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Response to HM Treasury's review of the UK funds regime: A call for input

Executive Summary

We, the Association of Real Estate Funds[1] (AREF) welcome the opportunity to contribute to this call for input on the UK fund regime. At this critical juncture, post-Brexit, this is a key time to signpost the direction of travel for the industry and an opportunity to showcase the strategy that the government are adopting in presenting the UK as a place to locate and structure investment funds. We should stress it is not a time for complacency and the importance of clear actions, as further elaborated in our response.

Unauthorised Fund Structures – Onshore Professional Funds (OPF)

There is a clear gap that exists in the UK's fund offering for professional investors in comparison to that offered in several other jurisdictions that have successfully attracted investors through their domestic fund structures. UK fund managers are currently forced offshore if they are looking for certain fund structures. We believe that the UK should have a full suite of onshore vehicles for professional investors so they can choose the structure most suitable for their needs onshore. In responses to Question 30 through to Question 37 we have given a comprehensive response in relation to our proposal for an unauthorised contractual scheme, the Professional Investment Fund (PIF). We understand that the IA and AIMA will be providing you with the merits of the other OPFs, in the legal form of a corporate vehicle or a limited partnership, in detail in their own responses.

Similar to other jurisdictions, we believe there should be an overarching brand or label for UK fund structures that are targeting professional investors. Under this brand individual structures such as the OPF, PIF and QIS, in their various legal forms, would sit.

Professional Investor Fund (PIF)

In Question 1 we explain why the introduction of the PIF should be one of the government's priorities. the PIF should be quick and easy to deliver from a legislative point of view, with no need for primary legislation. In our response we have explained how the PIF would add value alongside existing and proposed authorised and unauthorised UK fund structures and how it would support the government's work on facilitating investment in long-term and productive assets; We have proposed that the PIF is an unregulated collective investment scheme, given that it would only be available to professional investors, and is managed by an AIFM. The PIF fills a significant gap in the UK for a

[1] The Association of Real Estate Funds represents the UK real estate funds industry and has around 60 member funds with a collective net asset value of more than £72 billion under management on behalf of their investors, including £18 billion on behalf of retail investors in the UK. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Quarterly Property Funds Index and the AREF/IPD Property Fund Vision Handbook.

contractual scheme structured as a closed-ended or hybrid fund with flexible redemption windows. Currently, this type of fund has to be established and operated outside the UK even in a scenario where the underlying real estate, asset and fund managers and pension fund and other institutional investors are all UK-located. In response to Questions 36 and 37 we provide a detailed response on the taxation requirements for the PIF.

Long-Term Asset Scheme (LTAF)

We appreciate that development of the LTAF is already underway but in our response, we support this as a priority for the UK funds regime. There is definitively a need for a suitable vehicle for defined contribution (DC) pension schemes, as well as other types of investors, to invest in less liquid assets, including real assets. In response to Question 28 we have commented on the tax treatment of LTAFs.

REITs

We have proposed that improving the REIT regime should be another priority for government; this would result in more real estate investment by institutional investors both in the UK and elsewhere through UK domiciled vehicles. One of the reforms we have proposed is widening the asset classes that a REIT can invest in, which would give the REIT regime the opportunity to help the UK achieve net zero emissions by 2050. We have proposed a range of reforms to the REIT regime in our response to Questions 8 and 9.

QIS

We have suggested some reforms to the QIS to make it more attractive to investors and competitive against other similar products in other jurisdictions.

Tax

The UK requires a competitive tax regime and we have made several suggestions in responses to Question 2 through to Question11 on how this can be achieved. A fund, whatever its legal form, should be able to opt between different tax regimes (taxable, exempt, transparent, income streaming etc) and different regulatory regimes (UCITS, QIS, AIF etc) independently depending on its investors' requirements; as it is possible to do in other jurisdictions. We recognise that it is necessary for the tax rules to define a fund, in order to differentiate genuine funds from privately owned vehicles set up to avoid tax. However, this definition need not be linked to regulation and we would suggest a definition based on a combination of a genuine diversity of ownership (GDO) test and a non-closeness test, with institutional investors not counted as participators, as was adopted in the non-resident capital gains tax (NRCGT) rules for funds.

There seems to be a perception that there are more tax efficient structures in other jurisdictions compared to the UK. Also, it is important that investors are confident that any tax structures put in place are unlikely to change in the future making the UK less attractive. Both of these issues will require promotion from the UK government to build up the UK's reputation as a tax efficient place to invest for the long-term.

Although the consultation for changes to the tax framework for Asset Holding Companies (AHC) is outside of this call for input, it is important that any policy decisions from the AHC consultation are not taken in isolation from the UK funds regime review. We have asked that any reform and/or renegotiation of treaties should consider HMT/HMRC policy decisions on the tax treatment of AHCs. Also, we believe enhancement to the AHC tax framework may make the PIF and LTAF more attractive to investors.

We are pleased to see that the government has committed to reviewing the VAT treatment of fund management fees. We have asked in our response that the VAT treatment of the PIF is considered as part of the overall improvement of the UK VAT regime for funds.

Promoting the UK funds regime

Like some other jurisdictions, the UK government needs to provide active and vocal backing to promote the UK fund regime as a whole, from a regulatory as well as a tax point of view. In order for a fund regime to be successful, simplicity is key; the regime needs to be simple to operate and simple to explain to investors. For a regime to be competitive and attractive it is important to use internationally established rules.

Fund authorisation

We have made some recommendation to improve the current fund authorisation process and suggested a fast track process for funds marketed to professional investors.

Fund administration

We have some fund administration firms as Affiliate Members of AREF and they have informed our response to how the government can ensure there is the right expertise for the UK fund administration industry and how this industry can provide jobs across the UK.

Capital distributions

To even out the income stream for investors over time authorised property funds may wish to distribute capital; this is permitted in other jurisdictions. This type of flexibility would be appreciated by investors such as pension funds that require a regular and smooth income over time.

Recent reforms

We totally agree, as mentioned in section 3.6 of the call for input, that the review of the UK funds regime should take into account recent and ongoing work by regulators and government on investment in illiquid assets. However, we are concerned that the reviews on liquidity mismatch in open-ended funds by the FPC and the long-awaited response to the FCA's CP20/15 Liquidity mismatch in authorised open-ended property funds, along with the open HMRC consultation on the arrangements for ISAs, are causing uncertainty amongst investors and increased redemptions in open-ended property funds. To ensure the property fund sector can assist in post COVID reconstruction any barriers, perceived or otherwise, to investors investing in the sector should be taken into consideration.

It is important to ensure the whole fund ecosystem can implement any changes made to the UK funds regime. This includes investment platforms; when NRCGT was initially introduced some platforms decided that it was not cost effective for them to implement the changes and removed UK property funds from their offerings. Also, there are still some platforms that can't provide income streaming many years after PAIFs were introduced which means that there are some investors that can't access the tax benefits of the PAIF.

Response to the call for input

Below we give a detailed response to the call for input. If you would like to discuss our response with us please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat at AREF. Also, as our members invest in real estate and other real assets for various types of open-ended and closed-ended funds, in the UK and in other jurisdictions, we are always willing to assist government by sharing this wealth of knowledge and expertise

Yours sincerely

Paul Richards
Managing Director, The Association of Real Estate Funds

Response to call for input

Chapter 1 - Introduction

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?*** AREF's view is that the top 3 priority proposals should be: • The introduction of an Onshore Professional Fund (OPF) regime which includes an unauthorised contractual scheme, which we have called the Professional Investor Fund (PIF); • Continued development of the Long-Term Asset Fund (LTAF); and • Reform of the rules in relation to REITs. All of the above priorities should take into account HMT/HMRC policy decisions in light of HMT's AHC second consultation. We would also mention that in order for any of the proposals and current products to be successful the UK funds regime requires extensive promotion by the UK government. Other jurisdictions have received active and vocal backing from their governments and to achieve similar success the UK government would need to provide a similar level of promotion. **Professional Investor Fund (PIF)** We believe it should be a priority to introduce an OPF regime in the UK and this should include a full suite of onshore vehicles so investors can choose the structure most suitable for their needs. We have provided below the reasons why the PIF should be introduced as part of the OPF regime as this is the structure most suitable for AREF members. The IA and AIMA will be in a better position to provide you with the merits of the other OPFs in their responses. As acknowledged in paragraph 4.22 of the CFI, AREF proposed in the IA's UK Funds Regime Working Group report, dated 11 March 2020, an unauthorised contractual scheme, known as the Professional Investor Fund (PIF). The PIF would be an Alternative Investment Fund (AIF), with a UK authorised manager and depositary. It could be closed-ended or a hybrid structure and would be unlisted; tax transparent and offer tradable units, not inhibited by transaction tax. AREF's full proposal for the PIF can be found on AREF's website[2] There is a clear gap that exists in the UK's fund offering for professional investors in comparison to that offered in several countries in Europe and elsewhere that have successfully attracted investors through their domestic fund structures. UK fund managers are currently forced offshore if they are looking for a closed-ended or hybrid fund, with the attributes of the PIF, to hold UK real estate investments. The managers' onshore fund choice is restricted to an open-ended authorised fund or a property investment partnership. Not all professional investors want or need the protections afforded to them by authorised funds and the imposition of Stamp Duty Land Tax on any transfers of units in property investment partnerships (which include limited partnerships) was a significant catalyst which resulted in many UK real estate funds moving offshore. The PIF complements existing UK fund structures, and has a particular appeal for UK real estate held through a UK domiciled fund solution. Other sectors can also utilise the PIF, given that it is designed to be unconstrained in terms of eligible asset classes and investment strategies. The contractual scheme structure is generally recognised as transparent for international tax treaty purposes. In addition, the PIF offers a speed to market solution without the need for prior regulator fund authorisation which can be a constraint when launching and operating authorised funds. The PIF will also facilitate the UK government's goals for COVID reconstruction, infrastructure revolution and 'levelling-up' the nation. In this respect, UK real estate and its funds sector have much

[2] *https://www.aref.org.uk/uploads/assets/c4b5668b-a54e-4d87-a45b7ba7e0badd1a/d8ee9fbe-961d-4e9a-8e99d2c18495de95/AREF-Professional-Investor-Fund-March-2020.pdf*

to contribute. For example, in the context of attracting capital and re-invigorating town centres, supporting social and affordable housing and developing social infrastructure.

In light of its Authorised Contractual Scheme (ACS) heritage, the PIF can be delivered swiftly without the need for new primary legislation. It would just require a secondary legislative solution such as amendment of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (Regulated Activities Order) and a FCA consultation. As it should be fairly straight forward to deliver, we believe that the PIF could be the first to be introduced out of the three legal forms of unauthorised funds within the OPF regime.

Also, we believe there should be an overarching brand or label for UK fund structures targeting only professional investors. Under this brand individual structures such as the OPF, PIF and QIS, in their various legal forms, would sit. This is similar to the Luxembourg RAIF, which is an umbrella brand under which individual structures sit.

