BlackRock

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HM Treasury
1 Horse Guards Road
Westminster
London
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Submitted via email to: ukfundsreview@hmtreasury.gov.uk

RE: Review of the UK funds regime

BlackRock[1] is pleased to have the opportunity to respond to the Review of the UK funds regime, issued by HM Treasury.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of HM Treasury on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

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Responses to questions

Prioritisation

1. **This call for input on the UK funds regime is necessarily wide-ranging. As the government would not be able to take forward all proposals immediately, what do you think the top 3 priority proposals should be for government implementation and why?**

Our first priority is not issue-specific but concerns the UK's objectives for its funds regime, and indeed for financial services regulation more generally. We have noted throughout that in reviewing the UK funds regime, the Treasury should seek to develop an advantage for the UK in future growth industries and avoid seeking to compete for market share in sectors that are well established in other jurisdictions. Two major areas we have identified are alternative investments and sustainable finance; but we also stress the importance of ensuring the UK has the technological skills and know-how to be able to take advantage of innovations within the asset management industry, as technology and digitisation continue to change how services are provided. More broadly, and as we noted in our response to Phase II of the Future of Financial Services Regulation Review, we believe the UK should look to re-orient its regulatory framework around the primary purpose of financial markets: funding the economy while providing end-investors with a means of generating returns.[2] One aspect of this is getting more individuals to save and invest – as well as protecting those who already do so – and building an investment culture which views success in terms of outcomes and net performance, not just lower costs. The latter point will be critical in developing the market for alternative and sustainable investments, particularly in the DC pensions sector.

Relatedly, our second priority is to develop a regulatory regime to support a Long-Term Assets Fund (LTAF), and a tax regime that works for the industry more broadly. Throughout our response we highlight where the questions raised touch on the development of the LTAF and offer our views on the optimal policy for encouraging it. We note that five fund taxation regimes are in place in the UK, but none are completely suitable for prospective fund structures such as the LTAF. We suggest creating a more liberal regime to replace the existing authorised funds regime, and extending it to all bona fide UK domiciled collective investment schemes even where they are lightly regulated. We discuss this in detail under Question 37. We additionally note that in order to remain and grow as an asset management hub, the UK should seek a competitive VAT regime underpinned by the principle that VAT should not be a cost borne by the end investor, whether implicitly or explicitly. We suggest how this might be achieved under Question 7.

Finally, our third priority is for the UK to develop a framework for sustainable investment products – and we note the absence of any reference of sustainable investing in the consultation paper. The UK has announced that it will not apply SFDR. At the same time, UK government bodies have set climate disclosure and tackling 'greenwashing' as policy priorities; while the FCA has announced that they will be articulating guiding principles to help firms with ESG product design and disclosure addressed to retail investors. Both of these developments point to the need for a naming convention for sustainable investment products that can help the UK to

[2] BlackRock (February 2021) Response to Financial Services Future Regulatory Framework Review: Phase II consultation

develop the access of savers to sustainable investment products while ensuring greenwashing is addressed.

Recent reforms to UK funds taxation

2. **How effective were recent reforms to UK funds taxation in achieving their aims? Please explain your answer. Could anything have made these reforms more effective, particularly in terms of increasing the attractiveness of the UK as a location to set up funds?**

Co-Ownership Authorised Contractual Schemes (CoACS) were introduced to ensure that the UK could compete as a fund domicile for tax transparent funds alongside Ireland and Luxembourg, and are aimed at institutional investors investing in assets such as securities and real estate.

The creation of this type of fund vehicle has been effective in achieving its aim and we have seen a large uptake in the use of these funds from UK institutional clients, principally insurance companies and pension funds. The regime puts the investor in the same position regarding income and capital gains taxes as they would be in if they had invested directly in the underlying fund assets. Access to the investors' beneficial withholding tax rates has been successful across the majority of jurisdictions where the fund is recognised as a tax transparent vehicle. We believe some improvements could be made to the Tax Treaty Network which would further improve the efficiency of this vehicle, and have outlined these in Question 10.

There has been a lower international uptake within these funds due to the size of the existing UK investor market and the previous uncertainty over Brexit. Operationally, extending these types of vehicles to international clients would make management of the access to the double tax treaties more difficult. In our product strategy these vehicles are targeted towards UK investors and currently an Irish CCF is preferred over the ACS for international investors. For the UK to be more competitive equivalent EU passporting is required and reliable treaty networks with overseas jurisdictions.

Investment Trust Company Regime Changes in 2011 aimed to remove the barriers to launching Investment Trusts, altering conditions that must be met to qualify as an investment trust and permitting the use of broader investment strategies with the ability to stream income. For Investment Trusts these reforms have been effective in allowing a better tax neutrality for the Trust with the ability to stream income and an easier route to market. However multi-asset Investment Trusts still incur corporation tax and have the same tax leakage concerns as multi-asset authorized unit trusts.

What the regime has not succeeded in doing is increasing the use of Investment Trust vehicles, this is mainly due to the closed ended nature of the Fund and investors seeking a return that reflects the values of the underlying investments. We have further comments on ITC structures under questions 24 and 25.

Unauthorised Unit Trusts and in particular, exempt unauthorised unit trusts ('EUUTs') are effective fund vehicles for UK pension funds and charities, but by design they do not serve for other UK and overseas investors.

Unit Trusts in general are not as easily marketable into Europe as they do not have an equivalent vehicle and the structure is not a well-understood concept. Even within the UK EUUTs are viewed as an old-fashioned structure and are not sophisticated in regard to investment strategy and objectives. They also attract VAT which puts them at a disadvantage.

As a firm we no longer operate unauthorised unit trusts as they held no commercial benefit. For our input on the future use of unauthorised unit trusts see our response for question 30 onwards.

