

Long-Term Asset Fund (LTAF)

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Long-Term Asset Fund

Introduction

The Long-Term Asset Fund (**LTAF**) is a category of authorised fund introduced in November 2021 and intended, in the words of the UK's FCA, "to facilitate investment in long-term illiquid assets combined with rules to address the specific risks these assets pose".

As such, the aim of the LTAF is to enable a wide range of investors (including retail) to enjoy better access to longer term, less liquid assets but ensuring at the same time that investors are provided with an appropriate level of protection.

The rules governing LTAFs can be found in Chapter 15 of the Collective Investment Schemes Sourcebook (**COLL**) in the FCA's Handbook, which notes that LTAFs are "only intended for investors that are, in general, prepared to accept a higher degree of risk in their investments or have a higher degree of experience and expertise than investors in a UCITS scheme or a non-UCITS retail scheme".

Legal structure

An LTAF may be established as:

- an authorised unit trust (AUT)
- an Authorised Contractual Scheme (ACS) or
- an Investment Company with Variable Capital (ICVC).

The LTAF manager

To ensure an appropriate degree of consumer protection, the authorised fund manager (LTAF manager) of an LTAF must be a full-scope UK AIFM (with permission of "managing an authorised AIF"). In particular, the FCA rules require that:

- a senior manager at the LTAF manager has responsibility for overseeing that the LTAF is managed in the best interests of investors
- the LTAF manager carries out an annual assessment of value of the LTAF (an obligation that applies for all UK authorised funds) which is designed to focus on whether the payments that are charged to the fund (including the charges of service providers) are justified in the context of the overall value delivered to investors
- the LTAF manager also carries out an annual assessment of how the LTAF is being managed in accordance with investors' best interests (this requires the LTAF manager to assess and report on at least four additional aspects of the operation of the LTAF: valuation, due diligence, conflicts of interest and liquidity management)
- the governing body of the LTAF manager must include at least two independent people or, if the governing body comprises more than 8 individuals, at least one quarter of that body must be independent. FCA rules include guidance on the meaning of "independent" for these purposes and
- the members of the governing body of the LTAF manager must also (a) possess the collective knowledge, skills and experience to be able to understand the activities of the manager and the risks involved, (b) commit sufficient time to properly perform their functions and (c) act with honesty, integrity and independence of mind.

Documentation

Instrument

Whatever form the LTAF takes, the instrument constituting the LTAF (i.e. the [trust deed](#) for an AUT, the [contractual scheme deed](#) for an ACS or [the instrument of incorporation](#) for an ICVC) must comply with certain content requirements set out in detail in COLL 15.3.6 (G). The Productive Finance Working Group has produced a [model instrument](#) for an LTAF which is structured as an ICVC – model versions for use where the LTAF is an ACS or an AUT are expected to follow shortly.

Prospectus

The authorised fund manager (LTAF manager) of an LTAF must ensure that a prospectus is drawn up. This must contain:

- certain minimum prescribed information (specified at COLL 15.4.5 (R))
- the prior disclosure information to be given to investors (FUND 3.2.2 (R) and FUND 3.2.3 (R))
- the periodic disclosure to be given to investors (FUND 3.2.5 (R) and FUND 3.2.6 (R)) unless published in the scheme's most recent annual report or half-yearly report.

If there is any materially significant change in this information, the prospectus must be revised immediately.

The prospectus must be offered free of charge to any person eligible to invest in the LTAF prior to his or her purchase of any units in it.

Key Information Document (KID)

If the LTAF is being “made available” to retail investors (see below under “Promotion of the LTAF”) it may qualify as a packaged retail and insurance-based investment product” or “PRIIP” and the “manufacturer” of the PRIIP (who will usually be the LTAF manager) will need to prepare a KID and anyone advising on or selling an LTAF to an retail investor must provide the KID in good time before they invest.

Reports

In addition, the LTAF manager must prepare an annual, half-yearly and quarter-yearly report on the fund. These must contain the information set out in COLL 15.5.3 (and COLL 15.3.4, if relevant), COLL 15.3.5 and COLL 15.5.9 respectively.

