Call for Input

Eversheds Sutherland's response to HM Treasury's call for input on the UK funds regime

Contents

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?

1. Improvements to the UK's treatment of limited partnerships

We consider that the UK has the most to gain by attracting managers to launch their institutional funds in the UK. Since the vast bulk of private funds are established in limited partnership form wherever they are formed and whatever their target markets, further modernising the position of UK limited partnerships and their taxation is likely to produce a bigger and more certain benefit to the UK than any other single measure. Our thinking is set out in our answers to **questions 2**, **9**, **11** and **30**-**37**.

2. Permitted links rules

Another discrete measure that would have a substantial impact domestically would be to update the permitted links rules to enable defined contribution pension moneys, including that held in the very substantial auto-enrolment pools such as Nest, to invest in infrastructure and other long-term alternative assets. This is explored in answer to **question 38**.

3. Amendments to REITs

Further amendments to the REITs regime, building on the changes introduced by the Finance Act 2012, enabling them to be used more freely as institutional funds but also as asset holding companies would also be very helpful. This is described in answer to **question 8-9** and **30-37**.

VAT

We note that HMRC is consulting separately on the VAT regime for UK funds and we intend to respond to that, however, we also note that VAT is a major factor for the location of a fund and whether the asset holding vehicle has a VAT exemption and whether or not the fund manager has to absorb downstream VAT are significant factors in the choice of domicile for a fund.

2. How effective were recent reforms to UK funds taxation in achieving their aims? Please explain your answer.

The introduction of CoACSs

There were originally two key aims for CoACSs (and authorised contractual schemes in authorised limited partnership form, together "**ACSs**"). The first was to provide a UK vehicle to compete with Luxembourg FCPs and Irish CCFs by providing a suitable tax-transparent authorised fund vehicle to act as a master fund for cross-border master-feeder arrangements. This was intended to attract major non-UK managers entering the European market following UCITS IV wishing to establish large, cost-effective asset pools as master funds with appropriate feeder funds in the various European countries they wished to market to. The second driver was to give UK management houses an authorised UK-based tax-transparent structure so that they no longer needed to go to Dublin or Luxembourg to establish them. The ACS working group anticipated that they would be used for other as yet unknown commercial purposes as well as by life companies to rationalise their internal funds and so, at all times, aimed to give them maximum flexibility.

No large US or other fund house has established an ACS as a European master fund and, in fact, there was very limited consolidation in the European market using master-feeder structures.

A material number of substantial CoACSs have, as noted, been launched. Indeed the vehicle was taken up more quickly and with greater assets under management than any new UK fund vehicle we have seen, including the introduction of open-ended investment companies (OEICs). There were three main reasons driving the CoACS launches. The first was to consolidate life funds within corporate groups that had grown by acquisition; this was an anticipated reason but had not been a main driver for the new vehicle. A second reason for their establishment was to facilitate life companies investing tax-effectively in funds rather than by reinsurance following the introduction of Solvency II[1]. The structure was therefore useful for UK fund managers although the particular driver for its use had not been anticipated. The third and

[1] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance

most important reason was central government mandating local government pension schemes ("**LGPS**") to pool their assets. More recently, following various tax changes facilitating investment in English (and then Welsh) property, two life groups have established major property CoACSs to market. This contrasts with the relative lack of success of pension fund pooling vehicles ("**PFPVs**") which were very similar.

In short, two of the main commercial reasons that have resulted in CoACS taking off were Solvency II and LGPS pooling, neither of which were anticipated during the legislation's long gestation period. Further, there are still, so far as we are aware, no authorised limited partnerships. The point we draw from this is that it is not possible to anticipate how a new fund structure might be used or whether it will be successful.

Changes made to the ITC regime in 2011

The 2011 changes did not lead to any immediate changes such as the launch of new funds as UK ITCs rather than London-listed Guernsey companies, although over the last few years we have seen a resurgence of listed funds being established as ITCs in the UK. We consider that this movement back to the UK would not have happened had the ITC regime not been reformed in 2011.

Changes to the tax rules for unauthorised unit trusts in 2013

For many years, fund managers had established few exempt unauthorised unit trusts ("**EUUTs**") in each case for a very specific reason, generally preferring to establish funds able to take in a broader range of investors and therefore potentially attracting more assets under management. Typically, where a fund manager wants to establish an unauthorised institutional fund vehicle, it would either look offshore or use a limited partnership, which might itself well be offshore too. EUUTs are however extremely useful in certain scenarios which we have summarised further below.

We have recently formed EUUTs for an LGPS pool which has largely finished pooling its straightforward traditional securities portfolios into CoACSs with qualified investor scheme ("**QIS**") status. These EUUTs are being used for the alternative asset classes, including infrastructure, private debt and some real estate (where the SDLT seeding relief is not required). Typically, the LGPS pools are using a CoACS for real estate where the availably of seeding relief for CoACSs but not for EUUTs has driven the choice of real estate vehicle despite the liquidity requirements of even QISs for LGPS property investment. The LGPS generally prefer to use onshore rather than offshore vehicles where they can and, all being exempt pension schemes, the EUUT structure works fairly well for them. EUUTs will also potentially be used a little more by other defined benefit pension schemes as a result of Brexit closing off other possible structures.

We also regularly use the EUUT for clients as a feeder fund for exempt investors investing in alternative asset classes including infrastructure and real estate. For example, we have recently formed EUUT feeders for two managers who implemented their closed-ended private equity style real estate funds using either an English or Jersey limited partnership. We have also recently worked on an affordable housing fund, structured as an English limited partnership investing via a REIT and a registered provider of social housing where an EUUT feeder was added for exempt investors. We have also recently worked on an infrastructure fund structured as a limited partnership where an EUUT feeder was added for exempt investors.

The changes to the tax regime for EUUTs in 2013 have not therefore, as such, been a driver in the use of EUUTs. The easier compliance will, however, generally be helpful though.

More general changes, such as amendments to the Substantial Shareholder Exemption for institutional investors in 2016

One of the conditions for qualifying as a UK REIT is that the principal company must either not be a close company or be a close company only because it has as a participator one or more "institutional investors" as defined in section 528(4A) of the Corporation Tax Act 2010 (the "**CTA**"). We suggest that the list of what constitutes an "institutional investor" should be updated as CoACSs (and their foreign equivalents) do not currently qualify as "institutional investors" which is inconvenient. Further, it seems unnecessarily restrictive for the open-ended investment companies, unit trusts and co-ownership funds to require authorisation by the FCA or equivalent foreign regulation to qualify. Since this is not the case for limited partnerships, the industry is currently being forced to use limited partnership/REIT structures even where another type of fund would be preferable commercially. We recommend that the provision confirming that a limited partnership that is a collective investment scheme is an "institutional investor" should be extended to cover any unregulated fund that is a collective investment scheme.

3. 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?

- **CoACSs** – It was slightly unfortunate that the stamp duty land tax amendments necessary for non-group property CoACS to be operated and the capital allowances changes were brought in so long after the changes for all the other relevant taxes. It is more inconvenient, however, that Revenue Scotland has still not introduced equivalent measures for land and buildings transaction tax.

- **ITCs** – If the government had been faster to react and kept pace with other jurisdictions it would have prevented a substantial loss of business.

  Further, the recent change in HMRC guidance that clarified that shares in an ITC that are placed by a broker or via intermediaries under an intermediaries offer are ISA-eligible has helped to improve the marketability of ITCs and also improved the efficiency with which ITCs can raise capital. It would have been useful if this guidance had been better communicated to market participants, as our experience has been that there was and remains a lack of awareness of it in the market.

- **UUTs** – A potential problem with the EUUT tax reforms, however, is the implications of the new system for the mutual agreement on UK pension arrangements (set out in the HMRC internal manual – Double Taxation Relief Manual). We do not know if this was considered at the time but it is currently complicating both withholding tax and FATCA-compliance which also relies on its continued application. We have clients who do not have certainty on whether they qualify for zero withholding and some clients who represent that they are subject to 15% withholding because of their concerns about which is the correct rate. It would be extremely helpful if zero withholding could be confirmed as the correct rate, which we consider was always the intention.

- **General changes, including the SSE**

  As set out above, we recommend changes are made to the Substantial Shareholder Exemption for institutional investors.

4. Why has uptake of TEFs been limited?

One reason for the limited uptake of the TEF regime was that there were relatively few balanced funds at the time and the tax leakage was generally modest. This was both because of the prevailing investment strategies then and that it was introduced after foreign dividends had generally been exempted from corporation tax.

One major fund manager did insert TEF wording into its prospectuses ready to switch on when it became practical to operate TEFs, but it never has.

Please explain any operational or commercial factors that have influenced their uptake.

An important factor affecting TEFs was that it was understood that TEFs would require the same platform changes as PAIFs but operated with two streams of income rather than three. It was clear fairly rapidly with PAIFs that the platforms were not keen to facilitate this. We understand that there were a number of reasons, but it is important to understand the commercial dynamics by way of context with the platforms being hugely influential in the promotion of individual funds and fund ranges.

Drilling down into the particular reasons, some platforms use a single nominee company to hold all their securities, both for their taxable and tax-exempt investors, which made paying both net and gross investors difficult. We understand another issue is providing appropriate reporting for streamed income.

How could these be addressed?

The only way we consider that the issue could be addressed, if indeed it is desirable to do so, would be for the FCA and/or government to make the facilitation of streaming income types by platforms mandatory.

