HM TREASURY

The UK investment management strategy

March 2013

HM TREASURY

The UK investment management strategy

March 2013

© Crown copyright 2013

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit http://www.nationalarchives.gov.uk/doc/open-government-licence/ or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or e-mail: psi@nationalarchives.gsi.gov.uk.

Any queries regarding this publication should be sent to us at: public.enquiries@hm-treasury.gov.uk.

ISBN 978-1-909096-79-0
PU1469

Contents

		Page
Foreword		3
Chapter 1	Introduction	5
Chapter 2	The challenge for the UK	7
Chapter 3	Taxation	11
Chapter 4	Regulation	15
Chapter 5	Marketing	17
Chapter 6	A principled approach for the future	19

Foreword

The UK investment management industry serves millions of customers all around the globe, generates around 1 per cent of GDP, and employs tens of thousands of people across the UK. As part of this Government's objective to equip the UK for success in the global race, I am committed to making the UK one of the most competitive places in the world for the investment management sector.

Whilst the UK remains Europe's leading centre for fund management, our share of fund domicile has fallen in the last decade. This document identifies the key challenges and opportunities we face in reversing this trend. We must act now to rebuild our share of this global business, to take advantage of growth opportunities in Asia and to respond to changes in European regulation.

This report sets out the steps we are taking as part of a comprehensive strategy to achieve this aim. We will focus on three main areas:

1. Taxation: we will work hard to ensure our tax regime is simple, fair and streamlined.
2. Regulation: we will ensure a regulatory environment that applies high internationally consistent regulatory standards and that remains responsive.
3. Marketing: we will work closely with key industry bodies to carry a co-ordinated marketing approach to all corners of the globe.

This Budget unveils an ambitious set of measures to improve the UK's competitive position. These measures are just the first steps of a broad and comprehensive strategy that we will deliver in partnership with industry.

George Osborne

Chancellor of the Exchequer

1 Introduction

1.1 The investment management (IM) industry is a key part of the UK's financial sector, managing £4.9 trillion of funds and earning an estimated £12 billion a year for the UK. It is a major source of funding for the economy, accounting for over a third of all investment in UK equities. The industry is a significant provider of high value-added jobs and skills, with clusters of expertise in London, Scotland, and across many UK regions. It matters not only to the UK, but to our European and international partners, providing liquidity to global markets and services to investors on every continent.

1.2 With its many advantages in skills, geography, legal and professional services, the UK is well-placed to be a global centre for investment management. Opportunities abound. In Europe, new directives and regulations are coming into force that will allow firms to sell their fund management and other services across the Single Market. Worldwide, the IM industry is growing rapidly as an emerging global middle class lives longer, saves for the future, and wants to invest. At the same time, the industry is consolidating into major financial centres where it can create economies of scale around sophisticated information systems and deep pools of skilled professionals.

1.3 The Government recognises however that success cannot be taken for granted. The IM industry needs a stable, responsive and fertile business environment in which to thrive and compete. This has not always been the case over the past decade. Despite its position as the leading centre for fund management in Europe, the UK has lost ground as a fund domicile, with a consequent loss of jobs and growth especially in the UK regions. Some of this decline has been a consequence of strong competition from other jurisdictions, whose companies and infrastructure have been better focused and marketed. But some has been the direct result of failing to adequately address concerns over rules and processes here, and insufficient attention devoted overseas to supporting and marketing this key UK strength. This Government has taken note, and is determined to improve the UK's competitive position with a comprehensive strategy to enhance the UK's position as a global leader in a global industry.