Again, a copy of the latest annual, half-yearly or quarter-yearly report must be provided free of charge to an eligible investor prior to investment. Only the annual report needs to be audited.

Promotion of the LTAF

When they were introduced, LTAFs were categorised as non-mainstream pooled investments (NMPIs), meaning that units in an LTAF could only be sold or marketed to (a) professional clients (within the MiFID definition), (b) certified or self-certified sophisticated investors or (c) certified high net worth individuals (HNWIs) as if the LTAF was an unauthorised fund, despite the greater levels of protection that it offers.

The NMPI rules have been widely criticised as being cumbersome to operate in practice as well as imposing too high a compliance burden upon distributors including wealth managers to justify building distribution capability internally. Platforms have similarly struggled to implement the rules.

The intention from the outset had always been that LTAFs should be open to as wide a range of investors as possible (subject to appropriate investor protection measures being in place). But, given its initial categorisation as an NMPI, when the FCA introduced new financial promotion rules in February 2023 following publication of [PS 22/10](#), “Strengthening our financial promotion rules for high risk investments”, a unit in an LTAF was categorised as a Non-Mass Market Instrument (NMMI).

In August 2022, the FCA consulted in [CP22/14](#) on further re-categorising units in LTAFs again – this time as “restricted mass market investments” (RMMI) under the new regime introduced by PS22/10.

The FCA published its final rules on 29 June 2023 in [PS23/7](#). As was widely expected, it went ahead with the re-categorisation to RMMI, with the new rules taking effect almost immediately, on 3 July 2023.

The re-categorisation means that:

- in addition to sophisticated and HNWI investors, all retail investors can now invest up to a total of 10% of their investable assets in LTAFs or other RMMI products, subject to going through the appropriate hurdles (i.e. the delivery of relevant risk warnings and making of an appropriateness assessment) and
- retail investors who invest based on a personal recommendation or advice are not restricted to the 10% limit of investable assets.

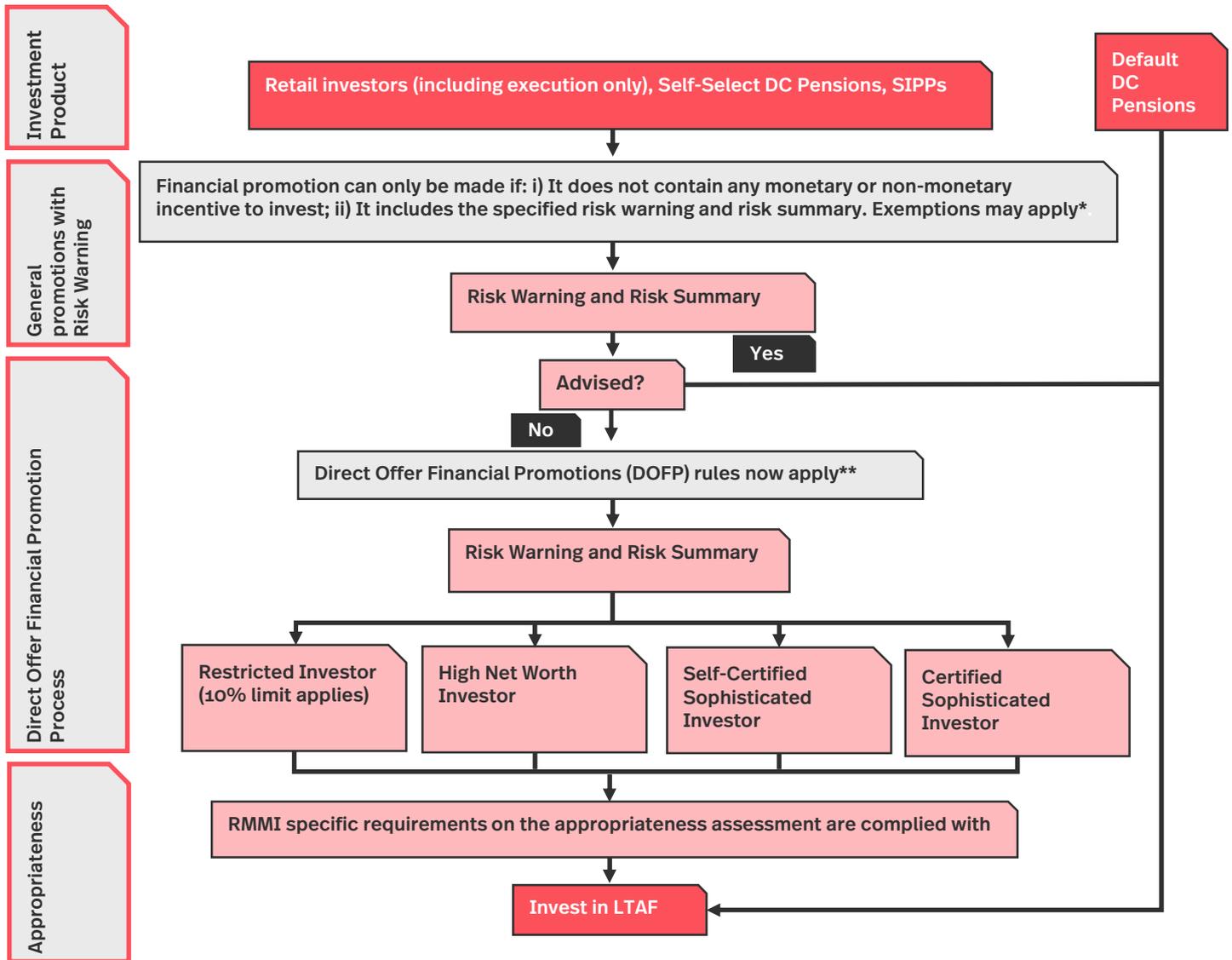
(The LTAF ‘consumer journey’ section on the next page includes a diagram representing the above.)

