THE UK TAX TRANSPARENT FUND

JULY 2014

FOR PROFESSIONAL CLIENTS ONLY
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>4</td>
</tr>
<tr>
<td>Executive Introduction</td>
<td>5</td>
</tr>
<tr>
<td>Executive Summary</td>
<td>6</td>
</tr>
<tr>
<td>Overview of Tax Transparent Pooling Structures in EMEA</td>
<td>7</td>
</tr>
<tr>
<td>The UK Tax Transparent Fund</td>
<td>9</td>
</tr>
<tr>
<td>The BlackRock UK TTF</td>
<td>11</td>
</tr>
<tr>
<td>The BNY Mellon Operational Perspective</td>
<td>12</td>
</tr>
<tr>
<td>Conclusions and Possible Future Developments</td>
<td>13</td>
</tr>
<tr>
<td>Contacts</td>
<td>14</td>
</tr>
</tbody>
</table>
We are delighted to see the launch of the first UK Tax Transparent Fund (TTF) within a year of the enactment of the regime in July 2013. UK domiciled funds have been a focus of government strategy on financial services in recent years. The government estimates that over 16,000 jobs in the UK are linked to UK domiciled funds alone. Over the last 18 months many improvements have been made to ensure that UK funds remain competitive for the investment and savings environment of the 21st century. The launch of the UK TTF was a significant step to ensuring the UK is the domicile of choice for fund promoters and investors in funds.

UK TTFs offer investors the benefits of collectivised investment alongside tax transparency – the ability to preserve the tax status of the investor in relation to the investments made by the fund. This is attractive to many investors including, for example, pension funds that can retain the benefits that are afforded to them by tax treaties and by many tax regimes throughout the world.

The success of UK domiciled funds relies on the strength of the UK’s legal and regulatory framework for investment. These factors are critical for UK TTFs where the UK has learnt to build on the experience of similar funds in Luxembourg and Ireland. The UK has built a regime for contractual funds that combines legal certainty with the safeguards of a robust and fair regulator, and the benefits of the UK’s tax treaty network.

The requirement for a UK TTF in the form of the Authorised Contractual Scheme originally came about to enable UK domiciled master-feeder fund structures, introduced into the retail market by UCITS IV. The original HM Treasury consultation document highlighted the potential benefits to investors: economies of scale and reduced management fees and costs, greater investment diversity, and enhanced returns. These are qualities that all investors want from their choice of funds and which all fund promoters seek from their fund ranges. With the addition of UK TTFs we can continue to look to the UK to provide the right environment for investment in funds.
EXECUTIVE INTRODUCTION

The introduction of the UK Tax Transparent Fund (TTF) regime in July 2013 brought the UK into line with the other European fund centres, creating a UK domiciled tax transparent pooling structure.

Investors today face an ever increasingly complex world and the delivery of a simple, transparent, tax efficient solution has arguably never been more important. We believe that the introduction of this new structure by HM Treasury last year creates the future roadmap for mutual fund pooling in the UK. Clients will no longer be forced to utilise fund structures as a result of their individual tax circumstances and will instead be able to consolidate assets to maximise economies of scale.

BlackRock is delighted to have worked with BNY Mellon to launch the UK’s first TTF. Our clients are, quite rightly, increasingly demanding enhanced efficiencies from their investments. At BlackRock, we are able to draw upon our experience managing similar products and are pleased to offer our clients the best of both worlds – the benefits of a pooled investment vehicle within a tax efficient structure combined with our expertise of managing these types of portfolios.

As is highlighted later in this paper, we expect a number of investor types to be interested in the UK TTF, from pension funds and insurance companies seeking to limit tax drag while achieving the administrative and scale benefits of pooling, to UCITS funds with similar strategies seeking to consolidate management in a single tax transparent master fund. In addition, the ability of UK-based fund originators to launch UK domiciled TTFs is likely to be attractive to both local management companies and local investors. Anecdotal evidence from our clients to date certainly suggests a growing interest in the use of the UK TTF.

From BNY Mellon’s perspective, we are delighted to further expand our relationship with BlackRock in providing custody, fund administration and trustee services to its BlackRock ACS US Equity Tracker Fund, the first UK TTF in the market. Tax transparent pooling across Europe has increased significantly over the past decade, and with the introduction of the UK TTF, that trend looks set to continue.
EXECUTIVE SUMMARY

Despite being one of the largest fund centres in Europe, the UK had previously lacked a tax transparent pooling vehicle similar to those available in other major fund jurisdictions.

After a period of consultation by the UK government, this changed from 1st July 2013 with the introduction of the UK TTF. Now, almost exactly a year after the commencement of the regime, the first UK TTF, BlackRock ACS US Equity Tracker Fund, has been launched.

