BIA consultation submission: Patient Capital, Authorised Funds, and permitted links rules

February 2019

UK BioIndustry Association

Introduction

This submission is in response to two related consultations opened by the Financial Conduct Authority (FCA):

- DP18/10: Patient Capital and Authorised Funds[1]
- CP18/40: Consultation on proposed amendment of COBS 21.3 permitted links rules[2]

The BioIndustry Association (BIA) welcomes the opportunity to contribute to the FCA's considerations on patient capital, and specifically how access to it for small and medium sized enterprises (SMEs) can be improved through changes to the Authorised Funds regime and permitted links rules. The BIA has also responded to "CP 18/27: Consultation on illiquid assets and open-ended funds and feedback to Discussion Paper DP17/1" (see annex 1 for the submission).

The BIA is the trade association for innovative life sciences in the UK. Our goal is to secure the UK's position as a global hub and as the best location for innovative research and commercialisation, enabling our world-leading research base to deliver healthcare solutions that can truly make a difference to people's lives.

Our members include:

- Start-ups, biotechnology and innovative life science companies
- Pharmaceutical and technological companies
- Universities, research centres, tech transfer offices, incubators and accelerators
- A wide range of life science service providers: investors; lawyers; IP consultants; and investor relations agencies

We promote an ecosystem that enables innovative life science companies to start and grow successfully and sustainably.

Summary of the submission

- The UK has a thriving life sciences sector, which provides jobs and contributes to the economy, and delivers health and social benefits
- However, the life sciences sector, and especially the biotech SME sub-sector, lacks access to long-term patient capital, as noted by the Government's Patient Capital Review. The BIA therefore supports the FCA's consultations' aims
- The life sciences sector relies largely on specialist investors for finance, with institutions and other generalists underserving the sector. The public strongly supports medical research but there are currently few opportunities for retail investors to combine their interest in life sciences and investment

[1] https://www.fca.org.uk/publications/discussion-papers/dp18-10-patient-capital-and-authorised-funds
[2] https://www.fca.org.uk/publications/consultation-papers/cp18-40-consultation-proposed-amendment-cobs-213-permitted-links-rules

- The FCA should work to create more opportunities for retail investment in biotech SMEs, to provide real asset value growth opportunities to consumers, and seek to balance consumer protection with consumer demand for investment opportunities in the UK's innovative sectors. The BIA is concerned that the FCA's focus is overly-centered on patient capital for infrastructure rather than innovative enterprises. This means it is not fully aligned with the Government's Patient Capital Review and industrial strategy, including the Life Sciences Sector Deals
- Collective investment vehicles offer many advantages for those wishing to gain exposure to alternative assets like biotech. We would welcome more vehicles that allow investment in alternative assets and are able to be marketed to a wider group than only professional/sophisticated retail investors. There is significant evidence from other countries, including for example the US and France, that more generalist retail investors are keen to invest in biotechassets. At present they are underserved by the UK market because the investment options are extremely limited and those that do exist also invest in large multinational pharmaceutical companies and therefore only invest a relatively small proportion (if at all) in UK biotech assets. Put simply, if you are a UK general retail investor seeking exposure to UK biotech assets, where do you go?
- The Government and FCA should look at policy levers to increase the number of life science specialist Investment Trusts and Venture Capital Trusts, and other collective investment vehicles. Crucially, these need the scale to be able to follow their money to build successful businesses, and scale to be able to attract large institutional investment, from pension funds and sovereign wealth funds, for example. The BIA has conducted research with wealth managers into collective investment vehicle design, which we would be happy to share with the FCA
- The BIA supports the permitted links rules change to a) allow investment in illiquid assets as long as liquidity is maintained at the fund level and b) clarifying that assets need not be priced daily. These will help to remove barriers to pension fund investment in patient capital

Overview of the UK's life sciences sector

The UK has a thriving life sciences sector developing medicines and other technologies that save and improve lives. The sector employs an estimated 64,120 people and generates £33.3bn in annual turnover (2015 figures)[3]. It is supported by a service & supply sector that employs a further 54,900 people and generates £14.9bn in turnover.

Within the life sciences sector, there is a vibrant and innovative cohort of biotech SMEs, which are discovering and developing innovative new medicines and technologies at the cutting edge of scientific knowledge. Government figures[4] show that the UK biotech sector comprises almost 700 businesses, 71% of which are SMEs. These companies are developing innovative new medicines to improve the health of the population. The UK is also the European leader in life sciences, with more medicines in pre-clinical and clinical development than any other European country, with almost twice as many in development as our nearest competitor (France)[5].

