UKSIF
UK Sustainable Investment and Finance Association

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Dear Commissioner Barnier,

Thank you for the opportunity to comment on the European Commission's consultation on 'UCITS: Product Rules, Liquidity Management, Depository, Money Market Funds, Long-term Investments'.

Our response focuses on the issues raised in Box 10 under 'Section 8: Long-term investments', specifically questions 1, 2, 4, 5 and 10. The submission draws on consultation with some of our members, discussions with Eurosif – our partner at a European level – as well as our previous response to the Commission's consultation on the "Social Business Initiative: Promoting Social Investment Funds" in September 2011.

The issues of long-termism and moving to a more sustainable financial services market have recently been attracting attention from a wide variety of political decision-makers in the wake of the financial crash and we believe there is an urgent need to restore public trust and legitimacy to financial markets and investment products.

One example of the recent increase in policymaker interest in long-termism has been the 'Kay Review into UK Equity Markets and Long-term Decision-Making'[1], an independent review commissioned by the UK Government which analysed how well equity markets work to enhance the long-term performance of UK companies and to enable savers to benefit from the activity of these businesses. UKSIF fed into the Review at the consultation stage and we look forward to supporting the resultant Government policies which build upon Kay's recommendations to boost long-term decision-making.

We think that UCITS provides a valuable and successful investment fund framework and welcome the Commission's focus on long-term investment in considering changes to UCITS' scope. However, we think that although product design is certainly an important part of supporting retail investors to invest in long-term assets, other regulatory developments also play a key role; for instance, the UK financial regulator's Retail Distribution Review of financial advice may have significant consequences on the provision of financial advice, impacting access by retail investors to long-term investment opportunities.

[1] www.bis.gov.uk/kayreview Accessed October 2012.

About the UK Sustainable Investment and Finance Association (UKSIF)

UKSIF promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investment. We aim to support the UK finance sector to lead the world in advancing sustainable development through financial services.

UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 250+ members and affiliates include investment institutions, pension funds, banks, financial advisers, research providers, consultants and non-governmental organisations. For more information about UKSIF, please visit www.uksif.org.

From Section 8. 'Long-term Investment (Box 10)':

(1) What options do retail investors currently have when wishing to invest in long-term assets? Do retail investors have an appetite for long-term investments? Do fund managers have an appetite for developing funds that enable retail investors to make long-term investments?

Currently, UK retail investors have a range of ways to invest directly or indirectly in long-term assets. These include holding:

1) Equities of companies involved with infrastructure or property, either directly or through funds. For example the First State Global Listed Infrastructure Fund offers exposure to listed companies involved with infrastructure.
2) Bonds issued by companies or social sector organisations. For example, social sector housing providers may issue "social housing" bonds. Traditionally, UK retail investors had access to such assets only via funds but, in recent years, the London Stock Exchange has introduced a retail bond platform that assists retail investors to hold these securities directly.
3) Real Estate Investment Trusts (REITs).
4) Forestry, particularly as unregulated investments for sophisticated investors.
5) Investments which attract Enterprise Investment Scheme (EIS) and/or Venture Capital Trust (VCT) tax relief – this helps smaller companies carrying out qualifying activities to raise finance by offering a range of tax reliefs to investors who purchase new shares in these companies. This may be used, for example, to invest in community energy schemes.
6) Shares of unlisted companies such as 'Triodos Renewables', which holds renewable energy assets, or the Ethical Property Company, which provides offices for social sector organisations. Liquidity for these shares is provided via a stockbroker-run 'matched bargain' market.
7) Shares in Industrial and Provident Societies.

"Ethical" or "social" investment marketplaces such as Ethex[2] are now being launched.

In addition, retail investors can invest in funds that take a long-term responsible approach to investment and/or focus on industries that are growing in response to the challenges of sustainable development.

Significantly, there is a strong market in the UK in savings deposits that are committed for a specific time period which may be as much as five years.

In practice, these routes offer a restricted range of opportunities for retail investors to access long-term assets although the introduction of the retail bond platform and ethical/social investment marketplaces are very positive developments. EIS and VCT relief are intended for early stage companies and the total investments in companies such as Triodos Renewables and in Industrial and Provident Societies is very

[2] http://www.ethex.org.uk/

small by comparison with the assets in UCITS funds. In addition, some of our members have expressed concerns to us about the quality and communications of some unregulated investments, particularly in the forestry area, although they confirm that there are also high quality and responsibly marketed forestry opportunities.

