

Democratization of Private Assets

The U.K. Long-Term Asset Fund



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J.P.Morgan



Background

Encouraging asset managers and owners to allocate a greater proportion of investment portfolios to longer-term investments and infrastructure has become an increasing focus point for national and regional policymakers. These ambitions have gained significance in the U.K.'s post Brexit environment, which emphasizes domestic economic growth and international competition, and aligns closely with global momentum on ESG and sustainability themes. While national priorities on economic development and employment may vary, a common objective is the alignment of financial services products and regulations with real economy outcomes.

In a significant step forward, the U.K. fund industry has recently seen the first fund launches under the new and highly anticipated Long-Term Asset Fund (LTAF) regime. The LTAF (and in-flight reforms to EU's European Long-Term Investment Fund (ELTIF) vehicle) is a direct response to this increasing demand for financial products which facilitate democratization of private asset classes and offer the ability to provide controlled liquidity facilities to meet distribution and end investor requirements.

The LTAF product is expected to continue to develop significant momentum due to U.K. policymakers' objectives of encouraging certain investor classes, particularly pension funds, to apply 'patient capital' i.e. financing real economy projects and new business startups, in order to enhance the international competitiveness of the U.K. as one of the leading fund hubs globally.

It is designed as an open-ended financial product dedicated to investment in illiquid assets such as real estate, infrastructure, private credit, private equity and venture capital, and the final rules set by the Financial Conduct Authority (FCA) in October 2021 reflect an extensive, industry driven development process to resolve a gap in the current U.K. fund range and meet demands of a target investor base.

In early 2023, J.P. Morgan Securities Services proudly supported the launch of the very first FCA authorized LTAF in the U.K. market. To enable the LTAF structure for our clients, J.P. Morgan developed an operating model which blends and builds on our deep expertise and capability in both the traditional and alternative fund services space, together with our ability to deliver at scale in respect of fund vehicles with enhanced fiduciary obligations and investor protection standards.

LTAF AT A GLANCE:

- Wholly new product based on Qualified Investor Scheme (QIS)
- Subject to the U.K.'s implementation of AIFMD and FCA product rules
- Requires a U.K. domiciled Authorized Fund Manager (AFM) and Depositary
- 'Expected' to be at least 50 percent invested in long-term assets
- Flexible investment powers subject to maintaining a spread of risk
- Borrowing limited to 30 percent of NAV
- Redemptions no more frequently than monthly and minimum 90-day notice period following a determination that redemptions can be conducted
- Retail distribution via new Restricted Mass Market Investment (RMMI) regime
- SIPP access as non-standard product
- Not yet Individual Savings Account (ISA) eligible

LTAf: The result of product development and industry collaboration

The LTAf regime was originally proposed as an industry led initiative spearheaded by the Investment Association (IA). Following IA’s recommendation to create a regulated vehicle for investors to access illiquid assets^{1,2} and to progress the IA’s design and develop solutions to other barriers to investing in long-term assets, the U.K. Government convened the Productive Finance Working Group (PFWG) in November 2020, co-chaired by the Bank of England and the FCA, with members from across the industry.

This close cooperation between the industry and policymakers continued following the launch of FCA’s LTAf consultation in May 2021 and the publication of final rules through Policy Statement 21/14 in October 2021. J.P. Morgan, as one of the leading securities services providers in the pensions, alternative and traditional fund sectors, welcomed the consultation

and supported the Depositary and Trustee Association and IA responses, consistent with our work within industry during earlier phases of the LTAfs development. We have continued to engage with the industry bodies and policymakers to ensure successful launch of the first LTAf and assist in shaping the recently issued Policy Statement 23/7. In this Policy Statement, FCA announced the final stage of opening the LTAf product to retail investors, self-select defined contribution (DC) pension schemes and Self-Invested Personal Pensions (SIPPs).

The industry welcomed this move by the FCA to expand LTAf to a wider pool of investors and it is anticipated that fund managers will pursue new LTAf launches or expand existing investment fund offerings through new share classes or feeder structures linked to a master LTAf.

Key Design Features

Open-ended structure

The choice of a regulated fund vehicle for the LTAf regime was deliberate, not only to allow for retail investor access but to meet demands from some institutional investors for a financial product with consumer level investor protection. IA’s design identified workplace DC pension schemes as the key target market for LTAf, with assets in DC pension schemes expected to double to £1 trillion by 2030³. This aligns with regulators and pension fund trustees responding to U.K. policymakers’ intentions to ensure pensions deliver value for money⁴, including initiatives on consolidation of smaller schemes and allocation of investment portfolios to longer-term assets.

