What the Edinburgh Reforms mean for private markets

Chancellor Jeremy Hunt has unveiled a raft of financial services reforms designed to boost growth and develop a smarter regulatory framework in a post-Brexit UK. In a written statement to Parliament on 9 December 2022, Hunt outlined 30 reforms which, he hopes, will hand power over to the UK's financial regulators, and away from existing laws inherited from the EU.

Hunt will hope this programme of reforms transforms the UK into the world's most innovative and competitive global financial centre. But what do these reforms mean for the future of the UK funds industry and more specifically, for private markets participants? **Paul Harrison** shares his thoughts.

Chancellor Jeremy Hunt's plans to transform the UK into an open, sustainable and technologically-advanced financial centre are certainly welcomed. Hunt wants a UK financial centre that's globally competitive and acts in the interests of communities and citizens, creating jobs and supporting businesses, but will these changes achieve that? Do they go far enough?

A Government on a mission

The reforms aim to cement the UK's position as a formidable financial services centre outside of the EU. With a robust framework of financial services regulation, a dynamic, stable and competitive market can develop and thrive in the years ahead. There are more than 20 reforms aligned to regulatory change in the Chancellor's statement, some of which are of particular interest to private markets, such as the plan to repeal the Packaged Retail and Insurance-based Investment Products (PRIIPs) regulation.

End of an era for ELTIF, and the rise of UK LTAFs

Meanwhile, plans to repeal the EU's European Long Term Investment Fund (or 'ELTIF') regime, in the hope that the UK's own Long-Term Asset Funds ('LTAF') legislation will be a better structure for the alternatives market, is the most eye-catching reform of all. This doesn't seem to be a full-scale ripping up of the EU's regulatory framework, which is a positive step for encouraging investment coming from both mainland Europe to the UK, and vice versa. The Government has confirmed that the first LTAF is now established, and we will monitor with interest if its usage widens, exposing more of the retail investor ecology to alternative investment, where tokenisation could become an enabler.

The Chancellor has also pledged to improve tax rules for Real Estate Investment Trusts (REITs) with effect from April 2023. New rules will remove the requirement for a REIT to own at least three properties where they hold a single commercial property worth at least £20 million. This is expected to increase the number of investment companies eligible for REIT status and would therefore be exempt from UK corporation tax on the income and gains of their property rental businesses.

Finally, we’re encouraged by the Government’s intention to consult and then – presumably – review the VAT treatment of the Fund Management industry. The VAT recovery levels of both funds and Fund Managers have long been an incentive for the offshoring of the domicile of alternative investment funds, removing the taxable benefits of onshoring the industry. A sensible review and change to tax legislation in the UK could have a fundamental effect on the attractiveness of using the domicile for larger commitment funds. This could have far-reaching consequences.

ESG takes centre stage

Part of the Edinburgh Reforms aim to ensure that the financial system in the UK remains a world leader in sustainable finance. This means playing a major role in the delivery of the UK’s Net Zero target. For private markets, this means doubling down on Net Zero commitments in line with the Paris Agreement, and properly integrating Environmental, Social and Governance (ESG) factors into investment decision-making. The UK became one of the first countries to endorse Task Force on Climate-Related Financial Disclosures (TCFD), an influential initiative within this space, where we’ve seen a large proportion of private sector engagement. These disclosures enable companies to integrate environmental considerations into business practice, further confirming the statement that climate change is no longer an optional consideration.

Investing in innovation

Technology and innovation has long been a key component of financial services, and the Chancellor's reforms will aim to keep things that way. The Government wants a regulatory framework that supports innovation, facilitating swift adoption of cutting-edge technologies. This includes creating a safe regulatory environment for stablecoins – which can be used for payments – as well as covering a broader range of crypto asset activities.

Alongside the Bank of England, the Government will be consulting on a UK retail central bank digital currency in the coming weeks. It will also publish a response to the consultation on expanding the Investment Manager Exemption to include crypto assets. A Financial Market Infrastructure Sandbox is expected to be implemented in 2023 while a new class of wholesale market venues will be trialled by regulators and market participants, which would operate on an intermittent basis.

These recent and upcoming changes will strengthen the direction we're seeing to open up the marketplace and we will see new fund structures that encourage a new generation of investors. The acceleration and introduction of tokenisation, digitalised platforms and digital currency is set to transform the industry in the next five years.

There was much to digest in the Chancellor's Edinburgh reforms, but his intentions to reset the UK financial sector in this post-Brexit landscape seem clear for all to see.