

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 1,807	High: 1,863	Best Estimate: 1,835

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	63	6	55
High	128	13	111
Best Estimate	96	8	83

Description and scale of key monetised costs by 'main affected groups'

There would be no mandatory costs to industry. Legislation will create the option for fund managers to set up tax transparent fund vehicles. They will incur incremental set up costs if they choose to do so, estimated at £83m on an NPV basis over 10 years. The FSA would incur transitional costs making changes to their rules which are estimated to be within their existing resource capacity

Other key non-monetised costs by 'main affected groups'

None

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			
High			
Best Estimate	0	238	1,918

Description and scale of key monetised benefits by 'main affected groups'

Without the initiative, investment management will likely remain in the UK but the administration of TTFs (and the jobs that go with this) may be lost. Allowing for authorised TTFs will also provide industry with the opportunity to convert overseas domiciled funds to a UK domicile and increase market share. The estimated benefit given certain assumptions is £1,064bn additional assets managed into 1,266 tax transparent funds, £325m directly accruing to the investment management industry and £1,592m to wider UK industry.

Other key non-monetised benefits by 'main affected groups'

The UK retains a reputation for innovation and as an international financial centre that is 'pro-business'

Certain classes of tax-exempt investor may reduce tax drag suffered on investments resulting in a transfer of tax from foreign jurisdictions to UK investors.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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0.2% funds under management represent GVA linked to the domicile of the fund (IMA/KPMG report)

Over the coming 10 years:

30% of UCITS domiciled in UK would go elsewhere

25% of UCITS managed in the UK with an overseas domicile could be converted to UK domicile

UK can attract inflows (in domicile terms) of a further £395bn of the EU market of which 10% become FUM

£500 billion non-UCITS domiciled in the UK would go elsewhere out of desire for corporate simplification

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 83	Benefits: 326	Net: 242	No	NA

Evidence Base

Problem under consideration:

Under the current legislative framework in the UK there is not a suitable vehicle (that would be capable of authorisation by the FSA) under which a competitive 'master fund' could be established, as permitted by the EU Undertaking for Collective Investment in Transferable Securities (UCITS) IV Directive (UCITS IV).

A 'master fund' is capable of pooling the investments collected in multiple 'feeder funds' allowing the funds under management to benefit from increased scale and therefore higher returns for the investors. The UCITS IV Directive has been fully implemented in the UK, the requisite changes in legislation and FSA rules came into force on 1 July 2011. In order to be competitive master funds need to be tax transparent. EU jurisdictions including Ireland, Luxembourg and the Netherlands have already recognised such vehicles in their national legislation to increase their attractiveness as a fund domicile.

Rationale for intervention and policy objective:

Presently, vehicles that can be set up for authorised collective investment in the UK are: Authorised Unit Trusts (AUTs) and Open-Ended Investment Companies (OEICs). However, these are unsuitable within a 'master-feeder' structure because they do not benefit from tax transparency. Tax authorities 'look through' Tax Transparent Funds (TTFs) when considering tax liability. They look directly to the investor within the TTF who is then assessed on any income or gains associated with their contribution to the fund. This allows the investor to benefit from any double taxation agreements between their domicile and the jurisdiction in which the collective funds have been invested rather than seeing the fund taxed on income and gains and then being taxed themselves on distributions.

Asset pooling arrangements such as a master-feeder structure are not tax efficient if the master vehicle is opaque for tax purposes as investors effectively suffer double taxation (the master fund is taxed and then the feeder fund is taxed).

The lack of a suitable TTF vehicle for authorised collective investment schemes in the UK discourages fund managers from establishing cross-border master UCITS funds in the UK. Instead such funds are typically established and administered in domiciles that recognise tax transparent vehicles.

UCITS are a type of authorised scheme that can take the form of an AUT or OEIC in the UK. They are the only type of collective investment scheme that can be promoted cross-border to retail investors throughout the EU and EEA as they are governed by criteria and requirements laid down in the UCITS IV directive. The European UCITS market is estimated at €5.6 trillion (Source: European Fund Managers Asset Management Association Statistics Q1 2012). Presently the UK investment managers manage €1.4 trillion of this market but more than half (57%) of that is domiciled outside of the UK (Source: Investment Management Association Annual Report 2011/2012).