An open-ended structure allows DC pension schemes and wealth managers to process regular cash inflows and balance investment portfolios as well as provide an alternative to a listed closed-ended vehicle. FCA’s October 2021 Policy Statement on LTAf also reflected industry’s recommendations to exempt LTAf from the permitted link rules⁵ that require underlying funds held by a unit-linked vehicle to have a 35 percent cap

on illiquid assets where forming part of a default DC pension arrangement. The pension fund trustees or scheme operator remain responsible for determining the proportion of any default DC pension arrangement which may be invested in illiquid assets or financial products such as an LTAf.

Liquidity Management

Given the open-ended nature of an LTAf, robust liquidity management controls and structural features such as redemption notice periods to manage potential mismatch between investor terms and the underlying assets were deemed critical for LTAf’s success. The LTAf regime therefore provides an extended liquidity management toolkit, consistent with the Financial Stability Board (FSB)⁶ and International Organisation of Securities Commissions (IOSCO)⁷ recommendations, imposing a minimum 90 day redemption notice period. FCA also requires LTAf to have valuation points no more frequent than monthly, with managers expected to set dealing frequency based on the target investor base and objectives and policy of the LTAf.

1 <https://www.theia.org/sites/default/files/2020-04/20200330-ukfrwgfinalreport.pdf>

2 <https://www.theia.org/sites/default/files/2021-02/20200731-ltafpositionpaper.pdf>

3 <https://www.bankofengland.co.uk/-/media/boe/files/report/2021/roadmap-for-increasing-productive-finance-investment.pdf>

4 <https://www.gov.uk/government/consultations/value-for-money-a-framework-on-metrics-standards-and-disclosures/value-for-money-a-framework-on-metrics-standards-and-disclosures>

5 <https://www.handbook.fca.org.uk/handbook/COBS/21/3.html>

6 <https://www.fsb.org/wp-content/uploads/FSB-Policy-Recommendations-on-Asset-Management-Structural-Vulnerabilities.pdf>

7 <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD590.pdf>

Investor Protection

In the context of investor protection, FCA’s June 2023 Policy Statement aligns retail LTAF with certain existing rules for U.K. retail funds. These include but are not limited to: corporate governance rules on shareholder meetings and changes to the fund; the operation of the investor register; use of liquidity management tools; and product fees. Exceptions to these additional investor protection requirements are provided for what FCA defines as limited protection LTAFs or share classes, that can only be marketed to professional clients and sophisticated or high-net-worth investors.

Investor protection will also be facilitated through strict governance requirements: fund managers seeking authorization must demonstrate they possess the knowledge, skills and experience to operate an LTAF. Assets must be valued by either an appointed ‘external valuer’ or the fund manager, provided that certain conditions are satisfied, including that the valuation is performed independently and the depositary is and remains satisfied that the manager has the necessary resources and procedures to carry out such a valuation⁸. An exemption exists for fund of funds vehicles which themselves have an external valuer, but this is difficult to apply in practice, for example where a fund holds other assets for liquidity purposes.

Key Market and Investor Considerations

Institutional Target Investors

The first LTAFs to market were generally seeded by or established to serve DC pension schemes, local government pension schemes and master trusts and this is expected to remain a key target market for any such product. U.K. policymakers and regulators have been clear on their expectations of the industry in this respect, citing benefits of long-term asset allocation in the context of long-horizon performance.

In order to support trustees in meeting these expectations, the PFWG (comprised of BoE, FCA and industry participants) issued guidance on investing in less liquid assets and required due diligence¹⁰. The Department for Work and Pensions (DWP) and The Pensions Regulator (TPR) have also indicated that

Tax

From a tax perspective, the rules permit LTAFs to be established taking a number of legal forms such as an open-ended investment company (OEIC), a unit trust or an authorized contractual scheme (ACS). U.K. policymakers have indicated an intent to ensure that the tax regime in place for the ACS and for Property Authorised Investment Funds (PAIFs) can continue to operate effectively in the context of an LTAF. HMRC enacted specific tax regulations⁹ to ease the conditions under which the “genuine diversity of ownership” (“GDO”) conditions are met, allowing LTAF to avail of the efficient tax treatment applicable to authorized funds.

In particular, the tax transparency and tax neutrality of the ACS is favorable. The ACS structure is well known to U.K. tax exempt investors (including pension schemes) and should enable access to beneficial withholding tax rates under relevant double tax treaties. However, it should be noted that the asset base for such relief may be narrower in an LTAF given its expected investment portfolio profile and input from a professional services/tax advisor would be necessary at the planning stage in order to assess the relative benefits and operational requirements of the respective potential legal entity types.

trustees without the necessary skills should assess what advice and input may be necessary to help them govern effectively¹¹.

