

# The Future of Real Estate Funds & Illiquid Assets

# A review of real estate fund behaviour following the EU referendum

A report for The Association of Real Estate Funds



John Forbes  
CONSULTING LLP

24th

Financial Conduct Authority



Discussion Paper

DP17/1

**Illiquid assets and open-ended investment funds**



Febr



The Association of Real Estate Funds  
Camomile Court, 23 Camomile Street  
London, EC3A 7LL  
+44 (0)20 7269 4677  
info@aref.org.uk

Mark Glibbery  
Strategy & Competition Division  
Financial Conduct Authority

By email: [dp17-01@fca.org.uk](mailto:dp17-01@fca.org.uk)

8 May 2017

Dear Mark

**Response to DP17/1: Illiquid assets and open-ended investment funds**

We, the Association of Real Estate Funds<sup>1</sup> (AREF), welcome the FCA's discussion paper as a constructive and timely contribution. In particular the review of the events following the referendum provides a balanced account of the period. We also applaud the FCA observations throughout that there is a risk that imposing restrictions on activities or limits on exposures can be counter-productive both in their short term implementation and in their longer term consequences.

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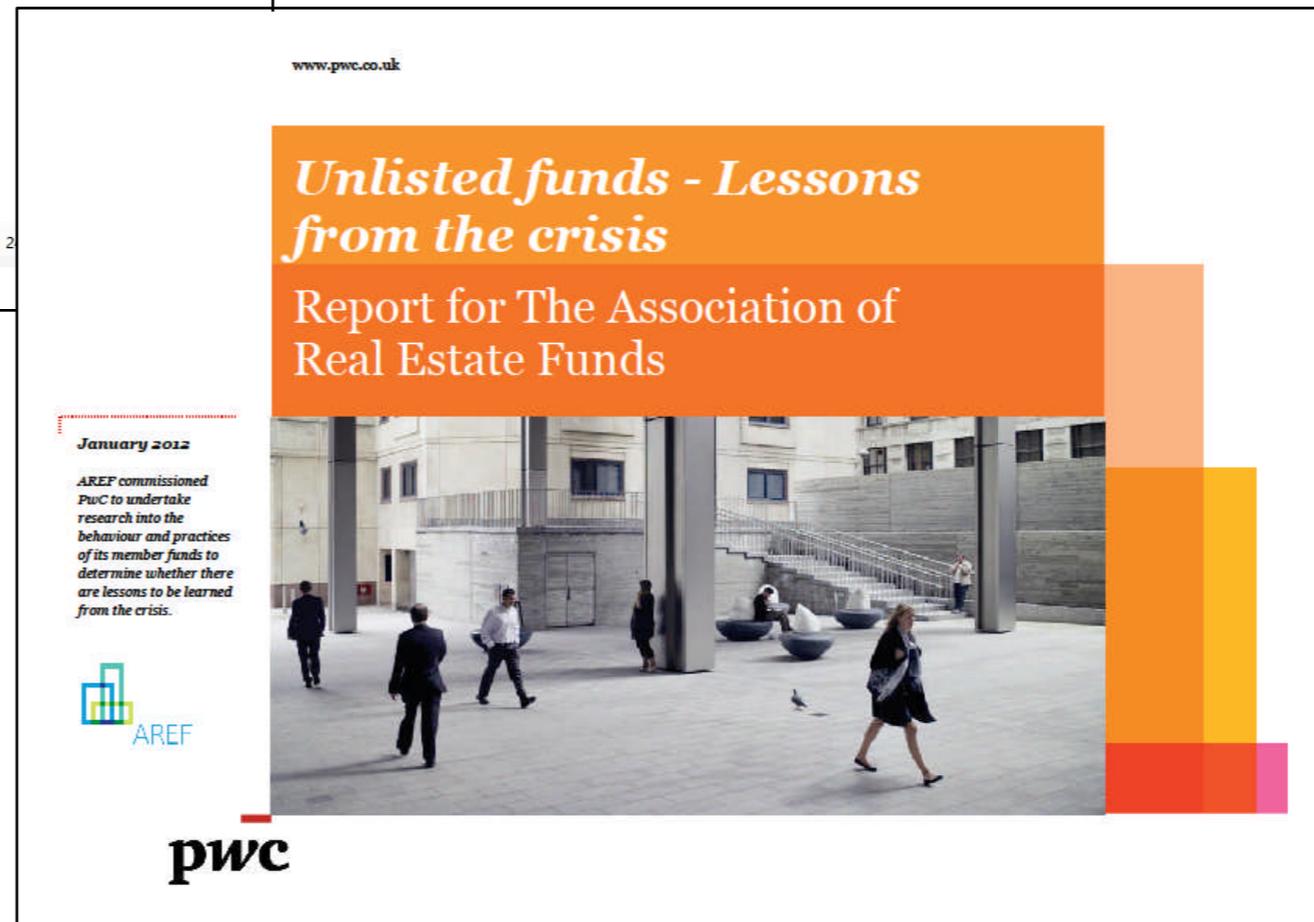
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Major differences from 2012.....