As is described in greater detail below, it has been shown that fund domiciles benefit proportionate to the value of funds domiciled in their jurisdiction; a benefit that is incremental to the value added by the actual management activity occurring there.

The policy objective for the Government is therefore to improve the UK's competitiveness as a domicile of choice for funds.

Options considered:

The objective would be achieved, through the introduction of an authorised vehicle for contractual schemes (a type of TTF). These would form a new class of collective investment scheme within the meaning of section 235, Financial Services and Markets Act 2000 (FSMA) and exercise a right, established within UCITS IV, to set up a scheme for collective investment under contract law. Legislative changes would be required to introduce this vehicle.

Further, it is proposed to amend the legislation concerning limited partnerships (the Limited Partnership Act 1907) to enable the FSA to authorise Limited Partnerships as partnership schemes (one form of contractual scheme vehicle).

Legislation would enter into force in 2012 subject to appropriate parliamentary procedure.

This legislative proposal constitutes 'Option 1' for the Government. The Government has also considered the implications of not introducing a TTF vehicle through legislation (i.e. a 'do-nothing' scenario) which is described as 'Option 0' throughout the rest of this impact assessment.

The costs and benefits to stakeholders are set out for both options below on the basis of available information. This has been subsequently validated by industry with some adjustments in relation to their analysis. The level of analysis supplied below which relies on historic available public data as well as estimates from stakeholders is considered proportionate. Industry feedback has led to assumptions being revised from the draft impact assessment. Industry has also reviewed the estimates provided in this impact assessment.

When reading the cost:benefit assessment that follows it is important to do so with the understanding that the proposed legislation confers no obligations on business, rather it will provide businesses with an opportunity. Should businesses choose to take advantage of this opportunity they will do so on the basis that doing so has a positive net present value for them.

Given the use of estimates and assumptions within the calculations rounding has been applied throughout to avoid the impression of spurious accuracy.

Estimated industry benefits:

Policy Option 0

There are no benefits to the industry from doing nothing.

Policy Option 1

There are a number of benefits to the wider UK business community that will accrue from the availability of a TTF in the UK. Quantifying the marginal benefit of increased UK competitiveness from launching a TTF vehicle is challenging particularly for a specific and technical piece of legislation that will depend on voluntary industry uptake to achieve its potential benefits. However, the public consultation with industry suggests that there is a strong desire from participants to have access to such a UK vehicle.

The benefits arise from the marginal benefit of avoiding the flight of funds with a UK domicile and creating the opportunity to capture more than the UK's current 12% market share of the wider European UCITS market. Some industry respondents felt that just making the option available to fund managers in itself would make the UK an attractive domicile for funds separately from take-up as it widened the choice of fund structures available in the UK.

The avoidance of such a flight will translate into retained UK corporate profits, retained UK jobs as well as other intangible benefits to the UK's reputation as an international financial centre of excellence. Responses to the public consultation indicated that industry itself perceived the benefits of asset pooling in terms of cost savings particularly in relation to compliance, lower management fees for investors and greater transparency and governance by fund managers.

Should the UK fail to launch a TTF it is highly probable that this would result in a shift in domicile for those existing funds with a UK domicile to EU jurisdictions that offer a recognised TTF vehicle. Such jurisdictions will likely also capture the domicile for asset pooling vehicles set up in future.

The benefit of fund domicile has been discussed at length in a joint IMA / KPMG report released in November 2007. This report concluded that the gross value added (GVA) by investment management activity could be analysed into variant and invariant categories relative to fund domicile. The major part of GVA by investment management is invariant and therefore independent of domicile. However the analysis showed that 16% of the total expense ratio (TER) levied by a fund manager was linked to fund domicile. This represents necessary administrative spending on services such as fund accounting, legal advice and audit. This spending is generally in the form of payments to local service providers (e.g. law firms) or wages to employees. Therefore there is a clear link to employment and also to corporate profits (i.e. those of the service provider). It is important to note that for the investment manager this spending is not incremental – only the jurisdiction in which the spending occurs changes. The report notes that the UK has a lower average TER than other comparative EU jurisdictions (at the time of the report) so this might imply that some savings could accrue to businesses. However, this is caveated in terms of the different requirements of funds typically domiciled in those two territories so we have not sought to attribute this potential benefit in this impact assessment.