Financial promotion marketing restrictions product categories



- New framework for financial promotions – set out in [PS22/10](#) – in force from 1 February 2023
- Under this framework, a unit in an LTAF became a Non-Mass Market Investment (NMMI)
- PS23/7, though, re-classified a unit in an LTAF as a Restricted Mass Market Investment (RMMI)

LTAF consumer journey



Notes:

- * FPO exemptions apply
- ** Direct Offer Financial Promotion (DOFP) rules apply in almost all cases where investor is unadvised
- DOFP rules don't apply to advised clients who can invest in an LTAF without the 10% limit and the appropriateness assessment
- Classification as an RMMI enables LTAFs to be generally mass-marketed. If a firm wanted to move beyond general mass marketing and the prospective investor does not receive a personal recommendation, then the Direct Offer Financial Promotion (DOFP) rules apply. (PS 22/10 sets out detailed guidance on how firms should apply the DOFP rules.)

Investment powers

There are very permissive rules governing the types of assets and investment strategies that may be pursued by a long-term asset fund. The FCA states in guidance though that it “expects” the investment strategy of an LTAF to be to invest at least 50% of the fund’s scheme property in assets that are illiquid and need to be held over the longer term (COLL 15.1.2G(2)).

Whilst there are no detailed spread requirements the LTAF manager must ensure that the fund aims to provide a ‘prudent spread of risk’ (PSOR) – a concept that is not defined in the FCA rules but which must be given its “ordinary natural meaning” in the context of the fund in question taking account of its investment objectives, policy and strategy. COLL 15.6.4 (G) provides some guidance of matters to be taken into account when considering whether the fund has a PSOR.

Eligible assets – General provisions

An LTAF is able to invest in any assets or investments to which it is dedicated including those within articles 74-86 and 89 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 but subject to:

- any restrictions in COLL and
- any limitations set out in the instrument constituting the scheme and/or the prospectus.

This means that an LTAF is permitted to invest in a wide range of financial instruments, the most important of which include:

- deposits
- rights under contracts for insurance and under a pension scheme
- shares
- instruments creating or acknowledging indebtedness (bonds etc)
- government and public securities
- units in a collective investment scheme
- options, futures, contracts for difference
- emission allowances
- interests in real property
- interests in loans (subject to certain conditions – see below)
- precious metals (gold, silver and platinum) and
- commodities traded on a recognised investment exchange or recognised overseas investment exchange.