LTAF

We appreciate that development of the LTAF is already underway but we would like to support this as a priority for the UK funds regime. We understand that the LTAF is being designed to be particularly accessible for defined contribution (DC) pension schemes but should also be available for certain individual investors. The LTAF will allow investments in a wide range of less liquid assets, but of particular importance is the ability to open up a broader range of options for investment in real assets (real estate and infrastructure) to qualifying investors. Defined benefit pension schemes and life insurance companies have in recent years become major long-term lenders to real estate and infrastructure, some of the larger ones directly and others through specialist funds. The LTAF can facilitate this opportunity for DC and appropriate individual investors. We believe that this is crucial for long-term investment in view of the increasing proportion of retirement capital that is held in DC schemes and individual investment arrangements.

Reform of the rules for REITs

Priority should be given to improving the REIT regime; this would result in more real estate investment by institutional investors both in the UK and elsewhere through UK domiciled vehicles. As indicated in our response to Question 8, we would support more flexibilities to the REIT regime, by specifically:

- no longer being a requirement to be listed where the REIT is owned by an institutional investor;
- there no longer being a requirement to hold at least three properties;
- relaxation of the 10% requirement, i.e., the requirement should not apply to qualifying entities where there would be no risk of loss of UK tax;
- introduction of a seeding relief; and
- widening the definition of eligible assets.

We would particularly like to point out that by broadening the asset classes that a REIT can invest in, gives the opportunity for the REIT regime to help the UK achieve net zero emissions by 2050. It could provide a route for capital to be channelled into, for example, renewable energy generation and other technology and infrastructure to enable that transition.

Chapter 2 – The UK's approach to funds taxation

2	***How effective were recent reforms to UK funds taxation in achieving their aims? Please explain your answer. Could anything have made these reforms more effective, particularly in terms of increasing the attractiveness of the UK as a location to set up funds?*** Various recent reforms have been focussed on targeting specific issues and to that extent each has been useful in their own right to solve the particular problem they were aimed at. Of those listed in the Call for Input, the reform that has seen the most success is the launch of UK Tax Transparent Funds in the form of Authorised Contractual Schemes (ACS). One of the key reasons for the popularity of ACS is that it came at the right time to fill a gap in the market for investments by Local Government Pooling Schemes. The regime was developed with input from the wider industry including accounting experts, administrators and lawyers to ensure that every aspect of its functioning was considered before the introduction of the ACS regime and that played a key part in its eventual success. An example of this is the fact there was seeding relief for ACS, any frictional tax costs will always discourage take up of new structures for existing investments. Nevertheless, the authorised nature of the ACS has limited its use outside the LGPS sector. Providing the necessary liquidity to investors is detrimental to performance. Professional institutional investors do not always require liquidity and therefore there exists a significant gap in the market, currently fulfilled by offshore structures.
3	***Why has uptake of TEFs been limited? Please explain any operational or commercial factors that have influenced their uptake. How could these be addressed?*** In order for a fund regime to be successful, simplicity is key - the regime needs to be simple to operate and simple to explain to investors. TEFs introduced complicated streaming rules that were operationally difficult and hard to sell. The TEF regime compares poorly against most international fund regimes and hence is unlikely to prove popular even with small fixes.
4	***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.*** This issue is not relevant for real estate funds and as such we have not commented on it.
5	***Are there any additional changes the government could consider to reduce tax leakage in multi-asset/balanced authorised funds?*** This issue is not relevant for real estate funds and as such we have not commented on it.
6	***Where funds are already tax-neutral, how would a tax-exempt status for funds influence decisions about how and where to set up funds?*** This issue is not relevant for real estate funds and as such we have not commented on it.
7	***How would tax-exempt funds affect the competitiveness and attractiveness of the UK funds regime? Please explain your answer providing evidence and international comparisons where possible.*** AREF understands that tax exempt fund status would not apply (outside the streaming regimes applicable to REITs and PAIFs) to funds which derive their income from UK real estate, given the policy objective of ensuring that the UK retains taxing rights over such income. For a regime to be competitive and attractive it is important to use internationally established rules. One of the reasons for the success of the UK Property Authorised Investment Funds (PAIFs) has

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	been that it utilised the existing and international well understood REIT regime in an open-ended fund context and was therefore easy to explain to investors and relatively easier to operate. A regime which provided exemption in respect of non-UK property income for UK funds would provide significant attractions, facilitating the creation of UK-based funds investing globally. This is discussed further in our response to Q8 and applies equally to non-REIT funds.
8	***What would be the likely impact if changes were made to the REIT regime in the areas discussed in paragraph 2.16? To what extent could investment in the UK be expected to increase, and what would be the drivers for this? Could such changes be expected to impact the extent to which funds with UK and foreign property assets are managed in the UK?*** **Relaxation of the listing requirement** The requirement for a REIT to be listed or traded on a recognised stock exchange leads to increased expense and administration and can delay setting up a REIT. Following changes to the rules in 2012, REIT shares can be held by a small number of qualifying investors (subject to the close company test). It is therefore not clear what function the listing requirement serves in these cases. We recommend removal of the listing requirement entirely or at the very least removing the requirement in cases where a substantial proportion of investors are qualifying institutional investors. That said, it is important to ensure that removal or relaxation of the listing requirement does not prohibit REITs from listing should they wish to. **Relaxation of 10% requirement** A holder of excessive rights, is, broadly, a company beneficially entitled to at least 10% of distributions paid out by a REIT or to at least 10% of the share capital of the REIT, or who controls 10% or more of voting rights in the REIT. A charge may be triggered in certain cases where a REIT makes a distribution to a holder of excessive rights. In line with published HMRC guidance these rules cause some investors to disaggregate their holdings across a number of vehicles. This significantly increases cost and complexity for investors without providing any specific advantage for HMRC. In addition, this could discourage or prevent use of a UK REIT by certain investors who might wish to invest large sums in real estate via listed vehicles. Holders of excessive rights rules should be retained where they prevent companies with larger stakes in a REIT accessing lower rates of taxation available under double taxation treaties, but the rules should not apply to qualifying institutional investors where there would be no risk of loss of tax. The 10% requirement is also a significant issue for PAIFs, and provides a greater challenge to comply with given the open-ended nature of PAIFs leading to a situation where an investor could breach the limit due to other investors' redemptions without adding to their holding. As a consequence, PAIFs typically operate with a feeder AUT structure, adding significantly to the operational complexity as well as requiring corporate investors to suffer and then reclaim tax, under streaming rules, that would not have been suffered if they had invested directly into the PAIF as gross recipients. Any relaxation of this limit should therefore apply, in similar circumstances, to PAIFs. **Removal of the interest cover test** We agree that the interest cover test is no longer required and can be removed. **Amending the 3-year development rule** We believe that the 3-year development rule should be amended to bring it up to date with current practices and the commercial environment. We agree with the British Property Federation (BPF) that well-established case law on the distinction between trading and investment, together with Transactions in UK Land provisions, should be used to determine whether a REIT has made an exempt gain on the disposal of an investment, or a taxable profit. **REITs holding a single property** We support the REIT rules being changed to enable a REIT to hold a single property. This would provide a useful simplification to a rule which has little practical implication – for example, it is

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	possible for a REIT to arrange that 3 floors within the same building, let out to different tenants, are treated as different assets to meet the requirement to hold at least 3 properties. **Improve the position for non-UK real estate held by REITs** Rental income and gains will be taxed in the jurisdiction where the real estate is situated. Therefore, it is not appropriate for further tax to be raised in the UK on that income and gains, whether through tax at the holding company level or through including the income within the REIT's Property Income Distributions. For the regime to be attractive, tax neutrality must be practical to obtain with administrative ease and minimal technical complexity, and simple for investors to understand and compare with alternatives in other jurisdictions. We refer also to our response to the recent consultation on the Tax Treatment of Asset Holding Companies in Alternative Fund structures. Tax neutral treatment should be available whether property is held by the REIT directly or via an AHC. **Widening of qualifying asset base** We would welcome a broadening of the definitions of the qualifying assets for the REIT regime in the UK to bring it in line with REIT regimes overseas and the broader development of the Real Estate investment industry. The evolution of the industry and the nature of the underlying assets has changed significantly since the introduction of the regime. The definitions should be widened to include certain infrastructure assets, real estate assets with bundled services and real estate debt.
9	***Are there any other reforms to the REIT regime that the government ought to consider, and why?*** **Seeding relief** Once changes are made to the wider REIT regime to make it more attractive, a wide-ranging Stamp Duty Land Tax seeding relief and roll-over of capital gains should be made available where there is no simultaneous disposal of value to a third party in order to make it easier for existing funds to transition into the REIT regime. **Assist in achieving net zero emissions** We agree with BPF that the REIT regime is currently restrictive in terms of the types of assets it can hold and the types of activities it can carry on and these restrictions inhibit REITs from being able to raise capital in the UK and overseas for desirable objectives, such as net zero emissions by 2050. The REIT regime should encourage commercial and residential property-owning REITs to invest in renewable energy assets in order to support moving their own property portfolios and tenants' businesses towards net zero emissions. Such investment should be treated as 'good' for the REIT balance of business tests and qualifying for REIT exemptions where it is otherwise ancillary to a predominant property rental business. This could also be achieved through a permissive list of assets; albeit we note that lists have a tendency to become outdated as industry evolves more quickly than the lists are capable of being updated.
10	***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.*** We would note that, with effect from 1 January 2021, the EU Directives (in particular the Parent-Subsidiary Directive (PSD) and the Royalties and Interest Directive (IRD)) no longer apply in the UK, which means the UK based entities will have to rely on benefits available under the bilateral double tax treaties with the 27 EU Member States. In the majority of cases, there are no equivalent tax benefits available under those treaties when compared to the benefits available under the PSD and the IRD. Concerning outflows of income, UK domestic law fully exempt dividends from withholding tax, but this exemption is not extended to interest payments which are not aligned with exemption of interest payments from withholding tax in most key European jurisdictions. Although UK withholding tax on interest payments could be managed via other means, it remains one of the key concerns for an

	offshore investor when providing debt funding or investing in a debt/credit fund that provides returns in the form of interest payments. We urge any reform and/or renegotiation of the treaties to take into account HMT/HMRC policy decisions following from responses submitted to HMT's second consultation on tax treatment of AHCs.
11	***What are the barriers to the use of UK-domiciled LP funds and PFLPs, and how might tax changes help to address them? Please provide detailed proposals and explain your answers.*** We have listed down some of the issues that act as barriers to using UK Limited Partnerships in property funds. • **Statement of Practice (SP D12)** results in complex capital gains tax (CGT) issues for partnerships whenever there is a change in membership. In particular there can be dry tax charges for the existing partners as a consequence of a deemed transfer of a share of each asset on the admission of a new partner. This affects the ability of partnerships to operate effectively as fund vehicles for real estate as it means for example that a second or subsequent closing of the fund can trigger a tax event if there are already investments in the portfolio. This is of course only an issue for taxable investors, but means that in practice partnerships can either only operate for exempt investors, or with a very small number of investors (i.e. as joint ventures). • **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 this anti-avoidance measure was not specifically targetting genuinely widely held funds, it is applied to all transfers of interests in property investment partnerships, and is a significant barrier to setting up property funds in LP form. • Specific issues for UK (English and Scottish) partnerships are mainly around the **corporate filing and disclosure requirements** for investment partnerships, the fact that a tax return is always required (whereas a foreign partnership is only required to file a return if HMRC issues a notice to a UK partner). • **Capital/loan issue**: In a UK LP the partners including the limited partners remain on the hook to the value of their original capital contribution for partnership liabilities after they have left the partnership to the extent of the capital that they have withdrawn until the partnership is wound up. This is typically dealt with by their contributing a small amount of capital and a large proportion by way of a loan. The BVCA performance fee model is built on this. There is no ongoing liability on partners withdrawing from PFLPs, but typically they are drafted based on the old-style documents, often for performance fee reasons. • **Withholding tax:** While ITA07 s937 provides an exemption from the requirement to withhold tax on interest paid to partnerships, this only applies where every partner is itself entitled to gross payment (and not itself a partnership, even if that higher partnership is itself made up only of gross recipients). For an investment partnership this means 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/HMRC 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 (e.g. on interest paid by a partnership to third parties) it should be relatively straightforward to change the rules to allow private fund limited partnerships to receive income gross and pay out distributions gross, or net, based on the investor's own status. Of the above, the problems re SP D12, SDLT and withholding tax apply to both UK and foreign partnerships. SP D12 also applies to overseas CIVs that have made a transparency election under UK non-resident capital gains tax rules.