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

An important point in considering any change of regime is the need for simplicity, both at the fund but also the investor level. It would not be helpful to introduce a simplified regime for funds at the cost of extra complexity at the investor level.

Looking at the potential solutions presented in **paragraph 2.9**:

Option 1: Changes to the tax rates applied to UK funds, including applying a low rate of tax to authorised funds	This would be a very partial solution to the problem.
Option 2: Deemed deduction for distributions at fund level	This is already used domestically for authorised bond funds and is a methodology that is understood internationally. We understand that the Investment Association has consulted widely and recommends this solution.
Option 3: Amendments to the TEF regime	This would result in additional complexity and not resolve the situation with regards to UK rental income.
Option 4: Extension of corporate streaming to individuals	This would introduce considerable complexity for investors which would not be welcomed by them or the industry.

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

No comment.

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

Fund managers seeking to launch a fund will choose where to locate it based on a number of considerations, including the regulatory position, the location of the target investors, sometimes the location of the target investments and the investment strategy, current market norms (if any) and tax considerations, including tax-effectiveness, ease of operating and compliance in the jurisdiction and stability.

If all else is equal, and there is a choice between a tax-effective but complicated regime in the UK and a simple and tax-effective one somewhere else, there would be a real temptation to locate the fund in that other place. In fact, it would be very unusual for all else to be equal, and smaller managers without major bases outside the UK would always prefer to domicile their funds in the UK if they can. In the case of managers with substantial bases outside the UK then the impetus to use a UK or non-UK fund will depend on many factors including the dynamics within the group.

8. 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.

It is not clear how making UK funds tax-exempt would affect their competitiveness and attractiveness; the industry is divided between managers wanting UK funds to continue to be taxable and those which would prefer them to be exempt.

If the UK funds remain liable to corporation tax on their income, it will be important to deal with the potential for tax-leakage in multi-asset and balanced funds since they are likely to be of increasing importance, especially with increased use of solutions-focused strategies including liability-driven ones. It would also be useful to address the perception of UK funds not being tax-effective as compared with tax-exempt funds notwithstanding their potentially suffering additional withholding tax.

If tax-exemption is adopted for all UK funds, it will be important that this is not accompanied by increased complexity in the tax position of investors.

Indirect taxes are also important for funds, especially VAT. Currently, UK law allows VAT exemption on the management of certain funds which are mainly regulated collective investment funds. Where the asset holding vehicle does not have VAT exempt status, VAT is a major factor for the location of the fund. Even with the VAT exemption, the downstream VAT costs of fund managers are not recoverable and have to be absorbed by the fund manager leading to increased fees thereby adding to the cost of investment. Zero rating would alleviate this problem but it is recognised that the corresponding reduction in tax revenues needs to be balanced against the potential increase in inward investment and encouraging funds to move to or be established in the UK. We recognised that there are separate consultations which will focus on the impact of VAT for funds so we do not propose to go into further detail here, but the differing treatment of VAT on fund management in the EU and in other jurisdictions has a significant impact on the attractiveness of the UK for the funds industry.

9. 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?

In our view, if the changes suggested in **paragraph 2.16** were made to the REIT regime, it would greatly encourage their use by UK and overseas investors for UK property. We would expect them to facilitate the UK government's goals for infrastructure and housing but doubt that they would be used for non-UK property.

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

For REITs which are structured as closed-ended funds with a diverse investor base which wish to achieve liquidity by trading in the secondary market, the upfront cost and consequential abort cost risk is a major factor that can detract from the attractiveness of a UK REIT as an investment structure, for the same reasons as apply to ITCs described under the heading "Launch costs" in our response to **question 25** (other than the reason given in relation to the "close company" requirement).

Similarly UK REITs would be more attractive if their additional costs could be reduced; again this is covered in relation to ITCs in our response to **question 25**.

The REIT regime could be refined by offering a REIT that is only available to institutional investors, not publicly traded, unlisted and can be an asset holding company or a fund vehicle in its own right. We note that as part of the initial AHCs consultation, one of the considerations was the relaxation of the listing requirement. Giving managers the option to elect for a non-traded, unlisted REIT would give the vehicle additional flexibility but we consider that this option should only be available where the investor base meets certain eligibility criteria. Currently, the upfront cost and consequential abort cost risk of establishing a REIT, as well as the ongoing costs of operating a listed vehicle, inhibits their use. With a closed-ended fund where there is unlikely to be regular trading of investors' interests, the listing requirement results in managers being forced to look at offshore options such as The International Stock Exchange to meet this listing requirement. In the context of vehicles that will not be widely held and traded, the listing requirement is an unnecessary barrier. The concept of an unlisted or "private" REIT will be familiar to overseas investors, in particular, those in the US or familiar with US structures. It is common in the US market for funds investing in infrastructure and real estate assets to be structured as a limited partnership with subsidiary or joint venture REITs as the asset-holding entities. We have seen a move in this direction in the UK with the recent establishment of two affordable housing funds, structured as limited partnerships and investing via a subsidiary REIT which is a registered provider of social housing. The requirement for a listing makes those structures more cumbersome than they otherwise need to be, particularly as there is no need for liquidity by trading in the secondary market. If this barrier were removed and the proposals in 2.16 are adopted, it may make the structure more accessible to managers, and would be an internationally recognised and familiar structure for infrastructure and real estate. It would also be necessary to alter the provisions for holders of excessive rights, as mooted in the AHCs consultation.

One of the conditions for qualifying as a UK REIT is that the principal company must either not be a close company or be a close company only because it has as a participator one or more "institutional investors" as defined in section 528(4A) CTA. We have mentioned this in our answer to **question 2**.

11. Regarding the proposals covered in the 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.

The Investment Association has answered this question comprehensively.

12. 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.

In our view, when considering the international funds investing in alternative asset classes, including private equity, infrastructure, real estate, private debt, the limited partnership is one of the most popular and well known structures in the institutional investor market. It is increasingly used for both open- and closed-ended structures, having historically been used more in the closed-ended fixed life private equity space. It is also a vehicle of choice in the UK. We strongly believe that a reformed, tax-efficient and well promoted limited partnership vehicle offers the UK the best opportunity to attract international capital into funds structured in the UK to invest in those asset classes, and is already a well-recognised and widely accepted institutional vehicle for UK investors. Other jurisdictions have recognised the importance of the limited partnership. Luxembourg, Singapore and, more recently, Hong Kong have all introduced limited partnership regimes. Our experience, working with our Luxembourg colleagues, is that the Luxembourg limited partnership is likely to be the most popular structure for these asset classes in Luxembourg. As highlighted elsewhere in this response, the limited partnership would often be combined with other structures, including REITs, EUUTs, other LPs, LLPs and corporates and so their success also relies on reform of those vehicles and, importantly, the outcome of the consultation on asset holding vehicles.

Fund structure

A major barrier to the use of English limited partnerships is their lack of legal personality. We suggest that UK domiciled LP Funds and PFLPs regime could be further refined by offering a limited partnership with separate legal personality. That would be hugely helpful in structuring those funds, where is it common to choose another jurisdiction (eg Scotland, the Channel Islands, Luxembourg) purely because it is not available in England. We are regularly faced with a choice. Most jurisdictions offer limited partnerships in both forms, ie with or without legal personality. Similarly, other jurisdictions offer limited partnerships that can have separate sub-funds, eg Luxembourg, and those are widely used. We would suggest that separate sub-funds could allow costs savings for managers, making UK LPs more attractive as well as offering managers greater flexibility when structuring a fund for different asset classes or investors.

Marketability

An additional key barrier to using a Scottish or English limited partnership as a fund vehicle is the ability to market it to non-UK investors. In particular, fund managers which wish to access European investment will typically seek to structure the fund using an equivalent European structure. Improving the ability to market an English or Scottish limited partnership to investors beyond the UK would be helpful and more creative ways need to be considered to raise the profile of English and Scottish limited partnerships to a global investor audience. We consider that industry bodies would be best placed to continue to lead on profile raising efforts, and if government funding were to be allocated to the asset management industry in order to better market UK fund products, organisations promoting English and Scottish limited partnerships should receive a share of that funding.

Internally-managed AIFs

UK LPs do not currently have a vehicle equivalent to a Luxembourg internally managed alternative investment fund, due to the divergence in interpretation of whether or not a limited partnership is internally managed as between the Luxembourg and UK authorities. Current FCA guidance states that because a limited partnership is operated by an external general partner it is externally managed. The CSSF, however, views the LP and the GP as a single structure for these purposes of determining whether or not there is external management.

The Luxembourg internally managed alternative investment fund provides a solution for smaller start-up fund managers, enabling them to set up a small fund without the need to be authorised by the CSSF (either under AIFMD or MiFID). As noted above, the UK does not treat such fund structures as falling outside the regulatory umbrella, a position that seems conceptually illogical, as the UK already permits internally managed closed-ended funds to be treated, from a regulatory perspective, in a similar way to the Luxembourg internally managed alternative investment fund.

The Luxembourg internally managed alternative investment fund has been a very popular structure for start-up fund managers as it effectively enables the fund to start small and be set up very quickly. The additional service providers that the fund would require at the point at which it achieves sufficient scale to be "full scope" for AIFMD purposes, need only be hired and consequent costs incurred, at the point that scale is achieved, thus reducing the fund's operating costs (which should benefit investors) whilst the fund is small.

Tax and disclosure requirements

Issues common to both English and Scottish limited partnerships include the disclosure requirements and tax returns, withholding tax and VAT.

