CENTRE FOR A Better Britain

Boosting Britain

A blueprint for radical financial and tax reforms to improve economic growth

Author and project manager: James Mackenzie Smith

Foreword

This paper was a response to a simple exam question: How do we fix our financial and tax architecture to get Britain growing again and free household incomes from the stagnation they have experienced since the 2008 financial crisis? While financial reform is not the entire answer to Britain's economic challenges (a reformed energy market stands out as another essential area, and is another focus for CFABB), it is certainly one of the key pillars on which any revived economy must stand.

While it would be trite to summarise an almost 200-page document in a line or two, central to this report is correcting the UK's attitude to risk - we have over-learnt the lessons of the financial crisis and need to get back to a more robust way of governing our economy, freeing those who are able to take risk to take it whilst continuing to protect the most vulnerable, rather than trying to eliminate risk from the entire system. And yes, this will mean more tolerance of creative destruction, which is the essence of a free-market economy - something we as a nation appear to have forgotten.

The paper has been contributed to by a range of experts from across the political spectrum. These experts and practitioners have given their time for free across four working groups and a steering committee over nine months and we at CFABB cannot thank them enough. Many are listed by name in the acknowledgements; others have chosen to stay anonymous.

I would also like to thank our Head of Policy, James Mackenzie Smith, for his tireless and expert work in marshalling differing perspectives to make them complementary, and ultimately to create this formidable document.

While we believe that the multiple reforms suggested form a compatible and cohesive whole, we recognise that not all of them will be, especially in the short term, politically palatable to parties. It is the job of an independent think tank to push the opinion window on such matters and we hope ultimately our proposals, in part or in full, will be implemented by whoever has the privilege to govern our nation over the coming years. This is a time for courage: no meaningful change can be implemented without cutting across the interests of the status quo.

In a document this large there will be many things with which people disagree or quibble - that is natural and healthy, and we hope that this will set a debate running for many months on how best to govern our financial and tax systems. Policy must move from the realm of the soundbite to the world of the businessperson in the arena. This report moves it there.

Jonathan Brown, Founder and CEO, Centre for a Better Britain

Executive Summary

Background

- This paper is the culmination of Centre for a Better Britain's nine-month financial reform project, developed through working groups covering regulatory simplification and institutional reform, SME and growth capital, pensions and savings, and tax simplification. The project has drawn on the experience and expertise of senior figures from across financial services, business, economics and politics, including former Treasury and Civil Service officials.
- The result is a programme of radical reform to Britain's financial system and tax code, designed ultimately to raise productivity and living standards - through better-paid jobs, higher retirement incomes, higher business investment, more businesses starting and scaling, and less time and money spent on unproductive activity.
- Since the Global Financial Crisis of 2007-08, Britain has seen little productivity growth and improvement in living standards, with real wages broadly flat. This contrasts with most of the post-war period, when each generation could reasonably expect to be materially better off than the last.
- Part of this is down to Britain adopting an excessively 'precautionary' approach to risk: since the crisis, an understandable focus on preventing further failures has evolved into a process-heavy, compliance-based economy which, by seemingly trying to prevent all risk, has instead suppressed investment and growth.
- But risk cannot be abolished: trying to do so simply introduces other risks associated with a more stagnant economy and suppresses the life chances of millions of people - through lower-paid jobs, fewer businesses starting and scaling, and lower retirement incomes.
- This is fundamentally a governance challenge: individual rules and taxes may appear sensible in isolation, but collectively they impose costs on the wider economy for which no one is responsible. Regulators and other authorities are held accountable for visible harms, but not for foregone growth and opportunity, so rules and complexity tend only to accumulate.
- Britain is blessed with one of the world's largest pools of capital, and the financial system must once again play a central role in helping it get to where it is most needed.
- But capital will only invest where the expected return justifies the risk. Uncertainty over tax, regulation and the actions of government and arm's-length bodies has created 'state risk' and made Britain a less attractive place to commit long-term capital. The proposals in this paper seek to make Britain attractive again as an investable jurisdiction, rather than rely on the government to direct capital towards favoured assets.
- This does not mean a return to pre-2008 regulation. Our proposed 'smart and safe' regime builds on what has worked since the Global Financial Crisis but takes a more proportionate approach to risk: distinguishing between acceptable risks, which should be embraced in pursuit of specific growth objectives, and unacceptable risks, which the regime should seek to minimise whilst recognising that risk can never be zero.
- Elected governments alone must explicitly own risk appetite and any trade-offs - they cannot be allowed to emerge by default, nor be owned by regulators or arm's-length bodies. This is a crucial aspect of the reforms outlined throughout this paper.
- This paper reflects the collective judgement of the working groups and is intended to stimulate wider debate within policy, City and business circles. It is not a legislative programme or comprehensive literature review, but we intend its proposals, in their final form, to be

implementable mostly within a Parliament. We welcome challenge to help inform the next phase of work.

- While this paper focuses on the financial system and tax code, these reforms alone cannot restore growth and rising living standards. Equally ambitious reforms are needed across other areas holding Britain back, including energy, planning, welfare and public sector productivity. Many of the principles set out in this paper apply equally to these wider challenges. Moreover, AI significantly raises the stakes: Britain's ability to benefit from what is likely to be the defining economic force of the coming decade will directly depend on many of these reforms.
- In total, this paper makes more than 150 policy recommendations, many of which are necessarily technical but have important implications for the wider economy. They cannot all be reproduced in this executive summary - the full set of recommendations is set out in Chapters 2-6.

Institutional and regulatory reform

- **Ministers alone must own risk-reward trade-offs:** The government should set an explicit risk appetite for financial regulation, making clear which risks it is prepared to accept, the economic benefits it expects in return, and which risks it wants to minimise. Ministers should formalise these through mandate letters to each regulator. Regulators should report against both sides of the 'risk ledger', with a standing parliamentary committee holding ministers and regulators to account. Without this change, reforms to reduce the regulatory burden will not last, as regulators will continue to be criticised when something goes wrong, but face little consequence when excessive caution prevents investment and growth.
- **Spin off a new Department for Economic Growth from the Treasury:** Britain is unusual among comparable economies in concentrating responsibility for both fiscal policy and economic growth within its finance ministry. This creates an institutional bias towards short-term fiscal certainty over longer-term growth. HM Treasury should retain responsibility for fiscal policy, tax, spending control and debt strategy, while a new Department for Economic Growth should have an explicit mandate to drive growth measures, including responsibility for financial services policy and productivity-enhancing market reforms. The Treasury should no longer be able to veto approved growth reforms through short-term fiscal scoring.
- **Strengthen Bank of England accountability for inflation and financial stability outcomes:** The Bank has repeatedly failed against its inflation mandate without consequence. Performance should also be evaluated by the new standing committee, with inflation assessed over one-, three- and five-year horizons, and reporting also distinguishing domestically generated inflation from imported price shocks. The Monetary Policy Committee should have greater real-economy and markets experience, with senior remuneration more closely linked to performance. The Bank should not pursue a separate growth mandate.
- **Replace the FCA's precautionary approach with a proactionary one:** Duplicative regulation should be removed where ordinary law or contract already provides adequate protection, with published safe harbours giving firms certainty that specified good-faith conduct will be treated as compliant. This should allow a significant reduction in the volume of FCA rules, while deliberate, reckless or grossly negligent misconduct should face much tougher personal penalties, including through a new sanctions panel.
- **Extend the approach to other financial regulators:** Prudential regulation should distinguish between systemic institutions, whose failure could threaten the wider economy, and smaller firms whose failure can be absorbed, allowing challenger banks to compete and grow.

Pensions regulation should focus more on avoiding long-term underperformance and inadequate retirement incomes, rather than short-term volatility.

- **Extend the approach to arm's-length bodies:** ALBs with a material impact on investment and economic growth should also be subject to mandate letters from the responsible ministers, requiring their strategies to align with that of the elected government, and with their performance evaluated accordingly. Britain should adopt overarching ALB reforms, as Japan did in the late 1990s, including consistent reporting and regular sunset reviews, with abolition or consolidation presumed unless a body can justify its continuation.

SME and growth capital

- **Reform prudential regulation to allow challenger banks to compete and restore business lending:** Non-systemic challenger banks, whose failure could be absorbed without threatening financial stability, should face a lighter regulatory regime, evolving the PRA's existing 'Strong and Simple' framework, including simplified and more proportionate capital requirements and a much higher MREL threshold, while systemic banks remain subject to the full Basel III regime. This should reduce barriers to entry and expansion, increasing competition and enabling the banking sector to better serve British businesses. Ring-fencing should not apply to non-systemic challengers and should be phased out over time for systemic banks. The flat 3% bank corporation-tax surcharge should also be replaced with a variable 0-10% rate linked directly to SME lending.
- **Reform reserve remuneration to improve credit incentives:** The Bank of England currently pays Bank Rate on commercial bank reserves. Reserve remuneration should instead be tiered, with full Bank Rate paid only on a defined portion of reserves and a lower or zero rate paid on the remainder. This could alter bank margins, portfolio incentives and the relative attractiveness of risk-free central-bank balances, as part of a wider package to improve credit incentives.
- **Create a National Investment Bank to fill the remaining gaps:** Even after prudential reforms, gaps will remain in scale-up equity and small-ticket relationship finance. Modelled on the successful post-war ICFC, a National Investment Bank should fill these gaps, with its precise scope to be determined by where private capital will not suffice. It should consolidate the relevant functions of the British Business Bank and Innovate UK. The NIB should be permanently capitalised rather than dependent on Treasury spending rounds, with an independent board making investment decisions solely on commercial terms.
- **Restore AIM as a genuine growth market for British businesses:** AIM was created to give growing companies access to public capital, but regulatory accretion has made remaining listed increasingly expensive, while weak liquidity and valuations discourage new investment and listings. The AIM regime should remove unnecessary periodic reporting and governance requirements and adapt trading rules to improve liquidity in smaller stocks. This should make it easier for promising businesses to raise capital, remain in Britain and grow rather than sell early or move overseas.
- **Develop a pre-IPO market to address the 'missing middle':** Britain's growth-capital gap is particularly acute for businesses seeking between £20m and £200m, which are often too large for traditional SME finance but lack an efficient route to institutional capital. The new Private Securities Market should be developed into a standardised market for growth finance, with common standards for debt and equity issuance, reducing the cost for institutional investors of evaluating growing private businesses. This should give more British companies an alternative to prematurely selling to competitors or private-equity buyers.

- **Strengthen incentives for entrepreneurs to grow businesses and remain in Britain:** Britain is good at creating entrepreneurs, but poor at helping their businesses scale and at keeping successful founders in the country. We propose reforms to improve investment and employee share incentives, make HMRC advance assurance binding, provide German-style start-up finance and coaching, and build stronger domestic and international networks for British founders.
- **Introduce a 'sprint permissions' regime to help Britain build clusters in critical future industries:** Globally mobile industries can choose where to locate in months or even weeks, while British planning, regulatory approvals, visas and tax rulings can take years. Firms in qualifying industries, including AI, digital assets, quantum, life sciences, defence, nuclear power, advanced manufacturing and semiconductors, should receive a temporary faster, lighter regime, including default-to-yes planning on fixed deadlines, accelerated talent visas, regulatory sandboxes and preferential tax treatment.
- **Make British assets attractive again, rather than mandate investment in them:** Pension capital should not be directed into UK assets. The government should instead fix the tax, regulatory and state-risk barriers that make Britain less attractive to invest in. Capital should come to Britain because investments are attractive. Non-financial ESG constraints that deter investment in productive sectors should apply only where savers explicitly opt in.

Pensions and savings reform

- **Replace fragmented workplace pensions with a Lifetime Investment Account**: Auto-enrolment has been a success, but contribution rates remain too low and workers accumulate multiple pension pots as they change jobs. Every worker should instead have a single, portable Lifetime Investment Account, modelled on Australia's superannuation system, with contributions gradually increased to at least 15% of earnings, and workers using the same account throughout their careers.
- **Open a Lifetime Investment Account for every child at birth:** The new architecture allows the Child Trust Fund model to return, with an indicative £1,000 state contribution invested at birth and the same account retained throughout life.
- **Consolidate the ISA system into a single Investment ISA:** Britain has too much of its household savings held in cash rather than invested for the long term. The separate ISA regimes should be replaced with a single Investment ISA, with the Cash ISA allowance withdrawn for future contributions. Access to the full tax-free allowance should require at least 50% to be invested in UK assets.
- **Evolve the State Pension into a retirement safety net:** As the Lifetime Investment Account allows people to build greater provision for their own retirement, the State Pension should gradually move towards an Australian-style, non-contributory, means-tested safety net, while preserving all existing State Pension accruals and limiting the liability for future taxpayers. Cap the 'triple lock' uprating formula at the growth in the working-age tax take.
- **Make financial education a core part of the school curriculum:** Britain cannot become a nation of long-term investors if people do not understand how investing works. Financial education should become a core, assessed part of the mathematics curriculum from primary age, including practical teaching on saving, investing and running a business, learning from successful approaches in Denmark and Sweden.
- **Close public sector pensions to new entrants:** The LGPS and unfunded public-sector pension schemes risk creating unsustainable liabilities for future taxpayers and crowding out

spending on frontline public services. They should be closed to new entrants, with future public-sector workers joining the Lifetime Investment Account system, while pensionable pay should be capped for higher earners to limit further accumulation of taxpayer liabilities.

- **Apply open, competitive appointments, market-rate pay and a common performance framework to the LGPS pools:** The 2026 pooling reforms are a welcome start, but pool chairs and investment boards should be appointed through open, competitive processes, with boards recruited and paid at market rates. Each pool should operate under a common long-term performance framework, with pay and the option of further consolidation linked to performance.
- **Establish a Strategic Investment Vehicle to support national priorities:** The Vehicle should be organised into three sleeves: the aforementioned National Investment Bank, Frontier Programmes for technologies before a commercial market exists, and Strategic Projects for assets which have a market but cannot yet be financed privately, such as energy and major infrastructure.

Tax simplification and reform

- **Make tax reform part of a wider reduction in the size of the state:** Tax simplification cannot realistically be a fiscally neutral exercise, while public spending is now around 45% of GDP. Tax reform should form part of a broader reduction in public spending. Both are essential for stronger growth. Even if implemented in full, the magnitude of these measures would be substantially smaller than what is required simply to return the state to its pre-pandemic share of GDP.
- **Do not implement any tax change with an expected fiscal cost until an equivalent spending saving has been identified:** Given the state of the public finances and the experience of 2022, any measure with an expected fiscal cost should proceed only once public spending savings of equivalent value have been identified, without relying on future dynamic or ‘Laffer’ effects.
- **Remove the most damaging Income Tax distortions:** Scrap Making Tax Digital for Income Tax. Restore the universal principle of Child Benefit by abolishing the High Income Child Benefit Charge. Abolish the pension annual allowance and associated accrual rules. Remove the 60%-plus effective marginal tax rate by ending the withdrawal of the personal allowance above £100,000.
- **Phase out National Insurance over a generation:** National Insurance is a parallel tax on income which adds complexity and obscures the true tax on employment. Employer and employee NI should first be combined into a single charge visible on the payslip, with salaries grossed up so take-home pay is unchanged. As Lifetime Investment Account contributions rise, NI should then be phased down in lockstep. In the meantime, IR35 should be replaced with a clear statutory test of self-employment, with the NI gap between employment and self-employment phased down as NI itself is reduced.
- **Abolish (or radically reform) the most distortionary secondary taxes:** This includes Stamp Duty Land Tax, which suppresses mobility and undermines the productive use of property; Stamp Duty on Shares, which depresses UK equity valuations and liquidity, and raises the cost of growth capital; Inheritance Tax, which encourages capital flight, discourages investment and disrupts family businesses; Air Passenger Duty, which damages regional connectivity; and the Digital Services Tax, which passes costs directly onto businesses. The Landfill Tax, Aggregates Levy, Packaging Extended Producer Responsibility and Plastic Packaging Tax should also be abolished; if environmental externality pricing is retained, the

packaging regimes should instead be consolidated and the other levies rebased more proportionately. Insurance Premium Tax should be reduced to a VAT-equivalent rate of around 3%.

- **Abolish Capital Gains Tax, one of Britain's most destructive taxes, to allow capital to flow to its most productive uses:** Not only does CGT add significant complexity to the tax code, but it locks capital into existing assets, prevents it from moving to its most productive uses, and discourages entrepreneurship and business growth. Abolition should be introduced alongside targeted anti-avoidance rules to prevent income being reclassified as capital gains.
- **Announce an eight-year transition to reduce Corporation Tax from 25% to 15%, then move to a distributed-profits model:** Britain's 25% rate is internationally uncompetitive and taxes profits before they can be reinvested in hiring, equipment, R&D and expansion. Reduce the headline rate to 15% over eight years, while simplifying the calculation of taxable profits in the meantime; then move to an Estonia-style system under which retained profits are untaxed until they are distributed (except where Pillar Two top-up taxes apply). This would remove the tax drag on reinvestment and make large parts of the existing Corporation Tax code redundant.
- **Restore dividend imputation to encourage British savers and pension funds to invest in British companies:** UK corporate profits are currently taxed at company level and again when distributed to shareholders as dividends. Britain allowed pension funds to reclaim dividend tax credits until 1997 - removing this has contributed to the decline in domestic institutional ownership of UK equities. Introduce Australian-style 'franking credits' first for UK pension funds, then extend the system to UK-resident retail shareholders.
- **A truly simpler tax code would require rebuilding it from first principles:** Although the reforms above could remove up to 50% of the existing tax code, half of a 20,000-page code is still huge. Establish a time-limited Tax Code Commission to draft a replacement code from first principles, consolidated into a small number of streamlined Acts.

Implementation

- **There is a strong view across the working groups that the reforms proposed in this paper are valuable only with an effective implementation plan:** Reforms should be sequenced in advance into 'day one', first-session and longer-term measures, with core bills drafted and institutional engagement underway before taking office. Parliamentary time should be protected by using administrative and order-making powers wherever possible, with clear ministerial ownership of major reforms. The Civil Service must be able to recruit specialist expertise, reward delivery rather than process and risk avoidance, and keep named officials in post long enough to see reforms through.

Acknowledgements

Author and project manager

James Mackenzie Smith
James previously worked for 15 years in financial services, most recently as head of risk for a global asset manager and currency specialist with $100bn under management. He has also worked as an investment strategist, and as a management consultant, working with major banks and insurers. He holds a degree in Engineering, Economics and Management from Balliol College, Oxford.

Steering committee

Ben Ashby
Ben is the Chief Investment Officer of Henderson Rowe and Head of Fixed Income at Rayliant Global Advisors. He was previously a Managing Director in JPMorgan's Chief Investment Office and serves on the Advisory Board of the University of Cambridge's Centre for Financial History. He regularly contributes technical financial articles for CFA UK.

Tracy Blackwell CBE
Tracy is the former CEO and Director of Pension Insurance Corporation. Tracy was one of PIC's founders, joining in 2006. She retired as CEO following PIC's £5.7 billion acquisition by Athora Holding Limited. Under her leadership, PIC grew from a startup with five employees into a major specialist insurer of UK defined benefit pension schemes, managing over £50 billion in assets and securing the pensions of nearly 400,000 people.

Dr Martin Clarke
Martin's professional career of over thirty-five years has been spent mainly in private equity, latterly as Partner and Global Head of Consumer at Permira LLP. His focus there was primarily on the retail and leisure sectors. He was subsequently part of the team that led a management buy-in of the Automobile Association, the UK's largest roadside assistance business, which floated on the London Stock Exchange in 2014. He served as Group Chief Financial Officer of the public company for five years before leaving to concentrate on personal investing from his own family office.

Ian McKnight
Ian has 27 years of investment experience, as an institutional investment consultant at WTW, LCP, Morgan Stanley and KPMG as well as having spent over 13 years as CIO of the deca-billion Royal Mail Pension Plan, where he achieved consistently strong investment performance for over 100,000 postal workers. He is now Chief Investment Officer at Tontine Trust, Senior Adviser at Cartwright Pension Trusts and holds a number of other advisory roles covering alternative asset managers.

Peter Young
Peter was formerly Head of Research at the Adam Smith Institute, where he directed the Institute's 'Omega Project', which involved the production of 20 separate reports containing policy proposals for every area of government, many of which were subsequently implemented by the Thatcher government. He is the author of several reports on tax policy for the Adam Smith Institute, and he has also written on tax issues for a variety of institutions and outlets.

Working group members

Jeremy Apfel
Jeremy is Managing Director, Corporate Affairs at Pension Insurance Corporation (PIC), where his work includes public policy, regulation, and the relationship between government and long-term institutional investment. He has spent more than 30 years working across politics, financial services, and public policy. He began his career in politics before moving into financial services, including at Citigroup and Lehman Brothers, and subsequently into the pensions and insurance sector.

James Barham
James has over 35 years' experience in asset management and was most recently Executive Chairman of Schroders Solutions, helping establish it as a UK market leader in fiduciary management before retiring in 2026. He previously founded River and Mercantile Asset Management, later combining it with PSolve to form River and Mercantile Group plc, and led the strategic review that resulted in the sale of its Solutions business to Schroders. Earlier in his career, he was part of the team that founded Liontrust Asset Management in 1994. James began his career after service in the British Army.

Siobhan Barney
Siobhan is the founder of One Hundred Knightsbridge, an FCA-authorised advisory firm, supporting entrepreneurs with their financing and liquidity needs. A significant part of her work involves small and medium-sized businesses, particularly helping owner-managed firms address funding constraints and liquidity pressures that can restrict their growth. Earlier in her career, Siobhan worked in advertising and brand strategy across Europe, the United States and the Middle East, before moving into property and finance and establishing her own advisory business in 2010.

Phil Basey
Phil is an economist and chartered accountant who has contributed to the tax work in this paper. In his earlier career, he worked as a financial analyst for a US multinational and as a tax practitioner, before spending 20 years running SMEs. More recently, he has twice been the Research Director of the TaxPayers' Alliance.

Andrew Blowers OBE
Andrew is an insurance entrepreneur and company chairman. In 1992 he founded Inter Group, a multinational insurance intermediary, which he sold to Churchill Insurance before joining its Executive Board. After Churchill's acquisition by RBS, he co-founded Swiftcover.com, the UK's first fully online motor insurer, selling it to AXA in 2008. He has since held chairman and non-executive roles, including at AA plc and Telecom Plus plc, and in 2026 became Chairman of a specialist insurance broking business.

Chris Carr
Chris spent thirty years in the Civil Service, working for eleven administrations across five departments, as well as an independent review, a local authority and an arm's-length public body. For much of the past decade, he led government policy on regulation, including work on the 2019 and 2024 regulation White Papers and the Retained EU Law Act 2023. He now runs his own consultancy, advising on policy, strategy and regulation.

Byron Evans
Byron has contributed to the research underpinning the tax reform proposals in this paper. He is now a Research Fellow at Policy Exchange and previously spent three years as a Policy Adviser at Manchester Airports Group, specialising in tax, regulation and transport policy. He holds a first-class BA in Economics and Politics from the University of Manchester.

Ed Firth
Ed is a Managing Director at KBW, the specialist financial services investment bank and broker-dealer, where he is responsible for UK banks research. He joined in 2017, having previously been Head of European Banks Research at Macquarie. Earlier in his career, Ed was Head of Financial Planning and Head of Investor Relations at NatWest. He has been a UK bank analyst since 1999 and graduated from Durham University with a degree in Chemistry.