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Chapter 3 – The UK's approach to funds regulation

12	***What benefit does fund authorisation bring to product providers beyond access to retail investors? Does this benefit vary depending on the specific investor base or investment strategy? What relevance does authorisation of a product have to its appeal to the UK market and to the international market?*** For funds aimed at professional or sophisticated retail investors only, the fact that a fund is subject to some level of regulation can be an attractive feature of the fund. Investors often like the comfort of oversight of the fund by a regulator, in addition to the manager and depositary of the fund being subject to such regulation. It should be noted that the number of completely unregulated funds outside the UK has been lessening significantly in number over recent years. In addition, for a number of regulatory or tax reasons, certain overseas jurisdictions, e.g. Spain, Portugal, Italy and India require funds being marketed within the territory to be authorised or regulated. Furthermore, some professional investors acting on behalf of retail end-investors, such as wealth managers and pension trustees prefer to invest in authorised products to allow those investors to be subject to the full range of protections available. Regulation in the UK implies a standard of governance, such as board oversight, a committee structure, TCF, etc. However, managers report institutional investors, in some cases, expressing a preference for unauthorised funds for investment opportunities. There is a perception that a lack of authorisation would bring greater freedom for managers as regards investment strategy and that such freedom brings greater opportunity for higher rewards, albeit at a higher risk. The Alternative Investment Funds ("AIF") regulation requires AIFs to be registered and to be managed by an authorised operator (the "AIFM") and overseen by an authorised depositary. Under this regime, the AIFM is subject to reporting obligations to the regulator. This regime would be an alternative for managers who wish to establish funds aimed at professional investors that do not need the fund to be fully authorised, as detailed in the responses to questions 30 – 37 below. "Authorised", in the context of funds, can imply both that a fund is subject to FCA supervision and also that it is open-ended. Also, there is a third interpretation which is that it may fall into a particular tax regime such as the AUT, ACS or PAIF rules. In addition, AIFs are considered, by some to be "unauthorised" even though they have the protection of having authorised operators and depositaries. The words "unauthorised" or "unregulated" can have negative connotations, largely driven by the negative press surrounding unauthorised fund structures in offshore jurisdictions and can therefore make branding less effective. We would suggest, in the long-term, the government should consider replacing "unauthorised" in legislation and regulations with something like "lightly authorised" to truly reflect the status of these funds. As this would be a substantial task we would suggest this is a separate initiative and shouldn't delay any changes to the UK funds regime.
13	***Do you have views on the current authorisation processes set out in legislation and how they could be improved?*** AREF considers that the statutory authorisation processes and time limits are appropriate for more complex funds and would not advocate the time limits being shortened, in part due to the self-imposed voluntary service standards employed by the FCA. Members have not expressed a preference for the voluntary service standards to be shortened either, as the one-month and two-month time periods are deemed appropriate and the FCA meets these standards in over 90% of cases. A shortening of these service standards could cause issues with the authorisation of more involved cases, forcing managers to withdraw and resubmit applications. We should note that it has also been suggested to us that the requirement to withdraw and resubmit applications not approved within a set timeframe be abolished. Some of our members have commented that initial questions concerning fund applications are not received until late into the process and it is unclear whether the high figure of cases being approved within the time limits set by the voluntary service standards include applications withdrawn shortly before the deadline, due to agreement not being reached. We believe that the process could be

	improved in two aspects. Firstly, the process could be broken down into stages, with clear communication between the FCA and firms and checkpoints at each stage. The FCA could perform an initial review of applications shortly after receipt, with initial questions and comments being submitted to the manager at a much earlier stage along with a clear plan for subsequent stages. The second suggestion is that the FCA produces guidance for managers, which may include a checklist or list of standard questions for the type of fund in question. This would go some way to ensure that managers anticipate many of the standard questions or requests and provide full responses as part of the original submission. We would ask that the FCA should ensure that, when considering applications for QIS, they allow for the fact as QIS are marketed to professional and sophisticated investors and therefore do not always require the same level of protection as the UK UCITS and NURS. For funds marketed only to professional investors, it may be appropriate to introduce a fast-track authorisation process, where authorisation is granted within 24 hours to allow the fund to get to market in the fastest possible time. Funds subject to the AIF regime would also benefit from a fast-track registration process.
14	***How do the FCA's timescales for fund authorisation compare internationally? Is there value in providing greater certainty about these timescales? Other than by reducing the statutory time limit, how could this be achieved and what benefits would it bring?*** AREF understand that that the Central Bank of Ireland operates a fast-track authorisation process for QIFs and QIAIFs. Provided all parties have previously been authorised by the Central Bank, the fund's Board and legal advisers can certify the documents and file with the Central Bank, which will authorise the fund the following day without review of the documents, its authorisation being based on the certification. The Luxembourg RAIF does not require any pre-authorisation – it simply requires notification to the regulator. Fast-track authorisation or just providing notification to the regulator is preferred by funds that wish to get to market quickly, so they can benefit, for example, from new opportunities. Investors in these funds are comfortable with this as the manager is regulated under AIFMD.
15	***What would you like the QIS structure to enable you to do that is not currently possible? What are the existing impediments to your suggested strategies, and why would the QIS be the preferred UK structure for these strategies?*** AREF agrees with the recommendation the government has received to enable the QIS to distribute capital and also, carry over income. A QIS must distribute all its income to investors or provide accumulation share classes in which income distributions are re-invested. Investors are subject to tax on distributions received or re-invested. Similar regimes to the QIS, such as the Irish Qualifying Investor Fund (QIF), do not have a requirement to distribute income. Professional investors in QIS would welcome that option too. In addition, QISs cannot accommodate carried interest and are not generally permitted to distribute capital gains. The regulatory oversight of a QIS is akin to that of UK UCITS and NURS. AREF believes that regulatory oversight, including oversight by the depositary, should take account of the type of investors in a fund and provide greater flexibility within a regulated framework for a professional structure, compared to a retail structure. For example, in Ireland, the QAIF is lightly regulated, requiring the manager to set and adhere to a robust risk framework, which is complemented with a clear regulatory framework and has proved popular with professional investors such as pension funds and insurers. Another change we would suggest government and the FCA consider is providing more flexibility on dealing frequency of QIS, such as different subscription and redemption cycles and different dealing cut-offs for subscriptions and redemptions. Also, all authorised funds, including QIS should have a greater availability of liquidity tools.

16	***Do you think that the range of QIS permitted investments should be expanded? If so, in what way should it be expanded, what impact would this have, and would it still be appropriate for sophisticated retail investors?*** We agree that there should be a review of the range of permitted investments for QIS. We would like this to include a review of single asset vehicles. Currently, the FCA will not accept any single asset vehicles as they are deemed not to be "diversified" like collectives; our members have asked for this to be changed. For example, the FCA would consider a shopping centre with 100 shops a single asset but 100 shops bought separately on a high street as 100 assets.
17	***Do you think that the QIS borrowing cap should be raised or QIS constraints on derivatives exposure should be relaxed? If so, to what magnitude and why? Would this be appropriate for sophisticated retail investors?*** We have no comments regarding this question.
18	***Do you agree that the QIS sub-fund structure could be improved? If so, how? Would greater clarity for the segregation of assets between sub-funds via legislation or rules be helpful? Please provide details.*** We have no comments regarding this question.

AREF
The Association of Real Estate Funds

Chapter 4 – Opportunities for wider reform

19	***Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to the creation of entirely new funds that have not yet been set up?*** AREF believe that to make the UK fund regime more attractive, in addition to new fund structures, such as the PIF, other unauthorised funds and the LTAF, the government and FCA need to address the deficiencies in the current regime, for example, the REIT regime. Only by the creation of new types of funds and also, improving current regulations can the UK compete with other jurisdictions of choice for fund investment.
20	***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? 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?*** From a real estate perspective, there are fund offerings in other jurisdictions where there is no equivalent in the UK. That is the reason why the PIF, and the LTAF are being proposed, alongside reforms to REITs, to fill this gap. We have been advised by our members that there is a perception that there are more tax efficient structures in other jurisdictions such as Luxembourg and Channel Island compared to the UK. This may have been addressed over the years but that perception is still there. Also, the UK has a reputation for consistently making changes to its tax regime; investors have to be comfortable that the tax structures in place are unlikely to be changed in the future to make them less attractive. Both of these issues will require promotion from the UK government to build up the UK's reputation as a tax efficient place to invest for the long-term. More generally, the tax rules for funds should be based on the principle that investing in a pooled vehicle should not impose additional tax liabilities or tax complexity compared with a direct investment in the underlying assets. This principle should not depend on defining a fund by reference to its regulatory status – this results in funds being required to set up as fully regulated vehicles in order to achieve the necessary tax neutral outcome, even though the regulation provides no other benefit to the investors, In an ideal world, a fund (whatever its legal form) should be able to opt between different tax regimes (taxable, exempt, transparent, income streaming etc) and different regulatory regimes (UCITS, QIS, AIF etc) independently depending on its investors' requirements – as it is possible to do in other jurisdictions such as Luxembourg. We recognise that it is necessary for the tax rules to define a fund, in order to differentiate genuine funds from privately owned vehicles set up to avoid tax. However, this definition need not be linked to regulation and we would suggest a definition based on a combination of a genuine diversity of ownership (GDO) test and a non-closeness test (with institutional investors not counted as participators), as was adopted in the non-resident capital gains tax (NRCGT) rules for funds, in 2019.
21	***Do you agree that reforms to enhance the attractiveness of the UK funds regime should focus on appealing to AIFs targeting international markets? Which markets would be most valuable and what would be the key obstacles to overcome in each?*** AREF believes the main focus of reforms to enhance the attractiveness of the UK funds regime should be attracting UK and foreign investment which is currently in offshore funds because there is not a PIF or the other unauthorised funds proposed by the IA and AIMA. INREV (European Association for Investors in Non-Listed Real Estate Vehicles) keeps a comprehensive database of unlisted real estate vehicles in Europe. According to this database (Q4 2020), only 21% of the unlisted closed-ended vehicles targeting UK and European real estate, launched during the last 10 years by fund managers with significant operations in the UK, are UK domiciled funds. This shows that there appears to be an unmet need for a UK onshore tax-transparent unlisted closed-ended or hybrid real estate vehicle.