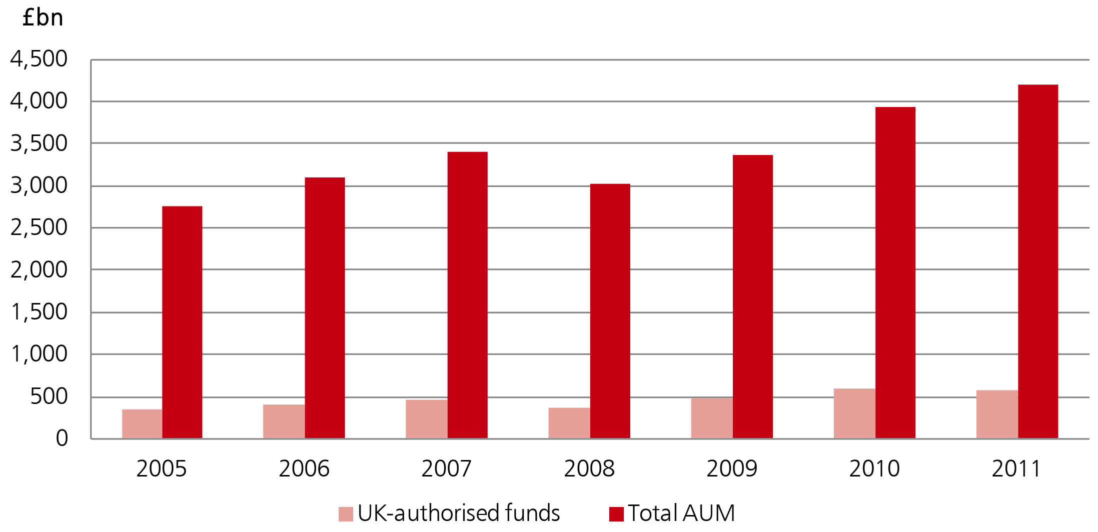
1.4 Following consultation with industry bodies, UK-based companies and inward investors, the Government believes that the UK can help industry in three main ways. First, HM Treasury and HM Revenue and Customs (HMRC) will continue to work together to improve the tax rules. Secondly, with the advent of the Financial Conduct Authority (FCA), we can start to make our new regulatory system as nimble as it is rigorous. And thirdly, as markets open internationally, government – HM Treasury, UK Trade and Investment (UKTI), the Department for Business, Innovation and Skills (BIS) and the Foreign and Commonwealth Office (FCO) – will work with industry bodies and individual companies to develop a sustainable marketing plan in all key regions of the globe. In addition, the Government will continue to engage strongly in the development of European Union (EU) legislation to ensure it is as effective as possible; supporting growth, providing investors with choice and enhancing financial stability and investor protection. This document articulates the Government's strategy for addressing these issues over the coming months and years, and the areas where we shall be engaging with the industry and its stakeholders to maximise the potential for all.

2 The challenge for the UK

A successful industry

2.1 The IM industry is one of Britain's most successful industries. In 2011, UK industry assets under management (AUM) totalled £4.9 trillion[1]. Whilst London continues to be the epicentre of the industry, it is a key component of regional economies: for example, Scotland managed 12 per cent of total assets in 2011 – a sum roughly equivalent to a third of UK GDP.

Chart 2.A: Industry assets and UK-authorised funds under management (2005-2011)



Source: Investment Management Association (IMA)

Importance to the UK

2.2 The IM industry accounts for about 1 per cent of the UK economy and a similar proportion of tax revenues. It plays a vital role for investors, investment and employment.

Investors

2.3 The industry is critical to the financial future of millions of savers and investors. In 2011 institutional clients such as insurers and pension funds accounted for almost 81 per cent of total UK assets, retail clients made up 18 per cent, and private clients accounted for 1.2 per cent.

Investment

2.4 The industry is a key source of liquidity for the UK and global economies, providing an efficient mechanism for the transfer of capital from those who wish to invest it, to those who need it. It provides significant investment, particularly in equity and fixed income assets, but also