General Tax Changes: The introduction of the Charity Authorised Investment Fund (CAIF) regime in 2019, allowing the application of direct tax exemptions available to charities and the management fee VAT exemption was beneficial to our charity business. We converted our existing CIF's to CAIF's allowing us to have pooled investment funds product more fit for purpose for our charity clients.

Multi asset / balanced authorised funds

3. **Why has uptake of TEFs been limited? Please explain any operational or commercial factors that have influenced their uptake. How could these be addressed?**

Since the introduction of the TEF regime there has been very little uptake within the industry due to the complexities of adhering to the regime.

While the ability to pay dividend and interest as separate distributions is attractive in theory and resolves the multi-asset tax leakage issue, the practicalities of handling two distributions for a single fund for product providers, and platforms in particular is a challenge. Platforms especially are not set up to report two different distribution types onto their investors.

Commercially, the costs associated with adhering to the regime outweigh the benefits. Most significant are one-off upfront costs such as changing IT systems to comply with the regime, increased administration to ensure that the income remains identifiable as it passes through the fund to its investors, and giving notice to the investors that the fund is joining the regime.

Fund administrators do not have the IT Systems in place to track the income streams and currently have no incentive to invest in developing the capabilities to support this regime. The property condition also restricts certain investment strategies that may have income form UK or overseas property businesses and restricts the commercial use of the regime.

We do not feel immediate changes to the regime would increase its effectiveness as the main barrier is operational. The use and application of the TEF regime should be reviewed alongside the resolution of the mixed fund issue and the new exempt fund regime. In our view a new exempt onshore fund regime with varying levels of regulation is the way forward. A simplified tax regime could be applied in line with the existing regime for Offshore Funds where the fund reports distributions and excess reportable income to the investor accordingly. This would simplify the reporting process of UK funds and the taxation of the investor, while also reducing the number of tax regimes applicable in the UK.

4. How would the proposals in paragraph 2.9 improve tax efficiency of multiasset authorised funds? Please explain how the proposals would work in practice and how a proportionate impact on HMRC could be ensured.

In our view a reduction to the tax rate applied to multi-asset authorised funds would reduce the impact of corporation tax incurred at the fund level, however it would not resolve the ability of the fund to neutralise the tax impact to investors. Single asset funds ultimately pay no corporation tax, and a lower rate would still put multi-asset funds at a disadvantage and create a tax liability for the investor at fund level. There may also be a risk that a reduced tax rate may result in the UK being perceived as a tax haven by certain jurisdictions e.g. Brazil, and the resulting loss of treaty access. As the BEPS Pillar 2 discussion evolves, a special tax rate that is well below the finally agreed upon minimum rates for corporates may be less well perceived than full exemption, as the latter approach more cleanly differentiates funds. We do not believe this is the way forward.

A streamed deductible deemed distribution at fund level would eliminate the tax drag and also remove complexities for exempt investors who subsequently have to reclaim the tax. We have considered the subsequent taxation of investors as follows:

- Individual investors who are taxable would need to receive streaming of the different income types. This remains akin to the TEF regime and results in the same operational complexities that were addressed in question 3.

- The deemed deduction would work for UK funds that only have exempt UK investors. A deemed deduction at fund level could be permitted alongside a declaration from the fund that there are only UK exempt investors and as a result no streaming of income required by the fund.

- Consideration of the application of a blended rate to mixed distributions would remove the need for streaming and simplify the operational complexities but change the tax treatment of the investor.

- Removing the differential tax treatment between interest and dividend for investors would greatly simplify the process as it would remove the need for the development of streaming on the funds.

- Applying a flat rate of tax. Some countries apply the same level of taxation to all income earned at the individual tax bracket rates or apply a flat tax regime, while others, for example Belgium have a flat tax regime with some exemptions and no capital gains tax.

In solving the multi-asset fund issue, we do not believe amendments to the TEF regime would be beneficial on their own for the reasons outlined in our response to Question 3.

Corporate streaming rules to individuals could be beneficial but highly complex. Operationally we do not feel it would be a viable option as tracking and reporting the tax credit available to each investor would create a large administrative burden on the Fund.

Ultimately, the existing system of taxation for UK investors is familiar to them and there may be reluctance to change the taxation at the investor level. We are also aware that changing the taxation of income at investor level may not be a palatable option for the industry and does not maintain the original character of the income which is important to HMRC. In the absence of significant revision of the existing rules for investors we would stand behind the deemed deduction being made available for UK authorised funds in order to remove tax leakage at the level of the fund. We do however believe that more innovative solutions should be considered, and in the spirit of simplifying the fund regime an effort is made to create any new onshore tax-exempt fund with the optionality for the tax regime to be applied to authorised funds. For example, an onshore fund regime for all UK funds that reflects the current offshore fund regime. This would eliminate the tax leakage on multi-asset funds and simplify the reporting to Investors.

5. **Are there are any additional changes the government could consider to reduce tax leakage in multi-asset/balanced authorised funds?**

We believe it would be beneficial to address the current taxation differential between interest and dividend income of UK individual investors. With the new tax-free allowances for savings interest and dividends and the use of SIPPs and ISAs there is less need for such a differentiation between types of income as the threshold for incurring tax is higher. The elimination of tax drag at the fund level and a simpler application of taxation on taxable investors would make multi-asset funds more tax beneficial and more competitive with other fund regimes.

Another consideration could be to allow UK multi-asset funds to report “Excess reportable income” comparable to that of Offshore Funds under the UK Offshore Funds regulations. There would be a deemed distribution reported to investors and no tax suffered at the level of the UK Fund.

Tax-exempt funds

6. **Where funds are already tax neutral, how would a tax-exempt status for funds influence decisions about how and where to set up funds?**

An important factor in determining where to set up funds is whether tax is incurred at the level of the investor, and not the fund, in that jurisdiction. If we looked to relocate a fund or fund range, we would do so only to a similar jurisdiction that is also tax-neutral for investors; and would be unlikely to move a fund from a tax-neutral jurisdiction to a taxable jurisdiction because that could disadvantage investors in the fund.