	Our members have developed over the years good relationships with investors in the EEA, so ensuring these investors can continue to invest in our members' funds should be the top priority. In addition, our members will be looking to market their funds to investors in other parts of the world but it will take time for them to build up those relationships to attract the level of investment they currently receive from EU investors.
22	***Do you agree that new UK fund administration jobs associated with new UK funds would be likely to locate outside London? How could the government encourage fund administration providers to locate jobs in specific UK regions?*** We agree that any additional UK fund administration jobs associated with the new UK funds regime are likely to be located outside London. The overheads for firms outside London are much lower than in London itself. Over the last year it had been proven fund administration staff can, in the main, work effectively from home. Therefore, going forward, fund administration firms may not necessarily be restricted to employing local staff and could attract talent from across the UK for many roles, regardless where the firm is located. There has been a trend over many years to outsource some fund administration functions to countries such as India and Poland. Some of these countries are becoming expensive. Also, asset management firms, and their clients, prefer to have their funds administered closer to home in the same, or similar, time zone and with people who understand the local market. Also, there is reputational risk to take into consideration and the cost of undertaking oversight of fund administration firms far away from the UK. This is especially important when they are complex funds. There are benefits from having the whole administration team in one place. Administration has to be split into separate operational functions if some functions are performed in different locations. Some fund administrators like to offer a client-based service where one dedicated team undertakes all the administration functions for an asset management firm's set of funds. Some UK fund administration firms already administer offshore funds. The cost of living in other fund administration centres, such as Luxembourg and Ireland, is higher than many regions within the UK. By setting up fund administration hubs within UK regions outside London, their expertise may attract fund administration jobs from other jurisdictions. To encourage fund administration providers to locate jobs in specific UK regions the government should consider the following: • Offering grants or subsidies for moving operations to certain locations. This should be accompanied by active marketing of the benefits of locating operations in specific locations: cheaper housing, educated resource pools in big universities, work/life balance etc. We understand that when Ireland set up their own fund administration centre they offered incentives such as low or no corporation tax. • Liaising with the fund administration firms to understand the job skills and capabilities they require and match these to specific regions. For example, fund administration of property funds requires specialist knowledge beyond standard fund administration. The government could encourage the creation of specialist regional hubs for the fund administration of particular types of funds. • Offering grants or subsidies for organisations to provide financial services training programmes in the targeted regions. This is already taking place in Scotland via the Scottish Financial Enterprise. • Ensure the roll out of technical infrastructure is implemented to allow high speed broadband etc in all regions. • Incentives for the UK fund industry to compete with other European jurisdictions who have proved successful as fund administration hubs.
23	***How can the government ensure the UK offers the right expertise for fund administration activity?*** In terms of ensuring that the UK offers the right fund administration expertise nationally, the government could consider the following:

- including financial services modules at secondary education level. These modules could cover financial services infrastructure, the high-level end-to-end process of the investment industry and financial products.
- the creation of a Financial Services Apprenticeships, with firms incentivised to offer more of these roles to school-leavers who choose not to attend university. We would encourage the government to work with the Financial Services industry to ensure the structure of the apprenticeship scheme works for them. We were advised by one fund administration firm that having to give trainees day release for college left them short of staff to complete daily administration tasks. They would prefer it if they could do more of the training in-house.
- university degrees in relevant subjects such as business studies to contain an element of practical studies in financial services. This would include an option for degrees with a year's practical experience in financial services. One fund administration firm, outside London, has advised us that a lot of their new trainees went to the local university. They have loved living in the locality and do not what to give up their lifestyle and move to a big city to start or progress their career. The fund administration firm is able to provide them with the opportunity to obtain professional qualifications without moving away.
- firms could offer a year's experience for gap-year students yet to embark on a degree. The experience would benefit those students after university, as they would already have practical experience on their CV.
- the government and regulators to work with the industry on a structured training program at all levels that can be rolled out nationally either online or in a classroom.
- fund administrators providing robust training for the roles. This could involve the creation of training roles, recruited from the huge pool of experience in traditional fund administration hubs.
- selective recruitment of experienced fund administration staff from the established resource pool, with attractive relocation packages offered to introduce the appropriate level of experience into the business.
- many of the ongoing initiatives to increase knowledge on initiatives such as digitalisation will provide fund administrators with the expertise needed to evolve and grow their businesses.

Any such initiatives would need to be publicised well by the government to raise the profile of fund administration roles and to attract talent from regional areas and make people aware of the opportunities in fund administration firms for them; most think they have to move to London to get a "good job" in finance. We would encourage government to work with organisations such as Investment20/20 who have a track record in bringing a wide variety of talent from a range of backgrounds into the investment industry.

Fund administration firms can provide an opportunity to train accountants outside the big 4 audit firms in locations with a lower cost of living. Having fund administration firms in alternative locations can lead to opportunities to attract other types of businesses which can offer professional roles such as law and audit firms into those locations.

24	***Are there specific barriers to the use of ITCs, either from the perspective of firms creating fund products or from the perspective of investors seeking to access them? Are there specific steps which could address these?*** We have no comments regarding this question.
25	***Should asset managers be required to justify their use of either closed-ended or open-ended structures? How effective might this requirement be, and what are the advantages or disadvantages of this approach?*** When designing a new fund, managers already consider the type of fund structure that would appropriate for the fund's underlying assets and the type of investors they would like to invest in the fund.

	It is not clear who the government are expecting managers to justify the use of closed-ended or open-ended structures to. Fund management companies would already have an internal product governance process to oversee, challenge and sign off the structure of new funds.
26	***Should the distribution out of capital be permitted? What types of products would this facilitate and what investment or financial planning objectives would they meet for investors? What are the possible advantages, disadvantages and risks for investors?*** Limited partnership and other closed-ended property funds can distribute capital but authorised property funds may wish to do this too. A property fund developing and refurbishing some of its portfolio would not be receiving rental income on those assets. To even out the income stream for investors over time they may wish to distribute capital until the development or refurbishment has been completed. The distribution of capital is permitted for property funds in other jurisdictions such as Guernsey. There is a precedent for authorised funds distributing capital in the UK; Charity Authorised Investment Funds ("CAIFs") allow for distribution of capital for the purpose of responding to their beneficiaries' needs in a changing financial environment. For example, if investment income is low and capital gains are high, charities have the flexibility to use capital in meeting any current income needs. If this flexibility were not available, the risk is that current income needs would not be met and future needs may be over-provided for. This type of flexibility would be appreciated by investors in authorised property, such as pension funds, that require a regular and smooth income over time.
27	***How do you consider that such a change might be delivered? Please explain your answer, providing specific examples of rules, how they could be changes, and the effect of the changes.*** There do not appear to be any COLL rules directly prohibiting capital distributions by UCITS, NURS and QIS but it is inferred in COLL as follows: COLL 6.8.3 R(3) requires an authorised fund to have a separate "distribution account" for the purposes of paying out any income generated by assets held via income units. This income in turn must be held in a separate "income account" prior to being moved into the distribution account. The fund must have a "capital account" which is distinct from both the income and distribution accounts and, whose holdings ("capital property") are essentially defined as the residual amount after the income and distribution accounts have been filled as appropriate. COLL 6.8.3 R(3A) sets out guidelines for calculating income allocations. While there are specific circumstances under which transfers can be made between the income and capital accounts, the AFM does not have any general discretion in this regard, which is what would be needed for authorised funds to be able to distribute capital as income. As mentioned in our response to Q26, CAIFs can distribute capital. The CAIF rules on a Total Return Approach (COLL 14.4.5 R and COLL 14.4.6 R) offer a model for application to authorised funds.
28	***Do you foresee any issues with the LTAF adopting the current tax rules for authorised investment funds? Would the nature of an LTAF's investments, and the tax treatment of the income it receives in respect of those investments, mean that the current rules for authorised funds lead to tax efficient outcomes?*** The suitability of authorised fund vehicles for an LTAF depends on the outcome of the ongoing FCA discussions and the impending FCA consultation on key features of the LTAF regulatory regime including the types of investors that LTAF may be distributed to. Based on an expectation that LTAF adopts the open-ended structure proposed by the IA and at the initial stage only available to DC investors, initial feedback from members indicates that a UK Co-ownership Authorised Contractual Scheme (CoACS) may be an appropriate vehicle in the first

	instance. On the basis that a CoACS is effectively tax transparent, the current tax regime for such funds should be suitable for LTAFs. However, as FCA discussions progress and the nature of investor and investments is expanded, consideration would need to extend to LTAFs taking an OEIC form, and any tax changes will, to a large extend, be dependent on the permitted investor base. If affluent and / or retail investors are permitted in LTAF then the issue of tax leakage for balanced funds (as already identified as an issue for authorised investment funds in Chapter 2 of the Call for Input) would arise. Additionally, the overall complexity of the UK funds regime would also need to be considered in such a case if an LTAF invests across a range of assets. There would also be issues if there was a need to accommodate UK property. In this regard, member feedback suggests that Property Authorised Investment Funds do not seem to be a solution given the intended long-term nature of an LTAF, and the government's intention to ensure that effective taxing rights for UK property are maintained. It needs to be ensured that seeding relief, which is currently available for ACS vehicles, would also continue to be available to ACS LTAFs. **VAT** As the LTAF is expected to adopt existing authorised fund structures, the UK fund management VAT exemption for management of SIFs the VAT Act 1994 Schedule 9 Group 5 Item 9 would also be available to LTAF set up as existing UK authorised funds. We would assume that any changes to the VAT treatment of management fees for authorised funds would also apply to LTAFs. A competitive VAT regime is a crucial element in decisions on the location of investment funds. To make the UK domiciled LTAF truly competitive and attractive, zero rating of the management and associated administration fees to an LTAF should be considered. **Use of underlying holding structures.** It is generally anticipated that an LTAF fund vehicle would use underlying holding structures to suit its investment strategies. The current HMT review of Asset Holding Companies (UK AHC review) in Alternative Fund Structures is a helpful step in offering UK holding structures as a potential choice as holding vehicles for LTAFs. The set-up of an LTAF is however not dependent on the AHC review and it is anticipated that an LTAF could use non-UK holding structures to hold investments.
29	***Are there any other tax considerations, outside of those that follow from the adoption of the current tax rules for authorised funds, that will be important to the success of the LTAF? Please explain your answer.*** We have no comments regarding this question.
30	***How would each of the proposed unauthorised fund structures add value alongside existing authorised and unauthorised UK fund structures, including the QIS? Would they bring value alongside each other? Would they bring unnecessary complexity? What would each structure allow fund managers and investors to do that they are unable to do currently in the UK regime? Please address each proposed unauthorised structure separately, and indicate which of the proposed unauthorised structures you consider most important.*** **Onshore Professional Funds (OPFs)** Our responses to this question and the following questions, up to Q37, are concentrating on the PIF. We are in full support of the corporate vehicle and limited partnership OPF structures proposed by the IA and AIMA. We feel that the UK should have a full suite of onshore vehicles available to investors so they can choose the structure most suitable for their needs. However, the IA and AIMA will be in a better position to provide you with the merits of the other OPFs in their responses. **The Professional Investor Fund (PIF)** In relation to the PIF, the questions posed above are largely addressed in AREF's proposal for the PIF. We suggest the PIF:

1 Is modelled (in terms of legislation and regulation) on the ACS legislation, and duly revised to reflect that the PIF will not be permitted to operate as an authorised fund. The PIF would be a closed-ended fund or a hybrid fund with flexible redemption windows.