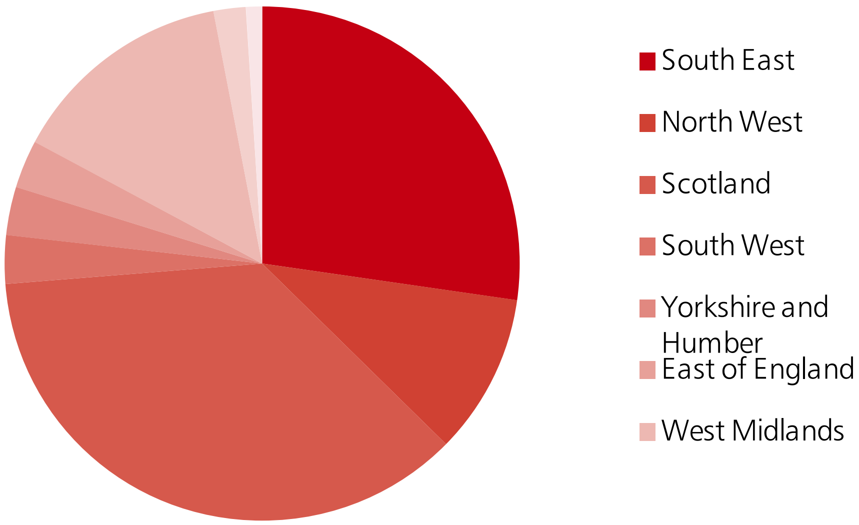
[1] IMA annual survey 2011-2012

in money market instruments, property and alternative asset classes. These investments can drive innovation and help to manage risk across the global financial system.

Employment

2.5 According to estimates, the UK investment management sector directly employs 32,300 people. But given that many investment management companies engage in outsourcing, with most outsourced functions remaining in the UK, the indirect employment figure is significantly higher. Twenty seven per cent of those directly employed by the sector work in fund management, with the remaining split between administration, IT services, corporate finance, business development and legal and audit compliance.

Chart 2.B: Breakdown of domicile related jobs by region



Source: TheCityUK

Opportunities

2.6 Opportunities abound for the IM industry to grow and contribute further to the UK economy. Across the globe, emerging economies are generating improvements in incomes and living standards on an unprecedented scale. A growing global middle class will live longer than any previous generation, and will save accordingly. The UK should aim to attract and manage a significant proportion of this growing pool of savings, providing rewards for global investors and liquidity for the global economy.

2.7 In particular, Asia and China are starting to look increasingly at opportunities to invest via European products and domiciles. Additionally, Asian fund managers are increasingly considering the need for a European-based alternative investment fund manager. The UK needs to have a compelling story for these investors and a marketing plan to deliver it.

2.8 A further opportunity for the industry arises from the introduction of the AIFMD this summer, as some offshore funds will move onshore to take advantage of EU passporting rules. More than £100 billion could be moving onshore into Europe, and the UK could look to secure these funds.

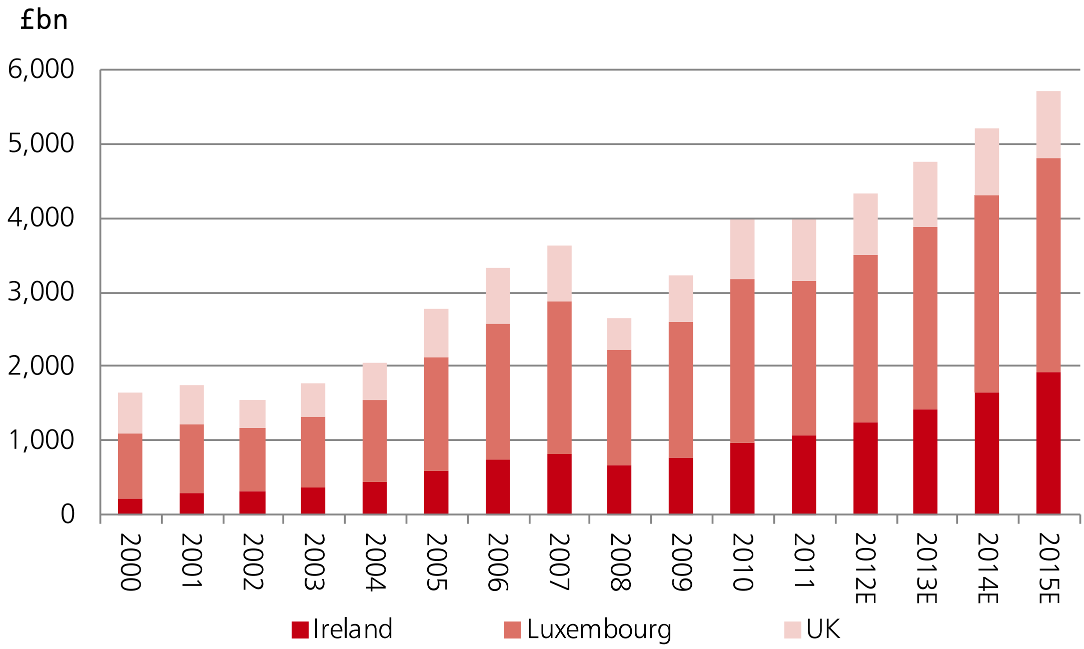
2.9 We have significant advantages which suggest the UK will be able to take advantage of these opportunities: a strong position in wider financial services; natural strengths in language, geography and law; an array of innovative and trusted firms; and an existing critical mass in AUM.