Tax transparent pooling allows investors to access the same double taxation treaty benefits which would have resulted from investing directly in the fund’s underlying assets, while achieving the scale efficiencies of investing alongside others in a pooled fund vehicle. Fund managers operating funds with similar strategies in different jurisdictions may also consider the use of a TTF as a master fund in a UCITS master/feeder structure.

Because of the possible range of different investor types in a TTF, both in terms of jurisdiction and tax profile, operational complexities can arise in running TTFs. The interaction of the custodian, transfer agent and fund administrator is therefore fundamental, to ensure that withholding tax is correctly applied based on the ownership of each investor type at the time of each income event.

TTFs in Luxembourg, Ireland and the Netherlands have historically been widely used by pension funds in particular, and it is UK pension fund clients which will invest initially in the BlackRock ACS US Equity Tracker Fund. UK pension funds are entitled to a 0% withholding tax rate on dividend income under the UK/US double taxation treaty. Therefore, the appeal of investing via a tax transparent pooling vehicle, as opposed to a tax opaque vehicle where rates of up to 30% withholding tax could be incurred, is clear.

The success of TTFs has been a real feature of the fund industry over the past decade. Indeed, BNY Mellon already supports over 165 European Contractual Vehicles, with over US$167 billion of assets under custody and/or administration between them*.

The UK government certainly intends that the UK TTF, with its different options of legal and regulatory profile, will allow the UK to increase its share of this market. Early indications show that there is a good degree of interest in launching UK TTFs. Time will tell whether these will continue to appeal primarily to domestic investors, or whether they go on to gain wider cross-border appeal.

*Source: BNY Mellon; As at June 2014 BNY Mellon had US$167 billion in assets under custody and/or administration in respect of tax transparent funds.
OVERVIEW OF TAX TRANSPARENT POOLING STRUCTURES IN EMEA

WHAT IS A TAX TRANSPARENT POOLING VEHICLE AND WHAT ARE ITS BENEFITS?
Pooling is the term used to describe the aggregation of different investors' assets into a single fund vehicle. It offers investors the opportunity to diversify their portfolio and spread portfolio risk, to achieve centralised administration, enhanced governance and risk management, and cost savings from economies of scale.

Pooling can take place through a vehicle which is opaque for tax purposes, or one which is regarded as tax transparent.

The pooling of assets in a fund which is transparent for tax purposes means that income and gains from investments made by the fund accrue to each investor in proportion to their holding in the fund, without changing their character, source and timing. In other words, the fund is “looked through”, and investors are treated for tax purposes as if they held their proportionate share of the underlying investments directly.

The benefit of this is that investors should be able to access the treaty benefits of their home jurisdiction, provided that both the jurisdiction of the investor and investment view the fund as tax transparent. Where viewed as tax transparent, this will allow investors to take full advantage of the relevant double tax agreement as if they had invested directly, while achieving the administrative benefits and scale efficiencies of pooling.

Where the pooling vehicle is regarded as tax transparent, withholding tax rates are applied based on the double taxation treaties concluded between the country of the investor and the country of the underlying investments. This allows investors such as pension funds, which are often eligible for a reduced withholding tax rate, to benefit from that rate as if they held the investments directly. The difference between withholding tax rates for pension funds investing in US equities via a tax transparent and non-tax transparent vehicle can be up to 30 per cent and points to the clear advantage of a tax transparent pooling vehicle in such a case.

In addition, it is usually preferable that the master fund in the master/feeder structure introduced by the UCITS IV Directive is tax transparent, in order to be attractive to feeder funds in different jurisdictions with different tax profiles.

(continued on page 8)
Transparent pooling vehicles have been available in Europe for many years, the most widely used are the Irish Common Contractual Fund (“CCF”), Luxembourg Fonds Commun de Placement (“FCP”) and Dutch Fonds Voor Gemene Rekening (“FvGR”).

In launching the new UK TTF, HM Treasury made it clear that the TTF was intended to compete with tax transparent funds available outside the UK. Since the launch of the UK TTF in July 2013, a further type of tax transparent fund, the German Kapitalanlagegesetzbuclh (“KAGB”), has been added to the range of such vehicles in Europe.

GROWING MARKET INTO TRANSPARENCY
The ability to achieve a range of operational and cost efficiencies while not creating the tax drag, which may otherwise be involved with the use of a non-tax transparent pooling vehicle, has undoubtedly contributed towards the growing market in tax transparency over the past decade. In that time, the number of tax transparent funds has increased significantly. BNY Mellon now supports over US$167 billion of assets under custody and/or administration in TTFs across Europe."