A PIF will be formed by a contract initially made between the PIF operator (also responsible as the PIF AIFM) and~~,~~ the PIF depositary to which the participants (PIF investors) become parties. The assets of the PIF will be held as legal owner by the PIF operator or PIF depositary, as applicable, on behalf of the participants who are jointly the beneficial owners of the scheme assets which they hold as tenants in common (or in Scotland as common property). The PIF operator must make decisions on behalf of the participants about the acquisition, management and disposal of assets subject to the scheme as permitted by the scheme deed and those decisions will be binding on participants.

Appendix 1 to this Submission sets out an analysis of key legislative and regulatory provisions to facilitate the establishment and operation of the PIF, recognising there will be further technical points that we are happy to assist with.

2 Is limited to a similar category of investors who are permitted to invest in a QIS ACS. Direct investment in a PIF should be limited to investors who invest a minimum of £1 million and are professional investors. Other investors should only be able to access a PIF through feeder funds that satisfy the professional investor status.

3 Is an Alternative Investment Fund (AIF), in respect of the Alternative Investment Fund Managers (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/328) (UK AIFMD), managed by a full scope Alternative Investment Fund Manager (AIFM), and has a depositary. We envisage the PIF operator being required to act as the PIF AIFM.

4 Constitutes an unregulated collective investment scheme (UCIS) for UK regulatory purposes, and accordingly would be marketed under the UCIS regime.

5 Is established and operated via a registration of the PIF and its investors at a registry (PIF Registry) maintained by Companies House, which we assume will operate electronically. The PIF AIFM will be required to register with the PIF Registry details about the PIF including its registered office, the PIF investors and any changes in the PIF investors. The PIF Registry will issue upon completion of the registration process a PIF certificate of registration. The PIF certificate of registration will be conclusive evidence that a PIF came into existence on the date of its registration (equivalent to s8C of the Limited Partnerships Act 1907 (as amended)).

We suggest certain information in the PIF Registry (such as its registered office) is publicly available. However, other information (such as details of the PIF investors) is only available to HMRC and the FCA, respectively, for tax collection issues and addressing concerns about harms or risks.

We highlight that the PIF adds value alongside existing authorised and unauthorised UK fund structures as it solves a significant gap in the UK fund offering. Currently, this type of fund has to be established and operated outside the UK even in a scenario where the underlying real estate, asset and fund managers and pension fund and other institutional investors are all UK-located.

We do not believe that the PIF would bring *"unnecessary complexity*"; it is providing a product that is already offered in other jurisdictions for which there is a demand and is based on a structure and legislative drafting that already exists within the FSMA framework

Funds being operated offshore are subject to associated operational costs. In addition, these funds have to address the challenges of multiple legal, tax and regulatory regimes including maintaining sufficient substance offshore, which can add significant cost.

The current available choices:

- Onshore: restricted to an open-ended authorised fund, requiring compliance with regulatory operational requirements that may not be required by professional investors, and
- Offshore: requiring multiple legal, tax and regulatory regimes including maintaining sufficient substance offshore.

As a result, managers incur costs which would be avoided if the PIF were available. These costs:

- are challenges for the establishment and operation of fund, particularly in the context of low yield market conditions; and
- represent a barrier to entry to small and medium-sized enterprises (SMEs) and aspiring asset and fund managers operating in the real estate and funds sector.

Assuming the PIF legislation were implemented:

- The PIF would be a solution that provides managers an opportunity to operate funds more efficiently and not to be burdened by such costs. The PIF enhances the prospects for future generations of UK assets and fund managers including those operating in the real estate sector.
- In addition, we expect adopting section 261P of FSMA, which applies to ACSs, the PIF legislation would facilitate a sub-fund or protected cell feature, i.e., allow for sub-funds with a legally enforceable segregation of the assets and liabilities of each sub-fund. PIF operators can then manage a large range of funds more efficiently: the sub-funds (or cells) are separately managed, charged, accounted for and assessed for tax, but do not have a separate legal personality.

Existing authorised and unauthorised UK real estate fund structures

Investors requiring high liquidity may choose to allocate to listed real estate companies (e.g., REITs), but these investors trade-off diversification for liquidity by introducing potentially unwanted correlation to the wider public equities market. Other investors requiring liquidity allocate to unlisted open-ended real estate funds, but these vehicles usually need to hold cash balances in order to meet redemption requests, which dilute the real estate return from such vehicles.

As an alternative conduit for real estate indirect investment, institutional investors are increasingly attracted to funds with the features of being unlisted closed-ended funds or funds which are not regulated as open-ended funds (and having to offer frequent redemption windows). The PIF is designed to meet these features. For a relatively illiquid asset class such as real estate, holding a longer-term view and investing in a fund with limited liquidity can result in higher returns and track the performance of underlying real estate assets. These types of funds hold little to no cash as they don't need to meet potential redemptions.

LTAF - and its relationship with PIF

Two frequent key goals, in the context of professional investors committing into alternative or illiquid funds, are

(i) accommodating investor exit expectations; and

(ii) flexibility, cost and other efficiencies in terms of the establishment and operation of the funds particularly given the prospects of market low yield returns.

In the context of these goals, we suggest that the LTAF and the PIF helpfully widen the choice of UK funds, which may involve some overlap in the context of each fund structure involving equivalent investors and underlying investments. Each of these fund structures will have the opportunity to offer investors complementary exit solutions, respectively from:

- an authorised LTAF: open-ended fund, dealing at different intervals as well as notice periods, and complying with regulatory operational requirements; and
- an unauthorised PIF: closed-ended or hybrid fund with flexible redemption windows.

The LTAF and PIF would seem to be designed to achieve similar objectives in terms of liquidity matching, but for slightly different client groups; the LTAF is aimed more at retail investors, subject to marketing restrictions, whereas the PIF is aimed at professional investors.

We consider that both proposals have the potential to broaden the options available to UK investors in alternative assets, and will complement rather than compete.

31	***Would these unauthorised structures support the government's work on facilitating investment in long-term and productive assets, as outlined in Chapter 1?*** **The Professional Investor Fund (PIF)** The PIF proposal would support the government's work on facilitating investment in long-term and productive assets, with reference to policy goals as outlined in Chapter 1. We strongly advocate that DC pension schemes, including via Conduct of Business Sourcebook Rules (COBS) 21 Permitted Links, be allowed to invest in PIFs and other unauthorised funds, i.e., not restricted as at present to investments in authorised "open-ended" funds. In terms of facilitating investment in long-term and productive assets: 1. The PIF is one solution that would facilitate: *"providing a source of diversification and potential for enhanced returns, and for the success of the UK economy, with capital required to fund the post COVID recovery, modernise and upgrade infrastructure, transition to a carbon neutral* economy and support innovation in private enterprise to drive productivity growth." (CFI paragraph 1.13) 2. We refer to the 23 July 2020 Speech of Alex Brazier, Executive Director for Financial Stability Strategy and Risk and a member of the Financial Policy Committee, Bank of England *. Also, the Bank of England: August 2020 Financial Stability Report (FSR), Box 4 on productive finance** which suggest key goals for facilitating investment in long-term and productive assets. We comment: (i) The PIF could be a structural solution given *"Investors need the right structures and platforms to invest in longer-term illiquid assets in a way that is consistent with financial stability"*** (ii) The PIF should be considered *…"as closed-ended funds, may be more appropriate vehicles for investing in certain illiquid assets*"** [albeit the context seems to refer to listed funds]….."*are therefore more able to invest in truly illiquid growth capital* and *additional equity or equity-like finance, particularly for unlisted companies, could support recovery and reduce liquidations in the medium term"*** (iii) The PIF … could operate as a conduit "*for more equity finance to minimise the scarring to the economy"** (iv) The target investors for the PIF can include "*Financial institutions with longer-term liabilities – pension funds – are the natural investors in growth capital"**. The PIF allows such pension funds to commit as co-investors with other professional investors (whether from the UK or elsewhere), and utilise attractions of the PIF including that the PIF is tax transparent, unlisted with closed-ended or hybrid exits. (v) The PIF would operate as a closed-ended or hybrid fund (closed-ended with redemption windows) *"Closed ended funds…..might be able to invest in truly illiquid growth capital and offer an even higher return"*.* We reiterate our response to Q1, the PIF will facilitate the UK government's goals for COVID reconstruction, infrastructure revolution and 'levelling up' the nation by supporting jobs outside of London. In this respect, UK real estate and its funds sector have much to contribute. For example, in the context of attracting capital and re-invigorating our town centres, as well as supporting social and affordable housing[3].