Robert Gardner
Robert is CEO and Co-Founder of Rebalance Earth and has spent over 25 years working across pensions, investment and financial education. In 2006, he co-founded Redington, helping build it into one of the UK's leading investment consultancies. He later served as Director of Investments at St. James's Place, overseeing £150 billion of client assets. Robert also co-founded mallowstreet and financial education charity RedSTART Educate. He is the author of *Save Your Acorns* and *FR££DOM: Earn It, Keep It, Grow It*, and is passionate about building lasting financial confidence and resilience.

Nicholas Hewitt
Nicholas is a former Global Leader of PwC's Strategy practice. He previously founded the COBA Group, a strategy consultancy in London and Boston, which he later sold to PwC. He led the British Venture Capital Association's industry consultation following the Global Financial Crisis. He later served as an Executive Director of AA plc after leading its £1.4 billion equity raise and London Stock Exchange flotation, and more recently chaired Bank of Ireland's financial services joint venture with the AA.

Christopher Howarth
Christopher previously worked as a tax consultant at KPMG and PwC before moving into politics and government, and has contributed to the tax research behind this paper. In 2007, he was one of the first to quantify the true length of the UK tax code. He has served as a parliamentary researcher, and later as a Special Adviser at the Home Office. He now works at CFABB on parliamentary engagement and policy.

Andrew Hunt
Andrew worked as an international economist at a major asset manager for thirteen years, specialising in Japan and East Asia, before founding his own economics consultancy in 2001. Andrew currently advises some of the world's leading financial institutions, including major banks, asset managers, hedge funds and family offices, on asset allocation, risk management and corporate strategy. He has also provided research to central banks and finance ministries around the world.

Dr Emmanuel Igwe
Emmanuel is an Economist at the Prosperity Institute. He previously led economic analysis and impact assessment at the Medicines and Healthcare products Regulatory Agency, developing appraisal models for changes to healthcare regulation. Before this, he worked as an economist and

policy adviser at the Department for Levelling Up, Housing and Communities, contributing to the appraisal of regeneration programmes and the development of investment and prioritisation frameworks for the UK Shared Prosperity Fund and Levelling Up Fund.

Ben Johnson
Ben is a Partner and member of the founding team at Vitruvian Partners, where he has invested in technology businesses across Europe for more than two decades. He began his career at Goldman Sachs before moving into private equity and growth investing. Ben is also an Independent Non-Executive Director of Oxford University Innovation, the University of Oxford's technology transfer company, and previously served on the Tech City and Tech Nation Future Fifty advisory panel. His policy interests include AI, productivity, regulation and UK competitiveness. He studied Politics, Philosophy and Economics at Magdalen College, Oxford.

Adam Knight
Adam is an active angel investor and sits on the boards of Fleximize (a leading UK SME lender), TrialScreen (a clinical trials recruitment business), BeZero and Black Soldier Fly Holdings. Before becoming a full-time investor, Adam was Global Head of Commodities at Credit Suisse and Global Head of Metals at Goldman Sachs before that. Adam studied Economics at Cambridge.

Rory Meakin
Rory is a tax policy expert who has written extensively on National Insurance, corporate taxation and wider tax simplification and reform. He was the lead researcher to the TaxPayers' Alliance's 2020 Tax Commission, playing a key role in the development of its Single Income Tax proposals. He is now a research fellow at the TPA.

Mervyn Metcalf
Mervyn has been an investment banker since 1994. In 2012, he founded his own advisory boutique, Dean Street Advisers. Prior to that, Mervyn spent over 11 years at Merrill Lynch. Mervyn has advised leading UK corporates and private equity firms on M&A and capital raisings across a wide range of sectors. Mervyn holds undergraduate and master's degrees in economics from the LSE.

Ramin Sabi
Ramin has been an Economist at HM Treasury where he worked on tax, infrastructure, and financial services. He is now an award-winning theatre producer, having founded and operated several businesses in the entertainment sector, with a focus on finance. He holds a degree in Politics, Philosophy and Economics from Balliol College, Oxford.

Alex White
Alex helps to run a boutique strategy firm advising businesses and investors on the intersection of financial markets, politics and policy. Previously, he was Chief Political Analyst at J.P. Morgan, where he established and led the firm's global research practice on politics and policy, advising its Operating Committee and major clients. He also led the Economist Intelligence Unit's global country analysis team and, earlier in his career, worked at HM Treasury during the financial crisis, helping lead the response to investment bank failures and designing the UK's investment bank resolution regime.

Gary Wilder
Gary is Founder Partner and Executive Chairman of Moor Park Capital Partners, which he co-founded in 2006. He has more than 35 years' experience across real estate, private equity, structured finance, wealth management and capital markets. Previously, he was Managing Partner

and Co-Head of Nomura's European Funds Group and led its Real Estate Principal Finance business. He has also served as Group CEO of Kingswood Holdings and held senior roles at Credit Suisse First Boston and Bankers Trust. Gary holds a BSc (Hons) from Bayes Business School and is a Fellow of the Institute of Chartered Accountants in England and Wales, having qualified with Arthur Andersen.

Conrad Young
Conrad is a founder of multiple technology businesses, with deep expertise across fintech, regulatory affairs and digital identity. He is currently co-founder of Paragon Strategy, a London-based strategy consultancy advising clients across finance and technology. He has advised governments across Europe on tech policy, bringing an industry perspective to national-level reform. He is a graduate of the University of Bristol.

Advisory support

William Mason
William is a senior financial services regulator with experience spanning supervision, risk and regulatory innovation. He held multiple roles at the FSA before and during the Global Financial Crisis, before moving to the Central Bank of Ireland, where he led Risk and helped redesign its supervisory approach through the development of the PRISM system. He has also championed innovation in digital and sustainable finance and regulatory technology, and led international work through the International Association of Insurance Supervisors on regulatory effectiveness.

Helen Thomas
Helen is founder and CEO of BlondeMoney, an independent macroeconomic consultancy specialising in financial market risk. She has more than 20 years' experience across banking, asset management and public policy, with particular expertise in macroeconomics, financial markets and the interaction between regulation, policy and investment. She is a CFA Charterholder and a Fellow of CFA UK, and holds an MA in Philosophy, Politics and Economics from Christ Church, Oxford.

The following contributors cannot be named in this paper for personal or professional reasons:

- Chief Investment Officer at a major global fixed income asset manager;
- Senior fixed income markets professional, with extensive experience working with pension funds and other long-term institutional investors;
- Former Cabinet Minister;
- Former HM Treasury official with experience in financial services policy, now working at a global asset manager.

With thanks to the companies and industry groups who shared their perspectives, provided feedback or took part in discussions and roundtables during the project, and to the wider CFABB team for their assistance and advice in preparing this report.

The individuals listed above have generously given their time and expertise to this project. Unless otherwise stated, they are not employees of Centre for a Better Britain and have contributed in a personal capacity. The paper reflects the collective judgement of the working groups as a whole; individual contributors may not agree with every recommendation or conclusion.

Table of contents

Chapter 1: Introduction

1.1 - Britain's growth challenge and what this means

The reforms proposed in this paper are about improving outcomes for British people: without a renewed focus on economic growth, living standards will keep declining and each generation will find it harder to build a better life than the last.

1.2 - How a disproportionate approach to risk aversion has significantly contributed to the crisis in productivity, growth and living standards

Britain has become so focused on preventing visible harms that it has made investment and growth harder, in turn making it harder for the financial system to support businesses and investment. Meanwhile, the tax code has continued to proliferate in both length and complexity.

1.3 - How no growth is ultimately paid for by households

The bill for no growth is paid by real people through foregone opportunity, including firms that do not grow and infrastructure which does not get built. The cost shows up through worse outcomes in housing, health, work and retirement - and declining trust in politics.

1.4 - Why Britain's economic challenges are reversible

It does not have to be this way: Britain still retains deep pools of capital and talent, but lacks the channels and incentives that turn them into domestic investment and productivity growth.

1.5 - A new governing mindset: 'smart and safe'

The current precautionary approach often treats avoiding risk as the overriding objective, whereas a 'smart and safe' approach instead protects against the biggest harms while accepting that measured risks are needed for an economy to thrive, whilst punishing fraud and gross negligence more severely.

1.6 - Restoring living standards requires more than financial reform

To achieve higher living standards, financial reforms alone are not sufficient - they must be undertaken alongside parallel programmes addressing the multitude of other issues holding Britain back.

1.7 - Implementation and timing are critical to the success of the policies we propose

Many reforms fail due to poor delivery. This paper therefore sets out the order, the legislative instruments, and the changes to the Civil Service needed to implement our policies within a Parliament. Moreover, tax proposals must be subject to corresponding reductions in public spending.

1.1 - Britain's growth challenge and what this means

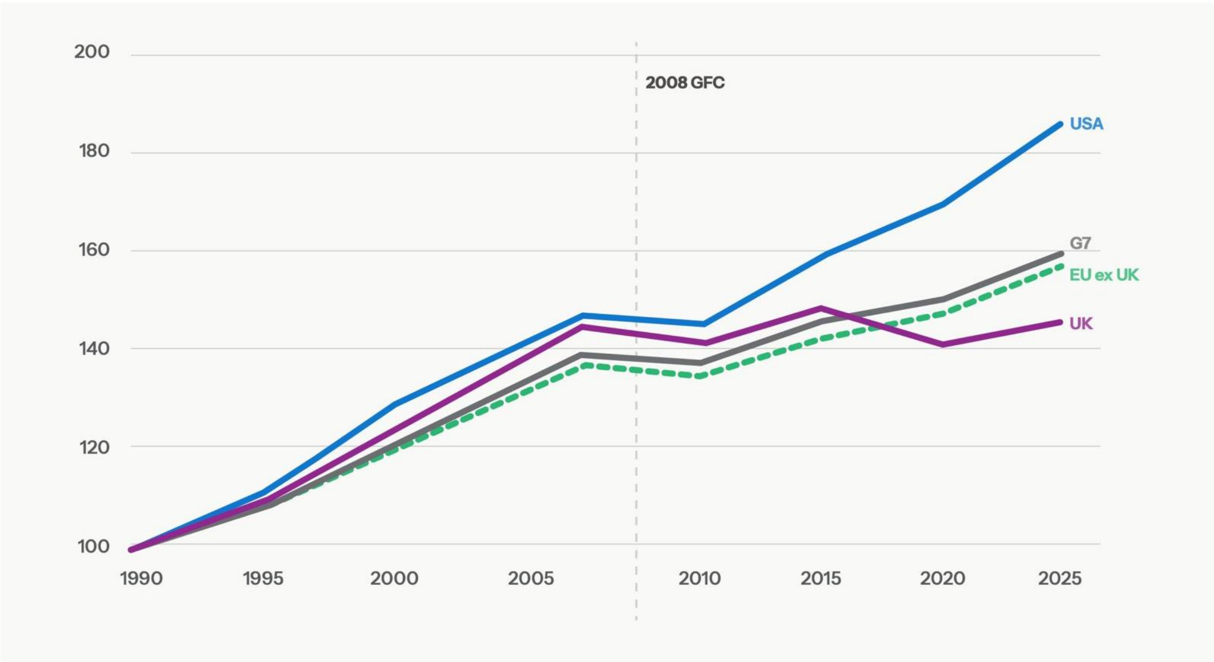
The reforms proposed in this paper are about improving outcomes for British people: without a renewed focus on economic growth, living standards will keep declining and each generation will find it harder to build a better life than the last.

The UK's post-war settlement, despite periods of crisis and the stagflation of the 1970s, delivered consistent gains in real GDP per capita which have eluded the country since 2008.

For most of the post-war period, Britain's growth delivered rising living standards for successive generations. Real GDP per capita grew at an average of 2-3% annually from the 1950s through 2007, with productivity growth running at a similar rate[1]. Each generation could reasonably expect to be materially better off than the last, achieving home ownership, family formation, and retirement security. Public services were funded by a tax base that grew alongside the economy.

Since 2008, this precedent has broken: productivity growth - the driver of rising living standards - has been close to zero for over fifteen years, while real wages have been broadly flat over the same period. This represents the longest stagnation in modern British economic history; moreover, the gap between the UK and comparable peers has widened.

GDP per capita growth chart, UK vs peers, 1990-2025



Source: OECD Data Explorer, Eurostat, and the Office for National Statistics (ONS)

[1] Bank of England, A Millennium of Macroeconomic Data; Office for National Statistics, UK productivity flash estimate

This is the reason why pay and opportunity have felt stuck for so many households. Without a change of course, Britain plausibly faces a trajectory of continued relative decline.

Sustained real GDP per capita growth of around 0.5% per annum has compounded into a meaningful gap with peer economies. At current relative growth rates, the UK could fall below the OECD average on per-capita output within the next ten to fifteen years. On a longer time horizon, UK living standards could converge with those of emerging economies, which are rapidly catching up.

The consequences are real and clearly visible:

- Persistent weak pay growth - stagnant real wages have compressed household living standards;
- Fewer good jobs - high-productivity, high-wage employment is generated by thriving industries and scaling firms, of which the UK produces too few, and increasingly loses the ones it does produce to overseas listing or acquisition;
- Reduced life opportunities - the path to home ownership and asset accumulation, and starting a family - things previous generations took for granted - is now much harder for the cohort now in their twenties, thirties, and indeed forties;
- Diminishing fiscal capacity - a stagnant tax base cannot sustainably fund growing pensions, the NHS budget, defence commitments, or other public services that the political settlement takes as given.

At present, there is no obvious economic reason to expect this pattern to break.

The damage is uneven: some parts of the UK still do well, but many have been left behind despite 'levelling up' - and even the most successful regions are losing ground to international peers.

London and the South East remain highly productive on international metrics. GDP per capita in parts of London is among the highest of any region in Europe, with financial services, professional services, and increasingly technology also clustered around the London-Oxford-Cambridge triangle. This 'Loxbridge' triangle is one of a small number of European deep-tech clusters with a global standing.

However, the gap between such areas and the rest of the country has continued to widen - despite the 'levelling up' agenda of the previous government. Several UK regions are now significantly below the EU average, with some below the average of comparable post-industrial regions in France and Germany. Productivity gaps within the UK are larger than productivity gaps within most peer economies.

Moreover, even London and the South East are now slipping relative to competitors. Productivity gaps with peer global cities (e.g. New York, San Francisco, Singapore) have widened over the past decade. Capital, talent, and corporate headquarters that London might once have attracted by default often now go elsewhere.

Given today's national debt level and structural fiscal deficit, productivity growth is essential to delivering higher living standards and better public services.

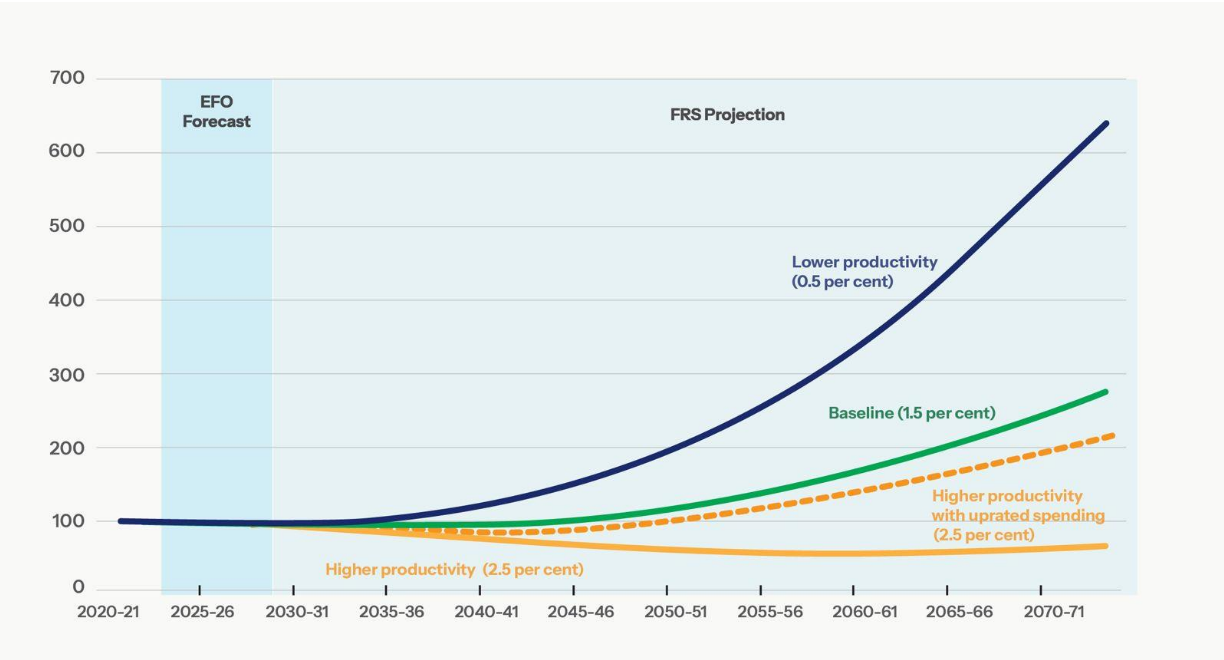
Fiscally, the OBR's projections show debt-to-GDP rising materially over the coming decades on current policy to a clearly unsustainable level, with the largest pressures coming from health, social care, and State Pension spending. These pressures will further compound with weak growth, with debt becoming harder to stabilise when borrowing costs exceed economic growth.

The UK's starting position is precarious:

- National debt is approaching 100% of GDP and is projected to rise significantly under current policy;
- The tax burden sits at a multi-decade high, leaving little if any room for further increases, while marginal rates are concentrated on the demographics most able to leave the country, and the UK is likely to be near or at the revenue-maximising point on several major taxes;
- Spending on health, pensions, debt servicing, and benefits is absorbing an increasing share of total output, leaving little fiscal headroom for new commitments;
- Borrowing is constrained by not only existing debt levels, but also market credibility considerations.

Growth is the only lever large enough to address the problem.

Public sector net debt sensitivity to productivity growth assumptions



Source: OBR, Fiscal risks and sustainability (September 2024)

1.2 - How a disproportionate approach to risk aversion has significantly contributed to the crisis in productivity, growth and living standards

Britain has become so focused on preventing visible harms that it has made investment and growth harder, in turn making it harder for the financial system to support businesses and investment. Meanwhile, the tax code has continued to proliferate in both length and complexity.

Following a series of corporate scandals and, most notably, the 2008 Global Financial Crisis, an understandable public policy instinct to prevent repeat instances has morphed into an institutional drive to squeeze all risk out of the financial system.

The post-2008 regulatory reform programme was a rational response to a systemic crisis, where hidden leverage and inadequate capital had produced a fragile financial system which the state could not continue to underwrite or rescue.

The subsequent implementation of more stringent capital and liquidity requirements - driven by Basel III and the Capital Requirements Directive (CRD IV) and Regulation (CRR) - has substantially mitigated the likelihood of bank failures, and the introduction of ring-fencing has insulated retail deposits from the contagion risks inherent in investment banking activities.

On top of this, regulation, including MiFID II, EMIR, the Senior Managers and Certification Regime (SMCR), and Consumer Duty, has significantly increased oversight regarding how financial institutions interact with their customers and counterparties.

Key UK Post-GFC Regulatory Initiatives and Primary Mandates

Reform	Year(s)	Primary Purpose
Basel III / CRD IV / CRR	2013 - 2019	Increase bank resilience after GFC
Ring-fencing (UK)	2019	Protect retail deposits from investment banking risk
MiFID II	2018	Improve transparency and investor protection in markets
EMIR (derivatives regulation)	2013 - 2016	Reduce systemic risk in derivatives markets
Senior Managers & Certification Regime (SMCR)	2016	Increase executive accountability
Consumer Duty (FCA)	2023	Ensure “good outcomes” for retail customers

However, while each reform was assessed against its primary objective, none were evaluated on a cumulative basis regarding their broader impact on the financial sector. Reforms were implemented sequentially by different bodies acting under their own discrete mandates; no single institution has been held (or made) accountable for how these frameworks interacted - nor for their compounding, cumulative drag on the wider economy.

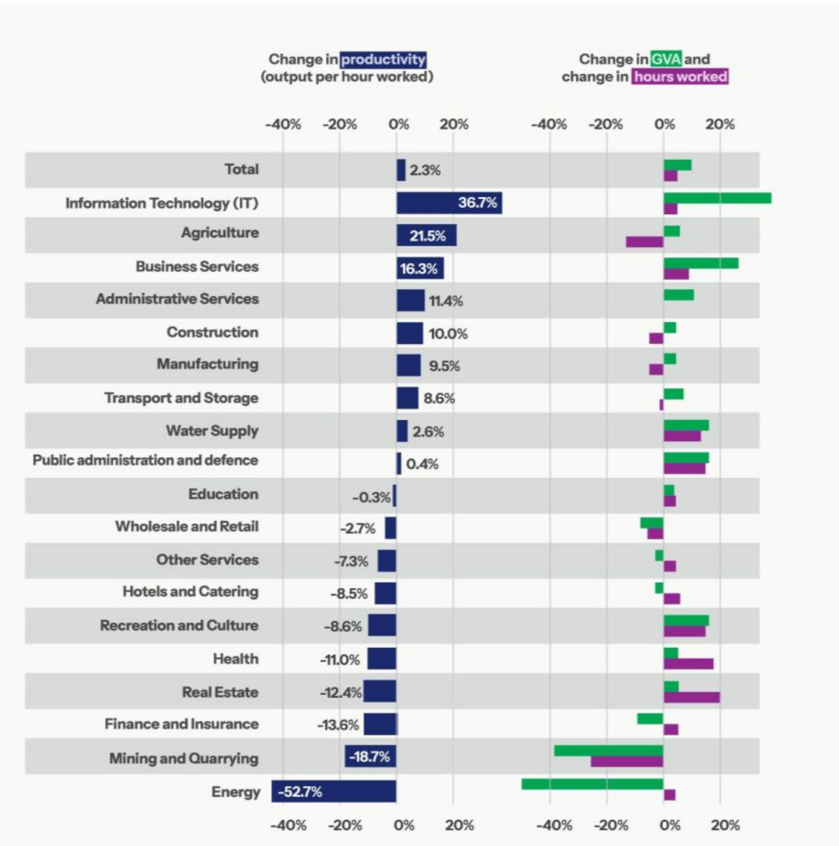
As a result, the financial system has achieved stability at a high opportunity cost. Banks have shifted toward lower-risk activity at the expense of SME lending, while capital markets have become less attractive for firms seeking to scale, leading to a marked decline in public market listings. Pension capital has progressively de-risked allocations at the expense of 'growth' assets. Authorisation and compliance costs have escalated at every level, generating significant barriers to entry and stifling competition, with smaller firms disproportionately affected.

> **"The UK is effectively growing at the risk free rate i.e. zero on a per capita basis."**

While this is not the sole driver of the UK's economic stagnation, a heavily risk-averse financial sector severely restricts the flow of capital to the wider economy. When funding is constrained across banking, pension funds, and public markets, this acts as a persistent drag on business investment and expansion.

The following chart illustrates collapsing productivity across the financial services sector, among other key industries.

Decomposition of growth of output per hour worked, hours worked and gross value added (GVA), Quarter 2 (Apr to Jun) 2025 compared with 2019 average, percentage change, UK



Source: Productivity flash estimate and overview, UK - Office for National Statistics

However, risk cannot be abolished; it must be responsibly managed for an economy to grow.

All economic systems carry inherent risk; the fundamental question is where risk exists and who is exposed to it (not simply whether it exists). A regulatory regime that attempts to eliminate all risk will invariably eliminate activity, including investment and risk-taking, that generates economic growth.