In the UK, for existing tax-neutral funds, a tax-exempt status is unlikely to change how and where we set up funds. Existing offshore funds are unlikely to move assets back to the UK for a tax-exempt status if they are already tax neutral and in a jurisdiction that is already tax-exempt. The availability of a tax-exempt regime for funds that are already tax-neutral in the UK could remove the administrative burden of filing corporation tax returns but is unlikely to impact the strategic decision of where to set up the fund.

A tax-exempt status could be beneficial for certain existing funds based on their investor profiles. For example, the authorised fund could remain subject to UK Corporation Tax, therefore maintaining access to the UK’s treaty network, but allow the fund to apply for an exemption from Corporation tax. Where a fund only has pension investors or tax-exempt investors, they could apply to be tax exempt for UK Corporation Tax purposes, simplifying the process for the fund and investors involved. We are supportive of the simplification of the tax regimes in the UK and the application of an Exempt Onshore Fund regime with a regime comparable to the Offshore Fund regime.

If this regime were to be adopted exemptions could also be offered to vehicles with only tax-exempt investors to remove the reporting burden on the Fund.

7. How would tax-exempt funds affect the competitiveness and attractiveness of the UK funds regime? Please explain your answer providing evidence and international comparisons where possible.

Offering a tax-exempt vehicle within the existing authorised funds offering is unlikely to increase the attractiveness of funds in the UK. Commercially it would make the regime competitive with Ireland and Luxembourg to the extent that it offered a similar vehicle, but as referenced above, the tax exemption could jeopardise the existing tax treaty network UK funds have at their disposal. From a tax perspective we would view the Tax Treaty network as a differentiating factor of setting up a UK fund over a Luxembourg or Irish Fund.

If the UK tax treaties were updated and did not include the “subject to tax” clauses the loss of treaty access would be less of a concern. We have provided a more detailed response in Question 10. We believe an unauthorised tax-exempt fund would be more competitive and attractive, and we have addressed this in detail in the subsequent questions.

When considering tax-exempt funds and the UK Fund regime it is also important to highlight that a competitive VAT regime for existing and new UK funds is required in order to ensure their competitiveness and suitability as an alternative to Offshore funds.

VAT can be a significant cost to UK-based fund managers when managing UK funds, disproportionately impacting business decisions. On the other hand, countries like Hong Kong and the US do not apply a VAT or GST regime; whilst others such as Japan, Singapore and Switzerland have VAT/GST regimes that work in a way that results in zero or minimal VAT costs for the investment management businesses.

In order to remain and grow as an asset management hub, the UK should seek a competitive VAT regime. VAT should not be a cost borne by the end investor, whether implicitly or explicitly, and we suggest that the following points be addressed:

- Under the current VAT regime, a UK investment manager managing an offshore fund can benefit from full VAT recovery while no VAT is charged on the fund itself. In contrast, the management of UK funds is either exempt from VAT (if they are qualifying funds) or is subject to VAT (otherwise). This is an important drawback of managing UK funds from the UK, and the regime should be augmented to extend the current VAT treatment available on UK management of offshore funds to the management of comparable UK vehicles. This can be done, for example, by applying a zero rate of UK VAT to the management of such funds.

- The application of VAT within the investment management supply chain also needs to be reviewed. We believe any service related to the provision of investment management or similar services should receive an exemption or zero-rating for VAT purposes.
    - The exemption for fund management services provided to special investment funds (referred to as the SIF VAT exemption) under Article 135(1)(g) of the Principal VAT Directive aims to ensure tax neutrality between direct investments (whereby investors do not incur VAT) and indirect or collective investments. A clearly defined interpretation of special investment funds in the UK allows the UK to be a good place for

international provision of management and management adjacent services, whilst providing scope for a UK fund range which does not suffer VAT drag.
  - In order for the purpose of the exemption to be respected, it is essential that UK VAT law properly reflects the principle that everything that is specific and essential to the management of a fund should also be VAT exempt, irrespective of how and by whom those essential elements are delivered.
  - The current regime can often lead to situations where services that are clearly fundamental to the supply of management are subjected to VAT because they are delivered via a technology and/or are outsourced to third party providers. This VAT is often irrecoverable.

- Another issue we suggest addressing is the so called ‘tainting’ principle regularly applied by HMRC in the context of pension fund management.
  - For example, an investment manager may manage a pool of assets for a client and charges a single fee for doing so. 99% of those assets relate to defined contribution (’DC’) pension schemes which are ‘qualifying funds’ for UK VAT purposes. The remaining 1% relates to a defined benefit (‘DB’) pension scheme which is not a qualifying fund for UK VAT purposes.
  - In this case, HMRC’s interpretation is that because the fee does not relate entirely to a qualifying fund, the whole charge must be subject to VAT. In this example, the 1% of DB assets ‘taint’ the whole pool resulting in VAT being applied to the entire fee, which defeats the purpose of the exemption. In this example, DC investors are suffering a 20% VAT cost because a tiny fraction of the asset pool relates to non-qualifying funds.
  - There has been a huge amount of consolidation and aggregation of legacy pension schemes over recent years that has been driven by a number of factors, none of them VAT related, such that this issue is a very real and prevalent one faced by managers and investors alike.
  - We strongly believe the UK should allow charges to be apportioned between qualifying and non-qualifying funds, adhering to the principle of the exemption.

Real Estate Investment Trusts

8. What would be the likely impact if changes were made to the REIT regime in the areas discussed in paragraph 2.16? To what extent could investment in the UK be expected to increase, and what would be the drivers for this? Could such changes be expected to impact the extent to which funds with UK and foreign property assets are managed in the UK?