The report demonstrates that 16% of the average TER in the UK can be approximated to 20 basis points of the funds under management. Of this GVA the report asserts that approximately 26% converts to operating surplus (i.e. corporate profit) within service providers. For the purpose of this impact assessment to reflect a prudent approach we have assumed that this is only 10% in our best estimate case. This revised assumption is based on the fact that the split of 74:26 between operating surplus and salaries and wages is an assumption within the report itself.

Further consideration about this 10% estimate did not prove conclusive in determining whether we should revise this assumption up or down. Closer scrutiny into the latest Economic Activity statistics (Source: ONS Blue Book 2012 and ONS Supply and Use Tables) indicate the gross operating surplus could be even higher as a proportion of GVA for the financial sector which includes fund managers. Discussions with the Office for National Statistics suggest the nominal ratio may be higher but not real terms and they agreed it is reasonable to assume that cost inflation and dampened overall revenues are likely to have reduced average net profitability since the KPMG report was published. Some consultation respondents suggested that the actual benefits from tax transparent funds would be subject to diminishing returns to scale over time. On this basis, we maintain our conservative assumption of 10%.

We have set out the risk of fund managers looking to leave the UK and domicile their funds elsewhere. Most respondents to our consultation and general feedback from industry suggested that the failure to introduce tax transparent schemes in the UK would increasingly mean more funds domiciled offshore. The UCITS market in the European Union is estimated to at approximately £5.6 trillion for which the UK is fund domicile to €695 billion (Source: EFAMA Q1 2012 Statistics) in terms of net assets. IMA figures, which are based on a slightly different methodology, show that for total UCITS assets managed and domiciled in the UK is £613bn, while funds managed in the UK with an overseas domicile stand at £765 billion (Source: IMA 2011/12 Annual Survey). On this basis if it were assumed that 30% of current UK domiciled activity would migrate to other EU jurisdictions over the next ten years there would be a net cost to UK business of approximately £184 million. The draft impact assessment had assumed a 50% outflow but feedback we had received from industry suggested that the UK fund domicile would be more competitive than this and therefore revised this downwards to 30%.

Equally, it is reasonable to assume that some investors that have assets managed in the UK would choose a UK domicile. It is likely to be the investment manager that makes this choice but there is an element of 'stickiness' once domiciles are designated. Consultation responses also indicated that major institutional investors such as life insurance funds and pension funds would be likely to require fund managers to manage funds onshore.

We assume that over ten years, a significant proportion of these offshore assets would be managed onshore. Some respondents were sceptical about our initial projections but this did not reflect the overall majority of comments received in our public consultation. The benefit to UK industry of 25% of foreign domiciled UK managed funds transferring to the UK would be approximately £191 million.

Finally, if the UK were able to increase its market share of the EU UCITS market to 20% over ten years that would equate to further 'domicile inflows' of approximately £189 billion and a benefit to UK industry of £335 million. Industry feedback has indicated that fund managers would be likely to launch new funds in the UK while investors are keen to use such a fund structure in order to take advantage of the strong UK regulatory framework. However, some respondents had doubts that the impact would be immediate and suggested that some investors would wait until the scheme was proved to work. So we have delayed this impact for a year in the underlying analysis.

This is demonstrably feasible given that Luxembourg is the market leader in terms of fund domicile in the EU but is not in the top 6 jurisdictions in Europe in terms of funds under management. This demonstrates that an attractive regime for domiciliation can open a jurisdiction to business even where the underlying investment management activity does not move across. Therefore it is reasonable that the UK should expect to increase funds domiciled by more than simply 25% of overseas funds already under management in the UK.

