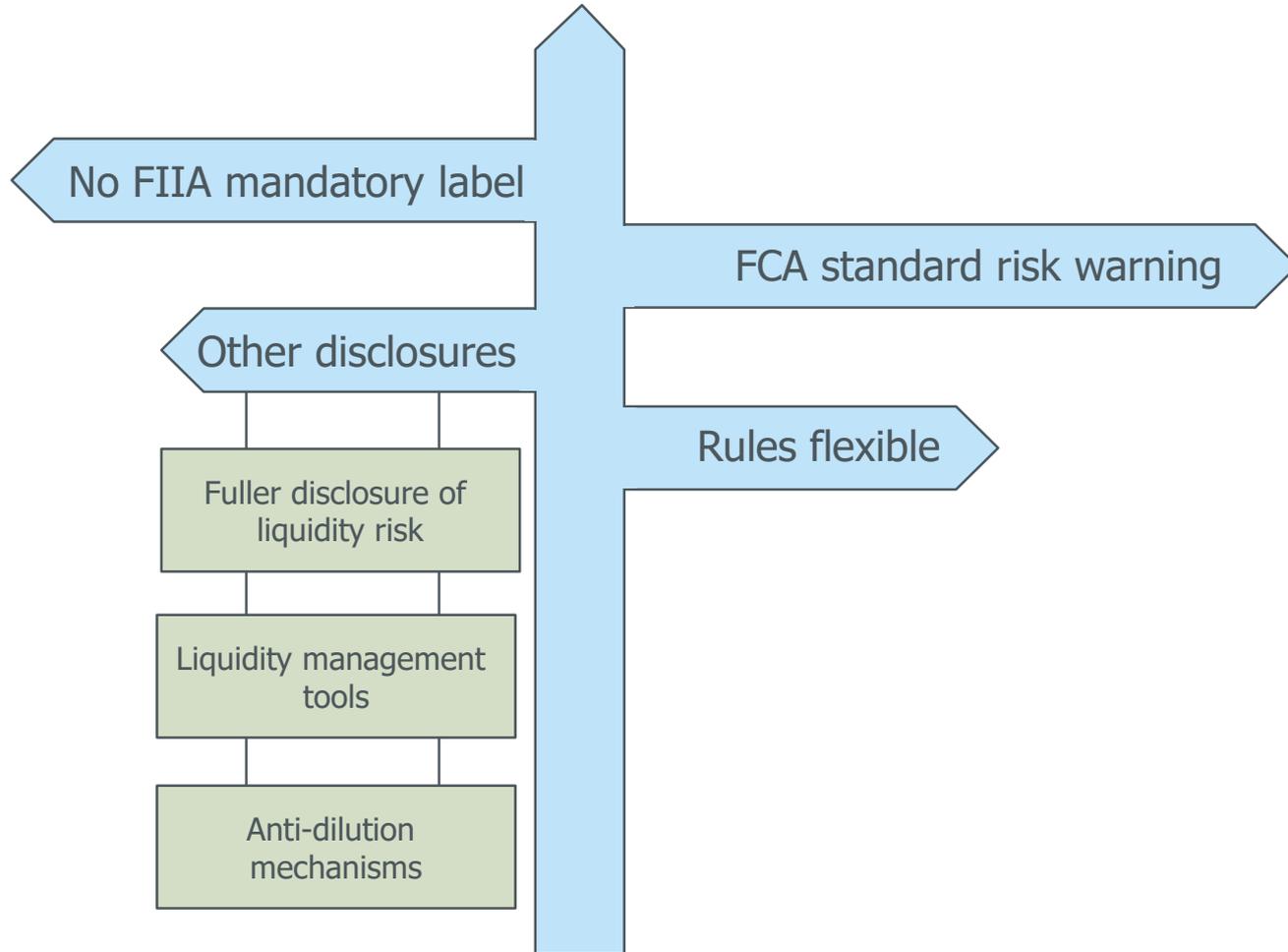
Fire sales and cash buffers allowed

- An AFM can anticipate selling assets quickly to meet redemption demand, if disclosed in prospectus
- FCA agreed to continue to allow the use of cash buffers for long periods to meet high levels of redemption requests

Depositary oversight

- Increased function in overseeing systems and processes to manage liquidity
- More explicit functions eg to establish an escalation procedure for potential non-compliance in this area (and inform the FCA if significant)

Risk warning and other disclosures for FIAs



Three takeaway points

- Fund managers: continue to explore the full spectrum of fund options that may fit their model
- Fund managers: consider adopting some of the new rules before they become mandatory in a year's time. Prudent AFMs should explore the opportunities presented.
- General/ industry: continue to monitor developments as policy makers make progress in their scrutiny of regulatory regimes and fund regimes in a broad and international context

Any questions?