The Partnerships (Accounts) Regulations 2008 potentially required English and Scottish limited partnerships to prepare audited accounts which must be available to the public. The accounts are frequently commercially sensitive and there is no clear public interest reason for the requirement. It is therefore common to structure around the requirement, but this adds otherwise unnecessary complexity of a type not seen in competing jurisdictions.

Further, a UK tax return is always required (whereas a foreign partnership is only required to file a UK return if HMRC issues a notice to a UK partner) even where the partnership is required to report within the CRS system.

Another unnecessary impediment to the use of English and Scottish limited partnerships is the potential technical stamp duty charge that can arise on transfers of interests in them. The fact that it is not in practice normally paid and that stamp duty is a "voluntary tax" takes some explaining. This and the certainty of the loan capital exemption has resulted in some private fund limited partnerships still being formed with minimal capital and substantial loan capital, notwithstanding that the continuing contingent liability on withdrawn capital not applying to them.

There is also a withholding tax issue. The Income Tax Act 2007 provides at section 937 an exemption from the requirement to withhold tax on interest paid to partnerships, which only applies where every partner is itself entitled to gross payment (and is not itself a partnership even if that higher partnership is itself made up only of gross recipients). The consequences for an investment partnership are that if the general partner is a limited liability partnership (LLP), as is often the case for accounting reasons, or if there is a fund partnership with a carried interest partnership (as is required to comply with the BVCA MoU) then the entire partnership is tainted even if every investor who will receive a share of the interest income is entitled to gross payment. Since partnerships themselves are already able to act as a withholding agent (eg on interest paid by a partnership to third parties) there seems no reason why the rules cannot be changed to allow partnerships to receive interest gross and to pay it out gross or net based on the recipient's own status.

Current issues regarding partnership taxation generally

A problem particular to partnerships with any non-capital gains tax exempt partners is the application of Statement of Practice D12 (SP D12). This results in complex CGT issues for those partners whenever there is a change in membership. The admission of a new partner can result in dry tax charges for the existing partners as a consequence of the deemed transfer of a share of each asset on its admission. This affects the ability of partnerships to operate effectively as fund vehicles for real estate and other assets as it can result, for example, in a second closing triggering a tax event if there are already investments in the portfolio and any of partners is within the UK CGT net. The problem becomes particularly acute in open-ended limited partnerships. We understand there is little appetite in the CGT team at HMRC to legislate or reform SP D12 but perhaps in these circumstances the payment of the taxation could be deferred. An ability to elect for CoACS-type treatment would be better though from a funds' tax perspective.

Looking at real estate partnerships, stamp duty land tax ("**SDLT**") is applied on transfers of interests in partnerships that hold UK land. This was an anti-avoidance measure following the extensive use of partnerships as SDLT avoidance vehicles in the mid-2000s. While not aimed at widely held funds this measure acts as a significant barrier to setting up property funds in LP form.

Manager taxation

An issue which indirectly affects the use of funds in partnership form by UK managers is the current complexity of their UK taxation.

We suggest that the applicable rules are reviewed with a view to having as simple and clear a system as possible to raise the level of tax that the government considers appropriate with the revenue protected by targeted anti-avoidance provisions. The current provisions include the mixed member rules, the close company loan to participator rules, the disguised remuneration for the self-employed rules and the disguised investment management fees ("**DIMF**") rules, as well as general provisions such as the transfer of assets abroad rules and the GAAR. A number of these codes overlap, while others are so broad that they are inhibiting ordinary commercial behaviour.

The topic is explored in more detail in the response from the Law Society.

VAT (and consequential corporation tax issue)

The UK VAT regime for funds in partnership form is complicated and the result usually less favourable than if the manager had formed the fund offshore.

The UK VAT treatment of UK funds in partnership form relies on the GP being entitled to a priority profit share ("**PPS**") from the limited partnership, as opposed to a straightforward management fee, to benefit from the CJEU *KapHag Renditefonds* C-442/01 decision that a partner does not generally make supplies to a partnership. The GP then typically pays the proceeds to the UK VAT-grouped manager as a management fee relying on the decision in *H Saunders & T G Sorrell* (1980) 1 BVC 1133. The VAT group will be partially exempt. In contrast, the same UK manager would probably benefit from a 100% recovery rate if it suppled the same services to a non-UK LP. More UK partnerships would be used if this were addressed, for example by zero-rating.

There can also be a corporation tax disadvantage for a UK company managing on onshore LP fund as a result of the PPS. This arises where, as is often the case, the profits arise towards the end of the fund's life so the fund initially has to lend money to the GP to enable it to pay management fees during the earlier part of the fund's life. Consequently, the 50% cap on the eligibility of profits to be relieved by carried forward losses can result in the GP paying corporation tax on amounts that are not net profits through the 50% cap restricting the deductibility of some fees paid earlier in the fund's life. Exempting GPs from the 50% cap would help to level the playing field between equivalent onshore and offshore funds in LP form.

13. 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?

While fund authorisation is a prerequisite for product providers wishing to sell to retail investors, it has a broader importance than that.

The UCITS badge, and the accompanying passporting rights, previously provided access to the EU retail market before the UK left the EU and its single market. Since then, UK UCITS can be marketed freely only to UK retail investors, unless the UK UCITS are registered for retail sale abroad. Registration for sale abroad, for example, in Hong Kong, generally requires certain additional information or disclosures to be provided to supplement the existing UK offering documents. It should be noted that the ability to sell to retail investors in certain other, non-EU, jurisdictions, is only available to a UK UCITS. We would expect that the UK UCITS will remain popular with international investors in such jurisdictions simply due to familiarity with the legacy UCITS regime.

The pre-Brexit position of NURS is unchanged by the loss of passporting rights, and it remains freely marketable only to UK retail investors. Consequently, the UCITS is arguably no longer the 'default' retail vehicle for UK fund launches as the loss of EU passporting for UK UCITS has removed its key differentiator/selling point. Now firms may feel that they ought to default to the increased flexibility offered by NURS (albeit with some additional AIFMD-related administration).

Firms seeking to sell their products across the EU will no longer establish a UK fund as the lack of passporting cannot be overcome. This is a great shame since the FCA's strong consumer focus is arguably its key differentiator when compared to EU counterparts. Following the FCA Market Study, there is now momentum in the UK market towards creating products which are clearer in their description, more transparent in their operation and expressed in a more understandable manner. That approach contrasts with the approach taken in key EU-27 jurisdictions.

While institutional investors, such as UK defined benefit occupational pension funds, can invest in funds that are not authorised, some prefer to invest in a product with the badge of authorisation, which is why the UK has the QIS structure. CoACSs established as QIS have proved a popular pooling vehicle for the local government pension schemes (LGPS); while they could have used an unauthorised vehicle to pool their traditional securities portfolios, there was no appropriate unauthorised UK vehicle available and co-ownership schemes only exist in authorised form. Further, the QIS status gives their LGPS investors a level of regulatory comfort.

A fund's regulatory status is also important for life companies offering unitised policies, both to the life and pensions markets and reinsurance. Not only do retail investors use these, including in SIPPs and SSASs, but they are also important for the increasingly large defined contribution automatic enrolment plans. It is permissible for a unitised policy to be linked to a UCITS or NURS without the life company concerned having to undertake any investigation itself of the underlying portfolio. Where they link to a QIS then, under the current rules, they need to check the underlying portfolio for acceptability under the permitted links rules which is impractical.

The benefit of authorisation does not vary by investment strategy. However, there are strategies that cannot be utilised in an authorised structure whether due to eligible assets (for example, a UK UCITS cannot directly invest in real estate or commodities), risk limits or other regulatory constraints (such as the need for depositaries to be legal owner of the assets).

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

There is an unjustified difference in the language of the triggers for FCA applications. In respect of authorised funds which are constituted as open-ended investment companies, the relevant statutory requirements are set out in s 21 of the Open-Ended Investment Companies Regulations 2001 (the "**OEIC Regulations**"). In respect of authorised funds constituted as authorised unit trusts or co-ownership schemes, the relevant statutory requirements are set out in ss 251 and 261Q of the Financial Services and Markets Act 2000. Whilst the latter two provisions mirror each other, the provisions relating to open-ended investment companies are more specific, including requiring FCA approval where any change to the instrument of incorporation is required. This lack of consistency has the possibly unintended consequence of similar changes being treated differently as regards the need to obtain FCA approval. A recent example is shown in the requirements to update scheme offering documents (including instruments of incorporation, trust deeds, and co-ownership deed) to reflect the post-Brexit regulatory regime. Whilst the FCA have indicated they do not consider they need to approve such changes in respect of authorised unit trusts or authorised co-ownership schemes, the language of s 21 of the OEIC Regulations does not permit the FCA such flexibility. Accordingly, firms are required to submit such changes to the FCA for approval, whilst the same or similar changes in other structures in their range, can be adopted without this additional process.

In practice, the majority of triggers for an FCA application derive more from convention than the statutory tests. For example, it is hard to argue in legal terms that the increase of a Manager's annual management charge for an OEIC is more 'significant' than a decrease, but the former requires an FCA application while the latter does not. This is of course, because the majority of changes are (and should be) considered principally from the perspective of the degree of impact (positive or negative) that they may have on an investor. A change to scheme documents which results in a beneficial impact on investors (such as a decrease in fees to be taken from scheme property) naturally could be supposed prima facie to require a lower level of scrutiny. This more "principle based" approach to assessing changes and the level of regulatory scrutiny that they require is possibly of more practical use to ultimate investors.

