20 October 2023

Summary of the FCA's investigation into LFSL

Important note: *This document sets out the key conclusions of the Financial Conduct Authority's (**FCA**) investigation into Link Fund Solutions Limited (**LFSL**). The FCA investigated LFSL in relation to its conduct as authorised corporate director (**ACD**) of the LF Equity Income Fund (formerly known as the LF Woodford Equity Income Fund) (**WEIF**). LFSL has accepted the FCA Conclusions (as defined below) for the purposes of its scheme of arrangement (**Scheme**)[1] only. If the Scheme is not implemented, LFSL intends to dispute the FCA Conclusions (as defined below). The outcome of that dispute may take years to conclude, and no payments will be made by LFSL to Scheme Creditors (as defined in the Scheme) or the WEIF during that period. Further information about the Scheme is available at https://lfwoodfordfundscheme.com/.*

The FCA has seen the summary and has confirmed that it is fair and accurate. The FCA is prohibited from disclosure of warning notices and does not consider that further disclosure is appropriate.

1. On 17 June 2019, the FCA notified LFSL that it was commencing an investigation in respect of LFSL into the events that led to the suspension of the WEIF on 3 June 2019 (the **FCA Investigation**). Following that FCA Investigation, on 20 September 2022, the FCA issued a draft Warning Notice. A draft Warning Notice is a normal step in the FCA's enforcement process and provides the recipient with an opportunity to resolve the case by agreement. A draft Warning Notice is therefore not a final decision.

2. The draft Warning Notice set out the FCA's current conclusions in respect of the FCA Investigation (the **FCA Conclusions**).

3. Due to restrictions under the Financial Services and Markets Act 2000, we are not able to publish the draft Warning Notice. However, in summary it alleged that from 31 July 2018 until the WEIF was suspended on 3 June 2019 (the **Suspension Date**), LFSL failed to comply with its regulatory obligations as ACD in respect of liquidity management. In particular:

   (a) the WEIF's liquidity profile was unreasonable and inappropriate in light of the redemption policy in the fund prospectus which allowed investors to redeem their investment within four days. However, LFSL failed to take adequate steps to deal with the problem;

   (b) the metrics used to measure liquidity contemporaneously (including stress testing) were unreasonable and inappropriate;

   (c) LFSL failed to properly supervise Woodford Investment Management Limited, the investment manager of the WEIF; and

   (a) the WEIF held certain securities which were originally unquoted but later admitted to eligible markets. However, there were no arm's length market dealings and only one trade was recorded for certain of these securities. The securities were valued by LFSL using fair value pricing at all stages, even after

[1] You can find a copy of the Scheme in the documents section of the LFSL Scheme Website, which is available at: https://lfwoodfordfundscheme.com/documents/

their listing. The WEIF thus held assets which remained illiquid even after listing and this increased the risks of liquidity issues arising. Although ACDs are not usually expected to be involved in an underlying asset's corporate actions, including listing on an exchange, LFSL failed to give consideration to the potential implications for the WEIF's liquidity profile where businesses in which the WEIF had holdings announced an intention to convert from unlisted status to becoming listed on an exchange.

4. The key conclusions from the FCA Investigation, as set out in the draft Warning Notice were that:

(a) investors who left the WEIF from 1 November 2018 onwards benefited disproportionately from the sale of the most liquid assets in the WEIF compared to those investors who remained invested in the WEIF on the Suspension Date (the **Suspension Date Investors**);

(b) the Suspension Date Investors were treated unfairly because they were left with a disproportionate share of less liquid assets; and

(c) LFSL had therefore failed to comply with both Principle 2 and Principle 6 of the FCA's Principles for Businesses (the **Relevant Principles**) from 31 July 2018 until the Suspension Date. Principles 2 and 6 of the FCA's Principles for Businesses are:

"*Principle 2: Skill, care and diligence: A firm must conduct its business with due skill, care and diligence….*

Principle 6: Customers' interests: A firm must pay due regard to the interests of its customers and treat them fairly".

5. Other than the conclusions that LFSL failed to comply with Principles 2 and 6, the FCA conclusions did not include any findings in relation to breaches of the rules.

6. As a result of the alleged breaches of the Relevant Principles, the FCA initially proposed that LFSL should pay:

(a) a penalty of £50 million (prior to taking into account any discount available for prompt settlement); and

(b) a restitution payment of up to £306,096,527.

7. The FCA explained that, in its view, the amount of the restitution payment reflected the loss allegedly borne by the Suspension Date Investors as a result of the regulatory misconduct. The FCA calculated this amount by comparing the difference between the amount of money that the Suspension Date Investors actually received after the Suspension Date and the amount that they would have received had the proceeds of the sale of assets realised from 1 November 2018 onwards been shared equally with those who had redeemed their investments during that period.