The 'paradox of aggregation' we diagnose - where new individual rules may make sense on their own, but collectively undermine the wider economy - is a natural consequence of the asymmetric incentives faced by regulators and those who set tax policy, where failings are censured but no-one is held responsible for lost upside.

The problems we diagnose and seek to fix have emerged as an incremental consequence of each new rule or tax coming into force, manifesting as excessively complex regulations that consume resource, policies that undermine the ability of SME and scale-up companies to access growth capital, poorer retirement outcomes, and an unreasonably complex tax code.

No individual rule is necessarily the problem; the issue stems from each regulator or arm’s-length body being incentivised to add rules, but none having the incentive to remove them. Each authority is simply acting rationally within its mandate. However, in aggregate, this produces the economic frictions and distortions which this paper seeks to address.

The underlying cause is that each body is subject to a starkly asymmetric model of accountability:

- Regulators and ALBs face immediate censure for visible failure - for example, bank collapses, mis-selling scandals, pension scheme losses, and other consumer detriments which drive negative media coverage;
- Conversely, they face no penalty for foregone growth: withheld or cancelled investment, stagnating productivity, and capital leaving the country.

> ***“You are hauled over the coals in front of the Treasury Select Committee if something bad happens, but you are not hauled over the coals if good things do not happen.”***

Because accountability is immediate and potentially career-terminal, regulators are rationally risk-averse - they act to minimise what they might be blamed for (and not what they won’t be blamed for). This is observable right across the financial system:

- The Prudential Regulation Authority (PRA) tolerates lower investment in the wider economy but not firm-level failure - prudential capital requirements are set conservatively against commercial lending, while challenger banks face high barriers to scale that also protect incumbents;
- The Financial Conduct Authority (FCA) tolerates market stagnation but not consumer harm, resulting in protracted authorisation timelines and an ever-expanding rulebook;
- The Pensions Regulator tolerates foregone member returns in pursuit of short-term funding stability, pushing pension capital into heavily de-risked allocations;

- The Bank of England tolerates suppressed credit conditions but not systemic collapse, maintaining stringent macroprudential buffers even when they stifle corporate growth;
- Arm's-length bodies (ALBs) - for example, the British Business Bank faces immediate scrutiny over loan defaults, but no equivalent censure for failing to deploy scale-up financing at the speed the market requires.

While the 2008 financial crisis is the principal catalyst for the present regime, elements of this mindset emerged earlier. The collapse of Equitable Life and the subsequent inquiries reinforced a growing expectation that institutions should prevent adverse outcomes wherever possible, helping shape the more precautionary approach that followed.

The institutions that hold these bodies to account heavily reinforce the defensive mindset. House of Commons Select Committees, as well as the media, historically evaluate risks that have already materialised, asking "why did you not act?", rather than interrogating the trade-offs of foregone growth by asking "what upside did this caution cost?". Similarly, the National Audit Office (NAO) and the Public Accounts Committee (PAC) interrogate failures after the fact, meaning they can censure errors but cannot shape risk appetite.

The cumulative effect is that risk is minimised by default, while the goal of maximising long-term economic outcomes is reduced to a secondary consideration albeit acknowledged in statute.

The volume and complexity of financial regulation is best understood as a symptom of this governance failure.

The volume of UK financial regulation is a direct consequence of the asymmetric accountability outlined above, and is best understood as a symptom rather than a deliberate policy choice. For officials and regulators, rules that mitigate a given risk are a defence against future blame. The cost of a given rule is borne across regulated firms and, by extension, their customers and the wider economy, while the benefit - in reduced personal exposure to blame - accrues directly to the rule-maker.

Conversely, removing rules carries the inverse incentive: any harm that subsequently occurs will be attributable to the removal of that rule, while the productive activity enabled will not be credited to anyone.

Therefore, the rational response of every individual authority is to add rules and not remove them. The accumulated effect is that the FCA Handbook alone runs to roughly 10,000 pages.

This further manifests in the conflicting strategic objectives of the regulators, as well as the self-perpetuating compliance industry.

The FCA today operates under multiple statutory objectives, over fifteen legally enforceable 'have-regards', periodic Treasury remit letters, and further self-imposed strategic priorities. With each added at a different time, in response to a different concern, and under a different government, there is no mechanism for review of the cumulative whole.

Each addition may have been individually defensible when it was implemented, but even the FCA's own leadership now acknowledges that the sheer volume of competing priorities makes it impossible to know what Parliament actually wants the regulator to focus on.

Three factors have recently amplified this dynamic across the UK financial regulatory landscape specifically:

1. The post-Brexit onshoring of EU regulation was conducted without a strategic review - much of the rulebook was simply lifted from EU sources that were themselves the product of compromise drafting, and Parliament had limited capacity to scrutinise it in detail;
2. A series of high-profile failures - including London Capital & Finance (LCF), the LDI crisis, and various mis-selling episodes - triggered immediate policy reactions which have resulted in a one-way ratchet of new rules;
3. Each new rule generates incremental compliance activity, which in turn builds a self-perpetuating compliance caste within both the regulators and regulated firms - senior executives may want to optimise for growth, but their own risk and legal teams face asymmetric personal accountability if a given rule is breached.

Further to the third point, this compliance industry creates a permanent lobby to defend and expand the complexity of the code, regardless of the cumulative drag on the wider economy.

As this is first and foremost a governance challenge, no exercise to simplify the rulebook can succeed by simply going through it line-by-line and asking which rules to keep. Any such exercise - especially if undertaken by the actors subject to the aforementioned incentives - will result in no meaningful change, as each rule will simply be defended one by one. We therefore address the challenge of regulatory simplification by considering the broader institutional architecture and governance.

The problem is compounded by ESG, DEI and sustainability mandates, which have been further imposed onto regulators, ALBs and PuFins - "the sand and grit in the wheel".

In addition to the sheer volume of compliance, this defensive mindset has produced a steady accumulation of ESG, DEI, and sustainability obligations on regulators, arm's-length bodies, public finance institutions (PuFins), and the firms they oversee. Again, each mandate was added in response to a specific concern. However, no one evaluated the cumulative impact on each institution's capacity to perform its primary function.

The pattern is identical to the aforementioned regulatory ratchet:

- The cost of adding an ESG, DEI or sustainability obligation is borne across the economy - on firms and by the talent it deters;
- The benefit, in reduced personal exposure to political and reputational criticism, accrues to the official or institution adding the obligation;
- There is an inverse asymmetry to removing an obligation, as any subsequent failure is blamed on the rule's removal (while no-one takes credit for any activity enabled).

This is visible across a range of institutions, where ESG, DEI and sustainability considerations have increasingly been incorporated into regulatory objectives, reporting requirements, investment processes and disclosure obligations. The issue is not that such considerations are necessarily illegitimate, but that they have frequently been added without any corresponding assessment of the cumulative impact on institutional effectiveness or growth.

The current regime has in any case failed to prevent many of the harms it was designed to prevent.

Despite the expanding compliance burden, the regime has failed to prevent a succession of significant harms. The justification for a larger rulebook is always that it better mitigates systemic risk and consumer detriment; yet the record is a list of high-profile failures - the LIBOR and FX benchmark-manipulation scandals, the collapse of London Capital & Finance in 2019, the systemic mis-selling of PPI, failings in motor finance, the repeated gating of open-ended property funds, and the LDI crisis of 2022.

The conduct failures occurred *while* the regulations were expanding. LCF, an authorised firm, raised around £237m from 11,600 retail investors in unregulated mini-bonds, while PPI (which resulted in around £40bn in compensation payments) was flagged by industry and consumer groups years before the regulator acted. The issue was not an absence of rules; rather, the regulatory regime was so preoccupied with process and disclosure that it missed deliberate misconduct.

Indeed, the LDI crisis of 2022 illustrated how a precautionary regime could itself *create* risk. The underlying leverage was encouraged by a pensions framework focused on suppressing short-term funding volatility, which contributed to the widespread use of leveraged liability-hedging and, in doing so, created systemic risk.

The same pattern is visible in the tax code - each relief and threshold may have been defensible when introduced, but no-one owns or takes responsibility for the cumulative result.

The tax code has grown in the same way as regulation. Each measure was introduced for a reason - to encourage or discourage an activity, protect a group, or close a loophole. While each may have fulfilled a specific purpose at the time, none were assessed against the whole, introducing a similar outcome to that of regulation.

The consequences are similar in nature: decisions distorted by tax rather than commercial considerations, and substantial resources spent on advice, which comprises a higher share of a smaller business's costs.

1.3 - How no growth is ultimately paid for by households

The bill for no growth is paid by real people through foregone opportunity, including firms that do not grow and infrastructure which does not get built. The cost shows up through worse outcomes in housing, health, work and retirement - and declining trust in politics.

Too few firms form and scale, too little infrastructure gets built, and too much effort is spent on process and compliance instead of productive activity.

The diagnosis set out in Section 1.2 ultimately manifests in three ways:

1. Too few firms successfully scale into the large, productive businesses that drive innovation and wage growth;
2. Infrastructure is not delivered to the scale needed to support economic activity;
3. Too much of the financial sector's capacity is absorbed by compliance and process rather than by financing productive investment.

Across advanced economies, productivity growth is driven disproportionately by a relatively small number of firms that successfully scale. These firms create high-value jobs, innovate, attract investment and raise productivity across the whole economy. The United States consistently produces such firms; Britain produces far fewer, and increasingly loses many of those it does create through overseas acquisition, overseas listing or relocation.

The issue is not primarily a shortage of entrepreneurs or early-stage capital. Rather, it is reflective of a financial system that struggles to support companies further along the corporate life cycle. Growth capital remains difficult to access, public markets have become less attractive, and institutional capital is increasingly directed away from productive risk-taking. The result is fewer scaling firms and weaker productivity growth.

With infrastructure, the UK has systematically underinvested in energy, transport, housing and water - all of which support long term growth. Projects are frequently delayed, scaled back or abandoned altogether.

Infrastructure and business formation are mutually reinforcing. Scaling firms require housing, transport, energy and connectivity in order to grow. Infrastructure, in turn, becomes more economically valuable when businesses are expanding. Instead, Britain is currently experiencing the opposite, vicious cycle.

Finally, finance exists to allocate capital towards productive uses - yet an increasing share of effort is devoted to compliance, reporting, governance processes and documentation. While some of this activity is necessary, the cumulative effect is that more resources are spent administering the financial system and fewer are spent financing economic growth.

The consequence is a financial sector that has become less effective at performing its core economic function. Capital remains plentiful, but too little reaches firms, entrepreneurs and infrastructure projects.

For citizens, this ‘managed decline’ means flatlining wages, an inability to buy a home or start a family, poor retirement outcomes, and an erosion of trust in the system.

Economic stagnation is often discussed in terms of GDP. In reality, its effects are experienced in the everyday lives of millions of households.

The most obvious consequence has been a prolonged period of wage stagnation. Real earnings have experienced their longest period of weakness in modern British history, leaving many households feeling little better off than they were fifteen years ago, despite continued technological progress.

"Many workers in their thirties and forties have spent their entire prime-earning years in economic conditions previous generations would have considered a recession."

At the same time, the traditional milestones of life have become harder to achieve. Home ownership, once attainable for most working households, has increasingly become out of reach. While this is caused by a multitude of factors (not least supply), flatlining real wages are crucial, and family formation and long-term financial security have become more difficult as housing costs have outpaced earnings growth.

The consequences extend into retirement: the first generation approaching retirement primarily through defined contribution pension arrangements is doing so with average pension pots that will likely fall short of adequacy. Many individuals who have worked, saved and contributed throughout their lives face retirement incomes significantly below what previous generations expected.

More broadly, measures of social progress have stalled: improvements in life expectancy have slowed markedly since around 2010, with some communities experiencing little improvement at all. While many factors contribute to this trend, it is difficult to separate it from a prolonged period of weak economic growth and strained public finances.

Taken together, these trends have created a large and growing imbalance between generations. Housing costs, asset inflation and the structure of pension liabilities have transferred wealth and opportunity towards those who already hold assets, while making it harder for younger households to build their own. Basic familial responsibilities, such as raising children and caring for elderly relatives, are becoming materially harder for households whose incomes have not kept pace with the cost of doing so. Increasingly, some of Britain's most skilled and mobile workers are choosing to pursue opportunities elsewhere, where the reward for effort and risk is more favourable.

Economic stagnation is increasingly translating into political instability.

Public services that were once funded by a growing economy increasingly require higher taxes and borrowing, or face a visible deterioration in performance. Trust in institutions, the fairness of the economic settlement, and ultimately in politics itself becomes harder to sustain when living standards stagnate and opportunities narrow. The political volatility of the past decade should not be viewed in isolation from these trends.

1.4 - Why Britain's economic challenges are reversible

It does not have to be this way: Britain still retains deep pools of capital and talent, but lacks the channels and incentives that turn them into domestic investment and productivity growth.

Britain retains many of the foundations required for economic success. It remains home to one of the world's leading financial centres, internationally respected legal and professional institutions, world-class universities, and a workforce capable of competing in the highest-value sectors of the global economy. Neither is the problem a lack of talent or ideas.

Britain is not short of capital, either: pension funds, insurers and household savings collectively represent one of the largest pools of long-term capital in the world[2]. Early-stage businesses continue to attract investment, while international investors remain willing to deploy capital.

The challenge is that too much of this capital fails to reach the firms and projects that would deploy it most productively. Capital that could support growing (especially scale-up) businesses and infrastructure is instead directed towards activities that prioritise regulatory certainty and short-term risk reduction. The result is the paradox of abundant capital alongside weak investment, underfunded scale-ups and stagnant productivity growth. Moreover, Britain's long-term savings sit across a fragmented landscape of DC pension schemes, many of them too small to invest directly in larger initiatives such as infrastructure, or negotiate on equal terms.

1.5 - A new governing mindset: 'smart and safe'

The current precautionary approach often treats avoiding risk as the overriding objective, whereas a 'smart and safe' approach instead protects against the biggest harms while accepting that measured risks are needed for an economy to thrive, whilst punishing fraud and gross negligence more severely.

We reject the false choice between unfettered deregulation and precautionary regulation.

Two framings currently dominate debate on regulation, both of which are inadequate.

The first treats regulation itself as the problem. On this view, regulation primarily impedes activity and growth can be restored principally through deregulation - with markets largely self-correcting. This approach understates the lessons of the Global Financial Crisis.

The second - and now dominant - approach treats visible losses as evidence of regulatory failure. On this view, safety is achieved by suppressing risk and precaution carries little immediate consequence - the principal role of institutions is to prevent adverse outcomes wherever possible.

These positions misunderstand risk as a single thing to be either embraced or avoided. However, a central theme of this paper is that different kinds of risk have different consequences, are borne by different people, and thus require different responses. Rather than ask how much risk the system should bear, we ask which risks it should bear, who should bear them, and on what terms.

A credible reform programme must therefore be capable of saying, simultaneously, where risk should be reduced and where it should be embraced.

[2] OECD, Pensions at a Glance 2025

While Britain's challenges are different today to those in 2008, we nonetheless do not advocate returning to the pre-2008 regime.

The challenge facing Britain today is different from the challenge it faced in 2008. The challenge is no longer simply how to prevent financial instability, but how to do so without unnecessarily suppressing investment and growth. Nevertheless, the pre-2008 light-touch regulation ignored a systemic accumulation of risk, and we do not wish to repeat the systemic mistakes of that era.

'Smart and safe', which is proactionary by design, means tightening where real harms justify intervention, and easing where precautionary defaults suppress productive economic activity.

The UK financial system is not uniformly over-regulated or under-regulated; it is miscalibrated. It is often strongest where failure is visible and politically costly, yet weaker in some of the areas where intervention is most justified.

A smart-and-safe framework therefore has two components:

1. Safe reform: tightening the system against harms that justify intervention - for example, systemic contagion, fraud, losses on participants who could not reasonably understand the risks they are taking;
2. Smart reform: easing the system where it suppresses risk that should be taken and managed - for example, commercial failure, investment losses borne by informed market participants, volatility accepted in pursuit of long-term returns, and experimentation.

As discussed, these approaches are not incompatible. 'Safe' reform creates the political and institutional space for 'smart' reform, while the latter ensures that the pursuit of safety does not come at the expense of growth, investment and innovation.

> "We need to tighten the harms that genuinely matter and create the political space to ease the losses that are features of a working economy."

A smart and safe, proactionary framework contrasts with a precautionary one. The precautionary principle starts from the premise that where there is uncertainty about potential harm, caution should take precedence over action. A proactionary approach recognises that uncertainty cuts both ways: action entails risks, but so does inaction. Although the previous government removed the formal status of the precautionary principle from retained EU law, much of its underlying logic remains embedded in decision-making across the state, producing the aforementioned asymmetries which a smart-and-safe framework seeks to correct by recognising both sides of the 'risk ledger'.

The same principles apply to the tax code, which the government controls directly.

In tax, this means fewer, simpler taxes, with fewer reliefs, so that commercial decisions are driven by commercial rather than tax considerations. Tax reform must also acknowledge the existence of the same trade-offs as the regulatory reforms: removing a relief will create losers, but the beneficiaries of a simpler system are spread out (and potentially even unaware) - such reforms require political courage as well as public buy-in. Indeed, what separates tax from regulatory reform is that, while the latter focuses on the incentives and behaviour of (operationally independent) regulators through risk appetite frameworks, the former depends on ministers themselves being prepared to embrace risk.

For this to work, we must accept that a free economy will always produce losers as well as winners; a well-governed economy prevents only the harms that are systemic, hidden or unfair.

The current regime often fails to distinguish between losses that are a normal feature of a dynamic economy and harms that a well-governed system should prevent.

- **Acceptable losses** - some businesses fail, investments lose money, new technologies displace existing ones, projects are abandoned, and pension funds experience periods of volatility - to name a few examples. These outcomes may be undesirable for those affected, but they are not evidence of the system failing.
- **Unacceptable losses** - systemic risk and contagion, hidden or misunderstood leverage, fraud, unsophisticated investors losing money to investments they could not reasonably expect to understand.

Treating these as the same thing is one of the core errors of the post-2008 regime.

The UK must learn to understand and restore this fundamental distinction, ensuring the state steps in to prevent systemic failure while leaving the market free to allocate capital, take risk, and drive economic growth.

Productive risk must be explicitly authorised by Parliament, not tacitly tolerated by regulators.

A proactionary, smart-and-safe framework cannot be delivered simply by asking regulators to become less risk-averse. Productive risk-taking must be explicitly authorised through Parliament, ministerial direction, and institutional objectives - rather than left as something regulators are expected to tolerate while remaining personally accountable for every failure.

This is therefore a political choice: the appropriate balance between resilience, growth and risk tolerance should be determined by Parliament and ministers on behalf of the public, not emerge indirectly from the incentives facing regulators and institutions. If society wishes to accept greater investment risk in pursuit of higher growth, stronger pensions or faster infrastructure delivery, that judgement should be made openly and democratically.

Explicit political authorisation changes who owns the outcome:

- Parliament and ministers state in advance what losses are acceptable in pursuit of what gains - a declared risk appetite (or ‘risk budget’) specifying acceptable failure rates, acceptable volatility ranges, and the upside being sought in return;
- Regulators then operate within that appetite;
- When losses materialise within the appetite, they are not scandals - this is the system working as designed;
- When losses materialise outside the appetite, accountability is clear and specific;

- Crucially: when gains fail to happen as a result of the risk budget not being utilised, accountability is also clear.

The political class must defend the trade-off when an authorised loss materialises and attracts hostile media attention. Without this, the reforms become worthless within one news cycle - every ‘acceptable’ loss will be reframed as a scandal and the declared risk budget is quietly abandoned. Sustaining political air cover is a governing capability in its own right and cannot be delegated to regulators.

> **“Without explicit authorisation and sustained air cover, every reform we propose will be reversed by the first bad headline.”**

This requires a political capability and courage that has atrophied. Decades of delegation have left ministers and Parliament without the language or habit of governing regulators strategically. Rebuilding this capability is an essential precondition for many of the reforms proposed in this paper.

This principle applies equally to accountability. Regulators should continue to answer for systemic failures, misconduct and consumer harm. But they should also be expected to account for the costs imposed by excessive caution, including delayed investment, reduced competition, weaker pension outcomes and foregone growth.

The necessary institutional reforms to bring this new framework to reality are developed in Chapter 2.

Example risk-reward trade-offs

The reforms in this paper each ask the government to, explicitly or implicitly, embrace specific risks in return for defined upside - for example:

- Accepting that authorised firms will sometimes fail and exit, and that firms acting in good faith within published safe harbours will sometimes make mistakes - in return for faster authorisation and simpler rules (see Chapter 2);
- Accepting more, and better-priced, lending risk - in return for a greater flow of finance to the SMEs (see Chapter 3);
- Accepting greater investment volatility, and measured illiquidity, in the nation's pension savings - in return for stronger retirement incomes and a larger pool of long-term capital invested in the UK (see Chapter 4);
- Accepting that removing tax reliefs creates losers as well as winners - in return for a simpler, less distorting tax system (see Chapter 5).

'Smart and safe' also means simpler regulation, backed by severe penalties for misconduct.

The current regulatory framework often relies on layers of rules, guidance, reporting requirements, and administrative process as a substitute for judgment.

A smart-and-safe framework instead relies on simpler rules - making it straightforward for firms to comply while streamlining supervision for regulators.

This approach requires a clear distinction between honest risk-taking and misconduct. Firms and individuals acting in good faith should face fewer unnecessary burdens and greater freedom to innovate, invest, and compete. Those deliberately engaging in fraud, market abuse, or gross negligence should face severe and swift penalties.

A 'smart and safe' system will only last if gains are real and widely shared.

A proactionary approach cannot rely solely on technical arguments about capital allocation or GDP. To be politically durable, it must produce outcomes that are visible in daily life and broad-based enough to sustain democratic support.

The public will tolerate greater risk only if a high enough proportion of people see a corresponding improvement in their living standards and economic prospects. Faster growth only matters if it translates into affordable homes, higher real wages, prosperous retirement and better public services. If a reformed framework rewards only a narrow group of firms while asking the public to absorb the risks, it will quickly lose legitimacy.

We therefore propose that success should be defined not only by real GDP per capita, but also real median household disposable income or a similar, equivalent measure.

1.6 - Restoring living standards requires more than financial reform

To achieve higher living standards, financial reforms alone are not sufficient - they must be undertaken alongside parallel programmes addressing the multitude of other issues holding Britain back.

Other barriers to growth require similar reforms: energy, planning, welfare, governance, state productivity - to name just a few.

The reforms proposed in this paper are necessary, but they cannot transform the economy in isolation. While financial reform unlocks investment, many of the deepest obstacles to British prosperity lie outside the financial system - most prominently in energy, planning, welfare, governance, and public sector productivity. Yet while these domains differ, they suffer from the same issues: excessive complexity, asymmetric accountability, and a structural bias towards caution.

This paper should therefore be viewed as one core component of a broader programme of national renewal. While unlocking investment is essential, cheaper energy, planning reform, and a more capable state are its necessary complements if Britain is to deliver sustainable, long-term improvements in living standards.

The elephant in the room: the size of the state must be addressed alongside the reforms in this paper; no credible programme can ignore the current size of the state, nor the broader fiscal context.

A further issue raised repeatedly during this project sits outside its formal scope, but cannot be ignored by any credible strategy for growth: the size and affordability of the state.

Public spending as a share of GDP, alongside the overall tax burden, has expanded under successive governments - accelerating sharply after 2008 and again after 2020. The supply-side reforms proposed in this paper are vital, but they cannot by themselves offset the drag of a state that consumes an ever-larger share of national output.