Retail investors

There is evidence that UK retail investors and the public more generally support a long-term responsible investment approach which takes into account environmental, social and governance (ESG) factors and mega-trends like climate change. This is based both on feedback from our financial adviser members and UKSIF/YouGov research for National Ethical Investment Week 2012, the UK's 'Socially Responsible Investment Week', which indicates strong retail investor interest[3]:

- **45%** of UK adults with savings or investments want at least some of those to take green and ethical considerations into account, with **15%** wanting all their investments to do this.
- **46%** of UK adults want to put at least some of their investments into 'impact investments' such as social enterprises, which produce both a financial and a social or environmental benefit.
- **55%** are interested in knowing more about 'impact investments'

Although clearly responsible investment and long-term investment are not directly interchangeable concepts, from these figures it is reasonable to infer that there is also increased support amongst retail investors for products which enable them to invest in long-term assets as well as using a long-term responsible approach.

However, UKSIF's financial adviser members also report a number of barriers today to them advising interested retail clients on social investments which may be worthwhile considering, as one can reasonably assume that advisers would be similarly affected when offering advice on long-term investments more generally and that this would therefore impact the long-term investment options available to retail investors. These include:

1) Due diligence requirements: the adviser may not have access to the due diligence support needed to enable them to assess the suitability of the investment for a client. This may be due to issues of availability, skills or cost.

2) Regulatory support and professional indemnity insurance: the adviser's regulatory support provider or their professional indemnity insurance provider may veto or discourage advising on these investments.

3) Business model: a critical mass of interested retail clients is needed to justify the development of the required general expertise. This runs the risk that such advice is available only from specialist practitioners until the market reaches greater scale.

In the UK, we have seen emerging demand from institutional investors for investment in long-term assets like infrastructure which can deliver predictable income to match liabilities; as populations age, it is reasonable to assume that the underlying reasons for this shift will apply also to those individual investors who are investing for retirement income. Indeed, as demand for income from investments increases, it is important that regulatory structures support rather than inhibit corresponding increases in supply. This is particularly an issue for sustainable and responsible investors who may prefer to seek income from long-term assets that deliver clear social value, like social infrastructure or renewable energy infrastructure, rather than some more traditional income producing assets in the tobacco, defence or oil/gas sector.

[3] UKSIF/YouGov figures, National Ethical Investment Week 2012.

Given this anticipated demand for investment in good quality long-term assets from retail investors, we believe that ways to satisfy this need are currently more limited than is desirable and so welcome action at both a European and national level to boost the available opportunities and/or make them easier to access.

Asset Managers

As the UK retail investment market responds to the forthcoming changes driven by the Retail Distribution Review, we anticipate that investment managers will seek new opportunities attract a critical mass of investor assets. It is reasonable to assume that predictable investment income, lower volatility and lower trading costs are all features likely to attract retail investors in the current environment. For this reason, we anticipate investment manager interest either in offering long-term investment funds or in including long-term investments within their funds. Of course, it is also true that economic uncertainty may inhibit the launch of new products, particularly those requiring a longer-term commitment.

Increasing numbers of UK investment managers are now engaging with long-term responsible investment approaches in response to institutional client interest. One indicator of this is the growing number of signatories to the UN-backed Principles of Responsible Investment (UN PRI). These principles aim to help investors incorporate ESG issues into their decision-making and ownership practices by providing a voluntary framework. Figures from Summer 2012 show, for instance, that the UK ranks second globally in signatory numbers, with 143 signatories, behind only the USA (158) and ahead of Australia (124). In addition, the number of asset manager signatories in particular has increased by nearly 50% since Summer 2010.

Signatory Category[4]	**Summer 2012**	**Summer 2010**	**% Increase**
Asset Manager	84	57	47%
Asset Owner	28	22	27%
Professional Service Provider	27	26	4%

(2) Do you see a need to create a common framework dedicated to long-term investments for retail investors? Would targeted modifications of UCITS rules or a stand-alone initiative be more appropriate?

In terms of whether to modify the UCITS rules for long-term retail investment or whether to create a stand-alone initiative, we feel that there is merit in both ideas.

On the one hand, the UCITS brand is valuable and generally considered to be a success in the industry, meaning that it could be argued that long-term investments would benefit from it.

Alternatively, one could argue that a bespoke fund framework could offer a desirable alternative for supporting long-term investments for the following reasons:

1) The nature of UCITS is that assets tend to be relatively liquid - while the very nature of long-term investments is their low level of liquidity and, often, long lock-up periods.

[4] http://www.unpri.org/signatories. Accessed July 2012

2) It may be the case that 'splitting' the UCITS brand is undesirable and would cause confusion amongst investors, both those who are looking to invest for the long-term and those who are looking to invest in the more traditional types of UCITS funds.

3) Publicity for a bespoke framework could raise awareness of long-term investments, deepening consumer education and supporting fund marketing.