*Source: BNY Mellon; As at June 2014 BNY Mellon had US$167 billion in assets under custody and/or administration in respect of tax transparent funds. The breakdown is as follows: 100 FvGRs US$51bn; 2 CCFs US$1bn; 49 FCP US$15bn*
THE UK TAX TRANSPARENT FUND

OBJECTIVE OF HM TREASURY
According to the HM Treasury document “Consultation on contractual schemes for collective investment” published in January 2012, the UK Government’s main objective for introducing the new scheme was to “ensure that the UK is able to compete to win an appropriate share of European pooled funds as UK domiciled funds and to consolidate the UK’s position as the largest asset management centre in Europe”.

After a period of consultation widely supported by the asset management industry in the UK, the new UK Authorised Contractual Scheme, commonly known as the UK TTF, was launched in July 2013. The contractual scheme rules provide for two different legal structures and three different regulatory statuses.

LEGAL/REGULATORY STRUCTURES
Two types of schemes exist: the co-ownership scheme and the limited partnership scheme.

The co-ownership scheme was a new type of structure in the UK, and a partnership was previously only available for use as an unauthorised vehicle.

The co-ownership scheme will be treated as fiscally transparent for income purposes, but as opaque for UK capital gains purposes. This means that the UK investor’s capital gains asset is its holding in the fund, rather than its share of each of the fund’s investments. The partnership scheme will be treated as fully tax transparent by HMRC for both income and capital gains purposes.

In making two different structures possible, the UK government aimed to create a best in class vehicle, giving different investor types a choice as to the type of vehicle which best suited their requirements from both a tax and an operational perspective.

Along with other types of regulated fund in the UK, the TTF can have one of three regulatory statuses: UCITS, non-UCITS retail scheme (NURS) or qualified investor scheme (QIS), depending on the fund’s intended strategy and investor base.

WHO MIGHT BE INTERESTED IN USING A UK TTF?
A UK TTF might be suitable for large institutional investors like Pension Funds and Insurance Companies looking to maximise their withholding tax treatment in a cost efficient pooled fund structure. It may also be attractive to Charities and Sovereign Wealth Funds looking to capitalise on the scale efficiencies of pooled fund usage. It is unlikely to be suitable for retail/individual usage, unless investing via an appropriate feeder fund.

(continued on page 10)
The UK tax authorities and dialogue with overseas tax authorities is essential for the success of the UK TTF.

Factors Influencing TTF Location
A decision on the type of tax transparent fund to use may not only be influenced by the advantages and disadvantages of each product itself, but also by other related factors. For example, the strategic location of the management company may be a determining factor, as may the location where the company has the most knowledge and expertise in tax transparent pooling concentrated. This may be important for the development of the UK TTF as the UK investment management industry is already very competitive globally.

Early indications are that there is a good degree of interest in launching UK TTFs. Time will tell whether these will continue to be marketed primarily towards single jurisdictional (UK) investors, or whether they will gain cross-border appeal. Key in both scenarios is that the countries in which the UK TTF invests and the country of the investor both recognise the vehicle as tax transparent in order to allow investors to obtain the full benefit of the relevant double tax agreements.

The UK tax authorities are very keen that this should be the case and that the UK TTF should be treated for tax purposes on at least an equal footing with the other types of tax transparent fund vehicles already in existence. Therefore, the continued support of the UK tax authorities and dialogue with overseas tax authorities is essential for the success of the UK TTF.
BlackRock has launched the UK’s first TTF as a UCITS fund under an Authorised Contractual Scheme (ACS) umbrella.

BlackRock believes that the new structure is an important first step in the creation of a new generation of tax efficient solutions for UK investors. BlackRock believes that acting as a fiduciary to their clients should be at the very heart of their business and are therefore constantly striving to be at the forefront of the development of new products for their clients.

The new structure allows investors to take full advantage of their individual tax position and to access double taxation treaty benefits as if they had invested in the fund’s underlying assets directly. Such transparency has been absent from the UK market in the past. Investors in the Fund must be Eligible Investors as defined in the ACS prospectus and must have completed all relevant documentation prior to the purchase of units in the Fund.

In contrast to life funds, the TTF will attract lower capital charges as legislation requires insurers to apply a look through when calculating regulatory capital. In addition, there may be ancillary benefits that accrue to users of TTFs for instance, fund management fees charged to TTFs are exempt from VAT. The new vehicle also offers the ability to pool assets from different types of clients, which can result in economies of scale.

The first sub-fund in the umbrella is the BlackRock ACS US Equity Tracker Fund, which takes the form of a co-ownership scheme. This means that any sub-Fund of this investment vehicle may be treated as tax transparent for the purpose of income and gains across relevant jurisdictions. The Fund aims to achieve capital growth for investors by tracking closely the performance of the FTSE USA Index by investing in companies in the Benchmark Index. The FTSE USA Index is a free float-adjusted market capitalisation weighted index representing the performance of US-listed large and mid-cap stocks. The Benchmark Index is part of the FTSE Global Equity Index Series, which covers 90% - 95% of the investable market capitalisation.