[3] ***The investment case for UK social and affordable housing in the UK***, *N Colley & J Fear, Property Funds Research, commissioned by Impact Investing Institute, Housing England & Investment Property Forum (forthcoming) May 2021, which states that the PIF "could provide an excellent "hybrid" solution that may provide a more tailored fund structure to suit the investors requirements and the risk characteristics of [UK social and affordable housing] sector."*

32	***How do you think the government could best achieve consistent branding for UK fund structures which target only professional investors?*** We believe that there should be an overarching brand or label for UK fund structures targeting only professional investors. Under this brand individual structures such as the OPF, PIF and QIS, in their various legal forms, would sit, subject to different legal requirements, depending on the structure. This is similar to the Luxembourg RAIF, which is an umbrella brand under which individual structures sit. It has been suggested to us that "Professional Investor Fund" (PIF) could be used as the umbrella brand. Then, the three OPF, for example, could be the PIF (CS) for the contractual scheme, PIF (Corp) for the corporate vehicle and PIF (LP) for the limited partnership. However, we are open to considering alternative names; the important thing is that there is an overarching brand that the fund industry and government can use for promoting these vehicles both at home and overseas. Also, the label should refer to the positive features of the funds rather than referring to the fact that a fund is unauthorised or unregulated.
33	***Do you think that these unauthorised structures should be unregulated collective investment schemes? If you consider any "light-touch" authorisation necessary or desirable, what do you understand this term to mean and what form could it take? Why would it be beneficial for investors, and how could it be explained to them in a way that avoid confusion with the regulatory assurances of fully-authorised structures?*** **The Professional Investor Fund (PIF)** We believe the PIF should be an unregulated collective investment scheme – given that it would only be available to professional investors, it is not necessary for it to be an authorised scheme. However, it would still be required to be managed by an AIFM with a Part 4A authorisation and to be subject to the oversight of a depositary. So, whilst the PIF will be subject to a lighter touch regulation than the existing ACSs, it will not be subject to no regulation Due to the fact that the AIFM Regulation has been in place for some years, the FCA has sufficient and knowledgeable resource available to regulate AIFs, recognising the difference from other types of fund, authorised or regulated. The FCA should also ensure that authorisation of the managers of such funds is not overly time-consuming or costly. Professional investors in the PIF should benefit from attributes typically available in equivalent professional investor funds in other jurisdictions including: • No regulator prior approval of promotion and scheme documentation; and • Speed to market launch. This is important in a low yield market, where launch and operational costs can have a material effect in eroding investor returns. As we mentioned in our response to Q32, we would rather the terms "unauthorised" and "unregulated" were not used, if possible; not just because they have "negative" connotations but they are misnomers in the case of the PIF: • The PIF would operate within the UK AIFMD authorisation regime and as such is not unauthorised. A more correct term would be a "light touch authorised fund". • The PIF would be subject to extensive regulation even as an "unregulated collective investment scheme". We appreciate that these terms are currently embedded in the UK legislative regulatory and tax infrastructure and were probably developed to distinguish funds from "authorised funds" and "regulated collective investment schemes." However, they have the potential to cause confusions when promoting the PIF, as prospective investors, particularly from outside the UK, would likely assume there is simply: • no authorisation required for an "unauthorised fund"; and • no regulation applying to an "unregulated collective investment scheme".

	In other jurisdictions, when labelling fund products, they apply more appropriate and less binary notions, like "lightly regulated fund". We would like to see in the near future a full review of these terms and reforms implemented. Although, we wouldn't want any review to delay progressing reforms arising from the CFI.
34	***Do you think these structures should have flexibility on whether they are open-ended or closed-ended? Should they have flexibility on whether they are listed or non-listed? How important is this?*** **The Professional Investor Fund (PIF)** As we mentioned in our response to Q32, institutional investors, who do not need the liquidity of REITs or unlisted open-ended real estate funds, are looking for unlisted closed-ended, semi-closed or open "hybrids" (with redemption windows) or even "evergreen" funds[4]. These funds particularly appeal to investment strategies focused on: • real estate sector-specific, alternative and emerging investment sectors such as residential property in various forms including elderly care, social housing, co-living and student accommodation that require specialist asset management skills. • fund management houses offering core plus or opportunistic returns and/or realising post J-curve returns[5]. However, it is estimated that, out of the total number of closed-ended/hybrid vehicles targeting UK and/or European real estate assets launched by fund managers with significant UK operations during the last ten years, only 21% by are domiciled in the UK[6]. As we have explained in our response to Q30, the PIF fills a significant gap in the UK for a contractual scheme structured as a closed-ended or hybrid fund with flexible redemption windows. Currently, this type of fund has to be established and operated outside the UK even in a scenario where the underlying real estate, asset and fund managers and pension fund and other institutional investors are all UK-located. Closed-ended funds for institutional investors typically operate with termination dates and can include manager and investor options to extend the termination dates. The life of a fund is typically 7-10 years after fund launch. In recent years the greater flexibility of fund liquidity windows in the UK has combined with a growing secondary market servicing closed-ended, open-ended and hybrid funds. Institutional investors and fund management houses have benefited from exits via the secondary market, which they have utilised for real estate strategic purposes such as asset allocation changes, rebalancing portfolio risks and satisfying redemption requests. An alternative exit may be an option for investors in a PIF to elect for conversion of the fund to a Co-ownership Authorised Contractual Scheme, i.e., as an open-ended structure (and comply with legislative and regulatory provisions applicable to Co-ownership Authorised Contractual Schemes). The UK is currently the global leader in secondary market trading of real estate fund units held by institutional investors. The market operates on a match-bargain basis (not via a listed exchange), with brokerage firms providing pricing transparency in the UK and certain other jurisdictions. The secondary market can be attractive to meet the MiFID II best execution requirements that apply to many institutional investors. However, overall transaction volumes are modest in comparative terms[7] and the secondary market (in the UK or elsewhere) may have liquidity limitations in certain market conditions.

[4] *"evergreen" funds mean funds with an infinite fund term combined with infrequent and qualified liquidity windows.*

[5] *"post J-curve returns" refers to the reduction in fund returns after launch resulting from capital deployment and associated costs i.e., the returns initially fall, then stabilise and increase as the fund matures.*

[6] *INREV Vehicles Database, Q4 2020*

[7] *See chart in respect of trades undertaken on the PropertyMatch platform: Appendix 2*

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35	***Do you think these vehicles should or could be implemented as part of existing structures set out in legislation? Please provide details. If not, please explain why not.*** **The Professional Investor Fund (PIF)** As indicated in response to Q1, the PIF provides a "quick-win" legislative solution given its ACS heritage, that is, it can be delivered swiftly in 2021 with no need for primary legislation. We understand that the legislative process would involve: • Secondary legislation like amending the Regulated Activities Order, Financial Services and Markets Act 2000 (FSMA) and/or UK AIFMD; and • The FCA consulting for the FCA Handbook (Investment Funds sourcebook (FUND), COBS and, may be, SUP Supervision and the Prudential Requirements). In our suggestions of updates required to legislation and regulations below we have used “Professional Investor Fund” or “PIF”. The final terms actually used will depend upon the branding and labelling that is agreed, as discussed in Q32. We consider the PIF could be easily recognised within the existing regulatory framework and subject to the same degree of regulation as is extended to UCIS Funds: for example: • PIF specific requirements could be included in a new section 4.2 of FUND to sit in the “specialist fund regime” section alongside the LTIF rules; or • by specifying the following as regulated activities: “Establishing, operating and winding up a PIF” by adding a further article to a (new) article 51ZEE Establishing etc. a professional investor fund “Establishing, operating or winding up a professional investor fund is a specified kind of activity.” In light of the approach to be adopted by the FCA, the FCA may prefer: • granting a requisite Part 4A permission to those carrying on these activities and ensure that only those who satisfy the FIT criteria are able to establish, operate and wind up such schemes, but leave the schemes otherwise available to professional investors only; or • PIF threshold conditions to be set out in Schedule 6 to FSMA. The limitation on promotion could be easily addressed by a minor modification to the COBS as follows (indicated by underlining): COBS 4.12.3 R (1) A firm must not communicate or approve an invitation or inducement to participate in, acquire, or underwrite a non-mainstream pooled investment <u>or a professional investor fund</u> where that invitation or inducement is addressed to or disseminated in such a way that it is likely to be received by a retail client. Appendix 1 to this Submission sets out an analysis of other key legislative and regulatory provisions to facilitate the establishment and operation of the PIF, recognising there will be further technical points that we suggest should be covered through technical working groups. The attractiveness of PIF s is not dependent on/interlinked with any other legislative reforms arising from the HMT Funds Review (including the Asset Holding Companies and VAT consultations), albeit such reforms may result in enhancing the attractiveness of PIFs.
36	***Are there any specific tax treatments that would be either necessary or desirable to support the successful introduction of new unauthorised fund vehicles in the UK? Please provide detail of how and where this is the case.*** **The Professional Investor Fund (PIF)** We set out below proposals on the implication for the taxation of the PIF. These proposals are not intended to be exhaustive, and they have an “England taxation" focus (recognising that there will be adjustments for the remainder of the UK implementing legislation). We assume that the same regime will apply as would apply in the case of the Co-ownership Authorised Contractual Scheme (**CoACS**), modified on account of the fund not being an authorised fund.

A PIF will not have its own legal personality and will not be within the charge to direct tax. Instead, the income received by the PIF will be liable to tax in the hands of each PIF investor as it arises, while their investors will be liable to tax on gains realised on the disposal of PIF units but not on gains realised at the portfolio level. We propose that the PIF will be specifically excluded from the definition of a company for purposes of the Corporation Tax Acts by s1121(1) of CTA2010 in a similar way to a CoACS.

Taxation of UK Investors - Income

PIF investors will be taxable on their share of the PIF's income. This will apply to both corporate and individual investors. Therefore, we envisage investors will require detailed information relating to their share of PIF income in order to fulfil their tax obligations. Any income received will be subject to the normal tax treatment applied to that type of income in the hands of that category of investor. For example, dividend income is likely to be non-taxable in the hands of a corporate investor. Income from real estate and interest received will need to be treated according to the general rules that apply to each stream of income. For some types of income, the computation and the treatment are different for taxpayers within the charge to Corporation Tax and those within the charge to Income Tax.

The PIF will be effectively tax-transparent so it cannot be liable to any tax on income. PIF investors will be taxable on their share of the PIF's income based on their own tax status.

Taxation of UK Investors - Capital Gains

Capital gains will not be treated as arising on the PIF's share of assets held subject to the PIF but, instead, a unit in the PIF will be treated as if it were an asset purely for the purposes of tax on capital gains. PIF investors will be liable to tax on capital gains made on their interest in the PIF, and not on transactions in the underlying assets held in the PIF. This means that a gain or loss will not arise when the PIF disposes of assets within the PIF. Instead, PIF investors will need to consider the chargeable gains consequences when they dispose of (or there is a deemed disposal of) their interest in the PIF. The gains of UK resident individuals arising from the disposal of an interest will be liable to capital gains tax (subject to the annual exempt amount and any capital losses), while similar gains arising to corporate investors will be liable to corporation tax. The amount of any gain will be calculated using the normal rules.

Insurance Companies

Insurance companies investing in PIF will be subject to different rules. An investment held in the long-term fund of an insurance company will be subject to TCGA1992/S212:

- in the same way as it currently applies to all other holdings in collective investment schemes held by insurance companies (except in partnerships); and
- meaning that if the interests are held in the long-term fund of an insurance company, the company is deemed, for the purposes of corporation tax on capital gains, to have disposed of and immediately reacquired the interests concerned at their market value at the end of an accounting period.

Tax-transparent fund status

We consider that the PIF – particularly on account of being structured as a contractual scheme and for professional investors - would have the attraction of being designated internationally as a tax-transparent fund (**TTF**) - like the ACS, Luxembourg's Fonds Commun de Placement (FCP) Dutch Fonds voor Gemene Rekening (FGR) and Irish Common Contractual Fund (CCF). The TTF was designed to facilitate cross-border pension fund pooling: it maximises tax efficiencies for pension funds from multiple domiciles with the benefit of a pooling vehicle. The TTF is also attractive as a fund vehicle for cross-border distribution to tax exempt institutional investors. TTFs are commonly used for a wide range of diverse mandates, allowing investors from single or multiple jurisdictions to invest in a single TTF, subject to any domestic requirements.

Taxation of Non-UK Investors

The fiscal transparency of the PIF means it will not be treated as resident for the purposes of double taxation conventions between the UK and other jurisdictions.