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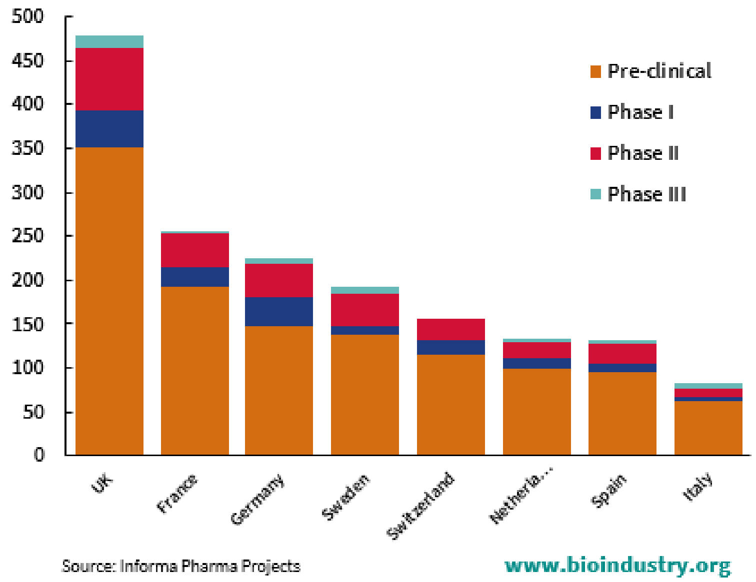
[3] PwC (2017), commissioned by ABPI, BIA, BIVDA and ABHI, The economic contribution of the UK life sciences industry
[4] DHSC/BEIS/OLS: Strength and Opportunity 2017: The landscape of the medical technology and biopharmaceutical sectors in the UK (May 2018)
[5] BIA/Informa (2018), Pipeline Progressing: The UK's Global Bioscience Cluster in 2017



Generally, each SME will be focussed on a specific disease area, with only one or a small number of candidate drugs in development. The R&D of these medicines (and other biology-based innovations) typically takes ten years or more, is highly capital intensive and risky, due to the nature of scientific research. The companies are generally pre-revenue and must therefore finance themselves through successive rounds of venture capital fundraising without additional income (while public listings are possible they are difficult to conclude and they are therefore increasingly not seen as a preferred finance source for small and emerging biotech companies). However, as the Government's Patient Capital Review rightly recognised, there is a current and particularly-acute gap in access to long-term and scale-up finance for life science companies in the UK.

The BIA therefore welcomes HM Government's and the FCA's focus on the patient capital agenda. This submission is informed by our interactions with both member life sciences companies and the investment community, we are therefore able to provide an informed view of both sides of the investor-investee universe. Our response is limited to policy perspectives rather than specific legal rules, which others will be better placed to comment on.

The need for more opportunities for patient capital investment in UK life sciences

Medical research is the most popular charitable cause in the UK and at least 8 million people donated to medical research charities in 2017[6]. Furthermore, 97% of the public think health research is important. There is clearly great interest within the UK population in supporting medical research but there are not currently enough retail investment opportunities for those who want to combine their altruistic and scientific interests with their investment interests.

The FCA's patient capital reforms are an opportunity to address this misalignment of interest and opportunity. Consumers should have the opportunity to invest in enterprises that will benefit their own and others' health *and* deliver real asset value growth for their savings and investments. As the regulator

[6] https://www.amrc.org.uk/pages/category/key-stats (accessed 18 Feb 2019)

responsible for protecting consumers, ensuring they can access real growth opportunities that outperform inflation and the market should be a priority.

However, the BIA is concerned that the consultation documents focus too heavily on patient capital investment in infrastructure and real estate, and not enough on innovative enterprises, such as biotech SMEs. Both are important and should be a focus for the FCA in this work.

How investment can be best facilitated

Collective investment vehicles offer many advantages for investors looking to mitigate risk by accessing an additional layer of diversification, addressing liquidity issues, and accessing specialist expertise. The BIA commissioned interviews with six private wealth fund managers and all expressed a strong preference for investing through collective funds and IP commercialisation vehicles when investing in biotech, rather than investing directly in the companies themselves[7].