This constraint is particularly acute given that the radical tax reforms proposed in Chapter 5 carry near-term fiscal costs. Unlocking dynamic supply-side growth requires fiscal headroom, which can only be created by controlling public expenditure and reducing the state's broader economic footprint.

A parallel programme addressing the size, scope, and efficiency of the public sector is therefore an essential complement to this paper.

AI significantly raises the stakes for the reforms in this paper.

Artificial intelligence is likely to be the defining economic force of the coming decade; no serious reform programme can ignore it. AI does not make the reforms in this paper less necessary. If anything, Britain's ability to benefit from it depends directly on many of the policies advocated here:

- Whether AI is financed and built in Britain: in addition to Britain's aforementioned energy challenges, capital and highly productive businesses are internationally mobile - reforms are needed to make Britain a better home and destination for investment;
- Job creation and economic dynamism: AI may plausibly displace many professions while creating the opportunity for new ones - reforms that make Britain a home for AI-intensive firms will facilitate the creation of new, well-paid jobs here;
- A live test of the proactionary approach: a precautionary regime, characterised by slow planning and defensive regulation, risks Britain losing out on AI, which we would view as a far greater harm.

Despite the extensive reforms in this paper, we remain mindful of the possibility that AI could transform the public finances and economic foundations to such an extent that even more fundamental reforms become necessary over the coming decade. Indeed, if advances in artificial intelligence materially reduce labour demand and, in turn, income tax receipts, a government that derives a significant proportion of its revenue from taxing employment must at least consider how AI could affect the long-term sustainability of that model.

1.7 - Implementation and timing are critical to the success of the policies we propose

Many reforms fail due to poor delivery. This paper therefore sets out the order, the legislative instruments, and the changes to the Civil Service needed to implement our policies within a Parliament. Moreover, tax proposals must be subject to corresponding reductions in public spending.

A consistent message from the working groups behind this paper is that policy proposals are of little value unless accompanied by a realistic strategy for execution.

Chapter 6 sets out the sequencing of these reforms, the dependencies between them, and the legislative strategy needed to maximise speed. This includes prioritising administrative action and secondary legislation wherever possible, reserving primary Parliamentary time for only where strictly necessary, and addressing the Civil Service capabilities and institutional incentives upon which delivery ultimately depends.

The delivery mechanism for tax reform requires equal rigour. Given the precarious state of the public finances, maintaining fiscal credibility is of the utmost importance. Every proposal must be costed, with tax reductions paired with corresponding spending discipline rather than relying on assumed growth to fund them.

Chapter 2: Institutional and Regulatory Reform

2.1 - The government takes responsibility for risk appetite

The government should no longer leave decisions on risk and reward to simply emerge by default. Instead, it should take responsibility for risks it wants to proactively embrace and the benefits which it expects in return, as well as risks it would like to minimise. Trade-offs then become democratic and explicit, rather than technocratic and implicit as presently. It also gives regulators clearer direction and makes it easier to hold them accountable.

2.2 - Treasury and Bank of England reform

Britain’s economic institutions require fundamental reform to ensure they work together to create the conditions for growth and higher living standards, rather than continue to manage stagnation and decline.

2.3 - What a 'smart and safe' regime means in practice for the regulators

Under the new framework, regulators should move from a precautionary approach based on process and compliance to a proactionary one which focuses on real economy outcomes and frees the financial sector to fund British businesses and deliver higher returns for savers, whilst more severely penalising misconduct.

2.4 - Arm’s-length bodies and state risk

Britain’s now-vast network of ALBs has made the country increasingly difficult to govern, while the risk of delay and policy reversal (‘state risk’) is deterring private capital. This is a major reason why much needed housing and infrastructure projects fail. Fundamental reform is needed to make it easier for elected governments to deliver their policies and give investors greater confidence that projects will actually proceed.

2.1 - The government takes responsibility for risk appetite

The government should no longer leave decisions on risk and reward to simply emerge by default. Instead, it should take responsibility for risks it wants to proactively embrace and the benefits which it expects in return, as well as risks it would like to minimise. Trade-offs then become democratic and explicit, rather than technocratic and implicit as presently. It also gives regulators clearer direction and makes it easier to hold them accountable.

Key policy recommendations:

- → **The government sets an explicit financial services risk appetite framework.**
- → **Ministers issue mandate letters setting each respective regulator's risk budget.**
- → **Regulators are required to report against both sides of the 'risk ledger': realised harms and foregone upside.**
- → **A standing parliamentary committee holds ministers and regulators to the declared risk budget.**
- → **Regulator operational independence is preserved, but exercised against the government's stated risk appetite.**
- → **Deliberate, reckless or grossly negligent harm attracts more severe personal sanctions.**
- → **A sanctions panel is created for serious individual misconduct.**

The current regulatory regime has no explicit risk appetite - its downside mitigation objectives are outlined in a detailed rulebook, while its growth and competition objectives exist in statute but have no KPIs, nor consequences for shortfall.

The UK's financial regulatory framework does not declare a position on what risks are acceptable in pursuit of what gains. Regulators operate under multiple statutory objectives which have accumulated over years, but these objectives have only limited hierarchy between them, nor is the trade-off between them made explicit.

The issue is in the enforcement of each objective: downside objectives, including consumer protection, financial stability and market integrity, are outlined in detail in their respective rulebooks, whereas growth objectives exist in statute but are aspirational in practice - unlike the downside objectives, they have no equivalent rulebook or supervision behind them, nor consequence for failing to advance them. The regulators are now required to report on their progress and have published metrics alongside, but this is an account of effort rather than a target.

The Secondary Growth Objective, introduced under the Financial Services and Markets Act 2023, is illustrative of the problem. Applied to both the FCA and the PRA, it was presented as a rebalancing of regulatory priorities towards growth, but in practice it has produced little discernible change in authorisation speed or rulebook volume.

The FCA itself now recognises the challenge. In a November 2025 speech, the FCA's Chair, Ashley Alder, made "rebalancing risk" the organising idea of the regulator's 2025-2030 strategy - arguing that risk is not merely something to be minimised, but a precondition for investment and innovation, and acknowledging openly the trade-offs with growth, along with the recurring cycle in which regulation tightens after each crisis and loosens as the memory fades[3].

But, while a regulator can acknowledge a trade-off, it cannot authorise one. The FCA, for instance, has many objectives, but these sit alongside a series of legally enforceable 'have-regards', are supplemented by Treasury remit letters, and are overlaid again by the regulator's own strategic priorities, with limited prioritisation among them. It effectively must infer a risk appetite.

Indeed, in the absence of a declared position from ministers, the inferred risk budget which defines each regulator's behaviour emerges from the 'asymmetric accountability' described in Chapter 1 - namely, they are censured for visible harm but not censured for foregone growth, and thus default to risk minimisation.

The FCA's statutory architecture - multiple objectives and considerations, no stated risk appetite

The FCA does not set its own objectives: Parliament sets them, with the FCA responsible for advancing them. Beneath the objectives sit legally enforceable 'have-regards', and beneath those, Treasury remit letters and the regulator's own priorities. There is limited prioritisation among them.

Objectives (5) - set in statute

- Strategic: ensure the relevant markets for financial services function well [s.1B(2) FSMA 2000];
- Operational: consumer protection [s.1C]; market integrity [s.1D]; competition in the interests of consumers [s.1E];
- Secondary: the international competitiveness of the UK economy and its medium-to-long-term growth [added by FSMA 2023].

Have-regards - legally enforceable considerations (judicially reviewable)

- Regulatory principles [s.3B], which cover efficiency and economy, proportionality, consumer responsibility, senior-management responsibility, openness and transparency;
- Minimising financial crime [s.1B(5)(b)];
- Consumer-protection-specific have-regards [s.1C(2)] - including the differing degrees of risk across products, consumers' need for information, and relevant Financial Ombudsman Service information.

Further layers - not statutory objectives

- HM Treasury remit letters, issued at least once per Parliament (latest November 2024), adding policy considerations the FCA must have regard to;
- The FCA's Strategy 2025-2030 priorities - internally set.

[3] Financial Conduct Authority, Chair reflections on rebalancing risk, November 2025

The government itself must declare an explicit risk appetite framework, set around 1) acceptable risk, 2) upside economic activity expected in return for this, and 3) unacceptable risk.

Chapter 1 established the principle that a free economy will always produce downside outcomes as well as upside, but that a well-governed one should prevent harms that are systemic and unfair.

Firms will fail and investments will lose money, and it should be made clear to regulators these are features of a working system rather than failures to be prevented.

Risks are set down as categories with tolerances, with risks not accepted as a price of growth - systemic contagion, fraud, misunderstood leverage - becoming where the regime aims to focus its efforts (whilst recognising that risk can never be zero). The upside sought in return for acceptable risks - growth, investment, competition, innovation - is what a regulator should actively enable but what the present regime omits.

Presented this way, the proposed framework departs from the present architecture in three key respects:

1. Trade-offs should be declared in advance, rather than struck internally by regulators balancing objectives;

2. There is accountability for foregone upside as well as realised harm; and

3. Political trade-offs become public record, so that losses or failures occurring within the declared appetite are not reframed, after the fact, as regulatory failure.

The framework applies to each regulator to reflect their respective activities and risks overseen.

Illustrative risk appetite framework for selected regulators

Regulator	Acceptable risk	Upside sought in return	Unacceptable risk
FCA	Commercial failure and exit of authorised firms; investment losses borne by informed investors; bounded product and market experimentation; good-faith mistakes	Faster authorisation and market entry; competition from challengers; new products, listings and capital formation; responsible innovation	Fraud and market abuse; mis-selling to those who could not reasonably understand the risk; systemic conduct failures
PRA	Orderly failure of non-systemic and challenger firms	More challenger entry and lending capacity; capital calibrated to free productive lending; a more competitive banking market	Disorderly failure of systemic institutions; taxpayer-funded bailouts; contagion and bank runs
TPR	Investment volatility and illiquidity	Growth-oriented deployment of pension capital; consolidation into schemes of sufficient scale; better retirement outcomes	Loss of accrued benefits through sponsor failure or fraud; systemic leverage risks (e.g. LDI episode)

Note: The distinction between an acceptable loss and an unacceptable one only holds if it is made through the mandate letter rather than inferred by the regulator. For example, the test of who "could not reasonably understand the risk" has now widened to the point where it captures most retail consumers, so that losses are treated as detriment by default.

Ministers in turn issue mandate letters to the regulators, outlining their respective 'risk budgets' - acceptable risk, what upside is expected in return, unacceptable risk.

The Treasury already issues remit letters to the FCA and the PRA at least once a Parliament; what changes is how these are used - to set a declared risk budget, built on the three categories above, against which each regulator reports and is held accountable.

The mandate letter is issued by the minister responsible for the respective regulator, published alongside the regulator's annual business plan, reviewed at least annually, and accompanied by a public statement in which the minister defends the balance struck.

Its content goes beyond current remit letters in three respects:

First, it states the harms and losses the minister judges acceptable in each category of activity - e.g. firm failures, investment losses, scheme volatility - in directional terms[4]. The budget describes the kinds and broad scale of loss acceptable in normal conditions and reserves precise targets for what a regulator actually controls, such as the time taken to authorise a firm.

Second, it states the upside expected in return e.g. capital deployed, firms authorised, time to decision.

Third, it states where the system is being deliberately tightened.

The mandate letter also names the conduct for which there is limited or minimal appetite - for example, for deliberate misconduct, or conduct that is reckless or grossly negligent - and the corresponding enforcement expected of the regulator - for example, referral to criminal authorities, or director disqualification. The minister sets the appetite and the priority, but the sanction process in any individual case remains with the regulator, sanctions panel, prosecutors and the courts.

The 'smart' side of the 'smart and safe' regime outlined in Chapter 1 - simpler rules, faster authorisation - goes hand-in-hand with the 'safe' side - harsh penalties for deliberate or reckless misconduct.

The regime rebuilds a political capability that decades of delegation have allowed to atrophy - namely:

- Ministers must hold a view on trade-offs and defend it in public;
- Regulators are given direction rather than left to infer it;
- Parliament has a document against which to hold both to account; and
- The public has a stated position that can be quoted back when events test it.

---

[4] Directional rather than as a single failure rate - the minister might state, for instance, that the system is currently too averse to firm failure and investor loss, and that a higher incidence of both is acceptable. (A precise figure would be counterproductive: a number which looks prudent in calm conditions could then be falsified by the next crisis, and one that looks generous in a downturn then looks reckless in a boom).

Crucially, this is what provides political air cover to each regulator. Without a published position, air cover has to be improvised under pressure in the middle of a bad news cycle; with one, ministers can more effectively defend a position.

Risk appetite statement worked example - FCA

The following shows how the three categories can fit into a single regulator's mandate letter, written by the responsible minister.

Risk we accept - and will not treat as failure if materialises within tolerance

- The commercial failure and orderly exit of authorised firms is a normal feature of a competitive market. The FCA is not expected to prevent firms from failing; rather, to ensure that when a firm fails, the loss falls on its owners and informed creditors - not on retail customers' deposits and client assets, which should be returned or covered by FSCS.
- Informed investors will lose money on decisions they understand. Losses of this kind are not mis-selling and should not be supervised or reported as though they were.
- Firms will make good-faith mistakes. Where a firm has acted reasonably and especially within a published safe harbour, the response should be remedial rather than punitive.

Upside we expect in return

- Faster authorisation and competition: X% of firms authorised within X weeks (measured from first substantive contact).
- Capital formation: measurable growth in (for example) capital raised, new listings.
- Where the FCA declines or delays, we expect it to account for the upside foregone - not only risk mitigated.

Risk we do not accept

- Fraud and market abuse - this does not mean no fraud will ever occur (there will always be residual risk in any authorised firm), but the response is prevention through proportionate controls and deterrence through severe personal sanction for deliberate misconduct, not the suppression of legitimate activity.
- Mis-selling to consumers who could not reasonably understand the risk they are taking on.
- Systemic conduct failures capable of undermining confidence in a market as a whole.
- For conduct that is deliberate, reckless or grossly negligent, we expect the FCA to pursue the individuals responsible (e.g. prosecution, director disqualification, industry ban) rather than to settle at firm level.

Regulators then report against their mandates on both sides of the 'risk ledger' - not only the enforcement actions and realised harms they already disclose, but also the productive activity enabled and foregone e.g. firms and products authorised, time taken to decisions.

Regulators already account in detail for the downside: enforcement actions, fines, refused authorisations, supervisory interventions, consumer detriment identified and addressed. However, they do not account for foregone upside - number of firms that did not scale, capital that did not deploy, products not launched, decisions which took too long.

This is the asymmetric accountability principle outlined in Chapter 1.

The reform is to require both: downside reporting continues as now, with upside reporting - number of firms authorised and time taken to authorise them, capital deployed (within the regulatory perimeter), new products and listings brought to market, decisions taken on competition cases, and the activity foregone.

Some of these are easily measurable, while others require estimates to be calculated (e.g. capital mobilised); others (like foregone upside) will be harder to estimate, since the subject of the measurement did not happen, though we argue that this is a better alternative to silence.

Two design points to maintain the integrity of the reporting framework:

First, the metrics must capture what a regulator actually controls - e.g. time to authorise, size of the rulebook - not outcomes it cannot, such as GDP.

Second, they must be built to resist gaming: authorisation time, for instance, should run from a firm's first substantive approach, not from the point at which the regulator deems an application ‘complete’, mitigating situations where firms could be quietly invited to withdraw and resubmit so that the clock restarts. Reporting is independently verified, not self-certified.

Finally, reporting is standardised across regulators so far as their activities allow, as the government needs to be able to see where the system as a whole is tightening and where it is loosening.

A standing parliamentary committee holds ministers and regulators to the respective declared risk budgets, with statutory access to regulators' information, expert support, and the power to require formal responses.

We propose a separate institution to enforce the framework - otherwise, mandate letters and reporting become just paperwork. We argue for a standing joint committee of both Houses of Parliament, dedicated to the regulation-growth interface and equipped to hold ministers and regulators to account against the risk budget.

The committee requires relevant expertise and support in order to adequately challenge the regulators in scope. It therefore has a standing secretariat of seconded expertise - from industry, academia and former regulators themselves.

Its composition is cross-party and cross-House, and holds statutory access to regulator information, including internal decision memoranda and dissenting views. Its scope is the whole regulatory perimeter - the FCA, the PRA, TPR and equivalent bodies elsewhere - together with the ministers accountable for them. Process frequency is a scheduled annual hearing aligned with the mandate-letter cycle, with the ability to investigate particular issues as they arise.

The committee can require a minister to respond publicly to specific criticism, require a regulator to justify a departure from its mandate, refer a breach to the responsible minister, and publish findings the minister must answer in writing. To carry those powers it is best constituted as a joint statutory committee on the model of the Intelligence and Security Committee (created by primary legislation), to ensure that it has the access it needs, and retains the right to be consulted on mandate letters. Members are appointed through the usual select-committee process, so that the committee keeps its democratic legitimacy and does not become a technocratic body.

The committee is also a source of political air cover - when a loss occurs (so long as within the respective risk appetite) and attracts hostile media coverage, it provides the cross-party institutional voice able to say that this was the agreed position, and why - shifting the political cost from an exposed minister or regulator onto a position held in common. Without this, the ratchet described in Chapter 1 tightens after a bad news cycle - with the said loss treated as a scandal, caution is restored, and the reforms unwind.

The process must continue to respect regulators' operational independence, but also require it to be exercised against the declared risk appetite - analogous to how monetary policy is exercised against an inflation target.

We do not propose that the new regime compromises regulator independence, which has been a deliberate feature of the UK system since the FSA regime was established in the late 1990s, successfully insulating technical judgement from short-term political interference, and aligning the UK with the international norms (on which its standing as a financial centre partly depends). Ministers should not direct individual regulatory decisions.

This is partly analogous to how monetary policy already works. The Bank of England is operationally independent in setting interest rates and its use of other monetary instruments, but the inflation target it pursues is set by the government.

International experience is instructive: Australia, a high-performing regulatory regime, frames its regulators' objectives more politically than the UK does. Australia's regulators, ASIC and APRA, are operationally independent, but the government sets their priorities directly, through explicit Statements of Expectations. The UK's pre-FSA regime had weaker independence and weaker political framing; the regime we have now has strong independence but still-weak framing. Our proposal takes the Australian combination: objectives framed politically but with independence preserved.

As appointments to the regulators fall due, ministers should use the powers they already hold to appoint people who accept the mandate.

Ministers already appoint the chairs and non-executive members of the regulators; we propose they use this power, as terms come up, to appoint people who accept the declared risk appetite and are prepared to be held to it, rather than treating appointments as a formality.

The experience of each appointment is also crucial: a regulator which weighs growth against risk needs senior leadership who have handled risk themselves in their prior careers (whether commercial or otherwise), as well as the necessary technical expertise.

The 'safe' side of smart-and-safe requires harsher deterrents for deliberate, reckless or grossly negligent harm - this includes criminal liability, director disqualification and lifetime bans - and correspondingly narrower personal liability for everyone else.

The crisis of 2008 was primarily a failure of misunderstood risk rather than an absence of conduct rules. The conduct that produced it was largely lawful and rule-compliant, encouraged by the incentives of the time. Wrong lessons, however, have been learned, as a series of conduct-related rules have since been loaded onto firms.

Moreover, actual misconduct has continued to be met mainly with firm-level fines rather than personal consequence - for example, systematic mis-selling of PPI, or more recently motor-finance commissions, have been addressed through firm redress, with limited action against individuals responsible. The one prominent attempt to go further - the criminal prosecutions over LIBOR and EURIBOR manipulation - reached traders rather than decision-makers; and even the two convictions that reached the Supreme Court were quashed in 2025 with no retrial sought.

This is the worst of both worlds: heavy conduct rules for honest activity, and weak personal deterrence for dishonest activity.

The proactionary regime we propose - simpler rules, faster authorisation, outcomes-based supervision, with safe harbours for good-faith decisions - is only politically defensible if it is matched by severe consequences for deliberate, reckless or grossly negligent misconduct.

For conduct for which there is low risk appetite, as listed in the respective mandate letters, the corresponding deterrents should comprise:

- Criminal liability for deliberate misconduct that causes material harm, prosecuted as such rather than absorbed into a firm-level fine;
- Director disqualification for senior individuals whose conduct falls within the unacceptable category;
- Industry bans, including lifetime bans for the worst cases;
- Personal liability under the Senior Managers regime, retained but narrowed to intent or gross negligence rather than process failure - the present version risks deterring capable people from senior roles without catching the culpable.

Severity is not enough on its own: the deterrent must fall on the senior decision-makers who are genuinely culpable. The intention is to narrow personal liability rather than extend it. This is especially important for non-executive directors, who are relatively modestly paid and reliant on the information they receive from management, and difficult to recruit in part due to the disproportionate downside risk they are exposed to.

A Sanctions Panel for individual misconduct

Criminal prosecution remains necessary for egregious, deliberate fraud, but it is a poor instrument for broader individual misconduct in financial services - with the LIBOR collapse being a case in point. The evidence bar is high, jury trials of complex financial conduct are slow and difficult, and such cases compete for resources with general crime, producing few recent prosecutions.

The civil alternative - FCA enforcement, with contested decisions considered by the Regulatory Decisions Committee - secures more outcomes, but is criticised for concentrating on more junior individuals, against whom responsibility is more easily established, rather than on senior decision-makers.

A Sanctions Panel could combine the speed of regulatory enforcement with the credibility of judicial process. It would be chaired by a senior judge or KC, sitting with members drawn from the financial industry and the wider business community, and empowered to impose sanctions specifically on individuals (with firm-level matters remaining with the regulator) - including industry and lifetime bans, director disqualification, and financial penalties.

There is international precedent for elements of this model - for example, Hong Kong's Market Misconduct Tribunal, Australia's Financial Services and Credit Panel, and the United States' PCAOB for auditors.

Prior to 1997, the Bank of England's formal powers over individuals were largely confined to vetting their fitness to hold office. In practice, it had significant informal powers over conduct - in a small and deferential City, a signal of the Governor's disapproval, the 'Governor's eyebrow', could end a senior banker's career without any formal process.

2.2 - Treasury and Bank of England reform

Britain's economic institutions require fundamental reform to ensure they work together to create the conditions for growth and higher living standards, rather than continue to manage stagnation and decline.

Key policy recommendations:

- → **Split HM Treasury into a finances-focused ministry (retaining the 'Treasury' name) and a growth-focused 'Department for Economic Growth'.**
- → **The Treasury retains fiscal discipline, tax, spending control, and debt strategy.**
- → **The Department for Economic Growth becomes responsible for delivery of growth, taking ownership of financial services policy, setting the strategic risk appetite for economic regulators, and driving productivity-enhancing market reforms.**
- → **The Treasury can no longer veto approved growth reforms through short-term fiscal scoring.**
- → **The OBR publishes fiscal forecasts as ranges with alternative scenarios to reflect model uncertainty, with measures scored against a cautious baseline to build a margin of safety.**
- → **Debt-management execution moves under the Bank, while debt strategy remains with the Treasury via the responsible minister.**
- → **The Bank of England's performance is evaluated by the new statutory standing committee, while the Chancellor continues to set the inflation target.**
- → **External Monetary Policy Committee members are selected independently, with greater real-economy representation.**
- → **The Bank's inflation performance is judged against CPI over one-, three-, and five-year horizons, with reporting required to distinguish domestic inflation from imported price shocks.**
- → **Bank leadership remuneration is linked to performance against mandate.**

HM Treasury should be split into two ministries, with one focusing on finance ('Treasury') and the other on growth ('Department for Economic Growth').