The changes discussed at paragraph 2.16 would be helpful to reduce some of the administrative burden of running a REIT and to widen the potential use of the regime. We consider the ability for REITs to hold overseas property, without incurring additional tax leakage, to be particularly important (i.e. no withholding tax should be imposed on distributions of income/gains that have already been taxed locally). This change would mean that managers establishing pan-jurisdiction real estate funds would be more likely to consider the UK as the location for the main fund vehicle, which should, over time, increase investment in and through the UK.

In addition to the areas discussed at paragraph 2.16, we consider that a relaxation of the listing requirement is key to unlocking increased investment via REITs. It is not clear what purpose the listing requirement serves where the investors, or a proportion of them, are qualifying institutional investors. The listing requirement is considered a significant burden, and if there is no relaxation/partial removal of the requirement, the other proposed changes may not be enough to encourage a shift towards use of the UK REIT. We note that other jurisdictions have unlisted REITS (e.g. US) and the OECD commentary on the characteristics of a REIT does not make listing a requirement.

As was identified in the AHC consultation and mentioned at paragraph 2.15, consideration should be given to the application of holder of excessive rights rule to large institutional investors. Currently the rules limit the shareholdings of these investors to less than 10% and leads to the need for some of these investors to fragment their shareholdings which can be a costly exercise. The relaxation of this rule would make the REIT regime more competitive.

9. Are there any other reforms to the REIT regime that the government ought to consider, and why?

The government should consider expanding the type of assets/income that qualify for a REIT to include broader infrastructure assets. Typically, the type of income produced by infrastructure assets does not fall within the definition of qualifying property income for the purposes of the UK REIT regime. If the definition of qualifying income could be expanded to cover operational income produced by infrastructure assets, for example, this would provide an opportunity for investors and asset managers to use the UK REIT to hold infrastructure. The government should also consider allowing the REIT to hold property backed debt, akin to the US mortgage REIT.

Treaty issues

10. Regarding the proposals covered in this call for input, are there any specific considerations that the government ought to take account of in the context of the UK's double taxation treaty network? Please provide as much detail as possible.

In the context of the UK's double taxation treaty network we believe it would be beneficial to consider the following areas:

General remarks

- For those jurisdictions where it is possible to do so, revise the language in the treaty to ensure the fund can access the domestic rate of taxation. This is more commonly seen across EU markets where UK Funds, previously regulated under UCITS, were historically able to prove equivalence to other EU UCITS and able to access a zero, or lower, rate of withholding tax.
- We also feel it would be beneficial if certain treaties, Memoranda of Understanding ("MOU") or Competent Authority Agreements ("CAA") were amended to remove scenarios where UK tax opaque CIVs are being treated by the overseas Tax Authority as look through or tax transparent.
    - An example of where this would be helpful is the existing UK-Switzerland treaty and supplemental MOU. The MOU requires that UK CIVs (such as Authorised Unit Trust and Open Ended Investment Companies) are only allowed to claim withholding tax relief limited to the amount or level of UK investors in the CIV, and that this quoted amount of UK investors is proven with evidence to the Swiss Tax Authorities.
    - This approach to withholding tax relief for CIVs is largely out of step with most other countries and could benefit hugely from revised agreements (either treaty or CAA). There are examples in operation today (for example,

between UK and Austria), where an agreement is reached between the UK and the foreign tax authority, which ensures that the foreign tax authority treat the UK (tax opaque) fund as the beneficial owner, without the need to look through to who the underlying investors are. It would be hugely beneficial if HMRC could adopt a similar agreement with Switzerland.

- An alternative approach to the above scenario could be to include language around the concept of equivalent beneficiaries. This would mean that even if a foreign tax authority wanted to apply tax transparent principles to an otherwise tax opaque CIV, and limit withholding tax relief based on the domicile of the investors in the CIV, the fund could claim withholding tax relief to the extent that the domicile of the investor was resident in a country that has an equivalent, or better, tax treaty with that foreign tax authority.
- This approach may also be attractive if UK funds are looking to attract more Non-UK resident investors in the future.
- An example of treaty language used to support the above approach can be found in the protocol to the 2011 Germany-Ireland treaty under Article 1 (b) – "Undertakings for Collective Investment".

UK-specific

- We believe it would also be beneficial if the treaties were amended to more explicitly allow tax transparent vehicles, like the ACS, to secure withholding tax rates at the level of the investors within the ACS.
    - For example, the UK-Japan treaty works well in this regard as under Article 4 (5), the beneficiary of the UK intermediate entity can benefit from the Treaty as long as the intermediate vehicle is look-through for UK tax purposes. Alternatively, the protocol to the 2011 Germany-Ireland treaty could also be referenced as an example of how the Irish Authorities have looked to include clarification language for its equivalent tax transparent vehicle – Common Contractual Fund ("CCF"). This can be found under Article 1 (c) – "Common Contractual Fund in Ireland".

- HMRC have helpfully negotiated language into a number of treaties that allows for life insurance companies to be treated (for the purposes of the treaty) as a "Pension Scheme", to the extent that the Life Insurance Company is itself used as an investment vehicle by UK Pension Schemes.
    - Whilst the language is certainly helpful, in our experience, it often takes many years for procedures to be developed that actually allow this tax relief to be realised by the Life Insurance Company. There is often a specific reliance on HMRC providing certificates of tax residence with supplementary language deemed acceptable by a given foreign tax authority, before the withholding tax relief is considered by the foreign tax authority. Some examples of this would be treaties with The Netherlands, Spain and Japan.
    - We would kindly request that the procedural element for supporting this tax relief is also considered when new treaties, with this language, are signed, and if possible, these procedures simplified.