This does not necessarily mean that the system does not work, but we think the real life process bears limited resemblance to the statutory one.

Concepts that are part and parcel of the authorisations process do not feature in the legislation (eg the cut off point for receipt of an application, the concept of an application being deemed 'complete' or not, the need for a depositary to co-sign the application etc).

Separately to any legislative framework, the authorisations process has become more intensive. It is often increasingly difficult for firms to be certain as to timing as new questions are often raised towards the end of the application period, with limited time to obtain and communicate responses and appropriate evidence if required. Once an application has been withdrawn on the FCA's request and the FCA's SLA targets missed, there is no formal impetus for the application to be signed off promptly, although our experience is that individual case officers are in practice helpful in continuing to work on re-submitted cases as priorities where they can. However some applications can go on for several additional weeks, particularly where the policy or supervision teams are inputting. This has the consequence of jeopardising firms' – and firms' clients' – timelines and adds an unhelpful degree of uncertainty surrounding the regulatory authorisations process. Given that an important part of firms' timeframes also encompasses the amount of time required to notify investors of changes to existing products – which are in many cases prescribed by firms by the COLL Sourcebook, with limited scope to flex these whilst maintaining the important principle of providing sufficient notice to investors, this can be frustrating. An example is that if a change is deemed "significant" according to the tests in the COLL Sourcebook, firms are required to provide at least 60 days' prior written notice to investors in the relevant fund. There is no scope to adjust this if the FCA's timeline slips, eg to provide 50 days' or 45 days' notice, within the same regulatory classification.

There is also (although we think unavoidably) an element of each individual case officer choosing to pursue certain points (that others may not), so even with peer review, what may have previously been approved for one firm may be challenged for another (ie previous decisions are not binding). It follows that it can be very difficult to offer any degree of certainty of outcome to applicants. Further, we understand that even within the FCA there is often no statement of internal, unpublished policy positions and this similarly can lead to inconsistency. Occasionally this also leads to case officers requesting additional and inconsistent levels of disclosure on points where such disclosure is not rooted in the rules of the COLL Sourcebook. This typically is the case where the COLL Sourcebook permits certain activities (such as, for example, the charging of a performance fee or initial charges in a retail fund) but the power is not commonly used in the market, and accordingly, the FCA may be reluctant to approve further examples.

15. 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?

We know that many firms feel that the UK is at a competitive disadvantage in terms of timescales when compared with certain jurisdictions, although we also have experience of other jurisdictions' timescales not being respected, in some cases, not even receiving a response before the application deadline. We also know that in some jurisdictions, the published response time is dependent on an application being deemed "complete". This process of obtaining a "complete" application in practice can simply be a way of the relevant regulator asking questions about the substance of the application eg the rationale, or commenting on specific text in an application, rather than requesting additional missing documents. This has the effect of delaying the clock even starting for the formal regulatory review. This causes an unacceptable level of ambiguity and can make proper planning and timetabling very challenging because there is no guarantee when the relevant case officer will agree to start the clock and commence the "formal" review. We are pleased that this is not a practice which the FCA undertake.

However, in our experience firms have been less concerned about the absolute amount of time for authorisations and more concerned about the predictability of the process (as explained above). Timelines are typically reliant on the statutory/voluntary periods for authorisations and delays (such as where the FCA requests that applications are withdrawn and resubmitted) can be disruptive to firms' plans.

That being said, our experience is that the FCA case officers do their best to organise questions and responses appropriately and do also try to take into account firms' specific timetable requirements when they can.

It is difficult to see how greater certainty in timetables will prevent the principle issue we encounter – that of questions coming too late to be answered properly, or issues "sticking" and requiring in depth analysis, often with input from other departments in the FCA. This is because we assume that the same process of being asked to withdraw and resubmit such applications, thereby starting the clock once more, would continue. However, it might be useful to consider:

- whether other departments within the FCA, not just the authorisations team, could be subject to similar, and aligned, statutory timescales. In particular this would be useful for the Policy and Waivers teams. If, for example, those teams could be subject to the same timetables, and process put in place for issues to be raised to them in an application, say, within the first week of submission, it would we think assist enormously in cutting down the number of times that withdrawal is required;
- it would be particularly helpful if the Waivers process was formalised in a way which mirrored the FCA process, ie a prompt acknowledgement and assignment to a case officer along with provision of the relevant case officer's details and an indication of a timeframe for receiving a response. This would assist because it would give firms and their advisors the ability to interact directly with the relevant Waivers case officer in the same way that the authorisations team interact directly with firms and their advisors. This assists in airing issues quickly and reaching appropriate solutions and avoids the risk that messages and responses are fed back and forth indirectly through internal processes; and

- it would be interesting to consider whether the FCA would be able to be more flexible in the kind of authorisation or approval letters it issues, ie could it consider "conditional approvals" which can be issued with the understanding and agreement of the relevant authorised firm, that any final issues or sticking points are to be resolved with the FCA prior to the relevant event or product change taking place. This would of course only be applicable in limited circumstances, but might obviate some of the disadvantages of having to withdraw applications, in that it would enable firms to continue with product builds and preparation confident that approval was obtained, subject to conditions (eg the obtaining of a waiver which is on a different timescale for approval, or where a product is simultaneously going through a process with an international regulator, eg the Hong Kong SFC, which needs to be completed or which requires approval before the product can launch).

Ireland Overview

The two main categories of collective investment schemes authorised in Ireland are as follows:

1. UCITS

    - UCITS established in Ireland are authorised under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (the "**UCITS Regulations**"). The UCITS Regulations transpose Council Directive 2009/65/EC, Commission Directive 2010/43/EC and Commission Directive 2010/44/EC into Irish law. The Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) (Amendment) Regulations 2019 (the "**Central Bank UCITS Regulations**") consolidates into one location all of the requirements which the Central Bank of Ireland (the "**CBI**") imposes on UCITS, UCITS management companies and depositories of UCITS.

and

2. Alternative Investment Funds ("**AIFs**"), being either:

    a) Qualifying Investor Alternative Investment Funds ("**QIAIFs**"); or

    b) Retail Investor Alternative Investment Funds ("**RIAIFs**").

        - AIFs in Ireland are subject to AIFMD (as supplemented by a number of supporting European Regulations) and the EU (Alternative Investment Fund Managers) Regulations 2013 ("**AIFM Regulations**") which transposes AIFMD into Irish law. In addition, there is the CBI's AIF Rulebook (additional rules required by the CBI), which stands alone and must be read in conjunction with the AIFMD framework and the AIFM Regulations.

The CBI is responsible for the authorisation and supervision of all collective investment schemes (ie both UCITS and AIFs). The authorisation process varies depending on the fund type selected:

Name of a product	Approximate authorisation time
QIAIF (including sub-funds)	**QIAIF Fast Track Process**
	QIAIFs (subject to the pre-submission process below (if required)) benefit from a fast-track authorisation process meaning that a QIAIF can be authorised by the CBI within 24 hours of filing the appropriate documentation subject to the following: – the service providers to the AIF (investment manager, directors, depositary and administrator) are already approved by the CBI; – confirmation must be supplied regarding compliance with the authorisation criteria; and – an application must be filed no later than 17:00 on the day before the proposed date of authorisation.

Name of a product	Approximate authorisation time
	Pre-submission process A pre-submission is required for certain QIAIFS which intend to hold uncommon asset types or have unusual features such as: – funds with high levels of leverage; – property funds; – life settlement funds; and – loan originating funds. No timeframe has been specified by the CBI but the process can range from 3-6+(months) (also subject to the relevant service providers to the QIAIF being already approved by the CBI).
UCITS and RIAIF (including sub-funds)	
	The CBI reviews key fund documentation as part of the application for authorisation of a UCITS and a RIAIF (eg UCITS applications to the CBI must include the prospectus, instrument of incorporation, agreements with service providers, business plans and the fund's Key Investor Information Document (KIID)). As such, the timeframe for obtaining authorisation depends on the level of comment received from the CBI on the documentation submitted. The CBI provides that applications will be assessed within the below timelines: – **Non-fast track UCITS/RIAIF (ie umbrellas other clones and complex sub-funds)** The CBI aims to respond to initial comments within 20 business days of receiving a complete application, and to responses to all subsequent comments within ten business days of receiving the responses. – **Fast track UCITS/RIAIF (ie clone umbrella, clone sub-fund and non-complex sub-fund)** The CBI aims to respond to initial comments within ten business days of receiving a complete application, and to respond to all subsequent comments within five business days of receiving the responses. Once the CBI has indicated that it has no further comments on the relevant draft documents, final signed documents are filed with the CBI by 12:00 on the proposed day of authorisation (the CBI will then authorise the fund by close of business on the same day). In total, the authorisation process can take approx. 8-12 (weeks) from date of initial submission of an application to the CBI (subject to the relevant service providers to the UCITS/RIAIF being already approved by the CBI).

16. 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 these strategies?

We understand that there is little appetite within depositaries to take legal ownership of alternative assets (including, for some depositaries, real estate) as would normally be required for a QIS under COLL 8.5.4 R. Instead, the preference would be for the fund (assuming a vehicle with legal personality) or the AIFM acting on behalf of the fund to be the legal owner with the depositary's oversight role satisfied instead through verification of the fund's ownership. This would align the QIS rules with the requirements under AIFMD and other key markets (including Luxembourg).