8. On 11 November 2022, LFSL paid the fifth Capital Distribution to the Suspension Date Investors.[2] Taking into account that Capital Distribution, as well as correcting a rounding issue, the FCA reduced the maximum restitution payment amount from £306,096,527 to £298,403,919. This sum does not take into account any further distributions resulting from the assets still held in the WEIF and may therefore be reduced further in the event of a further distribution. Further information regarding the FCA's calculation is set out at the end of this notice.

9. The FCA announcements in respect of redress to investors in WEIF can be found at https://www.fca.org.uk/news/statements/fca-statement-regarding-potential-enforcement-action-against-link-fund-solutions-ltd (FCA announcement dated 21 September 2022) and https://www.fca.org.uk/news/press-releases/fca-announces-plan-deliver-significant-redress-woodford-investors (FCA announcement dated 19 April 2023).

10. The FCA Conclusions do not represent a binding or final determination of the FCA and are disputed by LFSL. Other than concluding that LFSL failed to comply with Principles 2 and 6, the FCA did not make any findings in relation to breaches by LFSL of the rules set out in the FCA Handbook. This includes the rules which are alleged to provide the causes of action that certain WEIF investors have issued against LFSL.

[2] **Capital Distributions** are payments to investors in the WEIF from the sale of the WEIF's assets. There have been five Capital Distributions since the WEIF was placed into a wind-down procedure on 18 January 2020. For further details of the Capital Distributions, please see paragraphs 9 to 14 (*Winding Up of the WEIF*) of Part 3 of the Explanatory Statement. You can find a copy of this document at https://lfwoodfordfundscheme.com/.

FCA Calculation of Loss

The FCA alleges that investors leaving the fund between 1 November 2018 and 3 June 2019 enjoyed a "*first mover advantage*" in that their units were redeemed by sales of more liquid assets, while the illiquid assets remained in the fund and their proportion increased. Therefore, the FCA considers that an appropriate means to assess these losses is to compare the difference between:

- monies that the investors in the WEIF received post suspension; and
- what those investors would have received had the proceeds of the sale of assets realised from 1 November 2018 onwards been shared equally between those who redeemed their investments during that period and those who remained invested in the WEIF at the time of suspension.

The FCA concluded that the most effective way in quantifying the harm borne by the investors remaining in the fund at its suspension was to divide the sale proceeds of all investments starting from 1 November 2018 (including those sold subsequent to suspension) among all investors from 1 November 2018 and to allocate the same proportionate amount of pre- and post-suspension sales to each investor.

This is explained in more detail in the below tables which sets out the figures for the following calculation:

- Adding the number of shares redeemed (A) and the number of shares at suspension (B) to work out the total number of shares for fair division (C).
- Adding the amount redeemed from the fund between November 2018 and suspension (D) and the post suspension sales proceeds to work out the total pot value for fair division (F).
- Dividing the total pot value for fair division (F) by the total number of shares for fair division to work out the fair share of total pot per share (G) (assuming that all shares are equal).
- Dividing the post suspension sales proceeds by the number of shares at suspension (B) to work out the actual received per share post suspension (H).
- Taking the fair share of total pot per share (G) and taking away the actual received per share post suspension (H) to work out the "*underpayment per share*" (I).
- Multiplying the underpayment per share (I) and the number of shares at suspension (B) to work out the redress figure (£298 million).

FCA Calculation of Loss Tables

Date		**Number of Shares Redeemed**
Nov 2018		102,316,918
Dec 2018		79,466,023
Jan 2019		62,757,812
Feb 2019		82,939,018
Mar 2019		154,130,939
Apr 2019		107,237,874
May 2019		207,526,992
TOTAL	**A**	**796,375,577**
Number of shares at suspension	**B**	**3,853,319,155**
Total number of shares for fair division	**C=A+B**	**4,649,694,732**

Date		**NET Fund Redemptions £bn**
Nov 2018		0.113
Dec 2018		0.085
Jan 2019		0.067
Feb 2019		0.095
Mar 2019		0.17
Apr 2019		0.12
May 2019		0.241
TOTAL	**D**	**0.891**
Post suspension sales proceeds	**E**	**2.568913833**
Total pot value for fair division	**F=D+E**	**3.459913833**

Total pot value for fair division	**F**	3.459913833
Total number of shares for fair division	**C**	4,649,694,732
Fair share of total pot per share	**G=F/C (times 1bn)**	**0.744116341**

Fair share of total pot per share	**G**	0.744116341
Actual received per share post suspension	**H=E/B (times 1bn)**	0.666675593
Underpayment per share	**I=G-H**	**0.077440748**

Underpayment per share	**I**	0.077440748
Number of shares at suspension	**B**	3,853,319,155
Redress	**J=B*I**	**£298,403,919**