Treaty-specific

- An area where certain fund jurisdictions have an advantage over the UK is in respect of the taxation of Capital Gains on the disposal of Indian securities. Certain countries have signed treaties with India that would provide that capital gains from the sale of Indian securities are not taxed in India.

- The UK – India treaty does allow for a reduced withholding tax rate of 10% to be applied to Indian dividends. Whilst this is beneficial, we would request that HMRC consider also including a 0% tax rate on Capital Gains in any future negotiated treaty with India.

- Additionally, in the case of the Netherlands, there is also a most favoured nation clause included in the treaty that allows for an even lower (than the stated 10%) withholding tax rate to be applied to Indian dividends.

Fund Restructuring

- It would also be very beneficial to provide a more comprehensive set of rules for Stamp Duty when restructuring or merging funds, including a list of clear exemptions that can apply, specifically in relation to widely used retail funds. For example, a stamp exemption on transfers into funds with ESG objectives (e.g. by meeting requirements equivalent to those applicable to Article 8 or Article 9 funds in the EU's SFDR) would encourage the direction of capital towards more ESG centric investment strategies (see further comments in our response to Question 38). For these purposes a wider definition of the exemption would be required as like for like / perfect slice transfers would be unlikely when rebalancing the portfolio to an ESG portfolio. A more practical exemption would make such transfers easier.

- In order to ensure re-domiciliation of funds to the UK is possible it would be important to ensure that the UK exemptions align with the current EU Merger Directive exemptions for mergers and transfers and the appropriate investor level CGT exemptions.

Limited partnership funds

11. What are the barriers to the use of UK-domiciled LP Funds and PFLPs, and how might tax changes help to address them? Please provide detailed proposals and explain your answers.

For real estate funds, the UK limited partnership is not attractive due to the SDLT cost and complexities around calculating SDLT exposure on changes in partnership shares. The Jersey Property Unit Trust is commonly used as the fund vehicle for investment in UK real estate, as units in the trust can be easily transferred and redeemed without any stamp duty or SDLT.

Fund authorisation & Speed to market

12. What benefit does fund authorisation bring to product providers beyond access to retail investors? Does this benefit vary depending on the specific investor base or investment strategy? What relevance does authorisation of a product have to its appeal to the UK market and to the international market?

The decision to use authorised products is driven by clients: often clients will have requirements that investment solutions are delivered by authorised funds due to their governance structures, local laws, or just client preferences. Firms may also favour authorised products for a professional client base given the costs involved in setting up an unauthorised product; the speed to market; as well as other constraints for unauthorised products such as high minimum investment requirements.

13. Do you have views on the current authorisation processes set out in legislation and how they could be improved?

14. How do the FCA's timescales for fund authorisation compare internationally? Is there value in providing greater certainty about these timescales? Other than by reducing the statutory time limit, how could this be achieved and what benefits would it bring?

Questions 13 & 14 are answered together here.

Speed to market under the FCA authorisation regime is in line with other leading fund centres, and both the statutory timelines and voluntary internal targets for authorisation can generally be relied upon.

However, the process for authorisation could be achieved through adoption of some best practises to make the process easier to use:

- Timing of feedback and comments: often firms receive feedback or comments on their applications late in the process, while still within the statutory minimum, leaving a tight turnaround period to feed back within the authorisation period. This occurs more frequently in the UK than in some other jurisdictions, where our experience is that regulators tend to revert with comments or feedback within 10-14 days of the one-month authorisation period. A voluntary commitment on the part of the FCA to allow ample time for firms to respond to comments would be helpful.

- Topical issues / current concerns: regulators often have changing topical issues or concerns that they raise with firms during the authorisation process. In some other jurisdictions these are disseminated by the regulator through, for example, industry fora or consultants, allowing firms to pro-actively address these issues in the application process. Establishing a similar mechanism to let firms know 'what is on the FCA's mind' with regard to authorisation would be helpful.

- 'Stop the clock' provisions: it would be helpful to remove 'stop the clock' provisions, whereby the regulator can pause the authorisation process without contravening the statutory minimum time period. This can lead to delays and uncertainty around the authorisation period.

Qualified Investor Schemes

15. What would you like the QIS structure to enable you to do that is not currently possible? What are the existing impediments to your suggested strategies, and why would the QIS be the preferred UK structure for those strategies?

16. Do you think that the range of QIS permitted investments should be expanded? If so, in what way should it be expanded, what impact would this have, and would it still be appropriate for sophisticated retail investors?

17. Do you think that the QIS borrowing cap should be raised or QIS constraints on derivatives exposure should be relaxed? If so, to what magnitude and why? Would this be appropriate for sophisticated retail investors?

18. Do you agree that the QIS sub-fund structure could be improved? If so, how? Would greater clarity for the segregation of assets between sub-funds via legislation or rules be helpful? Please provide details.

Questions 15-18 are answered together here.

Currently the QIS structure is the only option available to professional or institutional investors seeking a UK domiciled, authorised vehicle (without retail-like protections, i.e. the NURS).

The primary obstacle to using a QIS vis-à-vis options available in other jurisdictions is its tax status, time to market, establishment costs and authorisation process. Whilst we find that generally the 'abilities' of the QIS in terms of investment strategy, permitted investments, borrowing caps, and sub-fund structure are in line with comparable structures elsewhere, the restrictions related to investing in other collective investment schemes (CIS), in particular, where the CIS is unregulated - which materially hinders the QIS's ability to reach broad investment strategies. Such restrictions do not exist in comparable structures available to professional investors in the open-ended fund space, such as the Irish QIAIF. The authorisation process for the QIS is another area where improvements could be made. As a comparison, the Irish QIAIF offers speed to market advantages (a 48-hour authorisation process) which we see as an important benefit.