The policy position on liquidity in a QIS could be clearer. The rules do not necessarily need to be changed, but if the QIS is to be used for a broader range of alternative asset classes, clarification in this area would be helpful.

The QIS rules presently require that a standing independent valuer price immovable assets at least once a month (COLL 8.4.13 R (2)(c)) even if the fund deals less frequently. Since only the most frequent valuation will actually be used for dealing of units in the fund, this represents an unnecessary expense and firms have, in the past, sought a modification of this rule. If longer dealing periods are to become more common, it would be sensible to see a relaxation of this rule or the availability of a modification by consent.

Further changes that would benefit authorised funds more broadly

There are a number of regulatory points that would be beneficial to authorised funds in general (and not only QIS):

- **Indemnities from scheme property.** In CP07/18, the Financial Services Authority consulted on welcome changes to the UK's rules around indemnities from scheme property. In Handbook Notice 73, it was revealed that these rules would be subject to a further consultation which never occurred. Presently it is not clear to what extent a fund can be liable even for its own risks. This is even more pertinent as we look to assets like infrastructure.
- **Liens.** As above, welcome changes to the rules around 'mortgages', 'charges' and other securities were discussed in CP07/18 but were delayed. For example, we know that in practice the granting of liens is a common necessity in the custody of assets. However, for UCITS it appears that they cannot be granted.
- **Soft closure.** In 15/27, the FCA consulted on powers to allow funds to soft close. This would be a valuable power (commensurate with that of other jurisdictions) to allow large funds to temporarily close on short notice (without suspending) to protect existing investors. We do not believe a response to the consultation was published. Presently firms have to work around the existing rules by using limited issue shares, by introducing initial charges to discourage investment, or by cutting off distribution and hoping that top ups will not be significant.
- **Investor communications.** We think it may be sensible to consider the future of investor communications and the need to write to investors for changes that require no action on the investors' part. We understand that there is often regulatory concern around changes to terms. Some changes could legitimately cause an investor to reconsider their investment – such as changes to the fees that will be charged. There may also be operational changes which investors may want to be made aware – like the name of the product. However, there does sometimes appear to be a disconnect between rules that are written for a model, retail, direct investor versus what we know happens in practice. For example, we approach matters as though all/most investors contact fund operators directly for investment, diligently read the prospectus/KIID, would want to be notified by post about fairly minor changes of exposure and would want 60 days to make a decision about whether or not to continue their investment. As we understand it, this does not reflect reality. It may now be sensible to consider relaxations to the rules to account for a digital first economy where platforms are the main interface to retail investors. For example:
  - Do investors ever benefit from EGM votes?
  - Are passive rather than active communications appropriate in many cases?
  - Should there be a mechanism whereby manufacturer product messages are automatically available to end investors on platforms – some sort of agreed pass-through?

17. 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?

Yes.

The existing rules on investment in underlying funds ("**second schemes**") are restrictive, even in the QIS regime (COLL 8.4.5R). The percentage limitations on holding other funds that are not authorised or recognised schemes are challenging. The prohibition on investment into second schemes holding more than 15% in another fund is often unworkable, and the rule seems to go further than the policy objective.

We agree, of course, that circularity of investment should be avoided, but as the FCA waivers in this area show, that can easily be dealt with. This rule has been a particular area of challenge for the LGPS as they have sought to transfer their legacy assets into their QIS in line with Government policy on LGPS pooling. This issue is, however, equally relevant for other managers.

The ability of a fund to lend money is a key area both for private debt funds in general but also for infrastructure and real estate debt funds. Currently, regulated funds must invest only in investments as defined under FSMA. Whilst that captures debentures and certain other debt instruments, it is not clear that it covers debt originations or all aspects of debt origination.

In alternative asset classes, it is quite unusual for the fund to own its assets direct, rather equity or debt instruments in intervening SPV entities, joint ventures and consortium companies. It would, therefore, be extremely help if the rules permitted the fund to own, wholly or partially, interests in underlying entities (something which is presently permitted only for holding overseas immovable property). A debt fund would typically own an entity for the purpose of entering into loan origination. Much of this structuring would be directly for the benefit of investors, in terms of ring-fencing fund liabilities and financings etc.

If a new category of regulated fund is implemented as a consequence of the call for input (eg an LTAF), we strongly believe that any flexibilities provided to that structure should also be afforded to the QIS as a predominantly institutional category of fund. We acknowledge that the QIS may also be invested in by certain categories of sophisticated investor (which is important to some managers and which we consider should not be changed) and so those flexibilities need to be weighed against that.

18. 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?

No comment.

19. 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.

We have not experienced this as a particular issue.

20. 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?

We agree that it would be best to focus reforms on appealing to the creation of entirely new funds rather than on existing ones converting.

As a general rule, once a fund has been established in one form and location, it is likely to remain there in the same form. For a fund manager to change the form and/or location of a fund will generally be expensive (particularly if it is a property fund) with the manager frequently bearing the costs and such a change increases the likelihood of investors redeeming in an open-ended fund. Having said this, we have seen a few funds imported in to the UK from Luxembourg, Ireland and the Channel Islands in recent years for varying reasons, including that the particular fund structure was no longer cost-effective to run and/or beneficial in tax terms to the fund house preferring to consolidate two European locations in to a single one in the UK. Similarly, we have seen relatively few UK funds convert to a different regulatory status or vehicle, with the conversions of the authorised property unit trusts into PAIFs (property authorised investment funds) being a notable exception. This having been said, if an LTAF in QIS form which is introduced, it is likely/possible that those local government pension scheme pools which have already created exempt unauthorised unit trusts to pool their investments in private funds would seriously consider converting them into CoACS, and especially in those cases where all their other funds are in CoACS form.

21. Why do firms choose to locate their funds in other jurisdictions in cases where the UK funds regime has a comparable offering, for example ETFs?

A UK fund manager may locate a fund in a particular non-UK jurisdiction for many commercial reasons. These include that the fund is to be marketed into jurisdictions which would be harder to distribute into from the UK, eg the EU. They may have a more suitable fund management operation in another jurisdiction, or want to use a particular non-UK subsidiary to give it more substance (which is a particular issue following the BEPS initiative). If a manager is launching a new fund to compete with similar funds that are all based in a particular location, then it would generally be appropriate commercially for it to establish its new fund there unless it has so much market presence that it can afford to go its own way.

The position with ETFs which have been pulled out as an example illustrates the point. UK managers originally established ETFs in Dublin to avoid the UK stamp tax issues that would have arisen had they been established in the UK. By the time that the stamp tax rules were changed in 2014 so that an ETF established in the UK would be competitive, the market was already firmly established in Dublin and was operating well so no one had an incentive to look elsewhere, that is, to the UK to launch ETFs.

Another example of the offshore/onshore dynamic is investment trusts and Guernsey closed-ended, listed funds. When a manager with a stable of investment trusts wanted to launch an investment trust investing in (non-distributor status) hedge funds in the late 1990's, this could not be accommodated within the constraints of the investment trust rules at the time. Consequently, they decided to use an offshore investment trust lookalike company and, having a base in Guernsey, incorporated and ran it there. The next couple of similar strategy funds were also incorporated and ran from Guernsey as the initial one had demonstrated that it was viable. From that chance beginning, Guernsey has become the dominant Channel Island for listed closed-ended funds.

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?

It is important for the UK either to be the first mover, or to move fast when it sees something being developed in a competing jurisdiction.

22. Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to AIFs targeting international markets?

There has long been a significant use of non-UK funds by UK investors. This is for a number of reasons including that there is no suitable UK vehicle as well as, in some cases, bringing tax advantages. Many of these UK investors would actually prefer to invest in a UK-based fund. It is likely to be easier to sell a new UK fund vehicle or regulatory status or tax regime to these investors than to international investors.

Having said this, it is important for the UK asset management industry to be outward-looking and it is important that the UK should have suitable AIF vehicles to target international markets.

Which markets would be most valuable and what would be the key obstacles to overcome in each?

No comment.

Where?

We would suggest that the US, Far East and Middle East would be the primary markets.

What are the key obstacles in each of these?

No comment.

23. 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?

We would expect that new UK fund administration jobs associated with new UK funds would be likely to be located where UK fund administration is already sited and similar locations, which is mainly outside London because it is relatively low-margin work so the cost-base is particularly important.

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

No comment.

25. 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?

Launch costs

The main barrier to using an ITC is the cost involved in its launch, especially given the fact that ITC launches are generally contingent on achieving a critical mass of investment on the initial public offering ("**IPO**") of the ITC. The requirement to achieve "critical mass" is driven by the need to:

- ensure that the ITC achieves a marketable total expense ratio on launch;
- ensure that the ITC is not a "close company" within the meaning of s 439 CTA (see R18 of the Investment Trust (Approved Company) (Tax) Regulations 2011/2999) to ensure that it receives investment trust tax status; and
- be of a certain size to attract certain institutional investors – investment participation of such investors is often needed to reach "critical mass".

Launch costs are incurred regardless of whether or not the ITC successfully launches and market participants therefore need to take account of the abort risk when deciding whether or not to launch an ITC.