Not incidentally an inflow in terms of domicile would likely be associated with an inflow of funds under management given the UK's predominance in this area and the availability of talented fund managers. Any such inflow would see a direct benefit to industry that could be approximated to 42 basis points of net inflows (from a 1.24% average industry TER and a 34% industry operating profit margin). In the scenario above we assumed incremental inflows over the ten year period of £189 billion in terms of domicile over and above conversion of UK managed funds to UK domicile (the fourth column in the table below). If this was accompanied by just 10% of these inflows also moving fund management to the UK this would equate to a direct benefit to the UK fund management industry of approximately £325million over the period.

Applying these effects in a linear fashion across ten years would mean an additional £380bn assets under UK management and in terms of opportunity cost, an additional £184bn of UK assets under management would be prevented from leaving the UK. Note that in the third column, the impact has been delayed for a year. These flows are set out in the table below, they do not take into account potential growth in the period of funds under management beyond the additional effect we have attributed to the tax transparent funds scheme. For simplicity the flows have been assumed to occur in a linear fashion although in reality they could occur far more quickly following a period of slower initial take-up as suggested by some respondents to the public consultation.

Year	UK domicile outflows (£bn)	UK domicile inflows from UK managed assets (£bn)	incremental UK domicile inflows from non-UK managed assets (£bn)	GVA variant to domicile	GVA impact (£m)	Impact on UK business profits resulting from variant to domicile (£m)	Impact on UK business profits from increased assets under management (£m)	Discount Factor (3.5%)	Annual NPV (£m)	Cumulative NPV (£m)
0	18	19	0	0.20%	0	0	0	1.00	0	0
1	37	38	21	0.20%	75	8	9	1.04	16	16
2	55	57	42	0.20%	192	19	18	1.07	34	50
3	74	77	63	0.20%	309	31	26	1.11	52	102
4	92	96	84	0.20%	426	43	35	1.15	68	170
5	110	115	105	0.20%	543	54	44	1.19	84	254
6	129	134	126	0.20%	660	66	53	1.23	98	352
7	147	153	147	0.20%	777	78	62	1.27	112	464
8	166	172	168	0.20%	894	89	70	1.32	125	589
9	184	191	189	0.20%	1011	101	79	1.36	137	726

In the table above, we apply the economic impact benefits from the transfer of funds into tax transparent fund vehicle into the following year.

Additionally assets managed by the major life insurance groups in the UK are presently estimated to be c. £1 trillion (Source: IMA and CityUK Fund Management 2011 Report). These groups (many of which have grown through merger and acquisition activity) are likely to benefit operationally from asset pooling and therefore make use of a master fund structure. In order to manage their funds in a tax efficient manner for their investors they will need to ensure that any such pooling is performed through a TTF so that the tax implications do not outweigh the operational benefits.

If, conservatively, there was potential for 50% of funds to be pooled within a TTF this gives a figure of £500 billion that would, presently, need to be off-shored from a domicile perspective (for life insurance companies only).

These companies are likely to be able to move their funds over a much faster period given that they are concentrated in large well resourced businesses. Industry feedback has suggested that take-up may be slower than originally anticipated in the draft impact assessment. To reflect this feedback, we have now spread this effect over a four year period: £50bn in the first year followed by £100bn in the following year, £150bn in the following year and £200bn in the following year in order to arrive at an estimate of £500bn to be transferred over four years. This shows a potential cost to wider UK industry of £582 million over the period as shown in the table below.