That said, while these changes would place the QIS on an similar footing to options available elsewhere, in the absence of passporting into the EU the QIS will not be able to attract an investor base as deep as other structures, and so is unlikely to be as competitive. We therefore encourage HMT to promote the LTAF as a truly differentiated offering that fills a gap in the market, rather than attempting to replicate offerings that are well established elsewhere. We believe the LTAF should be structured as a Non-UCITS Retail scheme, rather than taking the QIS structure as a starting point. This will allow it to be marketed to a broad range of professional and defined contribution investors; as well as catering for the wealth management market, an important opportunity for LTAF that should not be overlooked.

Areas of opportunity

19. Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to the creation of entirely new funds that have not yet been set up?

20. Why do firms choose to locate their funds in other jurisdictions in cases where the UK's funds regime has a comparable offering, for example ETFs? Are there steps which could help to address this following the potential reforms to the UK funds regime discussed in this call for input, and would the scope to address this vary depending on the type of fund or target investor market?

Questions 19 & 20 are answered together here.

We agree that the UK's objective should be to develop a fund offering that addresses gaps in the market – for example the LTAF, as a vehicle for making long-term illiquid investments – rather than attempting to replicate or win market share from well-established fund industries.

To take the example of ETFs, a major consideration for choosing a domicile is the ability to build scale in a fund or range of funds. As the question alludes to, other jurisdictions took decisions a number of years ago to incentivise funds to domicile in their territories and have since built up significant expertise around the administration and governance of these funds. Even if the UK were able to develop a comparable offering, these funds would be significantly disadvantaged vis-à-vis other jurisdictions with regard to:

- Liquidity: The benefits of ETFs are scale, so a UK start-up of, say, £100m could never hope to compete in terms of liquidity with a well-established one of £10bn. Further, duplication of ETFs tracking the same benchmarks and additional listings will fragment liquidity, leading to sub-optimal outcomes for UK investors;
- Taxation: Certain select but important tax advantages (notably US treaty relief to Irish ETFs) are well established for other funds, but would not be so for UK funds, particularly when the onshore has been recast to eliminate the well-rehearsed 'balanced fund' and 'synthetic investing' problems.
- Investor choice: Due to the significant operational, administrative and financial burdens of establishing a new fund platform (without any obvious commercial incentive for so doing), it would not be practicable for ETF issuers to seek to replicate their entire UCITS ranges in the UK, thereby reducing UK investor choice
- Returns: Start-up UK funds would not have the same benefits of scale as incumbents, and savers would lose out on value for money and lower performance on an ongoing basis. Some ranges would be uneconomic altogether, given the smaller asset base, and savers would have less investment choice, too. Furthermore, transferring UK clients into UK ranges would mean they realise capital gains, so there would be a tax impact across the pensions and retail sectors, and
- Passporting rights: One of the most attractive features of the UCITS regime is the relatively frictionless access it provides to EU investors, in addition to other large markets.

Instead, developing a world-beating fund structure for long-term investments like the LTAF could add significant value and fill a gap in the UK's fund offering, especially if the details are handled correctly such that it can be offered to the UK's substantial pensions market, and in turn allow the UK to continue to attract portfolio management activity from around the world.

21. Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to AIFs targeting international markets? Which markets would be most valuable and what would be the key obstacles to overcome in each?

It is worth noting that withholding tax efficiency is already an established topic in this segment of the market. In selling to Asian and Latin American investors, UCITS funds today compete against the US registered investment company product. Distributions from the latter are subject to US withholding tax at 30% (non treaty) and 15% (treaty), and in many South American jurisdictions the treaty rate is not available. To simplify a complex analysis, this has little practical impact where the country of investment is the US or the local jurisdiction of the investor. But a UK fund would, like the UCITS products it would be competing against, offer such investors an advantage when investing in say European or worldwide Emerging Market indices.

Spreading the benefits of fund administration across the UK

22. Do you agree that new UK fund administration jobs associated with new UK funds would be likely to locate outside London? How could the government encourage fund administration providers to locate jobs in specific UK regions?

23. How can the government ensure the UK offers the right expertise for fund administration activity?

Questions 22 & 23 are answered together here.

There are no particular barriers to fund administration jobs locating outside of London. To encourage fund administrators to locate jobs in specific regions, the government can ensure that there is sufficient talent in the main skills associated with fund administration – such as accounting or legal skills – and that the specific UK regions in questions are attractive places to live and work vis-à-vis London, i.e. with good transport links. Fostering clusters of financial services activity outside of London will help generate scale. This could be bolstered through reforms to the apprenticeship levy: in the first 12 months of the levy the UK investment management industry paid in approximately £10.9m and received back about £180,000.[3] Increasing industry access to the levy, possibly combined with incentives for apprenticeships outside of London, could be beneficial.

Investment Trust Companies

24. Are there specific barriers to the use of ITCs, either from the perspective of firms creating fund products or from the perspective of investors seeking to access them? Are there specific steps which could address these?

While we do make use of the ITC structure, we do not see significant barriers to its use, nor that in turn there are under-represented product or investor types.

Setting up an ITC brings with it many of the costs, complexities, and risks of a primary listing. The unique structuring and governance processes for ITCs is quite different to that of other established fund types, which means use of the ITC structure is usually chosen when requirements around governance or investment strategy preclude the use of other fund structures.

One way the ITC regime could be refined, however, is by amending the requirements to release an updated prospectus if there is new issuance of 20% or more of existing share capital on a rolling 12-month basis. Any capital issuance of that size will in any event require the approval of existing shareholders, and the requirement to product a new prospectus – with information that has significant overlap with the ITC's annual reports – adds unnecessary cost, to the detriment of end-investors.

[3] The Investment Association (February 2020): Representation for the Spring Budget 2020

25. Should asset managers be required to justify their use of either closed-ended or open-ended structures? How effective might this requirement be, and what are the advantages or disadvantages of this approach?

