

10th August 2023

Financial Conduct Authority
12 Endeavour Square
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Submitted via email to: ps237@fca.org.uk

RE: PS223/7: Broadening retail and pensions access to the long-term asset fund

BlackRock¹ is pleased to have the opportunity to respond to the PS23/7: Broadening retail and pensions access to the long-term asset fund, issued by the Financial Conduct Authority (FCA).

We welcome the amendments to the Long-term Asset Fund (LTAF) distribution framework set out by the FCA in PS23/7. This is an important step towards granting retail investors access to a broader range of investment strategies that have typically been available only to high net worth, sophisticated, or institutional investors.

We also welcome the robust safeguards the updated framework puts in place for retail investors, and strongly support the FCA's decision to re-focus the risk warning on liquidity risk, rather than investment risk. As we noted in our response to CP22/14, liquidity risk is the most important difference between LTAF strategies and other mainstream or Restricted Mass Market Investments (RMMI).² It is therefore right that prospective LTAF investors are made fully aware of the long-term and illiquid nature of the underlying investments.

We agree with the FCA that “when appropriately sold with risk warnings and an appropriateness assessment, an unadvised investor should be able to understand those risks and only invest [in an LTAF] if [it is] within [their] risk and liquidity appetite”, and that “where LTAFs are sold on an advised basis, advisers are required to have undertaken a suitability exercise, which involves the adviser determining the investor has the necessary knowledge and experience to understand the risks involved in buying units in an LTAF.”

As we noted in our response to DP21/5, we support the principle that retail investors should be protected from the potential costs of misconduct or poor advice and offered compensation where this occurs.³

It is possible that end-investors will be given inappropriate advice to invest in an LTAF, or that LTAFs are not managed in accordance with their investment objectives. If this occurs end-investors would legitimately be able to claim compensation for misconduct. But there is a difference between whether an investment fund is appropriate or suitable for a given investor's risk and liquidity appetite, whether an investment fund that is by design less liquid is managed in accordance with its investment objectives, and – crucially – which types of firms should be held responsible for each issue.

¹ BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world. BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

² <https://www.blackrock.com/corporate/literature/publication/fca-cp2214-broadening-retail-access-to-the-long-term-asset-fund-102022.pdf>

³ <https://www.blackrock.com/corporate/literature/publication/fca-discussion-paper-on-compensation-framework-review-030422.pdf>

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With this in mind, we do not believe that there is a case for excluding LTAF from the Financial Services Compensation Scheme (FSCS) in its current form. Without a wider re-consideration of the purpose and scope of the FSCS, solely excluding LTAF from its coverage could signal that there are unique risks to investing in one – at odds with the wider objectives of PS23/7.

The publication of PS23/7 therefore re-emphasises the need to go back to first principles on the purpose of and rationale for the FSCS and make fundamental changes that recognise the differences between provision of financial or investment advice and provision of investment management services.

The FCA suggests that “providing FSCS protection [with respect to LTAFs] in circumstances where investors seek higher risk investment might be said to create a moral hazard by providing additional protections for an inherently risky product”. In our view, the FSCS does not and should not “provide investors with a safety net” with respect to the inherent riskiness of an investment *product*. It should, however, provide investors with compensation in cases where a) a firm is or was authorised by UK regulators; b) misconduct has been identified; c) the firm cannot meet the cost of redress due to insufficient resources or failure.

The FSCS should be viewed primarily as an insurance mechanism, available if firms cannot meet their own compensation liabilities. In our view, the true moral hazard generated by the FSCS stems from the current design of the funding classes, which infer a collective responsibility for the cost of misconduct and failure between all financial services firms; and where the costs of compensation are not fully internalised by the sectors responsible.

We continue to believe the compensation framework should adhere strictly to the ‘polluter pays’ principle, and should therefore be fundamentally reformed. Asset management firms should continue to cover any costs related to misconduct within their sector. But for the purposes of FSCS funding, the provision of investment management services should be separated out from unrelated financial services that pose a different set of risks to consumers.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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