Challenges

2.10 But the Government appreciates that it cannot be complacent about the challenges that remain, and that none of the potential growth can be guaranteed without concerted action from government and industry.

2.11 The scale of the challenge is evident from the changed position of the UK as a location for fund domicile. Despite its dominant position in AUM, over the last ten years the UK has lost ground to both Luxembourg and Ireland as the leading location for European fund domicile. The UK is also under competitive pressure from jurisdictions outside the EU. The graph below illustrates the recent trends with the UK share of fund domicile compared to Ireland and Luxembourg reducing from 34 per cent in 2000 to 20 per cent in 2011.

Chart 2.C: Value of assets domiciled in Ireland, Luxembourg and the UK



Source: IMA

Risk of decline

2.12 If the UK cannot maintain its share of the increase in domiciled fund volume across Europe, we shall lose substantial potential for jobs and growth in middle and back office administration, and the legal and consulting services that support this. This would be especially damaging since we estimate that around half the 32,300 people directly employed by the investment management industry across the UK are currently working in jobs closely linked to fund domicile, with significant employment clusters in the West Midlands, Scotland, North West and South East. As more funds are domiciled offshore, the UK risks losing critical mass and may struggle to benefit from opportunities in emerging and new markets. If the UK is to arrest this relative decline then the Government recognises it will be necessary to act decisively and provide a sense of direction and stability to industry.

The key issues identified

2.13 HM Treasury analysis of the global environment in which firms operate has highlighted the challenges faced by the UK fund industry. Our conclusion is that there is no reason why the UK cannot compete more effectively while maintaining a rigorous regulatory approach and a fair tax regime. But to do so, we need to work hard to focus improvements in three key areas:

- Taxation: we will simplify and streamline taxes on the sector.
- Regulation: we will create a more responsive regulatory environment.
- Marketing: we will improve our marketing infrastructure in the UK and overseas.

2.14 This strategy aims to provide progress on all three fronts, as part of a coherent package of reform. These three areas are discussed in further detail in the following chapters.

3 Taxation

3.1 The Government recognises the importance of a simple, fair and stable tax regime. Guided by its ongoing engagement with industry, the Government aims to make sure the tax framework best meets investor needs.

3.2 Over the last few years the Government has actively consulted with industry on a number of proposals. This has resulted in the introduction of Property Authorised Investment Funds, Tax Elected Funds, Investment Management Exemption, white list provisions, and reform of the rules for Investment Trust Companies. Soon the UK will also be introducing two new authorised contractual (tax transparent) schemes. (Please see box 3.A below)

3.3 However the Government understands that while the foundations of success may have been laid, more work is still required. Therefore, the Government has announced a package of new tax measures in the 2013 Budget. At the heart of this package is the abolition of the Schedule 19 (stamp duty reserve tax) charge on funds, which will remove a complication in the tax system.