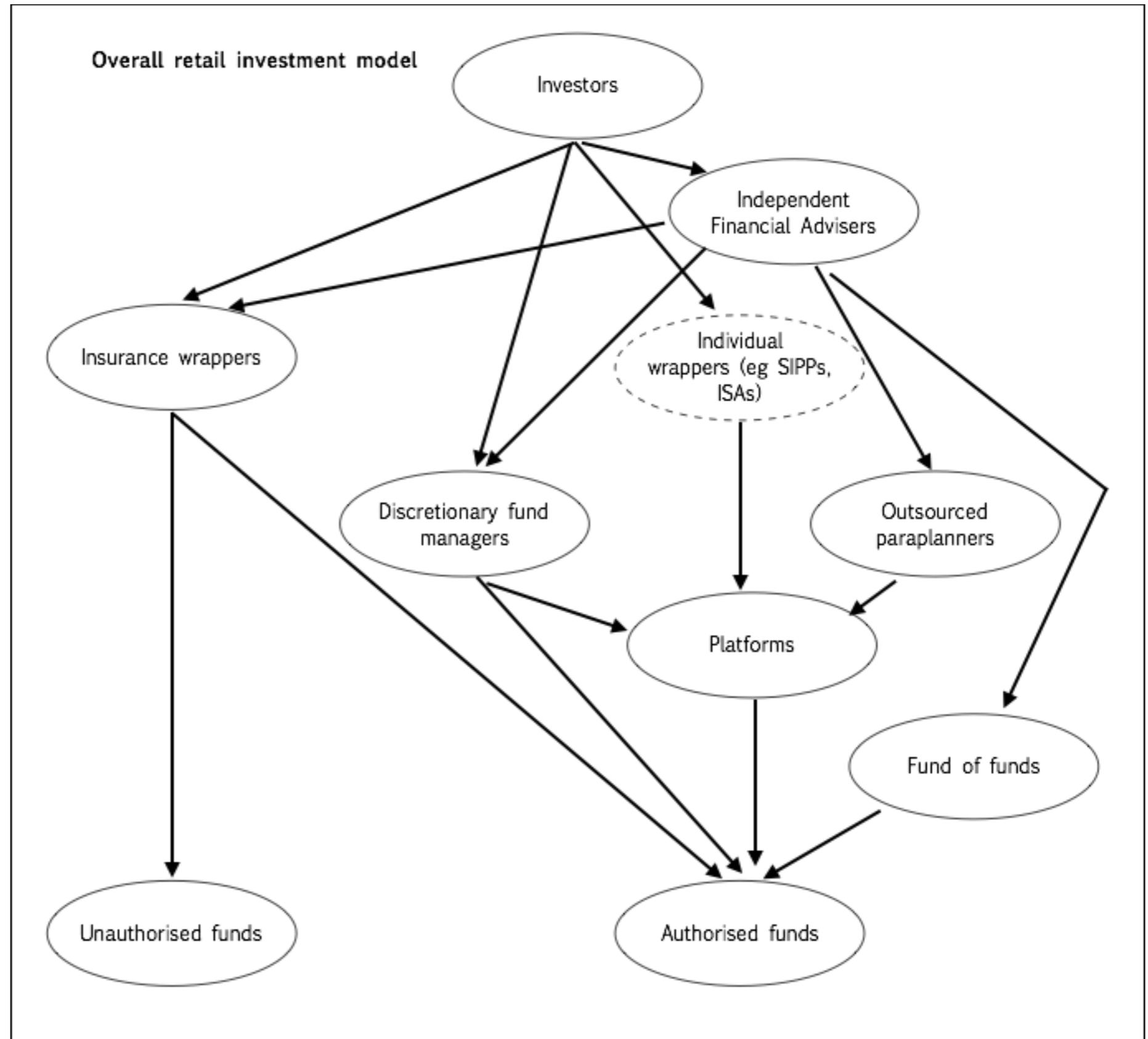
## Retail distribution

Retail Distribution Review  
2013

Regulation of retail funds

Operational issues from  
platforms

Importance of this



# Key findings

- Managers acted appropriately within the regulatory and operational limitations;
- Most managers had to choose between forced sales at distressed pricing or suspension. Investors did not know which route managers would follow;
- Uncertainty over valuation methodology;
- Limitations imposed by regulatory and operational framework;
- Retail investors have limited choice of different investment models;
- Similarity of issues in model portfolio money, unit linked insurance products and defined contribution pension schemes;
- Evolution rather than revolution in developing new fund models.