Considerations about whether to use open- or closed-ended structures are already an integral part of the product design and liquidity risk management processes for funds. Requirements to make these considerations are already present in MiFID, UCITS, AIFMD and many other authorised funds, and through best practise extends to unauthorised funds as well.

The decision over which type of fund structure to use depends on the proposed fund features, target market, investor base, investment strategy, asset class, and the distribution model. Asset managers take account of these considerations as a matter of course, but these best practises have also been bolstered at international level more recently by IOSCO's liquidity risk management principles, which make reference to liquidity risk management a part of the product design phase as well as in the ongoing management of funds. The existing set of rules is sufficient and we do not see the need for further changes.

Distribution of capital

26. Should the distribution out of capital be permitted? What types of products would this facilitate and what investment or financial planning objectives would they meet for investors? What are the possible advantages, disadvantages and risks for investors?

27. How do you consider that such a change might be delivered? Please explain your answer, providing specific examples of rules, how they could be changed, and the effect of the changes.

Questions 26 & 27 are answered together here

Distribution out of capital could help to facilitate investment solutions that aim to pay a more consistent or predictable level of income. Income streams from securities often fluctuate and making up a shortfall via payments from capital could help to bolster an income stream; while in periods where there is no shortfall the income can be reinvested. COLL currently specifies different accounts for 'distribution', 'income', and 'capital': giving greater clarity in COLL about managers' discretion to distribute capital in accordance with a pre-specified income target could be beneficial.

Long-term Asset Fund

28. Do you foresee any issues with the LTAF adopting the current tax rules for authorised investment funds? Would the nature of an LTAF's investments, and the tax treatment of the income it receives in respect of those investments, mean that the current rules for authorised funds lead to tax inefficient outcomes?

The nature of investing into private asset classes, such as those which are intended to fall within the remit of the LTAF, often requires intermediate holding structures. The wide variety of legal forms and funding instruments that are common in such holding structures means that the returns received by an LTAF will commonly be a mix of dividend, interest, and capital gains. This mixture of returns presents that same issues regarding mixed funds discussed elsewhere in this response.

Additionally, whilst structuring an LTAF in the form of a tax transparent vehicle, such as a CoACS, may go some way to mitigating the potential for taxation at the fund level, there are several practical limitations as to when a CoACS could be operated. If the investor base of the LTAF were a single class of tax-exempt investors (e.g. UK pension funds), then a CoACS may be viable. However, when it comes to having a blended pool of underlying investors (both taxable and exempt), this would become extremely difficult. It can often be very onerous to accurately classify each underlying item of income and gains from a UK tax perspective when looking at a private asset investment structure. Therefore, it would be unlikely that the detailed reporting that a UK taxable investor in a CoACS would need to receive could be accurately or reliably produced.

29. Are there any other tax considerations, outside of those that follow from the adoption of the current tax rules for authorised funds, that will be important to the success of the LTAF? Please explain your answer.

To allow for the necessary flexibility for an LTAF to hold the types of assets for which it is designed and to be able to be invested into by retail or other UK taxable investors, we would propose that the LTAF have the ability to be established as a tax-exempt onshore fund, as discussed elsewhere in this response.

New unauthorised fund vehicles

30. How would each of the proposed unauthorised fund structures add value alongside existing authorised and unauthorised UK fund structures, including the QIS? Would they bring value alongside each other? Would they bring unnecessary complexity? What would each structure allow fund managers and investors to do that they are unable to do currently in the UK regime? Please address each proposed unauthorised structure separately, and indicate which of the proposed unauthorised structures you consider most important.

31. Would these unauthorised structures support the government's work on facilitating investment in long-term and productive assets, as outlined in Chapter 1?

32. How do you think the government could best achieve consistent branding for UK fund structures which target only professional investors?

33. Do you think that these unauthorised structures should be unregulated collective investment schemes? If you consider any 'light-touch' authorisation necessary or desirable, what do you understand this term to mean and what form could it take? Why would it be beneficial for investors, and how could it be explained to them in a way that avoids confusion with the regulatory assurances of fully-authorised structures?

34. Do you think these structures should have flexibility on whether they are open-ended or closed-ended? Should they have flexibility on whether they are listed or non-listed? How important is this?

35. Do you think these vehicles should or could be implemented as part of existing structures set out in legislation? Please provide details. If not, please explain why not.

36. Are there any specific tax treatments that would be either necessary or desirable to support the successful introduction of new unauthorised fund vehicles in the UK? Please provide detail of how and where this is the case.

Questions 30 to 36 are answered together here.

For the majority of asset classes, BlackRock believes the requirement for a UK domiciled wholly unregulated fund structure can be met through the existing UK partnership framework, a structure with an established tax code. In order to complement the partnership fund structure we also see it as important to progress towards a UK Asset Holding Company. However, in the context of the real estate asset class in particular, we would welcome the introduction of a lighter regulation onshore professional fund such as the proposed Professional Investor Fund unauthorised contractual scheme (the "PIF").

A gap exists in the UK's fund offering for professional investors and fund managers looking to establish a closed-ended (or limited liquidity) real estate fund. We would be supportive of the proposal to establish a UK domiciled regime such as the PIF to hold real estate investments in a fund that has the attributes of being unlisted, tax transparent and offering tradable units ("tradable units" meaning not inhibited by transaction tax). We feel that this initiative too may play a helpful role in increasing the availability of illiquid assets to HNW investors and improving the flow of capital to the real economy.

We also see a clear need for high net worth mass affluent investors to be able to access long term illiquid assets (including real assets such as infrastructure). In the short term we see the immediate priority as getting the LTAF into being - and in a form that allows UK taxable as well as DC pension money in. We will in our forthcoming consultation response on LTAF suggest that a new regulatory code, positioned between the existing NURS and QIS, is right for the LTAF. We are aware of the high levels of industry interest in the UK creating a lighter regulation onshore professional fund, and we feel that this too may play a helpful role in increasing the availability of illiquid assets to HNW investors and improving the flow of capital to the real economy.