Collective investment vehicles are therefore a helpful means through which retail investors can access patient capital investment opportunities. They also provide a means through which capital can be pooled to achieve a scale where it can be strategically invested to support a company as it grows. It is therefore problematic that the only approved funds that allow significant investment in alternative assets are Qualified Investor Schemes (QIS), which are only able to be marketed to professional and sophisticated retail investors. This means that individuals wishing to find funds that provide exposure to their sectors of interest and access the higher returns opportunities of these funds must pay higher fees due to the involvement of advisor middlemen. There is significant evidence from other countries, including for example the US, which has a very healthy private investment market and patient advocacy groups, and France, which operates the FCPI regime[8], that more generalist retail investors are keen to invest in biotech assets. At present they are underserved by the UK market because the investment options are extremely limited and those that do exist also invest in large multinational pharmaceutical companies and therefore only invest a relatively small proportion (if at all) in UK biotech assets. Put simply, if you are a UK general retail investor seeking exposure to UK biotech assets, where do you go?

The BIA recognises the need for a balanced approach to regulation to protect consumers, and believes this can still be achieved with a less-restrictive approach to Approved Funds. When reviewing the rules for undertaking for collective investment in transferable securities (UCITS) or a non-UCITS, the FCA should ensure that these funds can provide access to patient capital investment opportunities in innovative enterprises alongside infrastructure and real estate.

Investment Trusts and Venture Capital Trusts (VCTs) are able to provide opportunities to invest in innovate enterprises and recent changes brought forward as part of the Patient Capital Review are helping to ensure that VCTs are better targeted. There is capacity and demand for more life science-specific collective investment vehicles of this type, and a need for them to be larger, to allow them to follow their money and support scaling companies. Unfortunately, there are currently too few on the market and available to retail investors – either directly or through pension schemes. The Government and FCA should look further at the barriers to establishing and attracting large-scale investment (£1bn+) in such vehicles, which could deliver capital flows into patient capital whilst providing the investment opportunities that consumers seek.

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[7] Unpublished. Phone interviews undertaken by Radnor Capital Partners. Further information is available on request.
[8] BIA (2013) BIA Citizens' Innovation Funds Second Report

Crucially, these collective investment vehicles need to concentrate capital to achieve scale. This concentration of capital has three advantages:

- It allows £100+m investments in individual companies (over time) because it remains an acceptable percentage of the overall fund
- It allows large investors (sovereign wealth, pension funds etc.) that have minimum investment sizes and maximum percentage holding sizes to invest in the vehicle
- It ensures the best investment management teams can be employed (which are expensive to support in their own right) and that they have sufficient capital to achieve their business plans

Changes to permitted links rules

In reference to CP18/40, the BIA supports the following proposals:

- Allowing investment by firms in permitted unlisted securities which are not "realisable in the short term" provided that liquidity requirements at the level of the fund can be met
- Clarifying that the regular publication of pricing does not limit the permitted scheme interests to those that are priced daily

Both of these amendments are helpful in removing barriers – perceived or real – within the pension funds industry that prevent investment in illiquid biotech companies that would greatly benefit from the patient capital these funds can potentially provide.

For more information on the content of this submission, please contact Dr Martin Turner, Head of Policy and Public Affairs, BIA, on 0207 630 2192 or mturner@bioindustry.org.

Annex 1: BIA submission to CP 18/27: Consultation on illiquid assets and open-ended funds and feedback to Discussion Paper DP17/1

Influence, connect, save

UK BioIndustry Association

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23 January 2019

RE: CP 18/27: Consultation on illiquid assets and open-ended funds and feedback to Discussion Paper DP17/1

Dear Mr Bolton,

I am writing in support of the FCA's work to increase levels of investment in venture capital through the above consultation.

The BioIndustry Association (BIA) is the trade association for innovative life sciences in the UK. Our goal is to secure the UK's position as a global hub and as the best location for innovative research and commercialisation, enabling our world-leading research base to deliver healthcare solutions that can truly make a difference to people's lives. Our members include

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For the UK to retain its world-leading position in life sciences, and for our sector to deliver the medicines, jobs, and economic growth the country needs, it is critically important that early-stage and scaling companies have access to a wide range of sources of investment.

As the discussion paper notes, the asset management industry is a vital source of economic growth and one of the most important providers of liquidity needed for the smooth functioning of markets. But, currently, funds investing in inherently illiquid assets mainly invest in commercial property. We therefore welcome the FCA's focus on enabling such funds to invest in a broader investment portfolio, which can include unquoted biotechnology companies. By including such companies in a diversified portfolio, retail investors can access real growth opportunities, ensuring their investment activity is sustainable, whilst supporting the UK's economically-important industries, like the life sciences.

We strongly support the Government's commitment to promote sustainable long-term growth by encouraging greater private investment in 'patient capital' and note that it also is committed to supporting the life sciences sector through the Industrial Strategy. We welcome the FCA aligning itself to this mission and hope that the final rules and guidance you publish help meet those goals.

Yours sincerely,

Steve Bates OBE
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