Year	Outflows averted for UK managed assets able to transfer domicile		Impact on UK business		Discount Factor (3.5%)	Annual NPV (£m)	Cumulative NPV (£m)
	(£bn)	GVA variant to domicile	GVA foregone (£m)	profits (£m)			
0	50	0.20%	-	-	1	-	-
1	150	0.20%	100	10	1.04	10	10
2	300	0.20%	300	30	1.07	28	38
3	500	0.20%	600	60	1.11	54	92
4	500	0.20%	1000	100	1.15	88	180
5	500	0.20%	1000	100	1.19	85	265
6	500	0.20%	1000	100	1.23	83	347
7	500	0.20%	1000	100	1.27	80	428
8	500	0.20%	1000	100	1.32	78	506
9	500	0.20%	1000	100	1.36	76	582

Additionally UK investors whose pension funds currently put assets to work by investing these in an opaque fund structure can suffer a 'tax drag' on their investments. This is because even though the pension fund into which savers have invested are tax exempt the fund their pension fund invests in may not be. It will therefore suffer withholding tax on foreign equity investments as well as potentially tax on income and gains before it can distribute proceeds back to the tax exempt pension fund. This could equally apply to other tax exempt investors (e.g. charities). Whilst many tax exempt investors can eliminate this tax drag through direct investment strategies there is some reason to think that some may currently choose not to do so (for example because they wish to benefit from economies of scale arising from asset pooling, desire exposure to a particular fund or can off-set the loss with securities stock lending income).

Informal consultation with industry has suggested that the potential tax drag may be between 20 and 30 basis points for such investors. An article in Finance Week suggested that on a compound annual basis over ten years this could potentially equate to 5.75% on the initial investment in gains foregone (cumulatively over the ten year period). A UK TTF would provide this type of investor with a fund structure that can provide the pooling benefits whilst preserving the appropriate tax exempt treatment. As it is not possible, at this stage, to reliably estimate the number of tax exempt investors that may be suffering from this tax drag we have not assigned a monetised benefit to these potential increased returns. We do expect that this would be a further driver of take up by industry affording non-trivial gains for end investors.

Estimated industry costs:

Costs of Option 0:

Option zero involves no direct costs for industry. However, there are negative financial and non-financial impacts arising from the pursuit of Option 0 which have been captured as marginal benefits within option 1 as described above.

The UK asset management industry would continue to experience a gradual shift in funds offshore if the tax transparent fund vehicle was not introduced. This would limit the choice for UK institutional investors who have mandates restricting them to UK fund managers. There is an additional opportunity cost for these investors as more attractive tax transparent fund structures are offered in other EU jurisdictions. This conclusion is confirmed by industry responses to the public consultation paper.

Costs of Option 1:

Costs for Option 1 have been split according to whether these are one-off transitional costs or will be recurring. It is important to note that the legislation proposed under Option 1 will simply confer an option on industry to launch TTFs without obliging them to make any involuntary changes to their businesses. Therefore these costs are not imposed by the legislation but may be voluntarily incurred by businesses. There was a strong consensus from consultation respondents that ultimately the costs to industry of the scheme would be voluntary as businesses would not take-up the scheme unless it was commercially viable and attractive to them.

Some respondents to the consultation indicated that there may be costs for industry in re-considering their fund structure in light of new options, but others indicated they would be doing this anyway due to known regulatory changes including the transposition of the Alternative Investment Fund Managers Directive. We have therefore assumed these costs are directly included in the analysis we outline below.

Further, our working assumption is that if this option is not available to fund managers in the UK they are likely to domicile funds in jurisdictions that recognise TTFs and therefore would incur the majority of these 'costs' in any case but without the UK seeing the benefit of the funds remaining UK domiciled as outlined above.

Legislation will create the option for fund managers to set up tax transparent fund vehicles. They will incur one-off set up costs if they choose to do so. These costs have been estimated to be in the range of £50-100k per fund established based on informal discussion with professional advisors and the fact that billing rates may range between c. £100 and >£1,000 per hour based on the seniority of resource applied by such firms to provision of advice. In the absence of final FSA rules and the publication of the tax regulations, we based our estimates on the cost of establishing similar structures in Ireland or Luxembourg and these costs were confirmed by some key industry stakeholders as broadly in line with their expectations subject to the final form of FSA rules and tax regulations being confirmed.