The Fund will invest directly into the Benchmark Index’s constituent companies, as well as using other transferable securities that give exposure to such companies. The BlackRock ACS US Equity Tracker Fund may also invest in permitted money-market instruments, permitted deposits, and units in collective investment schemes. Derivatives and forward transactions may be used for the purposes of efficient portfolio management.

While BlackRock’s first TTF accepts minimum investment of £50m, making it a vehicle more easily accessible predominantly by larger clients such as pension funds, BlackRock will be looking to provide access to a broader range of clients over time. As the mechanics of the TTF structure evolve, it is also BlackRock’s intention to seek to provide access to a broader range of investable assets.
A number of complexities arise from the operation of a tax transparent pooling vehicle, and addressing these requires the interaction and alignment of the global custodian, fund administrator and transfer agent.

The transfer agent or fund accountant (depending on the model) will need to confirm to the global custodian the percentage ownership of fund units by each different investor type. This is so that the ownership of securities and resultant income entitlements can be correctly allocated to each different category of investor, and withholding tax applied based on their individual tax profiles.

As a result, it is important that as ownership ratios change, whether through subscriptions or redemptions by participating investors, these changes are tracked and communicated to the global custodian, and, in turn, that the income entitlements of each investor are updated. This takes place through a number of notional trades between the various participating investors and is known as rebalancing.

As withholding tax is applied by the global custodian based on investors’ individual tax profiles, it is usual for the TTF to have separate share classes, one for each investor tax profile respectively. This could be done by allocating a class of share to each category and location of investor, but the method needs to be fair to all categories of investor. There may also be various shares in different currencies incorporated. In all cases, distributions by the fund will need to follow the share class allocation which is adopted.

For fund administration and accounting, there needs to be tax tables within the accounting function to reflect the withholding tax attributed in the custody model, in terms of the country and tax profile of investor, the country of investment, and the type of security invested in. The net asset value of the fund needs to include and reflect these various tax rates.

Fund accounting will, as for an opaque fund, pass the price (which may be calculated daily – or other frequency as per the fund prospectus) of the units to the transfer agency in order to arrive at the percentage ownership referred to above. This ownership calculation may be carried out by either fund accounting or the transfer agency through sharing of fund price and investor unit information.

In order to achieve economies of scale in terms of operational cost, a third party administrator is often used to provide the services described above.

BNY Mellon has extensive experience in pooling across Europe and each pooling structure needs to be considered on a case-by-case basis to accommodate the requirements of each individual scenario.
CONCLUSIONS AND POSSIBLE FUTURE DEVELOPMENTS

With the advent of the UK TTF, there is a significant new alternative in tax transparent pooling. The UK is an important centre for fund management globally and the launch of the first UK TTF, with others expected to follow, points towards UK TTFs being able to compete with other more established TTFs in the market.

Fund managers may also consider the UK TTF as an alternative to certain types of tax opaque funds in the UK used by tax exempt investors. For example, a UK TTF may have the advantage over an unauthorised unit trust of allowing exempt investors to retain the beneficial withholding tax rates they are entitled to where they hold (or are deemed for tax purposes to hold) underlying investments directly.

It is also possible, and we have already seen some evidence of this, that the renewed interest in tax transparent pooling generally with the introduction of the UK TTF, could give rise to further interest in other European Contractual Vehicles such as Irish CCFs and Luxembourg FCPs.

Ultimately, the decision for fund managers and investors on whether to use a TTF, and if so, which type, may be down to which is the most efficient and realises the most cost savings and improved returns. However, local experience and knowledge of the fund originator is also likely to be an important factor in deciding the location, as is choice in the legal and regulatory structure of the fund, so that it can be designed to best suit the tax and operational requirements of different investor types.

In this regard, the UK is well placed to claim its share of the TTF market. This was certainly the aim of the UK government in introducing the UK TTF, and early indications are that its introduction will prove a success.
BNY MELLON CONTACTS

Mariano Giralt
Head of EMEA Tax Services, BNY Mellon
mariano.giralt@bnymellon.com
+44 20 7163 6463

Chris Mitchell
Head of UK Tax Services, BNY Mellon
christopher.mitchell@bnymellon.com
+44 20 7163 3016

Steve Punshon
Global Head of Accounting Product, BNY Mellon
steven.punshon@bnymellon.com
+44 20 7163 5810

Bronwen Noble
Senior Manager, EMEA Tax Services, BNY Mellon
bronwen.noble@bnymellon.com
+44 20 7163 7758