Abolition of Schedule 19 (stamp duty reserve tax)

3.4 Schedule 19 acts as a proxy for the principal stamp duty reserve tax charge and is charged to fund managers on surrenders of units in funds, although investors ultimately bear the cost. The regime is regarded as complex and burdensome, requiring frequent tax calculations and returns to be sent to HMRC. Additionally, because of the way in which the tax operates its headline rate implies a much greater tax burden than the annual cost actually suffered. This is difficult to explain to investors and gives rise to presentational complications when trying to market UK funds, especially overseas. Since the charge is only applied to UK funds, those who do not wish to pay Schedule 19 already have the option of investing in funds domiciled offshore. It is for these reasons that Schedule 19 is identified as a major deterrent to domiciling funds in the UK, with a particularly damaging effect on the ability of UK funds to attract non-UK investors.

3.5 The abolition of Schedule 19 will be legislated for in Finance Bill 2014 to take effect in tax year 2014/15.

3.6 In addition, the Government will consult on three further measures:

1. Further clarification that managing offshore non-UCITS funds in the UK will not affect the tax residency of the fund

3.7 Currently s363A TIOPA 2010 provides that locating management functions of offshore UCITS (undertakings for collective investment in transferable securities) funds in the UK will not put the fund at risk of being deemed to be UK tax resident. This has been well received as it provides certainty to UK based managers. Following publication of this document the Government will develop and consult on proposals to widen the application of s363A TIOPA 2010 to provide greater certainty on the tax residency of non-UCITS foreign domiciled funds. In particular, this will provide comfort to managers who wish to operate offshore funds under the AIFM directive.

2. Allow UK domiciled bond funds to pay gross interest where they are marketed to non-UK residents

3.8 At present, managers of UK bond funds are required to withhold basic rate tax on interest distributions. This works well in the case of UK residents but creates difficulty when selling funds to foreign residents who are entitled to receive payments without tax being withheld. This puts managers wishing to export UK funds at a competitive disadvantage as it is administratively costly and difficult to separate out UK and non-UK investors.

3.9 The Government will develop and consult on proposals to allow such funds to pay interest on a gross basis where they are marketed to foreign investors in a manner that does not give rise to a risk of evasion.

3. Provide greater certainty to fund managers as to whether certain transactions will be deemed to constitute trading or investment activity

3.10 In the case of foreign domiciled funds that are managed in the United Kingdom, provided that the fund is not trading, the fund itself will not be taxable in the UK. However, if such a fund carried out transactions that were held to be trading then it is possible that having a UK manager would cause the fund's trading profits to be taxable in the UK. The Investment Management Exemption applies in such cases, and the white list in this context provides that the specified transactions will not be taxable in the UK.

3.11 UK funds (and offshore funds reporting income to UK residents) also benefit from a parallel white list which deems similar transactions not to be trading transactions when carried out by those funds as part of their investment activities.

3.12 When the white list was set up, the Government stated that it intended to keep the list of specified transactions under review. The Government will therefore consult on minor changes to the white list, in particular its application to traded life policy investments and certain forms of carbon credit that are not currently covered.

3.13 The Government believes that these measures represent a significant step forward in making the UK a leading centre for fund domicile in Europe. Nonetheless we appreciate that constant effort is needed to remain competitive in such a fast paced industry. With this in mind we will continue to engage constructively with industry.

Box 3.A: Tax transparent fund

By the end of spring 2013, two new authorised contractual (tax transparent) scheme (ACS) vehicles will be available for fund managers to establish in the UK. These vehicles are the limited partnership and co-ownership schemes. Both schemes will be available for authorisation as UCITS, NURS (non-UCITS retail scheme) or QIS (qualified investor scheme).

By introducing these vehicles the government is taking a significant step in supporting the UK investment management industry and providing the necessary framework to ensure that the UK can be the location of choice for international fund domicile.

These schemes are expected to be attractive to managers looking to pool assets from funds across Europe, and potentially more widely, using arrangements permitted by the UCITS IV Directive. In such a structure a UK ACS would form a 'master fund' into which other UCITS funds from across Europe could combine their assets. This will create economies of scale, allow industry to reduce costs and increase returns to investors.

ACSs will also be particularly suited to certain tax-exempt institutional investors, such as pensions companies, who may be able to take advantage of their transparent nature to secure more appropriate rates of foreign withholding tax than might be the case when investing in an opaque fund.

The new vehicles have been designed to be best in class, building upon experience elsewhere with a strong commercial foundation following extensive industry input into their design.