A well-designed LTAF will continue to present a strong candidate for pension schemes to gain exposure to longer-term assets.

Retail Target Investors

The rules enabling broad retail access were delayed until June 2023¹², with FCA reportedly seeking to assess how the initial institutional market developed. Now that final rules have been published, LTAF can now be held through self-select DC schemes, SIPPs and certain long-term unit linked products. The prospects for LTAF’s retail offering will likely depend on the ability of fund

⁸ <https://www.fca.org.uk/firms/ltaf-valuation-pricing-requirements>

⁹ <https://www.legislation.gov.uk/ukxi/2021/1270/contents/made>

¹⁰ <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/working-group-to-facilitate-investment-in-productive-finance/pfwg-guides-investing-in-less-liquid-assets.pdf>

¹¹ <https://www.bankofengland.co.uk/-/media/boe/files/report/2021/roadmap-for-increasing-productive-finance-investment.pdf>

¹² <https://www.fca.org.uk/publications/policy-statements/ps23-7-broadening-retail-access-long-term-asset-fund>

managers and fund distributors to navigate FCA’s new RMMI rules and the Consumer Duty regulation requiring uplifted standards of consumer protection.

As an RMMI, LTAF can be marketed to advised retail investors only following completion of suitability tests, and unadvised direct investors must attest that holdings in RMMI will represent less than 10 percent of their investment portfolios and complete appropriateness assessments. Standardised risk warnings and summaries must also be offered to all investors, focusing on liquidity risks. In respect to the potential LTAF eligibility for ISA, industry still awaits further announcements from HM Treasury and HMRC on whether it will amend the ISA’s retail tax wrapper rules to accommodate LTAF’s notice period rules for redemptions.

J.P. Morgan’s LTAF Operating Model

The LTAF allows for a hybrid portfolio of liquid securities and illiquid investments including real estate and private funds. J.P. Morgan provides expertise, flexibility and scale, with clients able to benefit from our seamlessly integrated end-to-end operating model. This model combines the capabilities and infrastructure of both our traditional and alternative fund services. We offer a comprehensive suite of services which can be deployed on a modular basis to cater for typical prevalent features which fund managers may choose to incorporate in their LTAF proposition.

We are leveraging the core capabilities of our traditional fund accounting and administration platform which supports open-ended, multi share class funds in various legal forms. Our breadth and depth of knowledge across financial instruments and accounting standards ensures appropriate treatment for the extended mix of asset classes anticipated for LTAF. The platform can cater for multi-streamed returns from a single asset and offers flexibility in policy-based treatments for lifecycle events relating to underlying assets.

We offer an integrated solution across traditional and alternative fund holdings through specialist sub-ledgers for specific asset classes, for example utilizing J.P. Morgan’s private equity (PE) portfolio administration service where partnership-type structures, a vehicle of choice for many private assets mandates, are held. This service offers administration and accounting/valuation for closed-ended commitment-based fund types, maintains direct links with general partners

Similarly, self-select DC pension scheme investors may only invest up to 10 percent of the value of their interest in the scheme, or to the exposure level of the default arrangements in the relevant scheme, and such investors must be provided with a notice of illiquidity as they approach retirement age.

It remains to be seen how expanded distribution rules will impact the LTAF market. LTAFs structured as OEICs or master-feeder funds appear as potential candidates to provide retail eligible products. A further option may develop if the U.K. proceeds with its new Reserved Investor Fund (RIF) Contractual Scheme (CS). A RIF could act as an institutional seed vehicle which could be converted into a LTAF once it has achieved sufficient scale.

“As part of our core long-term investment strategy, J.P. Morgan has developed significant expertise and leadership in respect of both alternative and traditional fund structures. In leveraging and integrating our capabilities in both, we were delighted to support the launch of the first LTAF in the market earlier this year.”

Diane MacFarlane,
Securities Services EMEA Head

and fund managers to receive notice of capital calls and distribution activity, and facilitates cash wire preparation and settlement, as well as supporting updates of accounting records and cash-adjusted roll-forward valuations utilizing flexible rules-based options. In addition, our PE portfolio administration service leverages an Artificial Intelligence (AI) solution to automate data feeds and consumption of non-standard reporting for capital events and valuations, enabling straight-through-processing from general partners into J.P. Morgan systems.

Our tax transparent fund capabilities support LTAF where structured as an ACS. J.P. Morgan is able to deliver comprehensive investor and fund level reporting, including categorization of income and expenses employing the primary accounting record as source. J.P. Morgan is also able to provide custody withholding tax services to both opaque and transparent funds.

Additionally, we have extensive experience of engagement with relevant transfer agency providers to consume data in order to determine individual investors' proportionate interest in scheme property throughout a reporting period.