The UK concentrates an unusually broad range of functions - spending control, tax, fiscal rules, debt strategy, financial regulation and growth policy - within a single department. Many comparable economies give economic growth its own ministry, separate from finance, including the USA, Germany and Japan. The UK instead includes growth within the Treasury, which has embedded a bias towards short-term affordability and risk-minimisation, with no apparent accountability for growth outcomes.

The Treasury itself compounds the problem: high staff turnover and frequent rotation can weaken institutional memory. Former officials consulted diagnosed the department as being unsure as to whether it is a technocratic or a political body, with no clear mission. Resistance to reform is primarily institutional: driven by inertia, loyalty, and the status that comes from having grown up inside the institution; though a counterargument to the proposal is fiscal credibility: there is a security in the markets knowing what they are dealing with, which any reform must preserve.

> **"Britain is unusual among comparable economies in having a single finance ministry responsible for both the brake and the accelerator."**

Splitting the Treasury is not a new concept. Indeed, it was Labour policy in the 1960s (see below), though the execution was mishandled, as the Department of Economic Affairs was given no real power.

Moreover, figures around Andy Burnham - including Louise Haigh and the former Bank of England chief economist Andy Haldane - have also made the case for a standalone growth department (though they have stepped back from pursuing it in this Parliament).

We propose two changes:

1. The Treasury would own spending control, departmental expenditure limits, tax and revenue policy, and fiscal rules, with HMRC underneath;
2. The Department for Economic Growth would own investment policy and capital markets: the FCA would report into it, as would the national investment vehicles proposed in Chapters 3 and 4; the relevant parts of business and trade would also fold in.

The OBR also warrants consideration. George Osborne created it in 2010 to fix the issue of chancellors relying on optimistic, in-house Treasury forecasts. However, the present fiscal framework means that the government's rules are scored against a single five-year OBR forecast, with only a thin margin of headroom left against it, so a routine revision can wipe out the margin and force mid-Parliament changes to tax and spending.

We propose that the OBR should still perform its essential function - independently scoring the government's measures against the fiscal rules (alongside the Budget as it does now) - but that rather than relying on a single projection, it should publish its forecast as a range with alternative scenarios, and score the government's measures against a cautious point within that range, enabling policy to be resilient against economic volatility rather than optimised to inherently unreliable model projection.

The Department for Economic Growth must be free to fulfil its mandate, without the Treasury vetoing approved growth reforms on short-term fiscal scoring.

Splitting the Treasury is necessary but not sufficient. If its successor keeps an unconstrained veto over every reform - through spending approvals, fiscal scoring, expenditure classifications, Green Book appraisal and 'value for money' sign-off - the institutional bias diagnosed above will persist.

This is how the Department of Economic Affairs failed, which was created in 1964 as a direct counterweight to the Treasury and given the task of long-term growth and planning. However, the Treasury kept control of key policy levers. When the 1966 sterling crisis forced a choice between defending the pound and pursuing growth, the deflationary measures which followed destroyed the department's purpose. It was wound up in 1969 and its functions returned largely to the Treasury.

Our proposed reform therefore requires a clear division of responsibilities: the Treasury keeps fiscal rules, debt sustainability, tax revenue and aggregate spending control, but it cannot veto a growth reform simply because the costs are incurred now and the benefits manifest outside of short-term scoring. Where the Cabinet has approved a growth mandate, the Department for Economic Growth executes its policies, and disputes are resolved at Cabinet level rather than within the Treasury, as these are strategic decisions (and, in the event of any fiscal or similar emergency scenario, priority could temporarily return to the Treasury at the direction of the Cabinet).

The Bank of England, while remaining independent, must be made genuinely accountable for inflation outcomes, following a series of evident failures.

The Bank of England's independence is rightly valued. However, we argue that independence has not been met with accountability: the Bank has failed against its inflation mandate repeatedly and faced no real consequence for this. We estimate the cost of above-target inflation since 2008 at around £180 billion - about 6-7% of GDP - with roughly three-quarters of it concentrated in the four years since 2022 (see below).

"Operational independence is not the same as unaccountability."

We observe the same issue through the Bank's quantitative easing and its unwinding. The cumulative cash cost of QE and QT to the Treasury is expected to run to well over £100 billion over the life of the programme - which the Treasury must make good under its indemnity - with losses crystallised sooner by the Bank pursuing proactive quantitative tightening - selling gilts rather than letting them mature (a course most other major central banks have not taken), which both crystallises losses sooner and adds to gilt market selling pressure[5]. Monetary-policy decisions with fiscal consequences of this magnitude are taken independently of elected government and have not been adequately debated by Parliament.

This is not about politicising monetary policy or second-guessing individual rate decisions; rather, it is a case for matching independence with accountability.

[5] Office for Budget Responsibility, Economic and Fiscal Outlook, November 2025, section 6.18; Bank of England, Asset Purchase Facility, 2025 Q4

The cost of the UK's excess inflation since 2008

Persistent above-target inflation incurs significant costs whilst inflating the government's index-linked liabilities. The estimate below sets out the costs. Note this is the cost of all above-target inflation, not the cost of the Bank's failure alone - a significant part is imported and outside its control.

Channel	Gross cost (£bn, approx.)
Index-linked gilts (uplift on principal and coupons)	150
State pension (triple lock and CPI uprating above target)	90
Working-age benefits (CPI uprating above target)	55
Unfunded public-sector pensions	40
APF / QE (inflation-attributable net loss)	30
Gross cost	**365**
less revenue offsets (VAT, fiscal drag, higher nominal GDP)	*-185*
Net excess cost	**180**

Source: working group estimate, AI assisted

The Bank's performance is independently evaluated by the standing committee rather than the Treasury.

Nearly thirty years after the Bank was granted independence, it is reasonable to ask how that independence has worked, and the failures set out above are a reason to ask this now. In Westminster, any mention of the Bank's governance is often received as an attack on its independence. This does not need to be the case - reviewing how an institution performs, and who holds it to account, is a standard part of good government, whereas treating the Bank as beyond examination is part of what has allowed failures to occur without consequence.

We challenge where accountability currently sits. The Chancellor sets the Bank's monetary-policy remit and appoints the four external members of the Monetary Policy Committee. To strengthen both independence and accountability, we propose that the Bank's performance instead be evaluated by the statutory standing committee introduced in Section 2.1. The inflation target would continue to be set by the Chancellor, while the Bank retains operational independence in how it achieves it.

Note: The Prudential Regulation Authority, which sits within the Bank of England, requires separate treatment. While operational matters remain with the Bank, decisions regarding risk appetite - firm failure vs. lending capacity - must be ministerial, and should also be set through the mandate letter process described in 2.1. Whether that minister is of the Treasury or the Department for Economic Growth requires further discussion: the fiscal exposure of a bank failure argues for the Treasury, while lending capacity is a growth question and the FCA reports to the Department for Economic

Growth. While we did not reach a resolution, either way the judgement is ministerial and the standing committee holds both the respective minister and the regulator to account.

Who sits on the Monetary Policy Committee, and who chooses them?

Two features of the MPC warrant more scrutiny:

The first is its voting balance: of the nine members, five are insiders at the Bank - the Governor, three Deputy Governors and the Chief Economist - and four are external.

The second is the selection of external committee members: the four external members are appointed directly by the Treasury minister, through a Treasury-run recruitment process. External members are generally drawn from academia and the large financial institutions, with little real-economy representation.

We propose that responsibility for selecting the Committee's external members pass to an independent appointments panel, appointed for fixed terms by the standing committee, with the panel selecting candidates against published criteria. The published criteria should include experience of the real economy, such as running or financing businesses, alongside the technical expertise the Committee already has.

The Bank's mandate is defined around enforceable targets - measured over one, three and five years, and evaluated against prices the Bank can more realistically influence.

The Bank's inflation mandate is a single target of 2% on CPI. We identify two issues:

1. Monetary policy acts with long and variable lags, so today's inflation, upon which the Bank is judged, reflects decisions taken up to two years ago;
2. The target captures prices the Bank is not necessarily able to control: the UK is a medium-sized open economy and a large part of the CPI basket is imported, so headline inflation can flatter or penalise the Bank for reasons unrelated to its decisions.

As an example of the second issue, in the mid-2000s, cheap imported goods held headline CPI inflation at near target while domestically generated inflation ran well above it - the Bank met its mandate without mitigating the credit and housing boom which was building.

The first change is to evaluate performance against multi-year horizons, focusing on three and five years (with one-year tracked for context), rather than relying on an annual rate. A multi-year horizon lets external shocks work through and judges the Bank on any trends it sets. Performance against the targets is evaluated by the standing committee, with consequences for sustained over/under-shoot, rather than a continuous exchange of letters.

The second change concerns the prices the Bank is evaluated on. We considered narrowing the target to domestically-generated prices - the non-traded goods and services that UK monetary policy actually influences - rather than a headline figure which is sensitive to global energy and traded-goods prices.

However, there was some challenge to this - the public already contends with enough inflation measures - namely, CPI, RPI, CPIH, core and services inflation - and yet another, technical measure would risk undermining the measure's legitimacy. We instead propose that 1) the headline target remains a simple, recognised measure (CPI), for which the Bank remains accountable, but with the judgement weighted towards the three- and five-year change rather than one-year, so that genuine one-off shocks are not misclassified as policy failure, nor policy failure excused as a shock, and 2) the Bank's quarterly reporting must decompose inflation into its domestic and imported components, with accountability focused on the domestic part it can influence.

A crucial objective is to ensure the Bank is better held accountable for its actions following external price shocks, which the decomposition into domestic prices enables. If a shock is allowed to pass through and embed into wages and prices, this will show up in a way a single headline does not.

This is not an attempt to mechanise monetary policy. Shocks such as a pandemic or a war require judgement, and the multi-year horizons exist to make room for this. In the same spirit, the Bank should step back from the elaborate forward guidance of recent years, toward a simpler approach that ties its hands less and leaves room to respond as events require.

We further propose that the remuneration of the Bank's senior leadership be linked to the domestic component of inflation, over the three- and five-year period for which they are primarily responsible. Measuring pay on the domestic component, over the medium term, does not penalise leadership for imported shocks beyond its control (or indeed for the lagged decisions of their predecessors). Again, this is not intended to be formulaic: horizons should be blended rather than judged at a single cliff-edge, to mitigate any risks of gaming.

Should the Bank retain a growth mandate?

We considered whether the Bank should retain a growth mandate. Currently, the Bank of England Act requires it to maintain price stability and, subject to that, to support the Government's economic policy including its objectives for growth and employment. Growth is, though, subordinate in the mandate: we questioned whether it should remain part of the Bank's statutory objectives at all.

We argue that it should not: a central bank cannot optimise for two targets at once without a trade-off, while investment and growth are in part dependent on the credibility of inflation control. Monetary policy is the wrong instrument for proactively pursuing growth - the Bank's contribution to growth is stable money - and growth belongs to the Department for Economic Growth, not least through the supply side reforms set out in this paper.

That does not mean growth should be absent from the Bank's deliberations. A representative of the Department for Economic Growth should attend the Monetary Policy Committee (without a vote), able to enter formal opinions into the record - so the growth consequences of monetary decisions are argued in the room and visible to the standing committee.

We propose removing the Bank's secondary economic policy objective.

Japan, 1974-76 - monetary discipline as the foundation for growth

By 1973, Japanese inflation had reached double digits, as a result of a loose, politically driven monetary and fiscal programme that had pushed broad money growth above 20% even before an external shock arrived. When the 1973 oil shock struck an economy importing almost all its fuel, consumer prices rose around 23% in 1974, and real output fell for the first time since 1945. The Bank of Japan, historically the junior partner in economic policy and formally subordinate to the Ministry of Finance, nonetheless began tightening before the shock and did not relent afterwards - raising its policy rate from 4.25% to 9% in eight months, against political resistance, and enforcing quarter-by-quarter lending ceilings on individual banks. This monetary discipline brought inflation down from roughly 23% in 1974 to about 11% in 1975 and 9% in 1976, and further into single digits thereafter - and held even as the Finance Ministry resorted to emergency deficit financing. This was followed by a decade of stability and growth, with far less imported inflation than its peers when the second oil shock came in 1979.

Debt operations are brought under the Bank to coordinate issuance with its balance-sheet operations, while debt strategy stays with the Treasury.

Since the financial crisis, the line between managing the government's debt and managing the Bank's own balance sheet has blurred. Quantitative easing left the Bank holding a vast stock of gilts; quantitative tightening now sees the Bank selling them back into the same market into which the Debt Management Office issues. Selling gilts adds to the supply against which the DMO must issue more gilts, raising the government's borrowing costs at a time debt servicing costs are already high.

Moreover, nearly a quarter of UK debt - the highest share in the G7, and roughly double the next-highest country - is index-linked, rising automatically with inflation. This exposure was built up by the Treasury in part to satisfy institutional pension demand, but has left the public finances exposed during inflation shocks.

We propose to resolve this by bringing the Debt Management Office under the Bank of England, so that gilt issuance and the Bank's balance-sheet operations are coordinated.

When the DMO was created in 1998, debt management was moved out of the Bank so that issuance decisions could not be influenced by inside knowledge of interest-rate decisions. This remains a legitimate concern, which we address by keeping debt *strategy* (how much the government borrows, and the maturity and index-linking profile) with the Treasury, and ensuring interest rate and balance sheet (QE, QT) decisions reach the issuance desk only when they reach the market.

The gilt market cannot be asked to absorb all of the above measures simultaneously. Splitting the Treasury should be the first reform, with the changes to the Bank subsequently following.

It is important to note that the reforms outlined in this section should be separate and sequential.

Notwithstanding even the logistical challenge of addressing, all at once, the governance issues of the Treasury, the Bank, the OBR and the Debt Management Office, a reorganisation of this scope announced as a single package is a significant signal to gilt investors, at a time the public finances are vulnerable.

The division of the Treasury should therefore proceed first, as it is the most consequential of these reforms for the objectives of this paper. Changes to the Bank of England's accountability and debt-management arrangements should follow, as should reform of the OBR.

Exhibit: central-bank frameworks compared

Country (central bank)	Mandate	Inflation target	Successes	Challenges
United States (Fed)	Dual - maximum employment + price stability	2%, longer-run	Real-economy engagement; high transparency - published votes, projections, minutes	Dual-mandate trade-off; widely judged slow on the 2021-22 inflation surge
Eurozone (ECB)	Price stability primary	2%, medium term	Clear price-stability primacy; medium-term horizon rather than a rigid annual test	One policy for 21 economies
Australia (RBA)	Dual - price stability + full employment	2-3%	2025 reform split monetary decisions from corporate governance	Dual-mandate trade-off; reform new and untested
Canada (BOC)	Price stability primary; employment sought using the flexibility of the band	2% (1-3% range), medium term	Target is a joint government-Bank agreement, formally renewed every five years	Decisions by consensus, no published individual votes - less personal accountability
New Zealand (RBNZ)	Price stability (dual mandate removed 2023)	1-3%	Pioneered inflation targeting; re-clarified a single price-stability focus; engages the real economy, not just finance	Mandate changed twice in five years - undermines stability
United Kingdom (BOE)	Price stability primary; secondary growth / employment	2% CPI, "at all times"	Credible and operationally independent	Ineffective open-letter enforcement; insider-dominated; parliamentary scrutiny exists but carries no consequences

2.3 - What a 'smart and safe' regime means in practice for the regulators

Under the new framework, regulators should move from a precautionary approach based on process and compliance to a proactionary one which focuses on real economy outcomes and frees the financial sector to fund British businesses and deliver higher returns for savers, whilst more severely penalising misconduct.

Key policy recommendations:

- → **The FCA reports to the new Department for Economic Growth.**
- → **The FCA's remit is narrowed to market failures and systemic harms - specifically, conduct, fraud, market integrity, and asymmetric risks to retail consumers.**
- → **Duplicative conduct rules are removed where ordinary law or contract already provide protection.**
- → **Published safe harbours give firms certainty that specified good-faith conduct will be treated as compliant.**
- → **FCA enforcement is evaluated by serious misconduct caught and losses recovered, rather than process breaches or headline fine totals.**
- → **A time-limited FCA Handbook simplification programme tests whether each rule addresses a market failure, covers a unique legal gap, and delivers net economic benefit, which we estimate will deliver around a 50% reduction to the volume of rules.**
- → **The PRA adopts a two-tier prudential regime, placing non-systemic challenger banks onto a lighter, evolved 'Strong and Simple' regime, while keeping systemic banks under Basel III.**
- → **The Pensions Regulator reports to the Department for Economic Growth, with pensions regulation shifting from avoiding volatility to avoiding long-term underperformance and inadequate retirement outcomes.**
- → **Anti-money laundering reform moves from process compliance to targeted intelligence flows, and a reusable MOT-style identity verification.**

The FCA, now reporting to the Department for Economic Growth, narrows its remit to the harms that are most relevant to it - conduct risk, fraud, market integrity, and treatment of vulnerable customers - and moves from precautionary, process-based regulation towards outcomes-based supervision ('proactionary').

The FCA's instinct is to prevent harm before it occurs - through a detailed rulebook and approvals given in advance - as well as to seek a widening of its perimeter each time something goes wrong. As previously discussed, this has produced an ever-complex rulebook, with long authorisation times.

A proactionary regime seeks to reverse this dynamic:

First, it narrows the FCA's remit to the harms that markets, competition, and ordinary law do not adequately address - market failures such as severe information asymmetries, the theft or misuse of client money, and conduct that threatens market integrity. Where existing law and competition -

such as general contract law, the Fraud Act, and standard commercial remedies - already cover this behaviour, a bespoke financial rule is not needed.

Second, it changes the method from approval in advance to supervision of outcomes. Authorisation is still needed, but it is calibrated to what a firm's failure would actually do.

This does not mean a free-for-all - for example:

- A firm cannot, for instance, simply set up a bank that takes deposits and lends them out, where failure directly threatens retail depositors and risks systemic contagion. Such business models sit firmly on the 'preventive' side of the regime.
- On the other hand, the failure of an agency asset manager - where client assets are segregated and held with an independent custodian - is contained. Such firms should still require authorisation, but with a lower, less burdensome hurdle and a predictable timetable, even as fitness, resources, and client asset protections are verified.
- The exception is leverage: an asset manager executing highly leveraged strategies can create non-bank financial risks that quickly become systemic - as demonstrated by the LDI crisis in 2022. Where substantial leverage is deployed, that specific activity moves onto the preventive, 'safe' side of the regime.

Once approved, authorised firms operate within clear, disclosed parameters, without seeking per-transaction or per-product approval, with supervision concentrating on their actual activities, rather than on documentary compliance.

This should not be seen as a return to the 'light touch' regime of the 2000s - the difference is the 'safe' side of the regime. Light touch was 'smart' without 'safe': it gave firms freedom but was blind to systemic risks as they built up. 'Smart and safe' restores the freedom but tightens in areas where risk appetite is low, including through the use of more severe penalties and the sanctions panel as outlined in 2.1.

This strips out the areas now widely recognised as FCA overreach, keeping the relevant and substantive protections in each case, and removing any superfluous compliance requirements.

We distinguish between protection and paperwork, and present a series of examples where protection is important (and thus stays), but where process can fall away:

<u>Best execution</u>

The requirement that a firm (for example, an asset manager) take all sufficient steps to achieve the best possible result for the client is reasonable, but this activity does not need a bespoke financial rule when the firm acts as agent, as it is already obliged, in law and under its contract, to act in its client's best interests. Where the firm instead deals as principal (for example, selling from its own book), a direct conflict of interest exists, so a light regulatory standard should remain e.g. a duty to deal in good faith and execute at prices demonstrably benchmarked against prevailing market rates. In both cases, protection is only meaningful if a client can verify execution quality. Firms will therefore still be required to maintain standard transaction records to enable claims or dispute resolution, while associated procedural and monitoring requirements can be simplified.

Client money

Client money is held on trust and segregated from the firm, so that if the firm fails it is returned to clients ahead of other creditors. However, the money must actually be segregated, which reconciliation verifies and should stay within the FCA. But the current CASS regime has morphed into a massive procedural process, with granular reporting returns, continuous paperwork, and prescriptive rules dictating daily operational workflows. If a firm can prove its client accounts balance each business day, it should not be burdened with process compliance that adds cost without incrementally adding assurance.

Capital-adequacy (ICARA)

A large firm running leverage should of course think about its own capital and liquidity, and how it would wind down in the event of failure. But for a small, non-systemic asset manager whose client assets are segregated and whose failure is contained, the modern ICARA (Internal Capital Adequacy and Risk Assessment) is a particularly heavy document which achieves very little. The ICARA can be scrapped in favour of a simple, formulaic capital calculation and a standardised wind-down template.

The above examples are illustrative of a wider problem we are looking to solve: the proliferation of prescriptive, one-size-fits-all rules which stifle economic growth without adding meaningful protection.

Safe harbours become a more prominent feature, so firms can act without worrying whether they could be retroactively punished in the future.

Several market participants we consulted highlighted a flaw in the current UK regime: firms are forced to make commercial judgements and hope that the regulator does not reinterpret the rules years later.

We propose the adoption of ‘safe harbours’, which are courses of action that the regulator commits in advance to treat as compliant, so that a firm cannot be retroactively penalised if it follows them. Safe harbours are a standard feature of the US regulatory framework and elsewhere, and in a proactionary regime, which relies more on principles, they become a necessity. A good example of an explicit safe harbour is one of self-reporting, where firms which identify and proactively report their own errors should be met with a presumption that they acted in good faith.

Safe harbours need not cover everything - otherwise, they risk rebuilding the rulebook. Instead, they cover areas where the right action is knowable in advance - for example, client money segregation or standard disclosure formats - rather than matters of judgement like whether a customer was treated fairly. This leaves outcome-based enforcement to be focused strictly on clear cases of bad faith or demonstrable client harm.

These are particularly important for small firms which struggle to compete with larger firms who are better placed to absorb regulatory uncertainty, through compliance departments and legal resource - an effective barrier to entry.

Enforcement is measured on outcomes that catch serious misconduct, not on minor process breaches.

Enforcement is currently reported as activity - for example, number of investigations opened, Final Notices, fines, prohibitions and convictions - and creates a perverse incentive for a regulator to hit its numbers by bringing many quick, easier-to-prove cases such as financial-promotion breaches, while substantial misconduct goes unaddressed.

And, as set out in Section 2.1, the individuals sanctioned tend not to be the senior executives whose culpability is harder to prove.

Our proposed reform is to measure enforcement efficacy by outcome - for example, the regulator should report, and be measured, against:

- Senior misconduct at major firms it detects and sanctions;
- Fraud and serious financial crime it brings to a successful conclusion;
- Time from initial detection to intervention (excluding time spent in contested cases which reach the Upper Tribunal).

Fine totals should stay published for transparency, but with the recognition that a fine for a technical breach is not the same as catching actual misconduct.

Such outcome-based metrics should form the enforcement KPIs in the mandate letter, with the standing committee evaluating performance.

A proactionary approach allows for substantial reduction to the size of the FCA Handbook.

Although page count is a symptom rather than a target *per se*, the Handbook runs to many thousands of pages. An early FCA exercise must include the removal of rules whose cost exceeds their benefit, alongside those made obsolete by newer regulation.

A time-limited simplification programme should work through the Handbook, applying three tests to every rule:

1. Market failure: Does it address a risk or harm the market cannot price for itself?
2. Regulatory overlap: Would its removal leave a gap that existing general law cannot fill?
3. Net economic benefit: Does it prevent more harm than it causes by deterring economic activity?