Investment in collective investment schemes (CIS)

An LTAF can invest in units in other CIS if the second scheme is:

- itself a regulated CIS (meaning any other FCA authorised fund or a recognised fund) or
- a scheme which the LTAF manager has taken reasonable care to determine:
 - is the subject of an independent annual audit conducted in accordance with international accounting standards
 - the calculation of its net asset value and the maintenance of its accounting records are segregated from the investment management function and
 - is prohibited from investing in the LTAF or, if there is no such prohibition, the LTAF manager is satisfied that no such investment will be made by the second scheme or by any fund in which it invests.

Where the other scheme is an umbrella, the above restrictions apply to each sub-fund as if it was, itself, a separate scheme.

An LTAF may invest more than 20% of its value in unregulated CIS or in Qualified Investor Schemes or other LTAFs if the LTAF manager has reasonably determined (following appropriate due diligence and all reasonable enquiries) that the scheme complies with relevant legal and regulatory requirements.

Where more than 20% is invested, the LTAF manager must carry out appropriate due diligence on these schemes 'on an ongoing basis' and guidance suggests that the LTAF manager should apply the due diligence guidance that applies to a non-UCITS retail scheme (NURS) (COLL5.7.11G(1) to (12)) as if it applied to an LTAF.

Finally, an LTAF may invest as a feeder fund into another fund to which it is dedicated (called a "qualifying master LTAF" in the FCA rules and which must meet certain criteria and operate on the principle of PSOR but which does not itself need to be an LTAF or indeed an authorised fund at all).

Lending and participation in loans

An LTAF can participate in, or originate, loans other than loans to:

- natural persons
- the LTAF manager, depositary and their affiliates
- anyone using the credit to invest in derivatives, crypto assets, precious metals or commodities.

Use of derivatives

An LTAF may invest using derivatives subject to a number of provisions in the FCA rules related to delivery of the underlying, cover and valuation.

The LTAF manager must also ensure that a risk management process is in place which enables it to monitor and measure the risk of the LTAF's derivatives positions, as well as their contribution to the overall risk profile of the LTAF. The LTAF manager must conduct the monitoring and measurement "as frequently as is appropriate".

Investment in real property

The rules in COLL 15 provide a potential new route for the structuring of open-ended property funds with the opportunity to align the liquidity of the fund with the asset base more closely. The rules, though, set out limits with which an LTAF must comply. These include:

- where an LTAF invests in an immovable (as defined in COLL 15.6.18(R)(2), its prospectus must identify the country in which this is located
- the LTAF manager must have taken reasonable care to determine that the title to the interest in the immovable is a “good marketable title”
- the LTAF manager must have received a report from an appropriate valuer that contains a valuation of the land or building, and which states that in the valuer’s opinion the interest in the immovable is capable of being disposed of in a timeframe consistent with the LTAF’s liquidity profile and redemption policy
- in the absence of such a report, the LTAF manager must have received a report from an appropriate valuer, which values the interest in the immovable and states both that (a) the immovable is adjacent to, or in the vicinity of, another immovable included in the scheme property and (b) in the valuer’s opinion, the value of the interests in both immovables together would at least equal the “price payable for the interest in the immovable and the existing value of the interest in the other immovable”
- immovables cannot be purchased if it becomes apparent to the LTAF manager that the report required under the above two bullets can no longer reasonably be relied on or if the price is more than 105% of the valuation contained in the relevant report.

In addition, a number of investment limits apply in respect of immovables. So:

- an LTAF is prohibited from investing in any immovable where the amount secured by mortgage exceeds 100% of the latest valuation by an appropriate valuer
- no option to buy or obtain an interest in any land or building held by an LTAF can be granted where this might unduly prejudice the scheme’s ability to provide redemption and
- the total of all premiums paid for options to purchase land or buildings must not exceed 10% of the LTAF’s value in any 12 month period (calculated at the date on which the option is granted).

Stock lending

An LTAF may enter into a repo contract or a stock lending agreement through

- the ICVC or its depositary at the ICVC’s request (where the LTAF is an ICVC) or
- its depositary at the LTAF manager’s request (where the LTAF is an AUT or an ACS).

However, the depositary is required to ensure that value of any collateral provided under the stock lending arrangement remains at all times at least equal to the value of the securities transferred by the depositary.