High launch costs are driven primarily by:

- the consequences of the statutory responsibility and reputational risk taken/assumed by non-executive directors and ITC sponsors/financial advisers in taking a product to market. In order to de-risk their position, non-executive directors and ITC sponsors/financial advisers require that extensive verification processes are carried out on ITC prospectuses and marketing materials. ITC sponsors/financial advisers also require extensive financial and legal comfort packages to be provided to them and the ITC board, which broadly assist to evidence that full disclosures have been made to investors with regard to the product and that the content of the ITC prospectus is true, accurate and not misleading, before an ITC can be launched. Even where an ITC is traded on the Specialist Fund Segment, meaning that it does not need to comply with the FCA's Listing Rules (which, among other things, impose the regulatory sponsor requirements), it is common practice for such ITCs to operate as if they were complying with the Listing Rules and for financial advisers to seek near equivalent financial and legal comfort packages to the comfort packages sought in circumstances where they are sponsor to ITCs seeking admission to the Official List. It is difficult to see how these costs could be reduced, as even if regulatory responsibilities were reduced, we expect that given the status of an ITC as a publicly traded product, non-executive directors and ITC sponsors/financial advisers would continue to seek extensive comfort; and
- whilst not strictly a launch cost, in the case of ITCs which wish to make regular distributions of income to their investors, it is common practice for them to cancel amounts standing to their share premium account shortly following their IPO. In order to effect this, the ITC needs to comply with a court process, which is really designed for trading companies and/or companies that have been operational for a period of time. The process does not add value or really protect shareholders who subscribe for shares on IPO because (i) the ITC prospectus will inform them that this process will take place shortly following IPO; and (ii) the ITC prospectus will include a statement that the ITC has sufficient working capital for its present requirements. We therefore consider that the statutory requirement for this process could be removed for new ITCs which cancel their share premium reserve within, say, 12 months of IPO, as we do not consider it provides any value to investors, and indeed adversely impacts them, as the investor money spent incurred to satisfy the process, would be better deployed in making investments.

International marketability

Another barrier to using the ITC is that ITCs are predominantly vehicles used by UK investors. Non-UK investor awareness of ITCs is not high, and the cost of attempting to market ITCs in multiple jurisdictions is generally prohibitive to many ITCs. Improving the ability to market an ITC to investors beyond the UK would therefore be helpful and more creative ways need to be considered to raise the profile of ITCs to a global investor audience. We consider that industry bodies, such as the AIC and the London Stock Exchange would be best placed to continue to lead on ITC profile raising efforts, and if government funding were to be allocated to the asset management industry in order to better market UK fund products, organisations promoting ITCs should receive a share of that funding.

Close company requirements

Meeting close company requirements can be challenging for ITCs on their IPO, particularly where they are reliant on investment from different investment sources ultimately controlled by only a few institutional investors. We therefore believe that consideration should be given to relaxing the close company requirements in such circumstances. We do not consider that any relaxation of the close company requirement for these purposes should be structured in a way that would prevent non-institutional investors investing in the ITC alongside the institutional investors.

26. 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?

No comment.

27. Should the distribution out of capital be permitted?

We consider that asset managers in the open-ended space would welcome the option for some of their funds to be able to distribute capital in appropriate circumstances, and would expect that life companies would too.

What types of products would this facilitate and what investment or financial planning objectives would they meet for investors?

We would expect that the main types of product that would be launched as a result of being able to distribute capital would be in the pensions space, but can foresee other circumstances where such a product would be useful, such as to provide for long-term care needs both of those with limited life expectancies and potentially others who need social care support, including after personal injury. They could also be used to pay school and/or university fees and maintenance. They may also be useful to provide more generally for a child or children in particular family circumstances. Another possible market might be to support a mortgage. The range of products based on the possibility of capital distributions to support income needs would develop over time.

What are the possible advantages, disadvantages and risks for investors?

There would be a real benefit to investors with a need for a stable income to be able to access such a product. Currently the best that an authorised fund can offer is income smoothing within an annual accounting period, and we are aware of a number of monthly income funds that do this because they cannot offer anything more within the current rules. A prospective disadvantage of such a product and risk for investors would be that the capital value would be at greater risk than in a fund which does not have the ability and intention to distribute capital to support a steady yield.

Another issue may be the tax consequences. Simplicity is always important for the product provider, investor and HMRC but with our current tax system that taxes income at a greater rate than capital gains, and where the annual capital gains tax allowance is sufficient to shelter many individual taxpayers from paying capital gains tax, there would be a real disadvantage to them in paying income tax on the entire distribution. We have seen one or two offshore funds which distribute capital gains marketed into the UK (this is the typical US model but very rarely seen in Europe even in their European outposts) possibly partly because of the tax disadvantage. It is also notable that where an ITC or offshore equivalent buys back shares from investors this can give rise to particularly tricky tax issues except where a third party acts as principal in the transactions.

28. 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.

In low interest environments such as the present, we suspect that firms would welcome the flexibility to introduce investment products that either plan to distribute capital (such as retirement 'lifestyle' products) or have that possibility (target income products).

The Treasury has already highlighted the potential use of these products for retirement savings by pensioners who have availed themselves of pension freedom powers.

We have seen that charities (and therefore operators of charity funds) in particular are focused on securing a steady flow of income from their investments. Charity funds therefore often use the power to smooth income between years as is specifically permitted for charities using their special income reserve powers and, where permitted, to reallocate between income and capital accounts to meet stated income targets. Being able to distribute capital may add options for charities with specific time horizons.

Consideration may need to be given as to whether the existing standard object clauses are appropriate for these products. For example, an OEIC must have as its object clause, a statement that it will invest with the aim of spreading risk and giving shareholders the benefit of the management of its property. That may need to be clarified if there are to be products that intend by design to diminish their assets over time. Amending object clause requirements may also solve for other issues, like the Charity Commission's hesitancy around the possibility of using OEICs for CAIFs.

29. 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?

Noting the indications from the FCA that initially at least LTAFs will have QIS status, or some variant of QIS status, and be aimed at defined benefit (DB) pension schemes, the likelihood is that the first wave of LTAFs will be formed as CoACSs. We would note, however, as highlighted elsewhere in our response that defined benefit pension schemes are accustomed to investing in a range of unauthorised investment fund, and so an LTAF targeted at that market would likely be less successful than one targeted at say defined contribution pension schemes. That would require detailed consideration of the regulatory and operational models applicable to defined contribution pension schemes. We have provided further commentary on this in our response to **question 39** below.

We envisage that the early LTAFs, and indeed most LTAFs if the regime is extended to funds under the NURS regime, will invest via private funds which in turn invest in long-term assets such as infrastructure, private equity in its various forms and debt. It is currently only the larger and more sophisticated defined benefit pension schemes which invest directly into such underlying assets. It may therefore take time before LTAFs would invest directly into those assets and accept the additional levels of risk involved. A real advantage of investing via private funds is that it should be possible to invest via some form of blocker feeder fund to neutralise any risk of the unitholders being treated as receiving trading income, or, in the case of US source income, receiving taxable US income requiring US tax compliance and liabilities. The exception to this is likely to be UK property.

If a retail-eligible form of LTAF is launched (whether that is to all retail customers or limited to mass affluent individuals), we would expect these to be formed as OEICs or OEIC sub-funds[2] (together referred to as OEICs in this response for simplicity). In this case, it would be necessary to consider the existing OEIC tax regime carefully for LTAFs, as these LTAFs would also be likely to invest through private funds. These are established using various types of vehicle but are most often in limited partnership form with underlying asset holding companies or in corporate form with the companies being offshore. Importantly, the investors may be required to contribute equity and/or loans; this is not linked to the investment objective or strategy or the underlying asset type. Consequently, simply applying the regular OEIC tax regime to LTAFs would be likely to produce tax-inefficient outcomes, unless the balanced funds issue is resolved, and even if it were, depending on how it is achieved, it might not give an appropriate tax result for the underlying assets.

A few LTAFs may wish to take the form of PAIFs assuming that the regulatory rules are written in a way that allows an LTAF to simultaneously be a PAIF.

While it was historically possible to structure OEICs with an underlying holding company financed predominantly by debt instruments issued by the holding company to the OEIC, so making the OEIC a bond fund for tax purposes, this is no longer possible because of case law developments. Further, we understood that they were fairly difficult to run, so they would not be/have been an optimal solution.

2 While it is possible that we may see LTAF umbrellas with LTAF sub-funds, we do not expect that LTAF sub-funds will be added to existing umbrellas. While this may be technically achievable, the various differences in terms would be hard to accommodate and our suggestions in the following answer (eg holding vehicles and tweaks to depositary safekeeping) do not lend themselves to nuances between sub-funds.

30. 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.

Tax considerations

It will be important for general retail and/or mass affluent investors (as applicable) that their income tax position is either the same as when they invest in other authorised funds or else be straightforward. In particular, income-streaming would not be practical.

General observations around the LTAF

It is important to the proper functioning of the LTAF that it has the flexibility to operate in a way that reflects how these types of assets are typically held. Particular items to highlight in the context of the current landscape for regulated funds are:

- there is, for obvious reasons, a focus on infrastructure investment. In our view, it is important that the other less liquid asset classes are factored into any solutions, particularly private debt and private equity;
- even in the infrastructure space, it is quite unusual for an infrastructure fund to own the immovable asset, but instead typically own equity or debt instruments in intervening SPV entities, joint ventures and consortium companies. The rules would, therefore, need to permit the fund to own, wholly or partially, interests in underlying entities (something which is presently permitted only for holding overseas immovable property). A debt fund would typically own an entity for the purpose of entering into loan origination. Much of this structuring would be directly for the benefit of investors, in terms of ring-fencing fund liabilities and financings etc;
- we understand that there is little appetite within depositaries to take legal ownership of infrastructure assets as would normally be assumed for a NURS under COLL 6.6.12 R or for a QIS under COLL 8.5.4 R. Instead, the preference would be for the fund (assuming it is a vehicle with legal personality) to be the legal owner with the depositary's oversight role satisfied instead through verification of the fund's ownership (as would be the case for an unauthorised AIF);
- the existing rules on investment in underlying funds is quite restrictive, even in the QIS regime. The percentage limitations on holding other funds which are not authorised or recognised schemes will likely be challenging, and the prohibition on second schemes holding more than 15% in another fund is another challenge (acknowledging that circularity of investment must be avoided). Please see also our response to **question 17** above;
- liquidity will be a key area, particularly around initial lock-up periods, notice periods and deferrals; and
- the ability of a fund to lend money is a key area both for private debt funds in general but also for infrastructure debt funds. Currently, regulated funds must invest only in investments as defined under FSMA. Whilst that captures debentures and certain other debt instruments, it is not clear that it covers debt originations or all aspects of debt origination.