The responsible minister sets the final reduction target after the review is complete, and the regulator reports progress against it under a hard two-year deadline.

We estimate that the scope for reduction is in the region of 50%, measured by volume[6].

Further reduction of the existing Handbook is implausible, as part of the remainder reflects international standards and cross-border recognition requirements (e.g. FATF standards on financial crime, market integrity standards, and the disclosure and prospectus standards on which cross-border recognition of UK listings depends).

[6] Working group analysis, AI assisted, indicative estimate

Jurisdictions such as Hong Kong and Singapore rely on shorter rules and a system of principles, with regulator judgement playing a bigger role. Britain worked in a comparable way before 1997, when conduct was overseen by self-regulatory bodies and the Bank supervised banks informally, as with the 'Governor's eyebrow' described above. Such an approach depends on firms being close to their regulator, which is harder in Britain in 2026, where far more firms are regulated across a wider range of activities. Moreover, participants we spoke with in this project consistently emphasised certainty - not only in regulation, but generally, as part of making Britain a more investable jurisdiction - which can become a trade-off in a principles-based regime.

Similarly, the FCA's headcount can fall. Despite now primarily regulating conduct, the FCA now employs more people than the FSA did in its final year, when it was responsible for both conduct and prudential regulation.

With its scope and respective rules significantly narrowed, fewer people are needed at the FCA. The FCA currently employs around 5,500 staff, versus roughly 4,000 at the FSA in its final year, when it was responsible for prudential regulation as well.

While some of the growth reflects a widening of its remit - for example, the FCA took on consumer credit in 2014 and claims management firms in 2019 - headcount has also grown alongside rule accretion and intensity of regulation.

Given the rulebook and remit reduction we propose, alongside the replacement of precautionary approval with outcomes-based supervision, we estimate a conduct regulator of around 3,000, with much of the reduction falling on routine supervision of smaller firms and rule writing. We refrain from proposing a further reduction to 1) preserve enforcement capability, and 2) address a common industry complaint that the FCA is slow (approvals still have to happen).

To mitigate the risk of future headcount accretion, under the mandate-letter regime of 2.1, the minister for the Department for Economic Growth can set a headcount budget alongside KPIs, which the regulator reports against.

The FCA today and under a proactionary regime

	FCA today	Proposed reforms
Accountability	HM Treasury	Department for Economic Growth
Objectives	Statutory objectives, numerous legally enforceable have-regards, Treasury remit letters and self-set strategic priorities - limited ranking among the operational objectives and no explicit risk appetite	Ranked statutory objectives, governed by declared risk appetite in mandate letter: acceptable risks, upside expected in return, and unacceptable risks
Scope	Prevents harm in advance across a wide perimeter, with further expansion sought each time something goes wrong	Narrowed to market failures and systemic harms (conduct risk, fraud, market abuse, asymmetric risks on unsophisticated retail consumers)
Method	Precautionary: Detailed rules, approvals sought in advance	Proactionary: Outcomes-based supervision of what firms actually do.

		Authorisation calibrated to what a firm's failure would entail.
Certainty	Firms interpret rules in advance and bear the risk of being second-guessed after the event	Published safe harbours, subject to use in good faith
Enforcement	Measured by investigations opened, notices issued and fine totals	Measured by senior misconduct detected and sanctioned, and serious financial crime brought to a conclusion (enforcement budget not reduced)
Handbook size	10,000 pages approx	Around 50% reduction
Headcount	Over 5,000	Around 3,000

The PRA stays within the Bank of England. Again, we argue for a more proportionate and pro-growth approach to risk - specifically, that it stops applying the full prudential rules to challenger banks, whose failure can be absorbed, whilst keeping strict rules for systemically important firms.

The PRA currently applies a common prudential framework across very different types of institutions, with Basel III and its UK implementation forming the core of the regime.

The indicative threshold range for a stabilisation strategy has recently been raised to between £25-40 billion of total assets (depending on how easily the Bank of England judges a firm can be resolved), but we argue this remains too low. The effect is that some challenger banks are subjected to a regime designed for much larger institutions, which raises their funding costs and discourages them from scaling, and in turn entrenches high barriers to entry.

We propose keeping the PRA within the Bank of England, given the tight overlap between monetary policy and financial stability. However, we argue for a much more proportionate approach to risk. Under the current regime, any firm failure is censured; the PRA thus rationally regulates to prevent firm failure altogether, in doing so pricing out the new entrants and challengers that a dynamic market depends on. The failure of a non-systemic firm should not be treated as a regulatory failure - it should instead be viewed as the system functioning as designed.

Any mandate letter should therefore establish a two-tier regime:

- Tier 1 (systemic banks): Large institutions retain the full Basel III regime and the UK's additional capital buffers, to maintain resilience where the failure of a systemic bank would threaten the real economy;
- Tier 2 (challengers and new entrants): Non-systemic lenders move to a lighter prudential track - evolving from the PRA's Strong and Simple framework - with the focus on strong resolution and depositor protection, on the explicit understanding that Tier 2 firms will occasionally fail as part of a normal, dynamic economy.

The threshold between the tiers is set in the mandate letter and reviewed by the standing committee. The starting point for the second tier already exists in the form of the PRA's Strong and Simple regime for small domestic deposit-takers, which comprises simplified capital, lighter reporting and proportionate supervision; the proposed reform extends the scope of this regime to cover all Tier 2 challengers (see 3.2 for scope).

MREL[7] is recalibrated to apply only to firms whose resolution would genuinely require bail-in - not to firms that could be wound down through insolvency or sold to an acquirer. Indeed, the Bank of England has already begun moving the threshold upward, but our proposed reform takes this much further. The details are developed in Section 3.2.

This should not be seen as a return to 'light touch' regulation - banks within Tier 1 should continue to attract close attention to hidden leverage, shadow-banking, maturity transformation, and concentration risk that can quickly become systemic.

The Pensions Regulator shifts from a bias against volatility to a bias against long-term underperformance (namely, members retiring on inadequate incomes).

The Pensions Regulator (TPR) currently demonstrates a systemic bias towards de-risking, with defined benefit (DB) funding rules prioritising short-term solvency over the long-term strength of the sponsoring employer, while defined contribution (DC) default-fund oversight[8] favours low-volatility and highly liquid assets (compounded by fee cap constraints) over higher risk, productive asset allocation.

(Note: It is right that closed, mature DB schemes - largely private-sector final-salary schemes paying pensions now - should continue to hold low-risk assets, as liabilities are shorter-dated. Our challenge relates to open schemes with long horizons - open DB and DC.)

As a result, UK pension funds hold around 30% of their assets in equities - low by international standards - and just over 4% in UK equities[9]. Our concern is with the schemes that have decades to invest - open DB and especially DC - where long investment horizons should allow greater allocations to illiquid assets. On private equity and infrastructure, UK schemes hold about 6%, against roughly a third for Canadian public-sector funds. By most measures, the UK runs one of the most de-risked pension systems in the developed world.

Once again, the cause is the aforementioned asymmetric accountability identified throughout this paper: TPR is held to account for schemes in distress and member detriment, but is not held to account for foregone returns, nor the cumulative cost to future pensioners from defensive allocations, nor the productive capital British business and infrastructure missed out on. De-risking is therefore always the safer course for the regulator - and the aggregate result is not only a massive stock of pension assets under-deployed to productive activity, but also suboptimal retirement incomes for pensioners.

An irony is that the narrow pursuit of stability has created systemic fragility, as recently seen in the 2022 LDI crisis, where funding rules introduced under the Pensions Act 2004 to minimise short-term deficit volatility inadvertently helped incentivise funds into leveraged derivative strategies that brought the gilt market to the brink of collapse.

---

[7] Minimum Requirement for Own Funds and Eligible Liabilities
[8] In part inherited from a DB supervisory culture
[9] Note these are whole-system figures, held down by closed, mature DB - where a low allocation is appropriate: for private-sector DB, mostly closed, it falls to roughly 1.4%

We argue that a TPR mandate letter would define a commensurate risk appetite, in which mark-to-market volatility becomes acceptable for open DB schemes with longer time horizons, as well as DC schemes. Examples of what remains unacceptable could be trustees who cannot demonstrate proper risk management, or DC fee structures that clearly undermine member retirement incomes.

We discussed whether TPR's stability role should sit under the Bank of England and PRA, for two reasons: 1) DB and LDI risk is system-wide (as 2022 showed); 2) governments can be tempted to redirect pensions, and keeping them at arm's-length mitigates this risk. We concluded, however, that TPR should instead be accountable to the Department for Economic Growth, as its primary task should be long-term retirement outcomes and productive investment.

We support the consolidation of smaller regulators into the FCA and PRA, provided this is paired with genuine regulator simplification.

A proliferation of smaller regulators has added to complexity. The Payment Systems Regulator, for example, operates alongside the FCA and the Bank of England with overlapping remits over the same firms, so a payments firm has to engage with three authorities for essentially the same activity.

The government has made a welcome start by announcing the consolidation of the PSR primarily within the FCA. However, the risk is that this becomes merely a ‘lift and shift’ exercise - moving the organisation but not addressing the frictions. Any absorbed rules must be subjected to the same proactionary tests as outlined above.

The reforms in this chapter have the potential to deliver meaningful benefits across the UK economy, chiefly through simpler, more proportionate regulations that remove drag on productive capital. We present two short case studies to demonstrate how these principles can apply in practice.

1 - Asset Management: Streamlining the regulatory footprint on a £10 trillion industry by stripping out redundant transaction reporting, disproportionate capital tests, and unnecessary retail rules

The UK manages over £10 trillion of assets, second only to the United States, and more than half of it for overseas clients. While a clear strength, asset management is also a mobile industry: portfolio management activities do not have to stay here, and the present regime is, in many ways, less competitive than jurisdictions such as New York, Hong Kong, Singapore, and Tokyo. The proactionary regime we propose can significantly reduce regulatory complexity in a number of key areas.

Reporting

The UK remains almost unique among major global financial centres in requiring buy-side asset managers to file their own transaction reports under three overlapping regimes (MiFID II, EMIR, and SFTR). MiFID transaction reporting alone costs nearly £500 million a year across the industry[10]. This duplicates data that venues and dealers already report. We propose removing this redundant transaction reporting burden from the buy side.

---

[10] The Investment Association, UK investment management industry hits record £11.1 trillion AUM; Financial Conduct Authority, FCA finalises rules to cut firms' transaction reporting costs by over £100m a year

<u>Capital and remuneration</u>

The UK imposes one of the heaviest capital regimes on investment managers anywhere - requiring multiple capital requirements and an additional ICARA assessment under IFPR, compared to no equivalent capital tests for SEC-registered managers in the US. We propose simplifying this by removing complex K-factor formulas and wind-down (ICARA) requirements. Moreover, prescriptive pay rules inherited from banking frameworks - such as mandatory deferrals and clawbacks, and burdensome material risk taker (MRT) processes - should be replaced by commercially flexible, market-driven standards, such as the approach used in the US, Switzerland, Hong Kong, and Singapore. The FCA's recent consultation on simplifying the remuneration codes should be followed through, or the regime scrapped altogether to align with the US.

<u>Retail</u>

We propose removing the ‘assessment of value’ regime and exempting managers who do not deal directly with retail clients from the Consumer Duty. Furthermore, the FSCS levy should be rescoped, so institutional managers stop funding a retail compensation scheme.

<u>Client money</u>

We propose that, because client assets sit with an independent custodian rather than the manager, adopting a ‘direct to fund’ model (which the FCA is now progressing) allows the client-money and asset rulebook (CASS) to fall away for managers who don’t hold client money in the first place.

<u>Accountability</u>

We propose scrapping annual re-certification and mandatory regulatory pre-approvals under the Senior Managers and Certification Regime (SMCR), while preserving the principle that named senior individuals remain accountable. We further propose that the regime's scope is narrowed to true decision-makers, which will reduce delays to key senior hires.

2 - Anti-Money Laundering (AML): Overhauling a bureaucratic yet ineffective compliance regime by introducing targeted intelligence and reusable identity verification

Anti-money laundering is a clear case study of the institutional failure diagnosed throughout this paper: paperwork-heavy compliance where firms are punished for process errors rather than for missing criminal activity. The result is extraordinarily high compliance costs with worse-than-useless outcomes.

The UK spends more than almost any other country on AML compliance, with criminal-asset recovery equivalent to roughly 1p for every £1 spent on AML compliance. Financial institutions across the UK spent an estimated £28.7 billion on compliance in 2021 alone, which has since risen. The system produces hundreds of thousands of Suspicious Activity Reports (SARs) and repetitive Know-Your-Customer (KYC) checks, yet much of this activity yields zero law-enforcement value.

The number of SARs filed with the National Crime Agency (NCA) has more than doubled in a decade to roughly 900,000 a year, yet asset recovery remains negligible: the NCA estimates well over £100 billion is laundered through the UK annually, while total assets recovered run to just a few hundred million pounds[11]. This is another example of the asymmetric incentives discussed throughout this paper: firms are penalised for missing paperwork regardless of whether they help catch criminals, and so the rational response from regulated firms is defensive documentation.

"Shell vape shops in plain sight while the rest of us are bogged down in KYC."

De-risking and manual checks

While banking networks are where illicit funds inevitably land, excessive compliance costs are passed to the wider economy through higher prices and lost banking access. If checking a customer is expensive and the penalty for a small error is severe, banks de-risk by refusing or closing accounts, forcing legitimate businesses out of the economy. The Treasury Select Committee found that major banks closed around 140,000 small-business accounts in a single year[12].

We propose retaining low-cost, frictionless automated checks (such as screening against sanctions, fraud databases, and any unusual patterns), while scrapping periodic, un-triggered manual checks. Staff should no longer re-verify long-standing customers on fixed calendar cycles or re-collect identical documents when nothing has changed.

Reusable, 'MOT-style' identity verification

The primary source of duplication in AML comes from firms repeatedly verifying the same individual or entity. We propose an 'MOT-style' identity model, extending existing certification of identity providers so that a credential can be relied upon by others: the state sets the standard and individuals hold a reusable credential they present as needed. Unlike a national digital ID card, there is no central database or compulsory usage; the state's role is limited to setting standards and certifying providers. Crucially, we propose a statutory safe harbour, where a certified provider is liable for bad checks, but firms who rely on a valid credential in good faith are protected.

A challenge to our proposal is as follows: allowing credentials to be reused introduces the risk of a single point of failure if a provider wrongly certifies an identity whether by error or deliberately. Indeed, this risk has materialised in other frameworks, such as visa routes being abused to support weak or bogus applications for low-value businesses. To prevent this, we propose continuous auditing, with immediate decertification for malpractice and severe personal penalties aligned with the deterrence framework set out in Section 2.1.

Targeted intelligence flows

Because firms receive limited specific threat intelligence, they defensively report anything remotely suspicious, contributing to nearly 900,000 SARs in a single year. We propose reversing the intelligence flow, whereby law enforcement outlines specific threats and patterns, firms then search their internal records against those defined threats, and only genuine matches are

[11] House of Commons Treasury Committee, oral evidence on anti-money-laundering compliance costs; Home Office, Anti-Money Laundering and Asset Recovery Programme Accounting Officer Assessment, 18 January 2024; National Crime Agency, Suspicious Activity Reports Annual Reports 2015 and 2025
[12] House of Commons Treasury Committee, report on SME finance

escalated. This builds on the proven success of public-private partnerships (like the UK's intelligence-sharing initiatives and Singapore's shared-risk platform), generating far more relevant and usable criminal intelligence while touching far fewer innocent civilians than today's regime.

Reduced scope

Although property is a known laundering route, ordinary home purchases are also a recognised area of scope overreach. Domestic buyers purchasing their main home with a regulated mortgage and funds from a UK bank account is not comparable to an offshore company buying a high-value property for cash.

Estate agents should be exempt from customer due-diligence obligations in ordinary residential property transactions where both the buyer and seller are represented by UK based conveyancers, unless the agent has clear grounds to suspect money laundering. For ordinary tenancies paid through UK-regulated bank accounts, letting agents should not be required to conduct sanctions checks.

Supervisory consolidation and mandate

The government's decision to make the FCA the single anti-money laundering supervisor for professional services is a welcome step towards ending fragmentation. The opportunity now is to use that consolidation to simplify the regime, rather than simply transfer existing processes to a new supervisor. We propose that the FCA's AML remit form part of its statutory mandate letter, as set out in Section 2.1, with success judged by crime detected relative to the burden imposed on legitimate business rather than by the volume of compliance activity.

2.4 - Arm's-length bodies and state risk

Britain's now-vast network of ALBs has made the country increasingly difficult to govern, while the risk of delay and policy reversal ('state risk') is deterring private capital. This is a major reason why much needed housing and infrastructure projects fail. Fundamental reform is needed to make it easier for elected governments to deliver their policies and give investors greater confidence that projects will actually complete.

Key policy recommendations:

- **The UK should adopt overarching ALB legislation, modelled on Japan's 1999 reforms.**
- **Every arm's-length body, as with the regulators, should also receive a published mandate letter from a responsible minister.**
- **ALBs should report, consistently with each other, on cost, output and activity enabled or suppressed.**
- **Every ALB should face regular sunset reviews, with continuation earned: abolition or consolidation is presumed unless a body can justify its continuation.**

→ **The 2025 ALB review should be completed and consolidated, rather than restarted.**

→ **Standing-committee oversight extends to major non-financial bodies affecting investment and growth.**

Along with reforms to the regulatory regime, the government must also hold arm's-length bodies ('quangos') - which can exercise substantial discretion within their statutory remits and are often insulated from direct ministerial direction, especially where their priorities diverge from the elected government's strategy - to the same framework.

The financial regulators are one instance of a much wider class of bodies - arm's-length bodies (ALBs, or quangos) - that exercise substantial state power with limited political accountability. There are over 300 of them across the UK, with their combined budgets comprising a significant share of public expenditure, despite repeated promises of a 'bonfire'. While a handful account for the bulk of the spend - UK Research and Innovation, HS2, Homes England - the governance problem is more widespread.

They fall into four broad groups:

- Economic regulators: including the FCA, the PRA and Ofwat;
- Bodies that shape growth indirectly: including Natural England - which has substantial power to block economic activity;
- Delivery bodies: HS2, the museums, research councils - operational rather than regulatory; and
- A long list of advisory bodies and tribunals.

Each category displays a similar issue: each may have had a good reason for its creation, however over time they have come to optimise for their own survival rather than what they were set up to deliver. An ALB is incentivised to expand its remit and grow its headcount, as this makes it more powerful and harder to abolish; it has no incentive to deliver efficiently or retire functions it no longer needs, or indeed align itself with the elected government's strategy. Moreover, ALBs are not responsible for the costs of expanding their remits - such as economic activity undermined or pressure on departmental budgets.

"Britain's challenge is primarily one of governance."

Where an ALB becomes a regulator in all but name, public bodies such as local planning authorities treat 'guidance' as binding because the political cost of ignoring it falls on them, not on the issuer.

Annual reports and KPIs reflect this: most ALB reporting is dominated by the body's own institutional metrics, which often include DEI, sustainability, and internal governance - rather than by what the body actually delivers or whether it represents value for money - for example:

- UKRI Board minutes contain little about what UKRI actually does - the £9bn of public research funding it allocates - with limited explanation of the body's own governance;

- Crown Commercial Service annual reports describe the organisation in detail without making clear how the £120m operating cost relates to the £5bn of claimed savings it delivers, or whether either figure is robust.

Natural England and nutrient neutrality blocking 100,000 homes

Following a 2018 European court ruling, Natural England - the government's statutory adviser on the natural environment - advised local planning authorities from 2019 that in catchments where protected habitats were already in unfavourable condition they should grant permission for new housing only where 'nutrient neutrality' could be demonstrated. Although the advice was not itself legally binding, under the Habitats Regulations an authority cannot approve a development unless it is satisfied the development will not harm a protected site - and once the government's statutory adviser had warned that these developments might, any authority that approved them anyway risked having the permission subjected to judicial review - so they treated the advice as binding and stopped granting permission. It is estimated that around 100,000 homes were held up across over 70 local authority areas, even though new housing is reckoned to contribute only minimally to the nutrient load[13].

In effect, a decision of significance was made, but with no-one accountable for what many would consider an unreasonable trade-off - Natural England, advising within its remit, was incentivised to advise cautiously and not to weigh the cost in homes, and local authorities were incentivised only to follow that advice. Crucially, no elected minister ever authorised, or took responsibility for, the trade-off between water quality and housing supply.

Natural England and Hinkley Point C

By way of a more recent example, Hinkley Point C (a nuclear project of strategic national importance) has become entangled in escalating requirements intended to protect fish in the Severn Estuary. EDF reports that the project's three fish-protection systems, including the notorious acoustic fish deterrent ('fish disco'), will cost approximately £700 million[14]. Again, each measure may well be defensible purely in isolation but, as with the nutrient neutrality example, the process did not require an elected minister to make an explicit judgment on whether the environmental benefit justified the cost imposed on a project of national importance.

The proliferation of these bodies has made Britain close to ungovernable. The same diagnosis we apply to the financial regulators extends to ALBs more broadly - especially those which resist ministerial direction.

Every ALB can defend its independence on reasonable grounds, including technical expertise and insulation from short-term politics. However, hundreds of bodies each defending and exercising

---

[13] Department for Levelling Up, Housing and Communities, Estimate of homes subject to nutrient neutrality requirements; Department for Environment, Food & Rural Affairs, Nutrient pollution: reducing the impact on protected sites
[14] EDF Energy, Hinkley Point C: Acoustic Fish Deterrent

their own independence produces an aggregate outcome which is emergent rather than deliberate. Elected ministers remain nominally accountable for outcomes that in practice they do not control and are determined by ALBs, and when the outcome diverges from the government's strategy, there may be no straightforward mechanism to correct it without public confrontation.

The Cabinet Office's line-by-line review of every ALB, launched in 2025, recognises the problem, and we agree with its premise - that each body must justify its continued existence. We argue that this work should continue, but must go further by enacting an overarching statutory framework (see below for our proposal, which is modelled on Japan's 1999 reforms).

Sometimes the issue is not emergent. The PRA's handling of post-Brexit Solvency reform is an illustrative example. Ministers had set an objective of freeing insurer capital for productive investment, but its translation into the detailed prudential regime became the subject of protracted discussion with the regulator. The episode illustrates the difficulty of assigning accountability when strategic policy objectives and operational regulatory judgements interact.

A damaging corollary of the ALB issue is 'state risk': the UK is no longer considered a reliable jurisdiction for long-term investment, and must urgently reverse this to attract capital.

The pattern described so far - bodies acting independently of any coherent national strategy - appears as unreliability to an investor, which either deters capital, or at the very least is priced into the cost of capital.

For long-term project and infrastructure investment, investors increasingly apply a risk premium of a kind associated with less predictable jurisdictions. The terms the state itself sets - subsidy regimes, tax treatment, regulatory rules, and sometimes its own contractual commitments - change unpredictably, and increasingly retrospectively, while ALBs can impose a *de facto* veto on a project another part of the state has approved. Approval timelines are long and uncertain, and routinely run past the investment horizon of the capital involved. Risk is shared badly: the public sector keeps political control while transferring economic risk to private parties. The result is that the world's large pool of long-term capital - which is willing to fund well-structured projects - discounts or even avoids UK opportunities.

This is sadly well understood by infrastructure investors. Where the state can credibly commit to predictable rules, stable regulation, enforceable contracts, and agencies that coordinate with each other, investors can more confidently apply a lower discount rate, and this can be the difference between a project being viable in one country and unviable in another. This ‘viability gap’ is often blamed on a shortage of capital but is in fact a function of state behaviour.

