NEWGATE COMPLIANCE

Newgate News

August 2020

- FCA consults on new rules for open-ended property fund structures
- High court orders Avacade to pay £10,715,000 in restitution
- LIBOR transition
- Capital distribution and accounting update on LF Equity Income Fund
- FCA's Dear CEO Letter: 'We expect you to act to prevent harm to your clients'
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FCA consults on new rules to improve open-ended property fund structures

Investors in open-ended property funds can buy and sell units on a regular basis. This can leave the fund vulnerable to liquidity mismatch because the underlying property in which these funds invest cannot be bought and sold at the same frequency. Fund managers may then be forced to suspend dealings in the units of the fund. Reviews by the Financial Conduct Authority (FCA) have recorded repeated suspensions of these funds for liquidity reasons.

The FCA note that the current structure could disadvantage some investors because it incentivises investors to be the first to exit at times of stress, and thus potentially causing harm for those who remain if the fund suspends or assets are sold rapidly due to liquidity demands.

Impact: Medium

Impact assessment key:

- Low
- Medium
- High

The FCA is consulting on proposals to reduce the potential for harm to investors from the liquidity mismatch in open-ended property funds. The new rules would require investors to give notice – potentially of up to 180 days – before their investment is redeemed.

Newgate's advice: *The proposed period would allow the fund manager to plan sales of property assets so that it could better meet redemptions that are requested. Fund managers would be able to allocate more of the fund to property and less to cash for unanticipated redemptions. Indeed, repeat suspensions due to a lack of liquidity could be a sign of an inappropriate fund structure and can impact market confidence.*

The FCA has invited firms to give feedback and we would encourage clients affected by the proposed rule to put forward their view via the link below.

https://www.fca.org.uk/news/press-releases/fca-consults-new-rules-improve-open-ended-property-fund-structures

High Court orders illegal pension introducers Avacade, Alexandra Associates and their directors to pay £10,715,000 restitution to their consumers

Two companies and three individuals must pay restitution to members of the public who were induced to transfer their pensions into self-invested personal pensions (SIPPs). The order was made on Friday 7th August 2020 against Avacade Limited (in liquidation), Alexandra Associates (UK) Limited trading as Avacade Future Solutions (AA), Craig Lummis, Lee Lummis, and Raymond Fox.
Additionally, AA, the Lummises and Mr Fox have been banned from engaging in regulated activities in the UK without authorisation, making financial promotions and making false or misleading statements about regulated investments.

Newgate's advice: *This High Court order reminds us of the FCA's approach to reprimanding firms that engage in regulated activities beyond their permission/without permission, making unapproved financial promotions and actively misleading their clients about the returns on their investments. Please contact your Newgate consultant for reviews of any financial promotions to ensure that the content is clear, fair, and not misleading and a Vulnerable Customers Policy if required. Please see our July Newgate Newsletter for detail on the importance of treating customers fairly.*

https://www.fca.org.uk/news/press-releases/high-court-orders-illegal-pension-introducers-avacade-alexandra-associates-pay-restitution

Impact:

LIBOR transition – the critical tasks ahead of us in the second half of 2020

In a speech delivered by the FCA's Director of Markets and Wholesale Policy, Edwin Schooling Latter discusses the 'forward path' for the transition over to LIBOR. Key highlights from the Director's speech includes:

- Although LIBOR is not due to be replaced by the risk-free-rates (RFRs) until the end of 2021, the FCA encourage immediate action.

- At the end of August, the International Swaps and Derivatives Association (ISDA) should have finalised the protocol and other documentation through which outstanding derivatives contracts which reference LIBOR can transform to work on the new RFRs.

- The FCA urges market participants from all sectors – sell side, buy side, non-financial, to ensure they are ready for the end of LIBOR by adhering to the protocol that ISDA is producing.

https://www.fca.org.uk/news/speeches/libor-transition-critical-tasks-ahead-us-second-half-2020

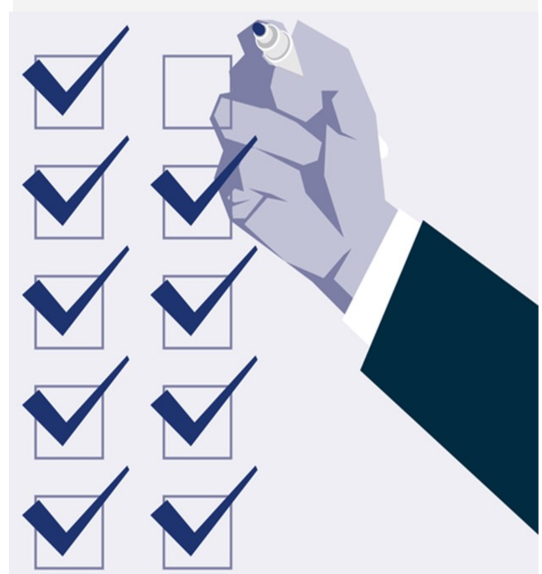
'The 4 to 6 months ahead of us are arguably the most critical period in the transition away from LIBOR. The time to act is now.'