We have assumed that approximately £1.1 trillion of assets would make use of a UK TTF vehicle over the ten year period. We estimate that these would be spread across approximately 1,266 funds. This is based on the mean fund value estimate in the IMA Annual Survey of £280m (and the assumption that a TTF would comprise approximately 300% of the current mean, i.e. it would pool three feeder funds); given that our analysis is predominantly based on the largest fund managers it is conceivable that their mean fund size would be larger than the industry average. Therefore the 1,266 figure may represent an overestimate (relative to the £1.1 trillion of converted funds). The creation of 1,266 funds would confer a cost to industry in a range of £63-128 million (constant prices) using the assumed range above. On this basis we have assigned a best estimate of £96 million as a one-off, optional, transitional cost to industry. This estimate is around £83m in present value terms over ten years. This is despite the fact that, as many of these funds would be established within the same corporate group, it seems likely that some cost synergy would be achieved. We have spread this transitional cost over the period years in the same proportion as for the assumed flows.

We estimate that transitional costs to the FSA of making relevant changes to their rules could be achieved within existing resource, although this will mean that other work is deprioritised, therefore there is no monetised transitional cost for the FSA. However, firms will have to have their TTFs authorised by the FSA. The cost of applying for authorisation is included in the set up costs above.

Annual recurring costs:

Funds that are set up will require administration which will confer costs on fund managers. These costs will only be incurred on a voluntary basis. The costs should be seen as the natural costs that any increase in volume or business activity necessarily entails. They would be more than off-set by the fees generated from managing the assets within the tax transparent funds. The costs are inherently included in the calculation methodology to establish the benefit as this incorporates firms' operating profit margin to get to a net operating profit figure.

The government has assumed that supervision of the UK domiciled funds by the FSA would entail some incremental costs in relation to resourcing. It has not been possible, at this time, to reliably estimate these costs. The FSA applies a risk-based approach to allocation of its resources. However, it is the case that the costs associated with additional supervision by the FSA will not be material to the overall NPV assessment of these proposals.

Impact on micro-businesses:

The proposal confers no mandatory costs on micro-businesses and therefore there is no compliance cost. The intention of the proposal is to provide an opportunity to industry on a voluntary basis to benefit from the availability of a TTF vehicle that can be authorised by the FSA. Applying an exemption from the force of the regulations to micro-businesses would be prejudicial to their interests as it would prevent these businesses from making use of the opportunity. Micro-businesses that choose to take advantage of the opportunity will inherently have considered any associated costs as being outweighed by the benefits. In addition we have consulted with the industry association and believe that the number of micro-businesses potentially affected is four.

One in One Out:

The consultation stage Impact Assessment said the policy was in scope of the One In One Out rule. This was incorrect since the measure takes advantage of a derogation as part of completing the transposition process for a European directive (UCITS IV). Taking advantage of the derogation is necessary to meet the standard expected for transposition and is therefore should be out of scope of One In One Out.

The measure is also voluntary. The measure will establish TTF vehicles which businesses can choose to use but will not be compelled to. It should also be out of scope of One In One Out on this basis.

This change of view has been agreed with the Better Regulation Executive. As a result this measure was not put on the Statement of New Regulations 4, although it is intended to come into force in 2012.

Equalities Impact

The Government has considered the proposed reforms in relation to its public sector equality duties under the Equality Act 2010. It has concluded that no relevant issues arise. It does not think the regulations will have an impact on discrimination, equality of opportunity or good relations between people who share relevant protected characteristics under the act.

Risks and assumptions:

Assumptions have been highlighted throughout the cost:benefit calculations presented above.

The launch of a TTF vehicle also has associated risks although these are considered improbable. A major risk is that the TTF fails to gain the take-up of industry. This could occur if another jurisdiction was able to make their TTF demonstrably more attractive than that of the UK. The legislation has been drafted taking into account consultation responses so as to ensure that the vehicle would be commercially viable.