4 Regulation

4.1 Since the financial crisis, the Government has undertaken extensive work to support the IM industry, working to secure the business environment through the creation of a new regulatory system, and negotiating effectively in Europe to develop appropriate and harmonised rules that allow the industry to market its services across the EU. This work has laid some solid foundations for the future and has shown evidence of success, such as the UK's now-established strength in marketing worldwide funds regulated under the UCITS Directive.

4.2 The Government's approach to regulation as part of this strategy will focus on professionalism, operational responsiveness, constructive engagement in the development of European legislation and implementation of new legislation which maximises economic benefits to investors, while ensuring adequate protection. In doing so, Government will work closely with the new FCA to ensure that the UK strikes the right balance of both rigour and responsiveness.

Responsiveness to industry's needs

4.3 The Financial Services Authority (FSA) has agreed to engage actively with the industry representatives in relation to the process for authorising funds, including hosting, with the Treasury, a roundtable to explore improvements that can be made and to enhance understanding on all sides. This would be with a view to ensuring that applications are expedited as quickly and efficiently as possible. It is immediately reviewing the application forms in order to make the application process as smooth as possible, and keep to a minimum any further information requests required during the consideration of an application.

Constructive engagement on new legislation

4.4 The Government will consult closely with industry on new legislation to identify and promote initiatives at both a European and UK level that support growth.

4.5 The UK has recently worked to ensure single market benefits of the AIFMD are maximised and that the forthcoming European Venture Capital Regulation (EVCR) meets the needs of small venture capital fund managers.

Effective implementation of new AIFMD legislation

4.6 In line with the Government's broader direction, a "copy-out" approach will be adopted wherever possible to implementing European legislation in order to simplify the regulatory approach for firms, with any gold plating supported by strong justification. In addition, the Government will consult closely with industry to ensure opportunities to minimise costs and maximise benefits will be identified and implemented.

4.7 The AIFMD is due to enter force in July 2013. It imposes significant costs on the industry. However, it has the potential to bring fund management business onshore in order to take advantage of EU management and marketing passports and, over time, potentially take advantage of a strong brand.

4.8 Treasury consultations on AIFMD have now closed and FSA consultations are ongoing. In response to industry feedback, the Government and FSA have taken the following steps:

- A flexible interpretation of AIFMD's transitional provisions has been adopted to give managers a more realistic timeframe in which to carry out their restructuring;
- Provision of a bespoke depositary regime for private equity funds for which standard depositary models would be inappropriate and disproportionately expensive; and
- FSA steps to ensure that UK firms may market to other EU jurisdictions without interruption after the implementation date of the directive.

4.9 The Treasury will continue to work with FSA and industry stakeholders to ensure that all appropriate opportunities are identified and exploited as part of the implementation process.

Limited Partnership reform

4.10 The Treasury will consult with a view to making technical changes to the Limited Partnership 1907 as it applies to funds, including the possibility of allowing them to elect for legal personality. This has been a major concern, particularly for the private equity and venture capital sectors and will ensure that UK Limited Partnerships remain an effective and attractive vehicle for the private funds industry.

.

5 Marketing

5.1 Other jurisdictions have adopted a co-ordinated approach to marketing their industries. The Government now intends to work more closely with key industry bodies to ensure a co-ordinated and focussed approach, creating a proactive investment management marketing strategy that will target key overseas investors in important overseas markets such as Asia and the Americas. This is not just a marketing surge. Our goal is to create a sustainable marketing infrastructure that will enable the UK industry to both have a strategic and targeted approach and identify and exploit opportunities as they arise.

Coordinated approach

5.2 The Treasury, UKTI, TheCityUK and trade bodies like IMA and the Alternative Investment Management Association (AIMA) are all working to promote the industry. But co-ordination between them needs improvement, prioritisation needs to be better, and initiatives need to be sustained over years.

