Personal Portfolio Bonds - Reviewing the Property Categories

Summary of responses
5 December 2016

Contents

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1. Introduction

1.1. At Budget 2016 the government announced its intention to review the property categories a life insurance policyholder may select to have their premiums invested in without triggering the provisions of the personal portfolio bonds (PPB) legislation.

1.2. Taxable gains from life insurance policies (which include capital redemption policies and contracts for life annuities) arise when value is taken from a policy, typically when the policy matures or is partly surrendered. The PPB rules prevent an individual from placing their personal assets within a life insurance policy in order to defer any tax charges on the income or gains arising from those assets until they take cash from the policy. An annual tax charge is levied where a life insurance policy falls within the definition of a PPB.

1.3. A life insurance policy will be a PPB if the terms allow the policyholder to select some or all of the underlying assets ("property"). However if all of the assets which may be selected fall within certain listed permitted property categories, the policy will not be a PPB.

1.4. The current categories of property that can be selected by policyholders are at section 520 of Income Tax (Trading and Other Income) Act (ITTOIA) 2005 and include the following.

- Property in an insurer's internal linked fund.
- Units in an authorised unit trust.
- Shares in an investment trust.
- Shares in an open-ended investment company.
- Cash.
- Life insurance policies.
- An interest in certain non-UK collective investment schemes.

These categories comprise of widely held funds, managed by third party investment managers, or property already held by the insurer, none of which can include personal property introduced by the policyholder.

1.5. On 9 August 2016, the government published the consultation document "Personal portfolio bonds – Reviewing the property categories". This consultation ran until 3 October 2016 and sought views on current property categories and additional property types that might also be included. The document explored three types of investment vehicles that fund representative bodies had previously suggested should be included and invited suggestions for any changes to the list.

1.6. The government received 11 contributions from industry, representative bodies, and individuals. A list of respondents is at Annex A.

1.7. Having considered the responses, the government has decided to legislate in Finance Bill 2017 to take a power to allow it to introduce regulations to update the list of permitted property categories. As well as enabling new asset categories to be added to the list of permitted property, the power will allow the government to introduce regulations to remove categories where they are no longer appropriate. Regulations which remove a property category will be subject to the affirmative procedure.

1.8. The government has now published draft regulations to allow the three investment vehicles, Real Estate Investment Trusts, Overseas Investment Trust Companies and Authorised Contractual Schemes, to be selected by policyholders without triggering the PPB rules,

1.9. A number of respondents suggested different methods for calculating the annual PPB taxable gain. Others suggested changes that would allow greater flexibility for policyholders that inadvertently invest in assets that are not within section 520 ITTOIA 2005. Although these responses are outside the scope of the consultation, they will be considered as part of a future review of the PPB rules.

1.10. Chapter 2 of this document summarises the responses received to the consultation.

2. Responses

General comments

2.1. Respondents largely welcomed the opportunity to respond to the consultation. Whilst most respondents recognised the need for the PPB rules, many recognised that the property in section 520 ITTOIA 2005 has not evolved in line with changes in the retail investment market. A more frequent review of the permitted property categories was widely suggested.

2.2. One respondent favoured an approach that would define property that would be considered personal to the policyholder and allow investment in all other property types. Others suggested different criteria such as the Financial Conduct Authority's Standard Asset list for personal pension schemes. These alternative approaches have not been taken forward because of the difficulties in clearly defining what "personal property" is. Furthermore the alternatives suggested (such as the Standard Asset list) could not guarantee that personal property could not be selected by policyholders.

2.3. One respondent highlighted a technical deficiency in one existing property category. Category 7, collective investment schemes outside the UK, refers to an interest in a collective investment scheme constituted by a company resident outside the UK other than an open-ended investment company. The government recognises this subcategory is empty and shall take steps to remove this in regulations.

2.4. A summary of the responses to each question asked in the consultation document is given below.

Question 1 – Should any or all of the vehicles discussed be added to the permitted property categories? In each case, what would the impact of inclusion or non-inclusion be on investment and what one-off and/or ongoing costs or savings do you anticipate will arise as a result in both the vehicles themselves and insurance policies?

2.5. The large majority of respondents welcomed the proposed addition of all three of the vehicles discussed, Real Estate Investment Trusts, Overseas Investment Trust Companies and Authorised Contractual Schemes. Respondents felt the proposed reform would lead to better asset allocation for clients and therefore stronger returns to investors. They also argued the increased competition and choice would help drive up standards for investors.

2.6. There was broad consensus in responses that the additions would recognise changes in the investment landscape since introduction of the PPB provisions. It was agreed that these additions would present no risk as they share the same fundamental features as existing categories.

2.7. Respondents also agreed inclusion of the proposed vehicles would level the playing field between the different types of collective investment vehicles.