We discuss the broader tax landscape in our answer to Q37. The specific point for any new lighter regulation fund such as the PIF is firstly that a change to statute law will almost certainly be needed, as we are advocating here for a vehicle with wider regulatory permissions than the QIS and by definition neither the current AIF or EUUT tax regimes would then apply (leaving the vehicle subject to full UK taxation). Second, that it would be desirable not to create a wholly new regime for such a new lighter regulation fund, but rather to include in the scope of the reformed regime we argue should replace the existing authorised funds tax regime.

37. Are there any interactions with wider tax policy that the introduction of new unauthorised vehicles would need to navigate, in order to avoid unintended consequences?

We think it is worth, in answer to this question, considering the UK's current fund tax regime in overview: At present, the UK offers five fund taxation regimes that are relevant here. While the tax policy need is partly a function of what new regulatory regimes are created, we believe that none of the five regimes are suitable for offering a wider range of assets (including long term assets) to hundreds or thousands of investors in the mass affluent-to-high net worth segment:

- Authorised funds: This tax treatment is only currently available to regulated funds; and as dealt with elsewhere creates issues for funds that hold both dividend and interest-bearing investments in varying proportions.

- TEFs: As the consultation document notes, little used but still on the statute books

- Partnerships: The issue being not their tax treatment per se, but rather that partnerships are only suitable for funds with tens of investors (so say, institutions or very high net worth investors).

- Exempt Unauthorised Unit Trust: This venerable regime is limited to investors who are UK pension funds or charities. While the regime was helpfully reformed in 2013 it is still relatively high touch for both the operator and HMRC, relative that is to the tax-exempt status of the only investors.

- Investment Trust companies: The tax code for ITCs functions well for the existing usage of these vehicles, but still creates occasional inflexibilities. And more fundamentally the regime is limited to fully listed vehicles.

Our principal point here is that five regimes are already too many, and creating a sixth to accommodate the new light regulation fund is undesirable. A bold but feasible reform would be to firstly create a more liberal regime to replace the existing authorised funds regime, and then extend it to all bona fide UK domiciled collective investment schemes even where those are lightly regulated. The two leading options for a 'more liberal' tax regime are deemed deduction and full exemption; for the purposes of answering this question the choice between these two is less important than urging consideration of having the same answer apply to both existing AIFs, LTAFs and the new lighter regulation regimes. We would then see that new regime making the current EUUT, and possibly even the current ITC, tax regimes redundant and able to be phased out. This would mean possibly reducing four regimes to as little as two, which would be desirable in its own right as a tax simplification.

Even if this one-size-fits-all approach proves unachievable, we still believe it necessary that the UK tax regime accommodate any new light-regulation funds without forcing the use of the legacy EUUT structure. This may necessitate the creation of a new regime, however in that case we would suggest that the EUUT regime be phased out and that any funds still using it transfer into the new tax regime for light-regulation funds.

Other proposals

38. Are there other things government should consider as part of this review of the UK funds regime, or proposals for enhancements to the UK funds regime which the government has not included in this call for input? If so, how important are they and how would you like to see them prioritised in relation to the proposals explored in this call for input?

We would reiterate that the UK's objective should be to develop a fund offering that addresses gaps in the market and developing advantage in future growth industries, rather than attempting to compete for market share in well-established industries.

Sustainable investment is one such sector that has significant growth potential. While the UK has announced that it will not apply the EU's Sustainable Finance Disclosure

Regulation, at the same time, UK government bodies have set climate disclosure and tackling 'greenwashing' as policy priorities. Mitigating greenwashing through appropriate disclosures is an important objective, and we believe a naming convention for sustainable investment products facilitating the transition can support this.

Separately, the FCA has announced that they will be articulating guiding principles to help firms with ESG product design and disclosure addressed to retail investors. There are opportunities for the UK to facilitate savers' access to sustainable investment products while ensuring greenwashing is addressed. Again, we see the need for a product naming convention that balances the need for rigour in evidencing specific sustainability claims while allowing innovation of new products that will support the FCA's policy objectives.

More generally, a paramount factor in the long-term retention of employment and tax base in the United Kingdom is that it remains an attractive place to locate portfolio managers and develop technological capabilities that can support future growth industries.

Developing capabilities in technology will be critical as the provision of financial services continues to evolve. In the US, there is growing interest in customised portfolio solutions – referring to the use of asset management products where, through the use of operational technology, it is possible to offer simple investment portfolios to clients where the securities are held direct in the client's name. It is far from certain that this is the future path of the US industry, or that the same trend may emerge in Europe. However, this does illustrate that the UK needs to be positioned for the products of the future, not the successes of the past, developing UK know-how and expertise in technology will be critical.

Similarly, we see an opportunity to use Distributed Ledger Technologies (DLT) (such as blockchain) to smooth the operation of foreign withholding tax processing, and also to improve the ability of UK funds to access important tax treaties such as that with the US. Indeed, HMRC has already shown willingness to engage with the use of DLT in this context. Ireland and Luxembourg have been highly successful in offering funds to investors from a wide range of countries, but those funds are as a consequence often unable to meet Limitation of Benefit tests in double tax treaties, resulting in relative withholding tax inefficiencies. A more sophisticated, DLT driven, approach to demonstrating to the tax authority in the treaty partner country that (despite being internationally offered) UK funds still have enough UK investors to qualify for treaty benefits would lead to a competitive advantage for UK funds. Again, this would be a result of UK investment in technology, as well as constructive joint working between the public and private sectors.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Review and will continue to work with HM Treasury on any specific issues which may assist in developing the UK's funds regime going forwards.