Instead, the availability of double taxation convention reliefs will depend on the convention between the PIF investor's jurisdiction of residence and the jurisdiction where the income or gain arises. Assuming the overseas jurisdiction recognises a PIF as a transparent entity, investors should be entitled to the

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same treaty benefits as though they had made the investments directly. While it is beyond the scope of UK legislation to prescribe how a PIF contractual scheme is treated by a foreign jurisdiction, it is hoped that the majority, if not all, foreign states will view a PIF as transparent for tax purposes.

PIF investors will need to consult the relevant tax convention in order to establish whether treaty benefits are applicable and, if so, in what circumstances. The treatment of a PIF will need to be discussed with the overseas jurisdiction concerned. Any claim for treaty relief will need to be made using the procedures existing in that state. In practice PIF operators/administrators may offer a service whereby they will submit claims for benefits on investors' behalf. In such cases the PIF operator or administrator will inform investors of the information that they will need from investors in order to establish any claims for treaty benefits.

We expect that non-residents will only be taxable in the UK on investment income arising in the PIF if the income arises in the UK and they would be taxable on it in the UK if they had invested directly into the underlying asset. The main example of this is income from the rental of UK real estate where we would anticipate that they would be chargeable to income tax or corporation tax (as applicable), under the non-resident landlord scheme rules.

Where the PIF meets the UK property richness condition, non-residents will be subject to the *non-resident CGT legislation. Additionally, it is noted*:

- individuals where they are considered to be temporarily non-resident; and
- corporates where they carry on a trade in the UK through a permanent establishment, would both fall within the UK CGT net.

Capital Allowances

As the PIF will be transparent for the purposes of capital allowances, the PIF investor – not the PIF – may be entitled to claim capital allowances subject to the normal rules.

However, we anticipate the PIF operator will hold the information that investors require to calculate their entitlement to capital allowances. To avoid the need for exchanges of information between the PIF operator and investors, we suggest the government introduce a simplified scheme of calculating capital allowances whereby the operator of a PIF may calculate the allowances and allocate them to investors, i.e., replicating the treatment of CoACSs and having the authority to sign a s198 CAA 2001 election to validly transfer capital allowances upon a disposal of property to a purchaser. The PIF's capital allowances regime should be elective for the same reason as the CoACS regime is, that is, because some PIFs will have only or mainly investors who are exempt investors, and who therefore are not entitled to claim capital allowances.

Combination of a GDO and a non-close test

In the context of the PIF, the nature of closed-ended investment offerings means that a simple "Genuine Diversity of Ownership" (**GDO**) test would generally be too narrow. HMRC recognised this in the design of the Schedule 5AAA TCGA 1992 requirements for offshore CIVs to benefit from exempt and/or transparent treatment. A similar approach – the combination of a GDO and a non-close test, with exceptions for qualifying institutions, and supplemented with the fallback option of an HMRC direction where necessary to protect the public revenue – may be appropriate here as a way of addressing potential avoidance concerns, and furthermore will ensure a fully level playing field between onshore and offshore equivalent investment vehicles.

Stamp Taxes

We set out our proposals for PIFs, which are based on the assumption that they may hold UK real estate. This assumes:

- vanilla transactions and that all consideration is for cash.
- the application of various anti-avoidance provisions and rules for redemptions in specie.

We recognise that our proposals below relating to Stamp Duty Land Tax (SDLT), SDLT seeding relief, Stamp Duty (SD) and Stamp Duty Reserve Tax (SDRT) involve government foregoing tax, the effect of implementing these proposals is crucial to ensure that the PIF will be a successful vehicle of choice. UK managers are currently attracted to operate offshore fund structures where there is nil transaction tax on an agreement to transfer or an actual transfer of fund units, and would expect an equivalent "nil transaction tax" scenario for the PIF if they are to utilise the PIF in preference to such offshore fund structures.

We consider that if government were to implement these proposals (and thereby ensure that the PIF will be a successful vehicle of choice), this success will also combine with a resultant positive multiplier effect including far greater revenue receipts than the foregone tax. The multiplier effect would be reflected in employment and other benefits arising from facilitating;

- UK government's goals (see our response to question 1); and
- investment in long-term and productive assets (see our response to question 31).

We should reiterate that - as indicated in our response to question 34 - the secondary market trading of real estate fund units held by institutional investors operates on a match-bargain basis: overall transaction volumes are modest in comparative terms[8]. Hence, we suggest that forgone tax - on account of a "nil transaction tax" scenario for the PIF- would also be modest.

Stamp Duty Land Tax (SDLT)

SDLT will not apply on transfers of units in a PIF – utilising the framework in s102A FA 2003 applying to CoACSs.

We consider that if a PIF (holding UK real estate) were deemed to be a property investment partnership it is unlikely that the PIF would provide an attractive onshore option. The imposition of SDLT on any transfers of units in property investment partnerships (which include limited partnerships) was a significant catalyst which resulted in many UK real estate funds moving offshore.

SDLT Seeding Relief

The PIF regime would be more attractive if the CoACS SDLT seeding relief were to apply to the PIF. This would assist launching new products. However, in assessing the merits of the new PIF, the government should consider it primarily a vehicle for new funds and should not assume a significant amount of conversion of existing fund structures (given that conversion is a complex legal exercise). Where SDLT seeding relief has been claimed, we would expect a similar clawback mechanism to apply as for CoACS to limit the scope for tax avoidance.

Stamp Duty (SD)

We suggest no SD will apply on a transfer of unit in a PIF (based on FA 99 Sch 13 Para 25A(1)(c) applying to CoACSs) and no SD on the issue or surrender of PIF contractual scheme units.

Stamp Duty Reserve Tax (SDRT)

We suggest no SDRT will apply on an agreement to transfer units in a CoACS (based on FA 1986 s 90(7B)(b) applying to CoACSs). In addition, there would be no SDRT on the issue or surrender of units.

VAT

We welcome that HMT's funds review is considering the VAT treatment of fund management fees and other aspects of the UK funds regime (VAT Consultation), and we hope the VAT Consultation will also consider the VAT treatment of the PIF as part of the overall improvement of the UK VAT regime for funds. We assume the same VAT regime that applies to the CoACS will apply the PIF.

A competitive VAT regime for management of UK fund vehicles (including the PIF) would be critical for their success as a suitable alternative to currently available funds outside the UK. Under the current VAT regime, a UK investment manager managing an offshore fund can benefit from full VAT recovery while no VAT is charged to the fund itself. In contrast, the management of UK funds is either exempt from VAT (if they are qualifying funds) or is subject to VAT (otherwise). Most alternative investment funds are not regarded as qualifying funds and hence suffer VAT on their management charges. Where the fund is exempt from VAT, the input tax recovery of the investment manager is restricted. The current VAT regime effectively limits the available onshore fund strategies for investors as VAT cost to a manager is a cost component in higher charges to the funds.

[8] *See chart in respect of trades undertaken on the PropertyMatch platform: Appendix 2*

	For the PIF to be more attractive, the current VAT treatment available on the UK management of offshore funds would need to be extended to management of the PIF. This can be done, for example, by applying a zero rate of UK VAT to the management of the PIF. From a VAT revenue perspective, the zero rating would be equivalent to the current position where non-UK fund vehicles are used with the associated benefits of encouraging the associated support functions such as fund administration and other support services to the UK. **<u>Tax Returns</u>** The PIF will be required to submit a return of income and capital gains, the PIF's allocation to its investors, details of expenses and capital allowances. This requirement ensures that HMRC receives this information for tax collection purposes, even though the PIF will not be liable to any tax on income and on capital gains.
37	***Are there any interactions with wider tax policy that the introduction of new unauthorised vehicles would need to navigate, in order to avoid unintended consequences?*** **The Professional Investor Fund (PIF)** **<u>Tax Avoidance</u>** It is recognised that appropriate anti-avoidance rules should be included to prevent the use of structures such as this from being used in a way that is not intended. Such rules should recognise the need for certainty of treatment of the PIF contractual scheme and include appropriate clearance mechanisms. **<u>Further Technical Points</u>** There will be further technical points that we suggest should be covered through technical working groups. These will include the treatment of holdings of PIF units for inheritance tax purposes. We welcome that the HMT UK Funds Review including the consultation relating Asset Holding Companies (**AHC Consultation**). We hope that the AHC Consultation will take into account the PIF. The attractiveness of PIFs is not dependent on any legislative reforms arising from the AHC Consultation, although such reforms may result in enhancing the attractiveness of PIFs.
38	***Are there other things government should consider as part of this review of the UK funds regime, or proposals for enhancements to the UK funds regime which the government has not included in this call for input? If so, how important are they and how would you like to see them prioritised in relation to the proposals explored in this call for input?*** **<u>UKFRWG Proposals</u>** In the IA UK Funds Regime Working group (UKFRWG) report to HM Treasury Asset management Task Force there were suggests for rebranding NURS as UCITS Plus; combining the current regulatory rule books for funds into one single rulebook; and enabling cross-border master funds for all types of authorised funds. AREF supports these proposals as well as some additional proposals, as detailed below. **UCITS Plus** The first was "UCITS plus": a fund regime with a similar investor protection standard as UCITS, but with broader investment powers. This would consist of a single fund structure, or overarching fund structure under which a range of structures could sit. A UCITS plus fund regime should offer the investor the protections of UCITS (depositary oversight, asset protection, spread limits, disclosure, valuation procedures etc.) but with more investment flexibility, and potentially greater flexibility around operational features to reflect the asset classes in the portfolios, for example, frequency of redemptions. The Non-UCITS Retail Scheme (NURS) already provides the basis for such a regime, allowing investment in a broader range of asset classes than UCITS, including real estate, unregulated collective investment schemes and physical gold, as well as having slightly broader spread limits. NURS was designed to meet domestic requirements, in particular offering the ability for UK investors to access asset classes not permitted under UCITS, such as real estate, while ensuring investor

protection was maintained. As such, it was never intended for an international audience, and NURS have to date not been sold to an international market. Its unattractive branding reflects this. Nonetheless, with investors increasingly seeking to diversify their portfolios into alternative asset classes, with the right branding the suite of NURS products could appeal to international investors wanting the investor protection offered by UCITS, but with more investment flexibility including exposure to some alternative asset classes. The NURS regime is particularly suited to multi-asset funds for retail investors given the greater investment flexibility.

Beyond proposing the LTAF as a specialist regime within the NURS, we did not propose any further changes to the existing NURS regime. Instead, the UKFRWG considered that the NURS already has the potential to be an attractive suite of products and therefore proposed that the NURS and its subsets be repackaged and rebranded as a 'UCITS plus' regime for both the domestic and international market.

Single rulebook

Authorised funds are regulated by the FCA and must adhere to the regulatory requirements set out in the FCA's Handbook. These include, inter alia, detailed rules in various different parts of the Handbook, knowns as Sourcebooks, including:

- Collective Investment Schemes Sourcebook (COLL) which covers matters relating to authorised funds such as operating duties and responsibilities, investment and borrowing powers, and investor relations.
- Investment Funds Sourcebook (FUND) which applies to all UK Alternative Investment Fund Managers (AIFMs).