2.8. The consultation document considered shares in an investment trust company (ITC). One respondent suggested that securities in an ITC should also be included. A security in an ITC does not participate in the underlying investments selected by the investment managers of the ITC. Thus there would be no effective guarantee that a policyholder would be unable to select personal assets.

2.9. No respondent was able to quantify the likely impact on investment. The measure may result in the launch of new funds and would make a positive contribution to levels of market and other economic activity. No material costs were envisaged for the investment vehicles or the issuers of portfolio bonds. Any one-off costs such as amending policy documentation, advertising, systems or staff training will only be incurred if the firms wish to take advantage of the increased flexibility offered by the reform.

Question 2 – For each of the three investment vehicles discussed, do you consider that their structure or nature means individual policyholders would be effectively prevented from introducing personal assets into their life insurance policy?

2.10. Respondents universally agreed that the structure of the three investment vehicles discussed effectively prevents the introduction of personal assets by individuals. Many stressed the importance of ensuring that there is a clear definition of the overseas investment trust company. It is necessary to ensure that shares are traded on a regulated market, the company is widely held and meets the spread of investment test.

Question 3 – In addition to the three investment vehicles discussed, do you consider that there are other types of property that should be included in the permitted property categories? If so, please describe the property in detail and explain why individual policyholders would be effectively prevented from introducing personal assets into their life insurance policy.

2.11. A majority of respondents asked for inclusion of exchange traded funds/contracts. These assets may come within the list of permitted categories as currently set out in the PPB rules, dependant on how they are structured, which may be determined by the jurisdiction in which they are located. One respondent explained that, at heart, these funds/contracts are collective investment arrangements and it would be impossible for a policyholder to introduce any personal property into such funds. Investors do not control selection of the underlying assets within such funds/contracts.

2.12. A number of respondents requested the inclusion of structured notes, offering returns based on the performance of an underlying index or basket of shares. Inclusion of these products in the permitted property categories would not allow the policyholder to introduce personal property as the policyholder does not control selection of the underlying indices or shares.

2.13. A number of respondents suggested including a restricted holding in equities listed or traded on a recognised stock exchange on the basis that the individual could not control the company.

2.14. There were individual requests to include market place lending, fixed interest products (including UK government gilts) and cash in other currencies

Question 4 – Are there any categories of asset currently within the permitted property categories where changes in their structure or nature means there is now a risk that they could be used by individual policyholders to introduce personal assets into their life insurance policy?

2.15. No respondents considered the current permitted property categories allowed individuals to introduce personal assets into their life insurance policies.

Question 5 – Do you have any comments on the assessment of impacts, either generally or in relation to the specific options set out below?

2.16. The majority of respondents either agreed the assessment of impacts or made no comment.

Question 6 - How do you consider the overseas equivalent of a UK investment trust could be defined?

2.17. One respondent suggested that in defining the overseas equivalent of a UK investment trust the following criteria needs to be met:

- Shares are traded on an EU regulated (or equivalent) market;
- It meets a spread of risk test; and
- The shares are widely held.

However, the respondent did not think that the distribution obligations of the UK investment trust company should form part of the criteria.

2.18. Another response stressed the need for clear guidance as to what constitutes an overseas equivalent of a UK approved investment trust.

3. Government response and next steps

3.1. The government thanks everyone who responded to this consultation. The responses have proven very useful when considering the changes required.

3.2. Draft legislation to take a power to amend the PPB permitted property categories in regulations is being published for further comment. This will form part of the Finance Bill 2017 and will come into effect on royal assent.

3.3. Draft regulations to add the three investment vehicles explored in the consultation document; Real Estate Investment Trusts, Overseas investment trust companies and Authorised contractual schemes, and to remove the technical deficiency within category 7 will be published with the draft power.

3.4. Detailed guidance will be published prior to the effective date of these regulations and this guidance will include the definition of an overseas equivalent of an investment trust company.

3.5. The government will give further consideration to the different methods for calculating the annual PPB taxable gain and other suggested changes that would allow greater flexibility for policyholders. This will require further informal consultation.

3.6. The government will not include equities, fixed interest (including UK government gilts), market place lending and cash in other currencies within the list of PPB permitted property categories as the nature of these assets cannot guarantee that personal property is unable to be selected by policyholders. The government will regularly review the retail investment market to ensure the section 520 ITTOIA 2005 property categories meet the policy objective of the PPB rules whilst allowing appropriate investment opportunities which policyholders can select. The government will closely monitor the effect of this change.

Annex A: List of stakeholders consulted

Aegon Ireland Plc
Association of British Insurers
Association of International Life Offices
Barclays Wealth
British Property Federation
Investment & Life Assurance Group
Manx Insurance Association
Old Mutual Wealth
The Association of Investment Companies

Two Individuals