Distribution model

In our view, any solution needs to facilitate the broadest range of asset classes, including infrastructure, private debt and private equity. It also needs to permit the use of all instruments typically held within those asset classes. We also consider that the distribution model for the solution needs to considered upfront as that will be key to its ultimate success. Any solution which is restricted to a particular market or asset type would be less likely to succeed and require future reform.

Were the LTAF implemented as a QIS or a QIS lite, it would be important to overcome barriers to market. Many defined contribution pension schemes continue to access the investment market through a life wrapper. Acknowledging, of course, the recent flexibilities added to the permitted links rules, the look through obligations and constraints on instrument types in the permitted links rules remains a barrier to access. We discuss this further below in our response to **question 39**.

LTAFs would potentially run into the same platform problem as many of the existing PAIFs where investors have to invest via their tax-ineffective feeders as the platform cannot accommodate gross and net distributions or multiple income streams. We very much hope that the industry working group described in **paragraph 4.18** of the Call for Input will address this problem affecting currently primarily ISA and SIPP investors.

31. 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.

We agree that there are opportunities to reform the UK's unauthorised fund range to facilitate a flexible, tax-efficient unauthorised fund range which would be used for products aimed only at professional investors similar to those offered in several countries in Europe and elsewhere that have successfully attracted managers to their domestic fund structures. However, we do not think this gap is necessarily addressed by introducing an entirely new structure or regime, but rather our view is that the existing domestic unauthorised structures could be reformed. Such structures would function under the regime introduced by AIFMD as onshored by the UK following Brexit. We consider the AIFMD regime to be sufficiently flexible and do not advocate introducing a new regime.

Whilst the UK dominates in investment management, it does not do so in available fund structures. There is no single reason why a managers select a single jurisdiction for their unauthorised fund structures. As highlighted elsewhere in this response, the availability of an appropriate, flexible and tax efficient structure is one important factor. There are other factors that it may not be possible to influence through available structures alone, including the location of the manager, the preferences of particular investors and simplicity of distribution (particularly post-Brexit). We believe, however, that there is appetite amongst UK-based managers to use onshore vehicles where possible.

We believe that having an appropriate and updated funds regime should go alongside the creation of more flexibility to form and manage alternative investment funds in the UK. The UK has a strong asset management industry but this is vulnerable to international competition without a better UK environment for the funds themselves. It should be noted, however, that for a jurisdiction to be "fund-friendly", it needs not only to have suitable tax, legal and regulatory rules for them but also to provide stability for these regimes.

We have set out our thoughts on proposed changes to existing structures, as well as the new unauthorised contractual scheme which has been proposed by various industry bodies.

Unauthorised limited partnership

In our view, the unauthorised limited partnership is one of the international vehicles of choice for alternative asset classes, including infrastructure, real estate, private debt and private equity. The limited partnership is also well established, well accepted and regularly used by the main types of institutional investor including defined benefit pension plans and insurance companies. It is very flexible structure that will often form the main fund vehicle alongside feeder entities (eg other limited partnerships, EUUTs) and subsidiary entities (eg other limited partnerships, REITs, corporates and offshore asset holding entities).

In our role as advisers to both managers setting up these types of structures and institutional investors investing into alternative funds, we see a wide range of proposed structures. Out of 205 alternative investment funds (across a range of jurisdictions) which we worked on over recent years, the vehicle split was as follows:

Companies	61	30%
Trusts	20	10%
Limited partnerships	122	59%
Contractual schemes	2	1%
Total	**205**	**100%**

These funds were established in a variety of jurisdictions, including the UK, Luxembourg, Dublin, Delaware, Cayman, etc. The investors were all major domestic and international institutional investors. Whilst this is only our experience within the areas of alternative fund within which we work, it seems to clearly demonstrate the importance and acceptance of the limited partnership in the international funds industry. It is, therefore, imperative that the limited partnership takes a central role in any reform of UK unauthorised funds. We have set out earlier in our response at **question 12** areas for reform of the UK limited partnership.

Real estate investment trust (REIT)

We note that HM Treasury is considering amending the REIT rules, including to allow for a relaxation of the listing requirement for REITs. We consider such reform to be very valuable. It would be immensely beneficial to have unlisted REITs (which is a common structure in the United States) and for REITs to be more flexible.

Whilst this is not the direct subject of the current call for input, we note that the government is gathering evidence and exploring the attractiveness of the UK as a location for the intermediate entities through which alternative funds hold fund assets. We mention this here, because having an appropriate asset holding company ("**AHC**") regime should go alongside the creation of more flexibility to form and manage alternative investment funds in the UK. The development of a suitable UK AHC would assist considerably in both facilitating overseas investment into UK assets as well as consolidating the establishment, operation, regulation and disposal/dissolution services relating to the AHC in the UK. We consider that a tax-transparent/exempt vehicle that owes its status to UK statute (such as an English LLP) is materially less useful in this regard. Such an entity is likely to be regarded as a "hybrid" entity for overseas investors' tax jurisdictions and will also potentially create complexities and issues in structure analysis, with the risk of trapped tax arising at the wrong level of the structure from a double tax relief perspective.

If a reformed limited partnership were to invest in a REIT, the REIT would act as a corporate blocker and, therefore, would not have SDLT issues. The special REIT status would mean there are no tax considerations. We, therefore, suggest amendment to the REIT regime to make it more flexible and allow it to be used as a UK AHC. As highlighted elsewhere in our response, this is a structure that we have used recently for funds investing in social housing. We would expect to see more similar structures, however the current requirements for the REIT make the structure complex and expensive to operate.

One area for further consideration would be whether a corporate vehicle for non-real estate assets would beneficial.

Limited liability partnership (LLP)

The LLP is not typically used as a fund vehicle and is typically used as a professional services firm. It is an especially difficult vehicle to use in property-rich structures. Having said that, there is a role for the LLP as a viable fund structure, particularly for onshore investors. There are examples of large institutional funds structured as LLPs, particularly in the infrastructure space.

The LLP could be made more attractive as an appropriate unauthorised fund vehicle on the basis that it is a body corporate displaying characteristics of a company but in partnership form.

We would suggest reforming it to work for property-rich structures. In particular, we suggest that the normal taxation exemptions in respect of property income and gains should also apply to pension funds, life office pension business and the tax-exempt business of friendly societies when they receive income or gains as a member of a property investment LLP.

Exempt unauthorised unit trust (EUUT)

We consider the EUUT to be a very valuable vehicle although, as set out in **question 2**, we would advocate for the ambiguity in the US/UK double tax treaty to be clarified, ideally confirming the zero rate of withholding. With that clarification, we consider the EUUT to be a very useful vehicle.

Unauthorised contractual scheme (PIF (CS))

We note that the Association of Real Estate Funds (AREF) and the UK Funds Regime Working Group recommended the establishment of an unauthorised contractual scheme functioning in a similar way to the authorised contractual scheme. In the remainder of this response we refer to the unauthorised contractual scheme as the "**PIF (CS)**".

As set out above in the context of limited partnership reform, we consider the limited partnership to be the main institutionally acceptable fund structure, and we consider that the limited partnership should be at the core of any reform. Our view is that the introduction of any new fund structure (including the PIF (CS)) would be complimentary to the existing options, and we would not expect a significant shift from the existing vehicles of choice to a newly created structure. We would welcome its introduction in this context to provide a full suite of available vehicles.

We consider the EU market to be a difficult market to break into. Whilst it may be true that even a reformed UK limited partnership may not be as attractive to the EU market as, say, a Luxembourg limited partnership, we consider this is equally true of the PIF (CIS) and we would expect the EU market to continue to use EU domiciled contractual schemes even if the PIF (CS) were available. Given that the global defined benefit pension scheme market (including that in the UK) is very comfortable with the unauthorised limited partnership, we consider that, in very broad terms, leaves the defined contribution pension schemes and the non-EU international market. Looking at the Luxembourg FCP-RAIF or the Irish CCF, in our view, the international market favours limited partnerships over contractual schemes. We have commented further on Defined contribution schemes in **question 39**, however our main concern for the defined contribution schemes is regulatory access to alternative asset classes and general operational and administrative infrastructure, which a new fund structure would not itself address.

As you can see from our table above, the limited partnership is by far the most popular choice in our data sample and only two of the funds which we have seen were structured as either a Luxembourg FCP-RAIF or an Irish CCF (both being contractual funds). We consider that major international institutional investors would continue to view the limited partnership as their investment vehicle of choice, rather than switch to the PIF (CS).