Summary:

In summary HMG believes that the benefits of launching a recognised TTF in the UK significantly outweigh the associated costs. The proposal will be implemented through secondary legislation in H2 2012

		Direct cost to fund industry	Direct benefit to fund industry	Indirect benefit to wider UK industry	Total UK industry benefit
		£m	£m	£m	£m
(A)	GVA not forgone through retention of UK domiciled existing funds			£331	
(B)	GVA gained from conversion of UK managed funds to UK domicile			£344	
(C)	GVA gained from attracting non UK managed funds to UK domicile			£335	
(D)	life insurance asset transfers			£582	
(E)	Increase in fund management profits from conversion of 20% of (C) to UK management		£325		
(F)	Transitional cost of setting up UK TTFs	(£83)			
	Total				£1,835

Supplementary Information on the Derivation of the Figures within the Impact Assessment

This paper summarises the costings which have been outlined in the summary pages of the impact assessment and how they have been derived. This paper is a supplement to the Tax Transparent Funds Impact assessment submitted on the 16th August to the Regulatory Policy Committee.

There is a summary of the quantitative costs and benefits of tax transparent funds at the end of the submitted impact assessment which tallies with the figures in the first two pages of the impact assessment. The following sections will set out in further detail more of the workings.

		Direct cost to fund industry	Direct benefit to fund industry	Indirect benefit to wider UK industry	Total UK industry benefit
		£m	£m	£m	£m
(A)	GVA not forgone through retention of UK domiciled existing funds			£331	
(B)	GVA gained from conversion of UK managed funds to UK domicile			£344	
(C)	GVA gained from attracting non UK managed funds to UK domicile			£335	
(D)	life insurance asset transfers			£582	
(E)	Increase in fund management profits from conversion of 20% of (C) to UK management		£325		
(F)	Transitional cost of setting up UK TTFs	(£83)			
	Total				£1,835

Total Net Present Value - £1,835m

In the above table, the figure of £1,835m is derived from the summation of benefits in the second and third columns and subtracting the costs in the first column.

On the second page, the net present value is adjusted to take account of the low and high estimates of business costs. The high and low costs are outlined a little later.

Business Net Present Value - £242m

The business net present value figure of £242m is derived from the available firm level analysis. There are only items in the above table which are at a firm level, item (E) and item (F). The increase in fund management profits of £325m is offset against the estimates of transitional costs voluntarily incurred by fund managers in setting up the funds £83m to make £242m. It should be noted that £83m is the median estimate of business costs.

Total Benefit - £1,918m

The total benefit present value is derived in summary from all the present value benefits identified. This should be the sum of the second and third columns in the above table. The detailed derivation of the present value of total benefits is outlined in a supporting spreadsheet where the annual average benefits have been calculated in constant prices.

We have indicated that the annual total benefits are estimated at £238m but this is not calculated as if it was spread over ten years and in present value terms. The table of benefits shows some benefits

are spread over ten years while others are spread over less so £283m is an *averaged* figure across ten years.

Total Cost to businesses- £83m

The total cost figures within the text makes reference to an endogenously determined cost. The following figures set out how the costs have been determined and then applied.

Derivation of the Number of Companies - £1064bn in 1,266 tax transparent funds

Within the analysis, we assume by the end of 10 years there will be an additional £1064bn in assets managed in the UK through the various benefits. To recap the total assets expected to be used within tax transparent funds, we said

- £184bn “created” from funds that would otherwise have gone offshore
- £191bn from offshore assets managed by UK fund managers moved onshore
- £ 189bn from UK market share growing to 20% of UCITS funds
- £500bn from assets transferred by life insurance groups

We have assumed that the average feeder fund size was £280m and three feeder funds would be pooled in order to make a typical tax transparent fund of £840m. These assumptions were based on industry discussions and also the average size of a UK domiciled fund as disclosed in the IMA Annual Survey of Fund Managers. The figure of 1,266 new tax transparent fund vehicles is a calculation of (total funds created / typical TTF size) or £1064bn in potential assets divided by £840m.

Derivation of Maximum and Minimum Costs

Calculation of the maximum and minimum business costs was based upon ranges. Within the text, we said the costs would be £50,000-£100,000 per fund established with billing rates of between £100 and £1,000 per hour. We calculate the staff cost of one hour and the costs are one-off.