Reducing ‘state risk’ is thus essential, and can be achieved without any fiscal cost; indeed, projects that today need a subsidy could potentially proceed on a purely private basis if the state simply behaved more predictably.

Norway and Sweden are able to plan and build major infrastructure in a fraction of the time and at a fraction of the cost the UK manages[15]. The A14 between Cambridge and Huntingdon cost £1.5 billion for 21 surface miles, while Norway bored the 14-mile Ryfast and Eiganes tunnels, 290 metres beneath the sea, for around £700 million. As discussed, the UK is building the most

[15] Britain Remade; Department for Transport, £1.5bn A14 Cambridge to Huntingdon upgrade marks its first year of construction; legislation.gov.uk, 2025 explanatory notes on infrastructure planning and judicial review

expensive nuclear power station in the world, and now takes around four years to approve major infrastructure - up by roughly two-thirds since 2012, with judicial-review challenges to those consents rising from about one in ten to nearly six in ten.

To reiterate: this is not a capital shortage challenge; this is a state behaviour challenge.

Case study: Inconsistent HMRC treatment of investments in the UK film industry

During the government of Tony Blair, as part of the 'Cool Britannia' initiative, generous film tax reliefs were introduced to encourage private investment into the British film industry, through which investors financed film production via partnerships promoted by firms acting on advice from accountants and tax counsel. HMRC's own published guidance described the standard structure in detail - a partnership of individual investors, around 80% of the contribution borrowed against guaranteed lease income, and an immediate trading loss - and recorded that many schemes were using the reliefs as intended and had contributed materially to increased British film production. Practitioners treated the guidance as a safe harbour.

However, HMRC later took the view that the arrangements amounted to avoidance, and subsequent litigation was largely resolved in its favour. Despite investors arguing they had relied on HMRC's published treatment, the Upper Tribunal held that HMRC's reservation for suspected avoidance entitled it to depart from its own guidance. Enquiries then ran for a decade and more, some approaching twenty years, with interest accruing over this period. An investor in 2003 could not have known that HMRC guidance would not offer protection. The episode has done lasting damage to confidence in the stability of the UK tax system.

Case study: Retrospective standards in motor finance

Discretionary commission arrangements, under which a car dealer could adjust the interest rate on a car loan and earn a higher commission as a result, were a standard feature of the UK motor-finance market for years and operated within the regulatory framework then in force. The FCA prohibited the practice in 2021, but subsequently launched a market-wide review into historical arrangements, reassessing pre-ban contracts years later. While some customers may well have suffered genuine detriment, the remedy was not confined to specific instances of harm; instead, it exposed lenders to systemic liability. Provisions across the motor finance sector quickly ran into the billions of pounds, leaving firms to face liabilities they could not have priced in when the business was written. Because several major lenders affected are foreign-owned, the episode has been viewed internationally as evidence that conduct entered into under one regulatory framework may be found non-compliant a decade later, further compounding UK state risk.

Infrastructure finance in particular is a governance and state-risk problem, not a capital problem - the money exists; the state needs to get out of the way.

Infrastructure finance highlights the problem clearly. On the debt side, insurers and bulk-annuity providers actively seek long-duration, secured cash flows to match their liabilities; on the equity side, specialist infrastructure funds hold vast global reserves of capital. The bottleneck is not a shortage of institutional funding, but a shortage of investable UK projects with predictable regulatory horizons.

> **"If it is faster and surer to fund a toll road in Poland than one in Britain, the money will go to Poland."**

The core challenge remains: uncertain timelines, asymmetric risk-sharing, and the risk premium the global capital pool applies to UK projects. Specific to infrastructure is the retirement of PFI which, whatever its flaws, provided a standardised contractual framework that has not been replaced.

The death of PFI destroyed an entire ecosystem for infrastructure investment, and no standardised replacement has emerged - leaving every government department to improvise

Private finance for public infrastructure was already in steep decline well before it was formally ended: new PFI projects had fallen from dozens a year in the mid-2000s to barely any by 2018, while the successor model (PF2) was hardly used, leading the Chancellor to abolish both for new projects in the 2018 Budget. As a financing model, PFI offered poor value, was frequently used to circumvent public sector borrowing limits, and failed to effectively transfer risk. However, abolishing the model also removed the standardised contractual framework it ran on, along with the ecosystem of specialist expertise and long-term equity that had grown up around it. Nothing has replaced it, and the expertise has now gone elsewhere. Every department now improvises its own approach to project finance.

The ALB issue is a further manifestation of the governance failure outlined throughout this paper; its resolution requires the same minister-set objectives and evaluation framework.

The ALB issue is simply another presentation of the problem set out in Chapter 1: when Parliament seeks to address a problem while insulating itself from the underlying trade-offs, its default response is to delegate authority to an arm's-length body. The result is a system where individual agencies effectively exercise unchecked power, but no single minister or entity owns the cumulative outcome.

The solution is to take the accountability architecture built in this chapter for the financial regulators and generalise it across the wider ALB estate:

1. Mandate letters for every ALB, with the sponsoring department required to publish what the body is for, what it should do and not do, and what upside it is expected to enable;
2. Standardised reporting, so that the output and cost of each body can be measured consistently;
3. Sunset reviews at regular intervals, so that continued existence has to be justified rather than assumed;
4. Standing-committee oversight extended to the major non-financial bodies whose decisions materially affect investment and growth, not just the financial regulators.

This model directly adapts the statutory reforms Japan successfully applied to its own public bodies in 1999.

Japan solved the same governance problem through its 1999 reforms, consolidating public bodies under a standardised accountability framework, with conditional autonomy.

Japan faced a similar problem to that of the UK. In the late 1990s, it faced a dense, semi-autonomous public-corporation sector with weak ministerial control and accountability, which it fixed with new overarching legislation.

Following a 1998 central-government reform act, Japan passed the Act on General Rules for Incorporated Administrative Agencies in 1999, and from 2001 reconstituted these bodies as Independent Administrative Institutions under a single overarching statute. One law sets common rules for the whole sector - purpose, governance, performance evaluation, and accounting - while each institution also has its own individual act detailing its specific remit and duties. The General Rules Act enforces uniformity, in contrast to the UK, which governs through bespoke framework documents that permit potentially unlimited variation.

The model grants conditional autonomy rather than independence:

- Each institution receives operational freedoms - corporate accounting, the ability to hire staff outside of the Civil Service rules - but these are set by the responsible minister;
- The responsible minister sets medium-term objectives;
- The institution draws up a detailed plan to meet them;
- Performance is then evaluated, annually and at the end of the review period, by both the sponsoring ministry and, where appropriate, the proposed standing committee in Section 2.1;
- The results are published, and feed directly into the body's future funding and its next set of objectives, as well as the question of whether it should continue to exist.

Supported by these reforms, Japan now sits consistently in the top tier of international government-effectiveness rankings[16].

While the Japanese model is not a perfect template, it demonstrates that the problem is solvable through legislative changes rather than by yet another incremental review. The lessons are transferrable to the UK.

The UK should adopt overarching legislation, modelled on Japan's reforms, to rationalise its arm's-length bodies and restore executive accountability to Parliament.

We propose three steps the UK should take in order to emulate the success of Japan’s reforms:

1. Complete and consolidate the 2025 review rather than start again - a fresh start would lose momentum;
2. Legislate for an overarching framework, modelled on Japan's General Rules Act, that applies common standards across the whole ALB landscape while preserving independence where it is needed;
3. Give ministers power through the framework: the present system has no real sanction for ignoring ministerial direction.

---

[16] World Bank, Government Effectiveness: Percentile Rank

The legislation would require four core obligations of every arm's-length body:

- A mandate letter from the responsible minister, setting out what the body is for, what it should and should not do, and what economic outcomes it is expected to deliver;
- A medium-term performance framework, on the Japanese model, with objectives set over a defined period, annual reporting against them, and an end-of-period evaluation that informs future funding;
- Standardised reporting of cost, output, and forgone economic activity, ensuring the standing committee and departmental select committees maintain clear, consistent oversight;
- A mandatory sunset review at the end of each period, carrying a statutory presumption in favour of abolition or consolidation unless a positive case for continuation is made.

Some institutions will clearly need continued independence - not least the financial regulators and Bank of England, as well as scientific advisory bodies or judicial appointments. But many will not, including delivery agencies whose work could easily sit inside a department, and advisory bodies whose remit has encroached beyond what was originally envisioned.

We do not advocate a blanket reduction target, which would risk abolishing useful bodies alongside redundant ones, while a blanket relocation into departments could simply recreate the problem one level up.

Chapter 3: SME and Growth Capital

3.1 - Why UK assets fail to get to where they are most needed

Britain has plenty of savings, but too little of that money ends up funding British businesses and projects. Getting more capital to where it is most needed is essential for stronger growth and higher living standards.

3.2 - Prudential reform

The pendulum with banking regulation has swung too far: banks are no longer providing enough finance to businesses so that they can invest and grow. Prudential reform should restore the balance with financial resilience and allow challenger banks to compete more effectively with the large banks.

3.3 - Bank of England reserve remuneration policy

Taxpayers should not be subsidising banks through open-ended reserve remuneration. It is essential to address the resulting distortion to bank margins and portfolio incentives while maintaining independent monetary policy.

3.4 - A National Investment Bank to fill the remaining gaps

Even with prudential reforms in place, many small businesses will still struggle to secure the patient, relationship-based finance needed to scale. An ICFC-style National Investment Bank should bridge this gap at smaller ticket sizes, delivering direct regional investment on strictly commercial terms.

3.5 - AIM reform

AIM was created to give growing British companies access to public capital, but years of additional regulation and tax changes have made it increasingly expensive and unattractive. Reform is needed so that more promising businesses can raise money, remain in Britain and grow into larger employers - rather than sell early or move overseas.

3.6 - Pre-IPO reform - addressing the 'missing middle' challenge

Too many businesses fall into the 'missing middle': they need larger amounts of capital but lack an efficient route to raise it. Developing the new Private Securities Market into a standardised market for growth finance would help institutional capital reach more growing businesses before they are ready for a stock market listing.

3.7 - Entrepreneur incentives and support

Britain must restore competitive incentives for entrepreneurs and founders, whose tax treatment has deteriorated from world-leading to internationally uncompetitive in just two decades. Successful founders should be encouraged to build their next business in Britain and reinvest their capital in the next generation of growing companies.

3.8 - 'Sprint permissions' for critical future industries

Britain is in a global race to attract the industries of the future, but is at risk of losing out because the state is too slow and inconsistent. 'Sprint permissions' would provide qualifying firms with a faster, lighter route through planning, regulation and other government processes, helping Britain secure investment and jobs before they go elsewhere.

3.9 - Against mandation and ESG

Measures which mandate capital into politically designated asset classes should be unwound; instead, the focus must be on making UK assets genuinely attractive to invest in.

3.1 - Why UK assets fail to get to where they are most needed

Britain has plenty of savings, but too little of that money ends up funding British businesses and projects. Getting more capital to where it is most needed is essential for stronger growth and higher living standards.

Britain holds one of the largest pools of savings in the world, yet invests less of it at home than almost any of its peers.

The UK is not short of capital. Its households, pension schemes, and insurers between them hold one of the largest stocks of long-term savings anywhere: pension assets alone come to roughly £3 trillion, and nearly £900 billion sits in ISAs. And yet the country invests a smaller share of its national income than almost any comparable economy. Whole-economy investment ran at about 18.6% of GDP in late 2025, the lowest in the G7; business investment specifically sat at around 10% of GDP. The UK has been at or near the bottom of these tables for most of the past three decades. By comparison, the US invests around 21% of GDP and Japan around 27%[17].

A core argument of this paper is that the shortfall is not one of saving, but of where saving goes and the channels that direct it - and that the domestic investment environment is simply insufficiently attractive.

A significant challenge is that UK savings are directed into cash, property and global index funds, rather than into productive UK investment.

Part of the problem is how British households hold their wealth. The national preference is for cash and bricks and mortar: of the nearly £900 billion held in ISAs, over £300 billion sits idle in cash. Moreover, over a generation, the country's pension savings have largely withdrawn from British business: UK pension funds now allocate about 4.4% of their assets to UK equities, down from more than half 25 years ago. The retreat was in part driven by the shift to global market-weighted indices, in which the UK now counts for about 4% of world stock markets against the USA's 60%, and also by tax measures[18].

Defined benefit pensions tell a similar story: as schemes closed, matured and de-risked into bonds (and were further undermined by the removal of tax benefits in the late 1990s), pension funds' direct ownership of UK-listed equities fell from 32.4% of the market in 1992 to around 1.5% today. The result is a doom loop the market now recognises: less domestic demand, lower valuations, and an increasingly illiquid market - and more reason for the next company to raise its capital, or indeed sell itself, elsewhere.

---

[17] HM Treasury, Pensions Investment Review: Interim Report; Office for National Statistics, Business investment, July to September 2025 revised results; Office for National Statistics, Business investment, October to December 2025 revised results

[18] AJ Bell, ISAs Unpacked: UK nears £1 trillion market; HM Government, Pension fund investment and the UK economy; Hansard, Pension Investment in UK Equities, 25 November 2025

The most acute shortage is that of capital reaching Britain's smaller and fast-growing firms.

The impact of this misdirection of savings is felt particularly acutely by young, smaller and fast-growing companies. Promising firms are often sold early or scaled abroad, with returns flowing to foreign investors rather than British savers.

Three main causes are responsible for this gap:

1. Smaller companies cannot reach the capital markets and thus rely on bank lending - yet prudential rules, including the capital charged against SME loans (and MREL thresholds which prevent challenger banks from serving this market at scale) disincentivise such lending, and have left much of the country in effective ‘banking deserts’;
2. There is no domestic pool of patient equity to take up the slack: the public bodies meant to fill this known gap are bureaucratic and often unable to write small cheques, while institutional capital has vacated the asset class;
3. The markets which are there to allow early investors to exit and recycle their capital are themselves seeing thinner liquidity - 88 companies left the London market in 2024, and new listings fell to just 18.

This chapter addresses these challenges as follows:

- The prudential rules which undermine SME lending (3.2) and reserve remuneration policy and its effects on credit incentives (3.3);
- A National Investment Bank to help bridge the small-ticket gap (3.4);
- Reform of AIM and the pre-IPO ‘missing middle’ that together rebuild investor exit options (3.5 and 3.6);
- The tax treatment and practical support for founders and their investors (3.7);
- Sprint permissions, to incentivise critical industries of the future to domicile in the UK (3.8);
- Unwinding capital mandation and non-financial ESG screening that direct savings into politically chosen ends (3.9).

Broader reforms to pensions and tax are addressed, respectively, in Chapters 4 and 5.

3.2 - Prudential reform

The pendulum with banking regulation has swung too far: banks are no longer providing enough finance to businesses so that they can invest and grow. Prudential reform should restore the balance with financial resilience and allow challenger banks to compete more effectively with the large banks.

Key policy recommendations:

- **Create a two-tier prudential regime, where systemic banks remain under Basel III and non-systemic challenger banks move to an evolution of the PRA's Strong and Simple regime.**
- **Allow challenger banks to use internal (IRB) capital models, and legislate for shared models and pooled industry data where a firm's own history is too short.**
- **Ease ring-fencing for systemic banks by expanding the proposed growth allowance and removing duplication with the resolution regime, and remove non-systemic banks from ringfencing entirely.**
- **Raise the MREL threshold to £500bn - a meaningful level for a £3 trillion economy - so challengers are enabled to grow and only genuinely systemic banks are captured.**
- **Create a faster, lighter banking licence for savings-only banks, giving specialist SME lenders access to cheaper deposit funding.**
- **Reform the capital treatment of unrated corporates, so that scaling firms are not penalised with higher capital charges simply for lacking an external credit rating.**
- **Make the PRA's Pillar 2A SME-lending offset transparent and rules-based, rather than opaque and bank-specific, giving lenders the capital certainty needed to price and expand SME credit predictably.**
- **Make the flow of credit to productive businesses part of the PRA's risk budget within its mandate letter, requiring the regulator to answer to Parliament whenever credit to business lags nominal GDP growth.**
- **Recognise cashflow and data-based SME underwriting as a legitimate, capital-reducing alternative to collateral-based lending.**
- **Recalibrate the flat 3% surcharge on bank corporation taxes to a variable rate which is directly linked to SME lending.**

We propose a two-tier prudential regime: systemic banks should remain under full Basel III; non-systemic challengers should move to a lighter regime - an evolution of Strong and Simple, with occasional failure accepted as part of a normal, functioning economy.

The current UK prudential regime was designed around the inherent risks of the largest institutions, whose collapse could threaten the whole economy. But, applied in full to every bank, it stifles competition and stops challenger banks from scaling, many of which exist to lend to smaller and growing businesses.

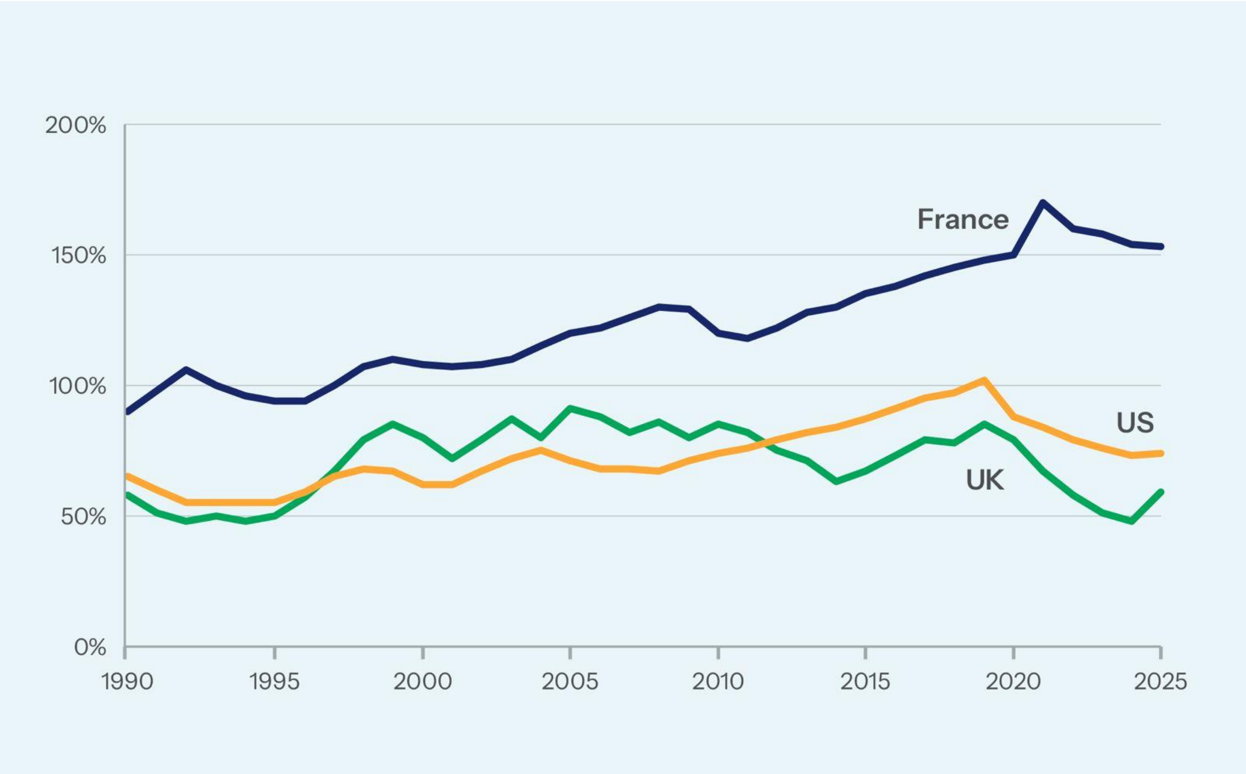
Britain relies on a concentrated handful of large banks. The largest incumbents have historically held around 85% of small-business current accounts, yet now make only about 40% of new SME lending - challenger and specialist banks supply the other 60%. The problem is not that the big banks still dominate lending, but that the market as a whole stays too small, because the challenger banks that have taken the lending on cannot scale.

Moreover, Britain does not possess the regional and local relationship-banking tier that provides credit to small firms elsewhere: in Germany, savings and cooperative banks are major lenders to SMEs; here, when the big banks pull back from small-business lending - as they have steadily over the past two decades - there is no second tier deep enough to take up the slack.

It is sometimes argued that Britain has too many small banks and needs consolidation; but the proliferation of subscale challengers is a symptom of the barrier to growth - the remedy is to let them scale.

Post-2008 changes compounded this: where Lloyds, NatWest, Barclays and HSBC once had distinct regional strengths and lending patterns, regulation pushed these survivors onto broadly the same low-risk, property-weighted model, undermining both competition and the variety of credit on offer. Real-estate-related businesses account for a disproportionately large share of SME lending relative to their share of the SME population. At the same time, overall credit to SMEs has declined materially as a share of the economy since the early 2010s.

Total credit to non-financial corporations (% of GDP), 1990-2025



Source: BCG

The challengers that might fill the gap are held back by capital rules. The largest banks set their risk weights using internal models (the 'IRB' approach), built on long data histories that newer entrants cannot match, so a challenger on the standardised approach must normally hold significantly more capital against the same loan. A lack of historical data is not the only barrier, as the PRA approves the use of each model, and is slow in doing this. Challengers are thus held on the ‘standardised approach’.

"It has suited the regulator to keep a lid on competition, albeit even if inadvertently."

The challenge is not confined to the Basel III framework, which is internationally agreed. The UK adds further capital buffers on top - notably the Pillar 2A and the PRA buffer (which requires banks to hold extra capital against stress scenarios), alongside countercyclical and systemic buffers - so that UK banks hold well above minimum regulatory requirements, further undermining lending capacity to SMEs.

The Bank of England has begun to recognise this: in its December 2025 capital review, the Financial Policy Committee (FPC) cut its benchmark for system-wide Tier 1 capital from 14% to 13% of risk-weighted assets, and it is now reviewing how the different layers of the capital stack interact for domestic lending.

On its own, however, this achieves little - the aggregate benchmark is not the issue which constrains individual banks, and the Bank's stress tests continue to show the banking system weathering a severe global recession. Capital held against the non-systemic sector, in particular, remains far more cautious relative to the underlying risks.

On proportionality, the PRA has also made a start through its Strong and Simple initiative and Small Domestic Deposit Takers regime, a simpler set of capital and liquidity rules for smaller institutions - lighter requirements for banks that do not pose a systemic risk. However, this regime does not let in-scope firms use their own internal models (so any challenger bank building these will be incentivised not to join), while it lacks a bridge to the full regime as a bank grows.

We thus propose a 'two-tier' framework, built as an evolution to Strong and Simple:

- Tier 1 - systemic banks, whose failure would threaten the financial system, stay under Basel III and the full resolution regime;
- Tier 2 - non-systemic banks move to an evolved Strong and Simple regime, holding capital which reflects their actual risk rather than that of a global bank, with a much higher MREL threshold that removes the debt cost barrier to scaling (see below).

The transition between tiers should be continuous: as a challenger scales towards systemic in size, capital and bail-in requirements should escalate incrementally rather than requiring a sudden regulatory cliff-edge.

As set out in Chapter 2, delivering this shift requires no political interference in day-to-day PRA operations; it is achieved by updating the PRA's statutory mandate letter to incorporate a proportionate growth path for challenger banks.