# Recommendations

## Review of regulation

We would recommend that the industry and the FCA work together to undertake a comprehensive review of the regulation governing retail investment in real estate as an asset class. We would recommend a review across all relevant regulation.

## Valuation

A review is required of the approach to valuation of the underlying assets of open-ended funds. This review should be a joint initiative involving FCA, RICS, AREF, and the DATA. Other organisations may also have relevant views.

## Communication

AREF should take a more active role in future in communication of broad real estate fund related matters for the retail investment industry and for the education of the intermediaries in that market, whilst taking care to ensure that this could not be seen as favouring any particular manager, fund or model..

## Product development

There would appear to be an opportunity following the post EU referendum liquidity events for product development for retail investors. We believe that this should go beyond direct retail investment and also look at insurance linked products and defined contribution pension schemes. AREF should take a lead on this, involving other organisations as appropriate.

## Timetable

Any changes to the structure and operation of real estate funds for retail investors and the retail distribution structure between the investors and the funds should be undertaken slowly, with extensive consultation and by evolution rather than prescription.

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Discussion paper issued by FCA in February.

Responses by 8<sup>th</sup> May.

AREF responded as did other industry bodies and fund managers.

What is in the discussion document and how did AREF respond?

Financial Conduct Authority

FCA  
FINANCIAL CONDUCT AUTHORITY

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February



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# FCA discussion paper DP17/1 and AREF response

## What are illiquid assets?

Q1: Do you have any comments on our description of the types of inherently illiquid assets that might be held in open-ended funds? Are there others you would consider inherently illiquid?

AREF response only on real estate but highlights similarity to other assets (especially infrastructure)

## Liquidity management tools

Q2: Do you have any observations on our analysis of liquidity management tools? Are there other factors affecting the liquidity management of open-ended funds investing in illiquid assets that we should take into account?

Tools should remain as varied and as flexible as possible, but more clarity regarding deployment.

Difficult in practice to second guess investor behaviour.

Role of valuation and valuers – “work with the FCA to help clarify the rules where ambiguity exists”.

Deferral and suspension.

Role of platforms.

# FCA discussion paper DP17/1 and AREF response

## Treatment of professional investors

Q3: What are your views on these, or other, possible approaches to the treatment of professional investors? Would these approaches be fair to retail investors in the same fund?

“We do not agree that retail investors and professional investors should not be allowed to invest in the same fund. In fact we think that to segregate in this way could compound the issues further and would remove some of the benefits of having a diverse client base e.g. diversification and scale.”

Practical difficulties of knowing who your ultimate investors actually are.

## Portfolio structure and liquidity buffer

Q4: What are your views on these, or other, possible approaches to the portfolio structure of funds?

Difficult in practice and likely to be counter-productive overall.

## Asset valuation and anti-dilution measures

Q5: What are your views on these, or other, possible approaches to the valuation of illiquid assets?

FCA, AREF and RICS to work together

# FCA discussion paper DP17/1 and AREF response

## Use of specific tools

Q6: What are your views on these, or other, possible approaches to the fund manager's use of specific liquidity management tools?

Problems with deferral mechanism regulations

Queuing versus pooling

RDR, the platforms and the practical challenges of knowing who your end investors are.

Restrictions imposed by ISA rules.

Direct intervention by the regulator

Q7: Do you think our analysis of the possible benefits and risks of direct intervention by the regulator is correct? Do you think the FCA should be more proactive about directing the actions of fund managers in a stressed situation, and if so how?

Yes.

More guidance would be helpful in the future.

# FCA discussion paper DP17/1 and AREF response

## Enhanced disclosure

Q8: What are your views on these, or other, possible approaches to requiring enhanced disclosure for funds investing in illiquid assets?

Regulations now enacted that will standardise such disclosures from the start of 2018 (PS17/6 KIID or EU PRIIP KID)

Dangers of being overly prescriptive.

## Secondary market provision

Q9: What is your view of the benefits and risks of a secondary market in the units of open-ended funds investing in illiquid assets? Should the FCA do more to encourage the development of such a market?

Practical difficulties and cost of providing this for retail investors. Who would use it in practice?

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