Edwin Schooling, Director of Markets and Wholesale Policy

Impact:

Newgate's advice:

We encourage firms to ensure that they become confident in the protocol that ISDA is soon to provide regarding the transition from LIBOR. You will need to ensure you have signed the protocol within the four-month adherence period that ISDA will offer after the protocol is published. It is a regulatory requirement for supervised firms to have a plan for cessation or material change in a benchmark like LIBOR, and this is something that Newgate can assist you with.



Capital distribution and accounting update on LF Equity Income Fund (formerly LF Woodford Equity Income Fund)

On the 18th January 2020, Link Fund Solutions Ltd (LFS), the Authorised Corporate Director (ACD) of the LF Equity Income Fund (LFEIF), started winding up the fund. LFS considered the winding-up of the LFEIF to be in the best interests of all investors and enabled the return of cash to investors at the earliest opportunity.

Since this date, the LFEIF has returned £2.267 billion to investors in the form of 2 capital distributors: £2.124 billion in January 2020 and £143.2 million in March 2020. Following a sale of healthcare assets, a third capital distribution of £183.15 million will be paid at the end of August 2020. At this point a total of £2.45 billion will have been distributed to investors since the commencement of the winding up of the LFEIF.

Newgate's advice: *Suspensions by the FCA generally last no longer than necessary for a firm to allow the fund to rebuild sufficient liquidity to meet redemptions again. In the case of LF Equity Income Fund, the liquidity mismatch could not be resolved even with suspension. The FCA is currently consulting on extending the suspension period (up to 180 days) to ease volatility for these types of funds. Firms should be cautious when offering open-ended opportunities to clients, particularly by mitigating unrealistic expectations where liquidity is likely to be low, so to avoid investment moving out of the fund when market uncertainty arises.*

https://www.fca.org.uk/news/news-stories/capital-distribution-accounting-update-lf-equity-income-fund

Impact:

Dear CEO Letter: We expect you to act to prevent harm to your clients

Megan Butler, Executive Director of Supervision – Investment, Wholesale & Specialists Division, has published a Dear CEO letter for firms providing non-discretionary investment services. The Executive Director highlights that because of coronavirus, several firms who hold client money have reported an increase in client money balances in their reporting from January to June 2020.

Newgate's advice: *Senior Managers should consider whether the firm needs to hold client money balances which are unlikely to be reinvested, or whether it would be in your clients' interests to place these balances directly with their own current or savings account providers. Newgate would encourage you to have an open dialogue with clients about increased money balances to gauge whether these should be returned to them or continue to be held so to enable investment in the short term. To avoid potential action from the FCA, Newgate recommend that you record evidence of client correspondence of such permission where significantly increased balances are reported.*

https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-increased-client-money-balances-covid-19.pdf

Impact:

Capital market regulation and coronavirus

In a speech delivered by the FCA's Executive Director of Enforcement and Market Oversight, Mark Steward discusses building market and investor confidence. Key highlights:

- Capital markets work well when investors have confidence that there are effective rules or standards directed to tackling distortions and unfairness. The FCA's secondary market surveillance capability enables visibility over trading in the market so that they can identify and probe potential suspicious activity and distortions in the market.

- In cases of market abuse, investor confidence is encouraged when companies take effective internal remedial steps, such as over their governance and oversight structures. Compensation to affected shareholders will play an important part in addressing the consequences of market abuse.

- The FCA has introduced many temporary measures to address the difficulties faced by capital markets during coronavirus. The FCA continue to address the issues of creating a 'bridge' between the pre-coronavirus and post-coronavirus world.

https://www.fca.org.uk/news/speeches/capital-market-regulation-and-coronavirus

Newgate's advice:

The Executive Director's speech reiterates the importance of keeping your market surveillance tools up to date and fit for purpose. Please contact your Newgate consultant for updated market abuse risk assessments and MAR Training via the Newgate Training Centre. We have published consistently on the effects of Covid-19 on FCA decision-making, including extensions to the deadline dates for SMCR conversion. Please contact your Newgate consultant for information on changes brought about by Covid-19 and assistance with your compliance obligations as a result.

Impact:

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