The constant price figures of £63m-£128m are simply the multiplication of the total one-off costs by the number of tax transparent fund vehicles expected to be created. These are then linearly distributed over ten years with present value calculations applied at a discount rate of 3.5%.

Range	Hourly Rate	Non-Staff one-off costs	Constant Prices	Present Value
Low	£100	£50,000	£63m	£55m
High	£1,000	£100,000	£128m	£111m

Total Benefit to businesses- £325m

If 10% of the incremental increase in assets of the UK’s “market share” of domiciled UCITS funds was attributed to fund managers themselves moving to the UK then it would result in industry benefit of £325m. This was based on the assumption that 42bps of net inflows could be approximated as the direct benefit to industry based upon the methodology of the KPMG report on the impact of fund management to the UK economy.

Derivation of the additional assets accrued from a market share of 20% in ten years

Data from the European Fund Managers Association¹ based upon Q2 2012 (the latest available information) indicated that there was €5.6 trillion in assets managed in UCITS funds domiciled in the EU. There was €695m funds domiciled in the UK and we already suggested at this point that £191m was already being onshored into the UK. Using an exchange rate of €1.19 per £, we determined that there was an additional £189m of fund assets to be transferred to a UK domicile.

Converting additional UK assets into an industry benefit


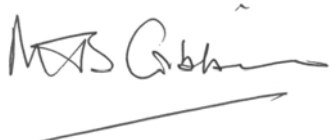
We assume slow take-up and that funds will be transferred after a year to obtain market share resulting in the third row. This is calculated by dividing the £189bn expected to be transferred by the remaining years on a cumulative basis.

To convert the additional accumulated assets into an industry benefit accrued from increased fund management in the UK, we then calculate 42bps of 10% of the assets transferred in each year in constant prices to obtain the fourth row. The next two rows then convert the same benefit into present values using the discount rate of 3.5% and then calculated as a cumulative benefit.

Year	0	1	2	3	4	5	6	7	8	9
Discount rate (1dp)	1.0	1.0	1.1	1.1	1.1	1.2	1.2	1.2	1.3	1.3
Inflows to 20%	0.0	21.0	41.9	62.9	83.8	104.8	125.7	146.7	167.6	188.6
Constant Prices Benefit	0.0	8.8	17.6	26.4	35.2	44.0	52.8	61.6	70.4	79.2
Present Value Benefit	0.0	8.5	16.5	23.9	30.9	37.5	43.6	49.5	55.0	60.2
Cumulative Value Benefit	0.0	8.5	25.0	48.8	79.7	117.2	160.8	210.3	265.3	325.6

Rounding at the bottom section means that we have taken a value of £326 in the benefits section at the bottom of page 2 for the sake of accuracy.

¹ <http://www.efama.org/statistics/SitePages/European%20Quarterly%20Statistical%20Release.aspx>

 Regulatory Policy Committee	OPINION	
Impact Assessment (IA)	Contractual Scheme Regulations	
Lead Department/Agency	HM Treasury	
Stage	Final	
Origin	European	
IA number	HMT 1204	
Date submitted to RPC	16/08/2012	
RPC Opinion date and reference	25/09/2012	RPC11-HMT-1150(2)
One-In, One-Out (OIOO) Assessment	GREEN	
<p>The IA says the proposal is out of scope of OIOO as <i>‘the measure takes advantage of a derogation’</i>, which is appraised to be beneficial to business. This is in accordance with the current One-in, One-out Methodology (paragraphs 22-24).</p>		
<p>Overall quality of the analysis and evidence presented in the IA</p> <p>The IA explains how the proposal intends to improve the UK’s competitiveness as a domicile of choice of funds, by improving the tax transparency of the fund management industry. The department has provided us with additional information which sets out more clearly how the additional impacts of the proposal have been estimated. This should be included in the IA prior to publication. The IA would benefit from clarifying how the benefits to the fund industry interrelate with those that accrue to the wider UK industry (page 10). This would help show that there is no element of double counting and therefore that the benefits have been assessed adequately.</p>		
Signed 	Michael Gibbons, Chairman	