5.3 The Government will therefore work with industry to establish such an approach and a coordinated infrastructure. As a first step, the new Financial Services Trade and Investment Board (FSTIB) will make promotion of the sector a key priority, working with the FCA, TheCityUK, UKTI and industry bodies. TheCityUK will play a new expanded role in leading the marketing agenda and will report to the Board. It will develop the marketing plan in consultation with Government and industry, and ensure the right messages are delivered through the right channels.

Ongoing industry engagement

5.4 The UK has a track record of innovation and responsiveness, but too often plays catch-up to other regimes in anticipating and responding to industry trends.

5.5 The Government will therefore work more closely with the industry to anticipate new trends, so that regulation and tax can develop quickly to allow the UK to take advantage of emerging opportunities.

One-stop shop

5.6 TheCityUK and key trade body the IMA will work closely with industry to lead a one-stop shop service for fund managers wishing to set up in the UK. They will bring together all relevant service providers to offer a comprehensive package to new fund managers. This might include, for example, a fixed cost consultancy and legal package to support the manager in setting up, and a “concierge” service to help managers access the right parts of the regulator and the wider industry.

Overseas marketing regime

5.7 For UK funds to be attractive, investors and their advisors need to be aware of them and understand their benefits. UKTI will therefore lead a sustained overseas marketing campaign, deploying their network of staff in areas including Asia. Their approach will be informed by the Programme Board’s identification of key target markets and audiences and they will deliver their message through the right channels such as conferences, events, dinners and support for trade delegations.

Islamic Finance Task Force

5.8 This Government continues to adopt a pro-active approach, and has formed an Islamic Finance Task Force. This will engage with important individuals and organisations in the UK and internationally to galvanise support and build momentum initially in the run up to the World Islamic Economic Forum (WIEF) and support continued progress thereafter.

5.9 Launched on 11 March, the task force is co-chaired by the Senior Minister of State at the FCO and the Financial Secretary to the Treasury, with the support of Ministers from BIS and the Department for International Development (DfID).

5.10 The task force will promote all areas of Islamic finance including, for example, asset management and the listing of funds in the UK.

6 A principled approach for the future

6.1 This document heralds the inception of a long term strategy. The immediate measures proposed are simply the first phase – to kick start growth as a fund domicile and cement our position as a global fund management hub. Success can only be achieved by working in partnership with both industry, regulator and across government. The Government proposes to adopt the following, principled approach to the industry which will shape this relationship.

A long term approach

6.2 The trends and processes that have led to the UK's loss of market share in fund domicile business will require time to turn around. To make key decisions, managers need to be convinced of the durability of a competitive regime. The Government is committed to providing this stability.

Innovative

6.3 The Government recognises that one of the key strengths of the UK investment management sector is its ability to rapidly innovate. In support of this and to accommodate the needs of investors, we will work to support growth opportunities for the sector. For example, we will identify opportunities to create an appropriate mix of fund vehicles and support sectoral needs.

Taking the tough decisions

6.4 The Government is prepared to take the tough decisions necessary to make the strategy succeed in order to safeguard UK jobs and promote growth. As a statement of intent in a difficult fiscal climate, the Government is repealing Schedule 19 (stamp duty reserve tax).

Resourcing

6.5 The Government will have staff dedicated to supporting the competitiveness of the industry. Within industry, bodies such as the IMA and TheCityUK have committed to provide extra resourcing.

Close collaboration across government

6.6 HM Treasury has agreed with HMRC, the FSA and UKTI to work closely together in a structured way to ensure the strategy succeeds.

Working closely in partnership with industry

6.7 We will organise ourselves to ensure that we are better placed to anticipate opportunities and respond to emerging challenges.

6.8 The Government will work closely with TheCityUK and other key trade bodies to understand future strategic developments.

Conclusion

6.9 The proposed tax changes comprise the foundation of a stable, simple, competitive regime for the UK investment management industry that will remain in place for the foreseeable future.

6.10 The message is simple; the UK is not just open for investment management business, it is actively seeking it. We look forward to working with industry and investors to win it, keep it, and help it grow.

HM Treasury contacts

This document can be found in full on our website: http://www.hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

E-mail: public.enquiries@hm-treasury.gov.uk

ISBN 978-1-909096-79-0