  Product Intervention and Product Governance Sourcebook (PROD) rules centre on making firms, including Authorised Fund Managers (AFMs) prove the products they recommend deliver good outcomes, meet the needs of an identifiable target market and are sold to the right clients.

In addition, the FCA Handbook includes eleven key Principles for Business, one of which requires managers of authorised funds to pay due regard to the interest of their customers and to treat them fairly.

The main focus of a fund selection by an international investor will be the investment strategy rather than the structure of the investment vehicle. An international investor will therefore usually opt for a structure and domicile they are familiar with. For a fund domicile to be attractive to overseas investors, it is important they are able to quickly understand and familiarise themselves with the legal structures, legal requirements, regulatory requirements and tax positions of the domicile. The difficulties in having to navigate any complexity in these areas can be enough to deter international investors, even where the outcome is beneficial, for example a more advantageous tax position or more robust regulatory protections. It is therefore important that laws and regulations are reasonably straightforward for international investors, who will not be familiar with local customs and conventions, to understand.

Instead of having many regulatory Sourcebooks for funds, particularly COLL and FUND, the UKFRWG recommended the Regulator focuses, post Brexit, on creating a single rule book for funds as this will ultimately add to the competitiveness of the UK, especially for overseas investors navigating the UK regulatory landscape.

Cross-border master-feeders

Master-feeder fund structures have been widely used in the alternative fund space for a number of years as a means of providing gateways for investors to access alternative funds through local or more efficient structures. More recently, UCITS, NURS and QIS have been permitted to adopt master-feeder structures. Although UCITS IV introduced master-feeder fund structures for UCITS, take up of these has been limited to date. This is partly due to restrictions on UCITS being able to invest in feeder funds as second schemes. While intended to avoid layering and circularity of investment in second schemes, the restriction within UCITS fundamentally misunderstands the nature of a feeder fund as conceptually a gateway into the master, rather than a fund of funds.

The UCITS restriction has hampered the development of master-feeder fund structures within UCITS, and thus prevented the realisation of the potential of master feeder fund structures. Master feeder fund structures enable investors to benefit from increased economies of scale at the level of the master, the efficiencies of a tax transparent vehicle at master level and cross border pooling of assets, while being able to access these through a familiar local retail friendly vehicle. As the fund is nearly wholly invested in the assets of the master, save for a small proportion that is retained for liquidity or hedging currency risk, an investment in the feeder fund is to all intents and purposes an investment in the master fund, but through a familiar gateway fund structure.

The UKFRWG recommended that master-feeder fund structures might be used more widely to allow investors to benefit from increased economies of scale and increased investment choice through being able to access funds domiciled in other jurisdictions (in EU and third countries) through familiar local fund vehicles, i.e. UCITS, NURS or QIS. In the context of post-Brexit international treaties, master-feeder fund structures could also be a key component in mutual fund recognition treaties – funds domiciled in the Far East for example, are unlikely to be attractive to UK retail investors, but these investors may be willing to invest in a UK-domiciled fund that invests in a Far East master fund. The master-feeder rules for NURS already provide that NURS feeder funds can invest in master funds that are recognised schemes (under section 272 of the FSMA). The UKFRWG proposes that this structure should be more heavily promoted as a gateway to opening up funds in other jurisdictions.

ESG/Sustainability

In recent years the issue of sustainability and the ESG-focused fund has become increasingly important and will become even more important in future as the industry follows the government in aiming to achieve net-zero emissions by 2020, among other environmental initiatives. Investors are also waking up to the importance of responsible governance within firms, with the pursuit of returns, although still important, not being the only factor when investing in funds.

We would welcome an approach from both UK government and UK regulators that seeks to encourage and support international harmonisation of standards and reporting of environmental, social and governance (ESG) factors for products and funds, including alignment with the EU sustainable finance rules, wherever this is deemed to be in the best interest of end investors. Fragmented approaches across different jurisdictions run the risk of not treating consumers consistently and fairly, including different regulatory requirements impacting the investable universe of certain consumers more heavily than others.

Notwithstanding our view on global harmonisation of rules and regulation, ultimately, we view as critical the need for the government to come forward with a UK ESG/sustainable investment framework as soon as possible to ensure good customer outcomes and a well-functioning UK fund market. Our members are committing significant time and resource not only to the development of new responsible investment products, but also on consistent and clear disclosure of the sustainable characteristics of their products. However, it is critical our members know what regulatory framework they will be working in. The FCA draft Guiding Principles on ESG/sustainable fund design, disclosure and delivery help this but firms need clarity on whether the UK will be adopting a regime like the EU Sustainable Finance Disclosure Regulation (SFDR) or alternative frameworks.

Digitalisation

The funds industry is becoming increasingly digitalised and firms and investors are seeing a number of innovative propositions on how funds can become more digitalised, with the intention of improving efficiency and lowering cost.

APPENDIX 1

OTHER LEGISLATIVE AND REGULATORY PROVISIONS TO FACILITATE THE ESTABLISHMENT AND OPERATION OF THE PIF

Authorised Contractual Schemes (**ACS**)s were introduced in 2013 by the Transferable Securities (Contractual Scheme) Regulations 2013 (SI 2013/1388), structured either as authorised co-ownership schemes or as authorised limited partnership funds (in each case being available as UCITS, NURS or QIS). We request that the government consider the introduction of the PIF as an unauthorised contractual scheme.

As indicated in our response to Q35, we suggest the PIF could be easily recognised within the existing regulatory framework and subject to the same degree of regulation as is extended to UCIS Funds: for example, in light of the preference of the FCA one of two approaches could be adopted:

- PIF specific requirements to be included in a new section 4.2 of FUND to sit in the "specialist fund regime" section alongside the LTIF rules; or
- by specifying the following as regulated activities: "Establishing, operating and winding up a PIF" by adding a further article to a (new) article 51ZEE Establishing etc. a professional investor fund (contractual scheme): "Establishing, operating or winding up a professional investor fund (contractual scheme) is a specified kind of activity."

We also suggest that the FCA grants a requisite Part 4A permission to those carrying on these activities and ensure that only those who satisfy the FIT criteria are able to establish, operate and wind up such schemes but leave the schemes otherwise available to professional investors only. The limitation on promotion could be easily addressed by a minor modification to the Conduct of Business Sourcebook Rules as follows (indicated by underlining): COBS 4.12.3 R (1) A firm must not communicate or approve an invitation or inducement to participate in, acquire, or underwrite a non-mainstream pooled investment <u>or a professional investor fund (contractual scheme)</u> where that invitation or inducement is addressed to or disseminated in such a way that it is likely to be received by a retail client.

The purpose of this Appendix is to identify other key primary and secondary areas of legislation which would potentially require amendment or (at least) consideration if PIF s were to be fitted into the current regulatory landscape. The suggested areas identified are not exhaustive, and can be appropriately adopted in light of the preference of the FCA. We suggest that the further technical points should be covered through technical working groups.

<u>Regulatory issues</u>

1 The PIF would fall within the existing definition of a co-ownership scheme as specified in the FSMA s235A (2) – (5). We would suggest the insertion of a definition of a PIF in FSMA s237 (3):

"*professional investor fund (contractual scheme)*" means a contractual scheme which satisfies the requirements of section 235A (2) – (5) and is not the subject of an authorisation order in force under section 261D".

2 s237 of FSMA should be amended to take a PIF clearly outside the definition of a unit trust scheme.

3 The provisions in ss261M – 261P of FSMA (grouped under the heading "Co-ownership schemes: rights and liabilities of participants" and comprising: s261M/Contracts, s261N/Effect of becoming or ceasing to be a participant, s261O/Limited liability and s261P/Segregated liability in relation to umbrella co-ownership schemes) should be extended to PIFs.

4 The PIF should be prohibited from operating as a small registered UK AIFM (for the purposes of UK AIFMD) by adding "or a PIF [as defined in [ ]" to UK AIFMD regulation 10(3)(b)(ii).

5 If the FCA adopts this approach, the activities of: "*Establishing, operating and winding up a PIF*" can be specified as regulated activities by adding a further Article to the current Financial Services and Markets Act 2000 (Regulated Activities) Order 2001/544 as a (new) art. 51ZEE Establishing etc. a professional investor fund (contractual scheme): "*Establishing, operating or winding up a professional investor fund (contractual scheme) is a specified kind of activity*."

6 "*managing a PIF*" will fall within Article 51ZC of the Regulated Activities Order and Article 51ZF and the Schedule 8, paragraph 2 exclusion for small registered UK Alternative Investment Fund Managers (**AIFMs**)s will not be engaged.

7 "*acting as a depository of a PIF (CIS)*" can be brought within Article 51ZD of the Regulated Activities Order by amending "*(1)*" to include "*Acting as — … [(a)(a) the depositary of a Professional Investor Fund (Contractual Scheme)]* and specifying in "*(5)*" that "*[In paragraph 1(a)(a) "depository" has the meanings given by section 237 of the Act]*.

Operational issues

8 The disqualification of auditor regime in s249 and discipline of auditors in s261K of FSMA might be applied to auditors of a PIF.

9 A PIF should be required to be subject to corporate governance mechanisms equivalent to those applied to companies, as envisaged by the COLL Rules, in particular 5.2.7CR(2): "(a) it is subject to corporate governance mechanisms equivalent to those applied to companies; and (b) it is managed by a person who is subject to national regulation for the purpose of investor protection". This will require amendment to the COLL Rules.

10 FUND 3.2.5R to the effect that "*an AIFM must, for each UK AIF it manages, and each AIF it markets, disclose to investors periodically: (1) the percentage of the AIF's assets that are subject to special arrangements arising from their illiquid nature; (2) any new arrangements for managing the liquidity of the AIF; and (3) the current risk profile of the AIF and the risk management systems employed by the AIFM to manage those risks*" will apply to a PIF.

11 FUND 3.3.2 R requiring that an AIFM of any UK AIF it manages and for each AIF it markets in the UK (1) make an annual report available to investors for each financial year; (2) provide the annual report to investors on request; and (3) make the annual report available to the FCA and will apply to a.

12 As indicated in our response to Q30, the PIF legislation should facilitate a sub-fund or protected cell feature akin to that applying to UK OEICs in view of by the Open-Ended Investment Companies (Amendment) Regulations 2011 (SI 2011/3049) i.e., allow for sub-funds with a legally enforceable segregation of the assets and liabilities of each sub-fund.

Promotion of PIF s

We suggest regulations which treat a PIF as an unregulated collective investment scheme combined with applicable rules that apply to QISs:

13 The operators of PIF s should be prohibited from contracting out of liability for negligence as with ACS pursuant to s261T of FSMA.

14 Specifying that COBS Rule 4, 12.3R (prohibiting promotion of non-mainstream pooled investments to retail clients) applied to PIF s.

15 The Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (SI 2001/1060) should be amended to specify that PIF s can only be promoted to high net worth and sophisticated investors/professional clients.

APPENDIX 2

CHART - TRADES UNDERTAKEN ON THE PROPERTYMATCH PLATFORM