Where the validity of any collateral expires, the depositary or LTAF manager must determine that sufficient collateral will be transferred by close of business on the day of expiry.

Borrowing powers

An LTAF can borrow up to 30% of its net asset value – with no requirement being made as to the purpose for which the borrowing is entered into and so borrowing may be for liquidity, for efficient portfolio management or for investment purposes. Arrangements must be in place, however, to allow borrowings which take the scheme over this limit to be closed out.

For these purposes, “borrowing” is stated to include any arrangement (including a combination of derivatives) designed to achieve a temporary injection of money into the scheme property in the expectation that the sum will be repaid.

Liquidity Management

Open-ended: LTAFs are required to be open-ended in the sense that FSMA and related legislation requires that investors in authorised funds must have an entitlement to redeem their investment at a price “related to” NAV calculated in accordance with the scheme.

Whilst FCA rules set a maximum frequency for such redemption windows at once a month and a minimum notice period of 90 days, the minimum frequency and maximum notice are not prescribed and in practice the frequency of redemptions and the notice period applied for a given LTAF will depend on the reasonable expectations of the target investor group and the LTAF’s particular investment objectives, investment policy and investment strategy.

An LTAF manager is required to align the redemption policy with the liquidity of the underlying assets and demonstrate that during the fund authorisation process and on an ongoing basis. This is an important feature of the LTAF as a properly aligned fund will allow investors to understand the liquidity profile of their investment and to accommodate it within their own liquidity requirements. A mis-alignment of liquidity obligations of the fund to its asset base has been seen as the cause of historic difficulties for open-ended funds and the FCA is likely to investigate carefully the liquidity management policy of firms seeking to establish new LTAFs.

AIFMD: The LTAF manager must comply with the requirements for monitoring and managing liquidity risks that apply to all AIFs in accordance with Articles 46 to 49 of the AIFMD Delegated Regulation (as amended by Regulation 27 of the UK’s Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2019.) The LTAF manager must also (FUND 3.6.3(R)):

- employ an appropriate liquidity management system and adopt procedures to monitor liquidity risk and ensure the liquidity profile of the underlying assets complies with the redemption obligations of the LTAF and
- regularly conduct stress tests under normal and exceptional liquidity conditions.

Value assessment: The LTAF manager is also required to assess and report each year on the management of liquidity during the year including:

- how the liquidity profile has been consistent with the redemption obligations
- any liquidity management issues identified by stress testing
- if any accelerated sale has affected the price obtained for an asset, how the price was struck and
- how decisions around the application (or not) of a dilution levy/or swing price ensured fair treatment.

Liquidity management tools: the LTAF manager must ensure that the investment strategy, liquidity profile and redemption policy for the scheme are consistent and redemptions should be carried out so all unitholders who have requested redemption at any one valuation point are treated fairly.

The LTAF manager may employ various mechanisms to support the efficient management of the LTAF’s portfolio and to ensure fair treatment for all investors (whether looking to redeem or remain in the LTAF). Such mechanisms (which will be set out in the prospectus) might include:

- lock-up periods (where redemption for a defined initial period are prevented)
- side pockets (where specific illiquid or hard-to-value assets are separated from the portfolio)
- In-specie redemption (where an investor receives assets rather than cash – less common for less liquid assets)
- investor or fund level gates (ie deferred redemptions)
- extended notice periods and
- suspension of dealing.

Taxation

ACS (Co-ownership scheme - CoACS)

- Generally sold to UK DC pension schemes and other non-taxable investors only. Although in theory a CoACS could also be invested in by retail investors, as it enables each investor to benefit from their own tax status (e.g. tax exemptions/treaty relief etc.), this is administratively complex for retail investors (plus FCA rules require a minimum subscription for any ACS of £1 million for retail investors)
- Tax transparent for UK income tax and double-tax treaty (DTT) relief, potentially providing a better post-tax return for non-taxable investors than where a tax opaque fund is used, for example where underlying returns are in principle subject to withholding taxes unless a DTT applies and/or where a pension scheme may benefit from reduced withholding taxes
- Not subject to tax (but deemed opaque) for UK capital gains purposes
- May benefit from additional UK tax reliefs compared to other investment fund types, e.g. seeding relief for UK real estate (subject to meeting certain conditions)
- Management of a CoACS is exempt from UK VAT, although a UK manager of a CoACS may therefore suffer a restriction on its input VAT
- The VAT treatment of fund management more generally is currently under review by HMT/HMRC.