In principle, we would like to see solutions which would enable development of a range of approaches from 'pure play' long-term investment funds to funds where only a proportion of funds are invested in long-term investments and which can be combined with other appropriate investments.

(4) Should a secondary market for the assets be ensured? Should minimum liquidity constraints be introduced? Please give details.

While we feel that there is a need for retail investors to be able to realise assets under certain circumstances – for instance, in the case of death – the level of liquidity currently offered under UCITS is greater than most retail investors should require for their long-term assets.

For example, the experience and success of Fixed Term Deposit Accounts in the UK shows that retail investors are happy to accept limited liquidity for a significant period of time. Similarly, investments like 'Triodos Renewables' have operated successfully in the UK for many years, including making multiple share issues, using only a 'matched bargain' market which offers limited liquidity.

(5) What proportion of a fund's portfolio do you think should be dedicated to such assets? What would be the possible impacts?

UKSIF believe that requiring a fixed proportion of investments in long-term assets would be less desirable than allowing flexibility. In our view, funds should be able to offer options ranging from very limited exposure to 100% in long-term assets (so-called 'pure play' funds).

This would allow investment managers to position a fund for those retail investors wishing to 'dip their toe in the water' by combining long-term investments with other assets in the same fund or for those seeking pure-play funds to enable them to be overweight in long-term investments or to diversify by combining funds managed by 'long-term asset' specialists with different funds run by specialists in other assets.

We do believe that transparency is key. A flexible and principles-based approach to the implementation of fund transparency and labelling, led by the investment industry, is likely to be the most effective way to deliver positive outcomes for retail investors. This is more likely to enable innovation and appropriate cost compared with the use of EU law.

Appropriate consumer education, information and advice which would, for instance, ensure a proper understanding of what 'long-term' means, is also vital.

We are conscious that UK regulators are currently consulting on banning the promotion of Unregulated Collective Investment Schemes (UCIS) and similar products to ordinary retail investors. However, we feel that it would be inappropriate to prevent ordinary retail investors from selecting long-term investment products as a result of concern that unscrupulous product providers or advisers might offer inappropriate choices. We see transparency, labelling, consumer education, trustworthy distribution channels and removal of barriers to good quality advice as the most appropriate responses to this legitimate concern. However, another option, although less desirable, would be to consider the proposals raised in the UK 'Red Tape Challenge' on social investment that ordinary retail investors should be subject to a cap on such assets that they can hold through any one fund.

While considering a cap, we would like to draw your attention to French “solidarity funds”, most of which direct a certain proportion of funds to social businesses and most of which are UCITS funds and hence use existing UCITS provisions. Although there are two types of solidarity fund, one that we think could be worth considering as a model is the so-called 90/10 fund, which places 10% of invested sums with companies which are directly related to the specific ‘solidarity concerns’, while the remaining 90% is invested in other assets and companies which are well-rated for taking account of ESG issues. These funds have been very attractive to those retail investors who want some social investment exposure while ensuring that a large proportion of their assets remains liquid though, of course, limiting the proportion to 10% also restricts the potential impact. This might provide a suitable model for incorporating a broader range of long-term assets into UCITS funds.

(10) Regarding social investments only, would you support the possibility for UCITS funds to invest in units of EuSEF? If so, under what conditions and limits?

Feedback from our members suggests that it would be desirable for UCITS funds to be permitted to invest in units of EuSEF. Fund managers who have included a limited exposure to social investments within existing UCITS portfolios have concluded that this is welcomed by some retail investors as well as offering potential benefits from the resulting portfolio diversification. In addition, please see our comments in response to Q5 on the popularity of “solidarity funds” in France.

Our preference would be to leave the precise proportion of funds which could be invested in EuSEF to the market, assuming appropriate measures to ensure transparency.

We are aware that UK regulators have concerns about the exposure of ordinary retail investors to more illiquid and less conventional assets – as outlined, for instance, in the UK Financial Service Authority’s recent consultation paper on “Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes[5]” – and that restrictions might therefore be deemed desirable until EuSEF reaches a greater level of maturity to avoid UCITS funds being used to circumvent regulatory measures intended to protect such investors. In our submission to the UK Cabinet Office’s ‘Red Tape Challenge on Civil Society – Social Investment’[6] in September 2012, we supported the proposal for a pre-defined cap on investments by ordinary retail investors into social investment products in the short-to-medium term to address such concerns.

We trust that our comments will prove to be self-explanatory but if you would like any further clarification, do please contact us. We would be happy to take part in or facilitate any further enquiries into this issue that you might conduct in the future.

Yours sincerely,

Penny Shepherd

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[5] CP12/19 http://www.fsa.gov.uk/library/policy/cp/2012/12-19.shtml [Accessed August 2012]
[6] www.uksif.org.