Whether the PIF (CS) is of value depends on how it is taxed. This is a question of policy. So far, the government has only ever given preferential tax treatment to regulated rather than unregulated funds. If the government is willing to give the PIF (CS) preferential treatment, we would question why it would not do so also for the unauthorised limited partnership. If there is a policy shift, it seems to us to make sense to also give such benefit to the existing vehicles, in particular the one which is as popular and well-understood as the limited partnership. The particular areas for consideration would be stamp taxes on seeding and transfers of interests, and VAT.

If the same tax treatment is applied to the limited partnership and the PIF (CS), the PIF (CS) would sit alongside existing structures and offer an alternative option for some investors. If the limited partnership tax regime and the limited partnership rules, as well as the REIT and EUUT, are not reformed, we can see why the PIF (CS) might then become more attractive, although we still consider there to be issues with using a structure which is not as familiar to the international institutional investor market as the limited partnership. It may be useful in a domestic context given how widely Jersey property unit trusts are currently used for UK property and domestic investors.

Summary

In summary, our view is that the government should consider:

- reform of the existing limited partnership regime and tax regime;
- reform of the REIT regime for it to act as a real estate holding company;
- reform of the LLP regime; and
- clarification of the EUUT's status under the UK/US double tax treaty.

We would highlight that reforms in relation to AHCs is key to the success of UK fund structures. We have separately responded to that consultation. We would note, however, that in addition to reform of the REIT to enable it to be an AHC, we would like to see a transparent AHC that would be appropriate for all alternative asset classes. This is important to tax exempt investors because there is currently no easy option to maintain the transparency of the fund structure without using subsidiary limited partnerships, which are cumbersome as subsidiary entities, or additional structuring that is time consuming and expensive (eg Eurobonds).

In addition, we consider further consideration should be given to whether it would be appropriate to introduce a securitisation vehicle for debt funds, similar to the Luxembourg and Irish versions.

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

We believe that reform the existing structures available in the market should be the first priority, which would support the government's work.

The introduction of new unauthorised vehicles would, in our view, be complimentary to such reform. Having been the leading legal adviser on the CoACS, it is clear that its success is based to a large degree on take-up of the vehicle which had not originally been anticipated (see our response to **question 2**). That was not the case for the pension fund pooling vehicle, which was largely unused as a vehicle. It would be important to identify sources of capital that would benefit from the introduction of a new vehicle, where their needs are not already met by existing options.

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

We recognise branding attraction and appropriateness of the name chosen for the suitable vehicle. We agree that consistent marketing is required to differentiate the unauthorised structures from retail and regulated structures. Whilst there are deficiencies in the Luxembourg RAIF regime, the RAIF brand has been very successful. In our view any new rules should apply to any unregulated alternative investment fund established in the UK and should be marketed as such.

34. 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 avoid confusion with the regulatory assurances of fully-authorised structures?

We do not advocate additional rules for any new unauthorised structures. We consider that all unauthorised funds should be treated equally from a regulatory perspective and we do not consider that additional rules or "light-touch" authorisation would be necessary or desirable.

One of the benefits of the regime for unauthorised funds in the UK is its flexibility. Unauthorised funds are subject to the UK's equivalent of AIFMD, which provides an overarching framework for the establishment, operation and supervision of the fund's service providers. The introduction of an authorisation regime or additional rules risks diminishing that flexibility. AIFMD, as onshored by the UK, works well and does not require and additional regulatory oversight layer. One of the major issues with the Luxembourg RAIF is that certain diversification rules were applied which make the RAIF less flexible than the UK version in this context. As a consequence, Luxembourg introduced a new regime (the SICAR) to allow some funds with less diversification, although that vehicle cannot be used by all managers. The current UK regime is preferable as those issues do not arise.

We believe that all unauthorised funds should be unauthorised alternative investment funds. Therefore, it would be required to be managed by an AIFM with a Part 4A authorisation and to be subject to the oversight of a depositary. This will mean that it is subject to a lighter touch regulation than authorised vehicles, but the managers will be authorised as AIFMs and consequently, investors can have comfort that there is regulatory oversight albeit of the manager, not the vehicle itself. This will have an appeal of flexibility and operational efficiencies for managers and investors, not constrained by additional rules or authorisation requirements. This is appropriate given the institutional nature of the investors.

The UK AIFMD marketing rules will apply, but these are more straight-forward and flexible than the rules which apply to authorised funds.

We do not consider there should be additional registration requirements or an additional regulatory category. We consider that introducing these additional requirements would diminish the government's goals. As set out in our response to **question 33**, we do consider that consistent branding, particularly in international markets, would be helpful.

35. 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?

Yes, we think that these structures should have flexibility on whether they are open- or closed-ended and should, where possible, have flexibility to be listed or non-listed.

Depending on the underlying asset class, these structures may have a particular attraction for holding less liquid assets. They are inevitably focused on liquidity/exit expectations as a key factor in an investment decision making process. Allowing funds to have liquidity profiles appropriate for the asset class, including the freedom to have an initial lock-in period, and periodic liquidity events would allow greater access to these asset classes by investors who, currently, cannot access these asset classes.

For illiquid asset classes, holding a longer-term view and investing in a fund with limited liquidity can result in higher returns and track the performance of underlying assets. The chosen structure should not be required to hold significant cash reserves given there will be limited potential redemptions.

As set out in our response to **question 34** above, we do not believe new investment or other rules or limits should be applied to any existing or new unauthorised funds.

36. 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.

In our view, reform of the existing limited partnership regime and tax regime, reform of the REIT regime for it to act as a real estate holding company, reform of the LLP regime and clarification of the EUUT's status under the UK/US double tax treaty would provide the UK with attractive options for investment in illiquid assets without having to introduce a new structure or regime.

We have set out our specific recommendations on reform of those existing vehicles earlier in this response.

37. 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.

The tax treatment at the fund level for each type of fund needs to be directly equivalent to the regimes for the competing international vehicles, that is, tax-exempt for funds in corporate form and tax-transparent for funds in partnership and contractual fund form. They also need to be VAT-efficient.

Crucially, the tax treatment needs to be stable with a government commitment to the exempt regime's longevity.

Regarding the UK tax treatment of UK investors in the funds, we would expect this to be broadly the same as for existing offshore funds. This having been said, it would be very helpful for UK taxpaying investors if their capital gains tax treatment in funds in partnership form could be ameliorated to avoid dry tax charges, as mentioned in our response to **question 12**.

38. 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?

An issue that would be particularly relevant to these funds, though it is of more general relevance, is the boundary between investing and trading. We meet the issue particularly with regard to credit funds which originate loans but also some hedge fund strategies where it is not clear whether the activity is investment or trading in UK tax terms.

One way of solving the problem would be by extending the applicability of the 'white list' in the Investment Transaction (Tax) Regulations 2014 (SI 2014/685). It would be useful if the list of investment transactions were updated more frequently to take account of investment changes including digital currencies, but more importantly if its applicability could be extended to UK funds to provide them with certainty regarding the tax treatment of what they consider to be investment transactions. Ideally a buffer would also be introduced for incidental trading activity to avoid introducing a cliff-edge situation requiring monitoring for both the managers and HMRC.

39. 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 consider that it is important to consider the shift of capital from defined benefit pension schemes to defined contribution pension schemes. We would advocate additional reform to facilitate investment by defined contribution schemes in alternative asset classes and unauthorised funds, subject of course to appropriate safeguards.

Whilst some defined contribution pension funds (principally trust-based schemes) can access private market funds directly (by virtue of being professional clients), and could invest in a QIS or an unauthorised fund directly, it is still not very common for them to do so. From an operational and administrative perspective, many trust-based defined contribution schemes still access their investments by using a life wrapper, which is subject to the permitted links rules contained in the Conduct of Business Sourcebook Rules, chapter 21. Other defined contribution pension schemes (eg contract-based schemes) may not be able to access a QIS or unauthorised funds directly in any case (due to the their regulatory classification), and may only be able to do so through a life wrapper.

The future shape of the permitted links rules will likely be key to access to the defined contribution pension scheme market. Acknowledging the recent helpful changes to the rules, it is clear that the recent changes to the rules have not unlocked the defined contribution market for investment into infrastructure and other less liquid assets, with only a few examples to date. Particular areas that we consider will be important to this are:

- the look through obligation that applies to funds that are not UCITS, NURS or recognised schemes makes investment into other funds extremely difficult. Specifically, it is very difficult to be certain that every asset of the target fund will comply on a look through basis, particularly over the life of that investment. Also, where it is a third party managed fund, there are real challenges for life companies in having access to sufficient data to be comfortable on a look through basis. This would be an issue for an LTAF that is classified as a QIS or a QIS lite, without further amendments to the rules;
- the current permitted links rules focus very much on permitted instruments. Inevitably, that focus means that there are always instruments that are not covered or, potentially, not covered. This is particularly relevant in the case of debt where, in common with the regulated funds, all debt instruments must fall within the definition under FSMA. Whilst that captures debentures and certain other debt instruments, it is not clear that it covers debt origination or all aspects of debt origination; and
- there is a jurisdictional aspect in the sense that unless an overseas fund is a recognised scheme, which is very rare in the illiquid assets space, the look through requirements will always apply. In a post-Brexit environment, many UK assets (including UK infrastructure) will be held in EU domiciled funds, so that those funds can also be sold to the European investor market. This would be an area to consider in the context of permitted links rules and the overseas funds regime.

It is not for this call for input, but the consultation on reform of the charges cap for defined contribution default funds is also key in this area.

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