ICVC/ AUT

- Generally sold to retail and other taxable investors. Tax opaque for income - net income is taxed on distribution or accumulation in the hands of the investor at usual rates (with an offset for allowable revenue expenses including management and potentially certain performance fees)
- Although in principle an ICVC/ AUT is subject to UK corporation tax (at 20%) on income, generally material tax is not paid (and in particular dividends should benefit from a corporation tax exemption)
- Tax opaque for capital gains tax purposes but generally exempt from tax on gains
- Due to being subject to corporation tax on certain income profits, the ICVC can generally access the UK's DTT network, which puts it at an advantage compared to tax exempt funds elsewhere which may only be entitled to access certain DTTs under the relevant jurisdiction's DTT network (which is also likely less comprehensive than that of the UK)
- Management of an ICVC/AUT is exempt from UK VAT, although a UK manager managing an ICVC/AUT may therefore suffer a restriction on its input VAT
- The VAT treatment of fund management more generally is currently under review by HMT/HMRC.

Permitted links

An important route for investment by UK DC pension schemes is to invest via a life insurance platform which means that such the schemes become subject to the “permitted links” regulations that aim to offer consumer protection to the end retail client by controlling the types of exposures that a life wrapper can take.

The FCA Handbook specifies (in COBS 21.3) categories of assets in which firms may invest to provide linked benefits in unit-linked life policies where the investment risk is borne by a policyholder who is a natural person which clearly includes retail investors but which also encompasses DC pension schemes as it is the members who bear the investment risk.

Investment in funds

One such category of permitted assets is “permitted scheme interests” which includes:

- all authorised funds (other than LTAFs which are dealt with by the rules separately – see below)
- recognised schemes and UCITS
- qualified investor schemes (QIS) / EEA equivalents or other unregulated CIS provided they invest only in assets which are permitted links.

The last point effectively requires a look-through approach to all investments made into QIS and non-UK AIFs to ensure on an ongoing basis that they do not invest other than in asset types that are permitted links. So, whilst it is possible for unit-linked life policies to provide benefits linked to non-UK AIFs, there are operational complexities to this type of investment which require monitoring, data exchange and record-keeping.

It is worth noting that the permitted link comprising “permitted loans” requires (amongst other things) that the loan in question is fully secured by a mortgage or charge on permitted land and property. So a QIS or non-UK AIF that pursues a credit strategy and is to be used as a reference asset to provide benefits within a unit-linked life policy can only invest in loans secured on property.

Investment in LTAFs

The permitted links rules now allow both the default and self-select arrangements of a workplace DC pension scheme (that part of the scheme that relates to the contributions of members who have not expressed a choice of investments – sometimes called a “Default Fund”) in an insurance wrapper to invest in an LTAF subject to certain conditions being met, as the LTAF is a “conditional permitted long-term asset fund” (a type of ‘conditional permitted link’) in its own right under the FCA rules.

The effect of this that there is no requirement to look-through the LTAF to monitor its holdings as the rules do not require that LTAFs invest only in asset types that are permitted links.

Also, the rules now exclude a wrapped LTAF (meaning a unit-linked fund which includes an investment in an LTAF) from the calculation of the 35% limit on illiquid assets where the underlying investor is part of a Default Fund.

The conditions are that: (a) the nature of the LTAF does not prevent a policyholder from exercising any of their rights under the DC pension scheme policy within the contract timeframe, and (b) the investment risks of the LTAF are suitable and appropriate given the circumstances of the policyholder, the expected maturity period of the policy, and the purpose for which the policy is held. Note: The insurer must also assess on an ongoing basis the total exposure of the Default Fund to conditional permitted long-term asset funds and other investments of similar risk profile, and information requirements must also be met under which certain information will be given to policyholders about the fund, its risk profile and investment strategy

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