In respect of J.P. Morgan depositary services, we currently serve an extensive book of funds holding alternative assets including the infrastructure investments envisioned by policymakers in designing LTAF (and the EU ELTIF) fund rules. As such, we have built an experienced team and developed the processes and controls to deliver on our oversight obligations for funds investing in these types of illiquid or less liquid strategies, including focused procedures for the enhanced liquidity and fund valuation oversight necessary for an LTAF.

Looking ahead

J.P. Morgan continues to participate in industry discussions in respect to evolution of the LTAF regime and remains an active participant in the IA's LTAF Implementation Working Group.

In particular, J.P. Morgan is engaged with HM Treasury and the FCA through the U.K. industry bodies, advocating for alignment of rules relating to the registration of non-custodied assets (held by LTAF and other U.K. regulated fund structures) with standard AIFMD conventions. This industry dialogue has been recognized by the FCA in its June 2023 PS 23/7 Policy Statement.

Equally, we are committed to engaging with our current and future clients as the LTAF continues its momentum.

"We are committed to continue supporting our clients as they build and develop their own LTAF offering. Consistent with the other areas of our business, we are perfectly placed to partner and enable our clients by providing expertise and integrated product solutions."

Michelle Butler,
Securities Services Sales EMEA Co-Head



For additional information, please contact your J.P. Morgan representative.

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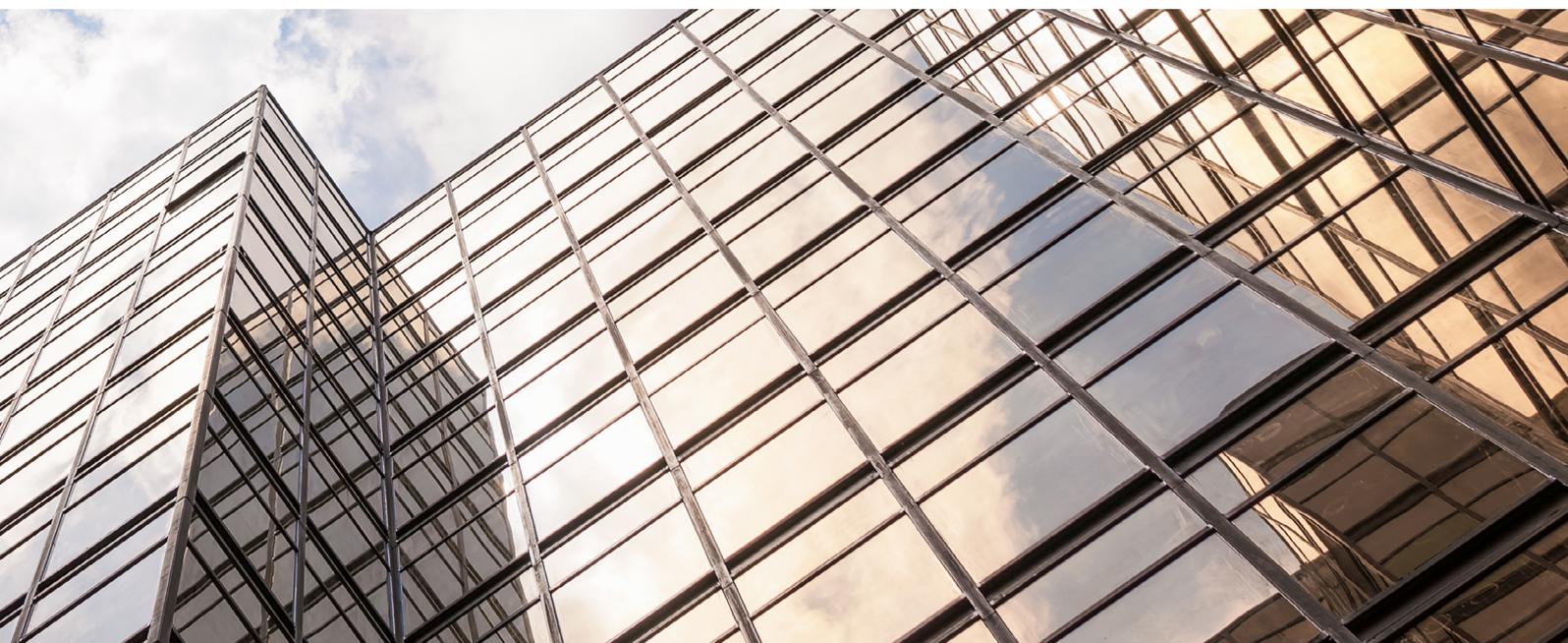
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