Silicon Valley Bank UK

SVB UK came under severe pressure after its US parent failed following losses on unhedged long-dated bonds. It was sold to HSBC for a nominal £1 over a weekend in a Bank of England rescue, protecting all depositors at no cost to taxpayers. The episode demonstrates that a non-systemic bank can fail without harm to the wider economy. However, we argue for a regime where resolution does not rely on acquisition by a large incumbent; resolution should preserve the bank as an independent competitor rather than folding it into a giant.

Ring-fencing has been superseded by the bank resolution regime in all but name: for systemic banks, it should be eased now and phased out in time, freeing capital trapped behind it; for non-systemic challengers it should not apply at all.

Ring-fencing requires the largest banks (those with more than £35bn of deposits) to separate their retail and small-business banking from their investment-banking operations, holding each in a legally distinct entity. It was one of the principal responses to the 2008 crisis: the aim was to protect ordinary depositors, and to spare the taxpayer a repeat of the bank rescues.

However, ring-fencing withholds capital from the economy, as in-scope banks must hold pools of capital and liquidity inside the fence that cannot be deployed across the group. The government has taken a first step at easing this, by announcing a 'growth allowance' which lets ring-fenced banks deploy up to a tenth of RWA which are inside the fence.

And the case for retaining ring-fencing has weakened, because the resolution regime now addresses the same risk more directly: the loss-absorbing debt (Minimum Requirement for Own Funds and Eligible Liabilities, or MREL) and the Bank of England's powers to wind down a failing bank are designed to let even a large bank fail without threatening the system or taxpayer bailout. With resolution now in place, the ringfence is increasingly redundant and indeed serves as duplication.

We propose to go significantly beyond the government's reforms:

- For systemic banks, the fence should be eased, building on the growth allowance and ongoing reforms that streamline operational restrictions, and removed in time once the resolution regime is confirmed to be sufficient on its own;
- For non-systemic challengers it should not apply at all and should be removed.

This applies regardless of the size of a bank. Banks just below the MREL threshold and not subject to ringfencing are still protected, as their failure would still be handled through resolution, funded by equity and the industry-financed FSCS backstop, rather than by bail-in debt.

MREL should be lifted from smaller banks and retained only above a much higher threshold - say, £500bn of total assets - since the current low threshold serves mainly to prevent challenger banks from challenging.

When a bank fails, the authorities need a way to absorb its losses without calling on the taxpayer. For banks with a bail-in strategy, MREL - the minimum requirement for own funds and eligible liabilities - requires a bank to hold a layer of loss-absorbing debt that can be written down or converted into equity to recapitalise it in resolution. For the largest banks, whose disorderly collapse would threaten the financial system, this is sound: such a bank cannot simply be wound up or sold over a weekend. The case for MREL holds wherever a bank is genuinely 'too big to fail'.

Under the current framework, firms above £40bn would expect a bail-in strategy (and those between £25bn and £40bn may be assigned either a transfer or bail-in strategy). Below that threshold, a bank instead enters a 'modified insolvency' or is designated a 'transfer strategy' (whereby it is transferred to a healthy purchaser) - or, for the very smallest institutions, simply wound up with deposits repaid by the Financial Services Compensation Scheme (FSCS).

For a challenger that crosses the threshold into bail-in, this becomes expensive. It must issue loss-absorbing debt, which investors will buy only at a steep premium, knowing these banks are not too big to fail and the debt could plausibly be written down. This risk premium challenge is less acute for systemic banks, as there is greater market confidence that their MREL debt will not be bailed in. This serves as a significant barrier to entry - as a challenger bank reaches the size at which it could begin to compete in mortgage and SME lending, it encounters higher financing costs which undermine the profits it needs to grow.

The cost is large enough to distort the market in both directions. Some banks approaching the threshold are incentivised to merge to reach the scale at which loss-absorbing debt can be issued more cheaply, while other potential mergers can be deterred because two challengers whose combined assets would make commercial sense would instead face the financing costs of the new entity. In both cases, the merger or non-merger are regulatory rather than commercial decisions.

The MREL indicative range of £25-40bn is far too low for a £3 trillion economy.

We propose raising the MREL threshold to £500bn of total assets - material enough for a £3 trillion economy, and capturing only systemic banks (which the regime was designed for) - with the onus on the Bank of England to justify any lower figure. Such a reform will give challengers the room to grow.

Two potential objections:

First, increasing MREL to £500bn exposes the taxpayer. We argue that it does not, below this threshold, because the loss is absorbed elsewhere. A bank's own equity capital - unchanged by our proposal (and several times higher than before 2008), takes the first loss. Beyond that, the FSCS recapitalises a failed bank through a levy on the industry, so the residual cost falls on the sector.

Above £500bn, we maintain that a bank's failure becomes too large for the sector to absorb between the remaining banks, and loss-absorbing debt becomes genuinely necessary.

Second, without MREL, a challenger might expand recklessly. However, MREL was never the tool to mitigate this risk - reckless lending is restrained by capital requirements and supervision.

As with the rest of this chapter, the calibration is set under the respective mandate letter and within its risk budget (as outlined in Chapter 2). What is political, however, and can be set out in the letter, is the instruction that a non-systemic bank should only face a loss-absorbing requirement matched to how it would actually be resolved - which, for most challengers, means none at all.

Metro Bank and the cost of the MREL

Metro Bank, long the most visible challenger to the big banks, spent years dealing with the cost of MREL. To meet the requirement, it issued loss-absorbing debt at punishing rates: a 9.5% bond in 2019, and £525m of notes at a 12% coupon in its 2023 recapitalisation, costing it around £63m a year in coupon payments. In our view, it is hard to argue that its balance sheet was ever large enough for its failure to pose systemic risk to the UK economy. When the Bank raised the threshold to £25-40bn - announced in July 2025 and effective from January 2026 - Metro was reclassified a transfer firm, and no longer required to hold loss-absorbing debt above its minimum capital. This relief came only after years of unnecessary cost and uncertainty.

A lighter, faster banking licence for firms that take savings but not current accounts would open cheap deposit funding to specialist lenders that already serve SMEs.

Specialist non-bank lenders which best understand SMEs and do the heavy lifting in originating and managing loans, typically fund themselves through wholesale markets at rates that force them to, in turn, lend expensively. By contrast, a deposit-taking bank funds itself far more cheaply through customer savings.

Moreover, the cost of setting up a bank, including the fixed costs and regulatory capital, is incurred before the bank can start taking deposits, which disproportionately hits smaller banks, including those lending to SMEs, and affects their funding costs.

We propose a faster, lighter authorisation route for firms that take savings deposits but do not offer current accounts:

Since a savings-only bank runs a much lighter operational overhead, with no payments and transactions, and with a much lower run risk than what the full prudential regime is designed for, it should be able to be authorised more cheaply and held to more proportionate requirements whilst keeping adequate protections for its depositors.

Such a reform would be transformative for SME specialist lenders, which would no longer need to fund their book through expensive wholesale credit lines, and could grow their lending significantly and pass the savings onto borrowers.

A non-bank lender locked out of cheap funding

A mid-sized non-bank SME lender consulted for this work funds its loan book on the wholesale markets, borrowing from banks and private credit funds that do no small-business lending of their own: senior debt at a little over the benchmark rate, and mezzanine finance at around ten percentage points above it. This expensive funding forces it to lend expensively to its SME borrowers. With a banking licence, it estimates it could fund most of its book through customer savings and grow its lending three to four times over within 5-10 years, at significantly lower rates to borrowers, but the cost of setting up a new bank is prohibitive.

The working capital crisis facing SMEs is also a consequence of prudential regulation: the relief that replaces the SME Supporting Factor must be made transparent and rules-based, and the treatment of unrated corporates should be reformed to reverse the decline in lending to this group.

Despite a recent pick-up in corporate lending, bank lending to business has lagged the growth of the economy almost every year since 2007, notably in working capital and overdrafts for small businesses. SME overdraft use has fallen sharply over the past two decades, with the stock of SME overdrafts reaching a record-low £7bn in 2025. This decline has coincided with extensive branch closures, weakening traditional relationship banking for some small businesses[19].

Two specific issues are worth highlighting:

1. Changes to the SME Supporting Factor under Basel 3.1 prompted concern over the capital treatment of SME lending. EY and UK Finance estimated that, under the proposals they assessed, its removal could increase capital requirements by around 30% for banks on standard models, reduce appetite to lend to SMEs by roughly a quarter, and raise SME borrowing costs by around 30 basis points[20];
2. The treatment of unrated corporates can penalise firms without a ratings history: general unrated corporates attract a 100% risk weight, while unrated corporate SMEs attract 85%[21].

The impact on SME lending has been stark: HSBC's head of corporate banking told the House of Lords that a bank must hold around five times as much capital to lend directly to a small firm as to fund a private-credit firm to lend to the same business, which is one reason lending is migrating away from banks' balance sheets[22].

The PRA has confirmed in its final Basel 3.1 rules that it will use a firm-specific adjustment within Pillar 2A to mitigate the impact. However, this offset is applied bank by bank.

The FPC's December 2025 cut in its system-wide benchmark, from 14% to 13%, has not so far been followed by a material acceleration in SME lending: banks generally hold capital above the requirement, so a lower benchmark does not by itself free capacity to lend - and, additionally, banks have not restructured themselves to undertake the work: SME lending is labour-intensive and needs continual monitoring, in contrast to lending against property or a personal guarantee.

The supply side is not the only issue: many small firms simply do not want to borrow, and few want multi-year term loans. What they want is working capital and an economic climate to give them a reason to draw on it - including a predictable tax, regulatory and cost environment - which successive governments have undermined.

For the supply side, we propose the following changes to prudential rules:

1. Reforming unrated corporate treatment, so that growing firms are not penalised with higher capital charges simply for lacking an external credit rating;

---

[19] British Business Bank, Small Business Finance Markets 2026
[20] EY and UK Finance, Impacts of Basel 3.1 on SME lending
[21] Bank of England, Implementation of the Basel 3.1 standards: near-final policy statement, Part 2
[22] Financial Times, report on bank capital requirements for SME and private-credit lending

2. Making the Pillar 2A offset more predictable, giving lenders the capital certainty needed to price and expand SME credit predictably; and
3. Letting the regime accept cashflow-based underwriting (see below) as an alternative to collateral.

Moreover, lending - including to SMEs - should also be visible and accountable, and we propose that the PRA's mandate letter under the framework we introduce in Section 2.1 should make domestic credit flow an explicit part of its 'risk budget', and thus accountable should business lending growth lag that of the economy (as measured by nominal GDP), setting out what it intends to do about it.

Underwriting by cashflow rather than collateral

Prudential rules favour lending against collateral, especially property, over lending against a firm's cashflow. Yet lenders such as Iwoca and Funding Circle already underwrite SMEs from real-time open-banking data, often judging risk more accurately than the collateral-based models which the rules favour. Machine learning and AI can improve this further - when trained on a firm's live transaction data, cash flow, seasonality, and the health of its customers and suppliers, such models can assess creditworthiness far more effectively than a collateral test or a static credit score. The prudential framework should adjust to recognise such cashflow and data-based methodologies as a legitimate alternative to collateral for unrated firms.

A lesson from the Community Reinvestment Act (USA)

America's Community Reinvestment Act, passed in 1977, requires banks to be examined on how well they lend in the communities where they take deposits, including low-income areas. There are no fines and no statutory quotas; instead, a weak grade counts against a bank when it seeks certain regulatory approvals. Research finds that bringing a neighbourhood into the regime lifts small-business lending there by around 3-7%.

Tax, as a policy lever, sits with the government rather than the Bank of England. We recommend redesigning the bank corporation tax surcharge from a flat 3% charge on profits, into a variable rate that encourages lending to SMEs.

In contrast to the above recommendations, which depend on the PRA changing regulation (albeit subject to its new objectives), tax is set by the government and is therefore a lever government can pull directly.

Two taxes fall specifically on banks: 1) the bank levy, which is a charge on the size of the balance sheet, and 2) the bank corporation tax surcharge, which is 3% over and above the standard 25% rate of corporation tax.

For the purposes of this section, we do not look to the bank levy as a policy solution: while we are against the principle of taxing the size of the balance sheet when we are trying to encourage balance sheet growth, with only around £1.3bn in total revenue, we expect any behavioural effect from a policy change to be marginal.

In contrast, the corporation tax surcharge can be a significant policy lever. Currently, this is a flat 3% on banking profits above a £100m allowance. We propose that it instead varies with how much a bank lends to SMEs. For this paper, we present the concept as an illustration; the policy can be calibrated in several ways, for example:

- Indicative surcharge range: 0-10%;
- Banks which grow SME credit pay less, those that let it shrink pay more;
- Surcharge based on percentage of a bank's balance sheet in SME lending, or growth relative to nominal GDP growth, or growth relative to its own balance sheet;
- Cannot be in absolute £ terms, as this would simply flatter the larger banks.

There is precedent for varying a price by lending performance (albeit through the Bank rather than the tax system): the Funding for Lending Scheme (2012) set the cost of banks' access to cheap central-bank funding based on how much they grew net lending.

To succeed, SME lending must be measured on a consistent, common basis and published, so that individual banks' figures reconcile to the economy-wide total. Without a single, standardised benchmark, individual banks can claim their SME portfolios are growing even as total lending to small businesses across the economy actively shrinks. And the system must not be easy to game - without a tight definition of what counts, a small hedge fund or a financing vehicle might be defined as a 'small business'.

3.3 - Bank of England reserve remuneration policy

Taxpayers should not be subsidising banks through open-ended reserve remuneration. It is essential to address the resulting distortion to bank margins and portfolio incentives while maintaining independent monetary policy.

Key policy recommendations:

→ **Introduce a tiered reserve remuneration structure, paying full Bank Rate only on a defined portion of reserves and a lower or zero rate on the remainder.**

→ **End the open-ended Treasury indemnity for QE losses, so that losses remain on the Bank's balance sheet rather than automatically settled by the Treasury as they arise.**

The Bank of England pays Bank Rate on reserve balances, providing banks with a risk-free return on central-bank money. The case for remunerating all reserves at the full policy rate should be reconsidered.

Full remuneration of reserves at Bank Rate is an important part of the Bank's current operating framework, helping to anchor short-term market rates. But it also affects bank margins and the relative attractiveness of reserves compared with other liquid assets. We question whether every pound of reserves should be remunerated at the full policy rate.

Moreover, reserve remuneration is expected to impose a massive cumulative fiscal cost on the public finances. When the Bank created central bank reserves to buy gilts under Quantitative

Easing (QE), the arrangement initially generated over £100bn in net cash transfers to the Treasury while interest rates remained near zero. However, as the Bank Rate rose above gilt coupons, this has now reversed, with the Bank also crystallising capital losses by selling gilts below their purchase price through its active quantitative tightening (QT) programme. Under the Treasury's open-ended indemnity, taxpayers are now responsible for these losses.

While this fiscal drain is not the primary focus of this chapter, full remuneration of reserve balances affects bank margins and relative portfolio incentives.

We are not challenging the Bank's independence in setting monetary policy; rather, we challenge whether the taxpayer should go on underwriting the losses, and whether all reserves should earn the full Bank Rate.

Tiering reserve remuneration would reduce the fiscal cost of remunerating reserves and alter the relative returns available to banks. Ending the open-ended Treasury indemnity gives the government a direct lever to leave balance-sheet losses with the Bank, incentivising it to reduce the cost of remunerating excess reserves.

Rather than paying full Bank Rate on every pound of central bank reserves, the Bank of England could introduce a tiered structure. Under tiering, the full Bank Rate is paid only on a defined tier of reserves, while excess holdings earn a lower or zero rate. Other major central banks, including the European Central Bank, have operated tiered reserve systems effectively, demonstrating that reserve remuneration can be calibrated without impairing the monetary policy transmission mechanism.

To encourage adoption, the government can withdraw its open-ended indemnity. Today, the Treasury automatically covers losses incurred by the Asset Purchase Facility (APF). We recommend ending the indemnity and moving to a model where the central bank becomes responsible for its own balance-sheet losses, akin to that of the US Federal Reserve.

Of course, care must be taken. While impairments to the balance sheet may theoretically push the central bank into 'negative equity', a more practical consideration is that banks may move into short-term Treasury bills or gilts rather than expanding real-economy lending. While stronger demand for short-dated government debt lowers public borrowing costs, this does not achieve the intended aim of encouraging more SME lending. Reserve tiering must therefore operate alongside the prudential and tax levers set out in this chapter.

3.4 - A National Investment Bank to fill the remaining gaps

Even with prudential reforms in place, many small businesses will still struggle to secure the patient, relationship-based finance needed to scale. An ICFC-style National Investment Bank should bridge this gap at smaller ticket sizes, delivering direct regional investment on strictly commercial terms.

Key policy recommendations:

- → **Create a National Investment Bank (NIB) to close the scale-up equity gap and restore small-ticket relationship finance.**
- → **Govern it as a commercially run institution with an independent board, no political direction over individual investments, and private sector pay flexibility including carried interest.**
- → **Structure it as an evergreen permanent-capital vehicle so that it can recycle and compound its returns.**
- → **Limit its remit to minority growth equity, stakes in third-party funds, and guarantees that restore working capital to small firms.**
- → **Restore small-business working capital by guaranteeing commercial bank lending on the US SBA model, leveraging private capital at minimal taxpayer risk.**
- → **Cap individual NIB investments to target genuine market failure and avoid crowding out private capital.**
- → **Capitalise the NIB through a blend of government assets and institutional cornerstone investors - not mandation.**
- → **Issue a retail 'NIB Bond' once an established asset book exists.**
- → **Reach businesses through banks, accountants, solicitors and local advisers before building a regional office network.**
- → **Consolidate relevant functions of existing public finance bodies (PuFins) into the NIB as it establishes itself, with overlapping or superseded programmes phased out.**
- → **Allow the scope of the NIB to evolve as broader reforms in this report take hold and private capital flows more freely into growth assets.**

Even after prudential reforms, scale-up equity and the smallest relationship loans are likely to remain beyond the reach of commercial banks.

Our proposed reforms to prudential policy widen the scope of what commercial banks can do and improve their lending incentives. However, they leave two critical areas unaddressed: patient equity capital and small-ticket, labour-intensive lending. Together, these constitute the 'Macmillan gap' - first identified by the Macmillan Committee in 1931 - which has re-emerged as a major barrier to small business expansion.

The first of these is equity at the scale-up stage, rather than at the seed and early stages, where Britain is comparatively well served (our proposals for this segment are set out in Section 3.7). On paper, Britain has Europe's largest venture capital market; however, the money thins out in the growth rounds, from Series B through to flotation. The capital that fills those rounds is increasingly non-British: in 2025, international investors participated in close to half of all UK deals which accounted for more than 80% of the total capital invested. Moreover, late-stage funding made up just a fifth of the UK total, compared to more than a third in the United States. These are Britain's true growth companies - perhaps 30,000 to 40,000 firms, capable of sustained revenue growth of 20% or more a year, forming the source of the next generation of large British businesses and future unicorns - and they face a persistent shortage of domestic equity.

When founders raise major scale-up rounds from American funds, they are generally pulled towards US markets to redomicile and list there. The consequence for the London market is stark: out of more than 200 UK venture-backed exits in 2025, just two were public listings on the domestic stock exchange[23].

"Britain has become a good place to start a company but a poor place to grow one."

The second challenge concerns a far larger population: the several million small firms - including plumbers, decorators, and hairdressers, often sole traders - that make up the bulk of British business. Most do not aspire to scale, and have no need for dilution or scrutiny associated with equity; for core capital, they generally rely on their own resources and family. What they do need, however, is working capital - especially overdrafts to bridge short-term cashflow gaps. As discussed in Section 3.2, commercial banks have steadily withdrawn from this vital market, lending only against fixed assets or personal guarantees.

Neither gap is a shortage of capital per se - Britain holds one of the world's deepest pools of savings, and foreign money is willing to back British firms. What is missing is a domestic institution prepared to do the specific, patient work of backing these companies.

The state already funds a crowded field of investment bodies meant to fill the gap, but they deploy only a fraction of their headline capacity and are weighed down by objectives that often have little to do with backing growth.

The state already recognises the gap: the British Business Bank, the National Wealth Fund, British Patient Capital, the National Security Strategic Investment Fund, and Innovate UK, are institutions created to push money into areas underserved by the market. Between them, headline capacity runs into the tens of billions of pounds.

While there is variance of views across the working groups regarding the efficacy of these so-called PuFins, a recurring concern is how little of the headline capacity reaches companies.

The British Business Bank, the primary vehicle, holds a total financial capacity of over £25 billion. Yet against this multi-year limit, it supported £6.8 billion of finance in 2024-25, of which just £1.2 billion was direct public capital - with the rest relying on private co-investment and commercial loan guarantees. Although we also propose an extended use of guarantees modelled on the US Small Business Administration (see below), what is still limited is direct, relationship-based

[23] NatWest Group, UK venture funding analysis, 2026; House of Commons, oral evidence on UK venture capital; ScaleUp Institute, ScaleUp Annual Review 2025; British Business Bank, Small Business Finance Markets 2026

backing of individual firms through patient equity and small-ticket lending. Even with expanded capacity, the Bank's own plan raises annual funded commitments to only around £2.5bn[24].

Another challenge is what these bodies are asked to optimise for. As with the regulatory and arm's-length bodies discussed in Chapter 2, their mandates contain objectives which have little to do with their core function - in this case, the financial return on an investment or the growth of a firm. For example, the BBB reports against diversity and net-zero targets alongside its financial ones. Entrepreneurs who deal with them complain consistently of processes that are slow, bureaucratic, and difficult to navigate.

Too small to bother with

An individual we consulted set out to create a £10 million fund to finance creative-industries projects - an underserved sector that the British Business Bank is tasked to support under government strategy. The response was that the £5 million the Bank might have put in was "too small" to justify the legal cost of its review, which it put at £25,000, and he was told to come back with a fund of £60 million or more. In other words, the British Business Bank turned away an investment which sits right inside the gap it exists to fill: small, high-impact commitments.

Germany and America show the gap can be closed by working through private managers and regional relationships.

Other countries have closed gaps similar to the UK's, and at a greater scale than Britain's crowded field of PuFins manages.

Germany's promotional bank, KfW, has a balance sheet of more than half a trillion euros, funds itself in the capital markets, and channels tens of billions of euros to smaller firms each year - interestingly, almost none of it directly. It lends through the commercial banks, which originate and own the relationships while KfW supplies the cheap funding and shares the risk. Unlike Britain, Germany has a dense network of regional and cooperative banks to lend through.

America's approach is more transferable. Since 1958, its Small Business Administration (SBA) has run the Small Business Investment Company (SBIC). It licenses privately run investment funds, vets their managers rigorously, and lends them government-guaranteed debt. The state sets the framework and underwrites the borrowing; private managers pick the firms. The record is considerable: the programme has deployed tens of billions of dollars into well over 100,000 US small businesses since 1958 - among them early-stage Apple, Intel and Tesla. Crucially, because the leverage is funded by bonds sold into the market and financed through user fees, it operates at virtually zero net cost to the taxpayer.

Two points follow:

First, scale comes from working through private managers and existing networks rather than from the state building its own ecosystem. There is no political direction, and financial discipline can be achieved by intermediation, as in America, or by independent commercial governance, as

[24] British Business Bank, Impact Report 2025

demonstrated by Britain's own Industrial and Commercial Finance Corporation (ICFC), founded in 1945 to address the aforementioned 'Macmillan gap'.

Second, neither model addresses Britain's scale-up equity gap. The mechanism pioneered in the US, of licensing private funds and leveraging them, is right for Britain, though the extension to equity needs care. The SBA ran an equity-oriented version - the Participating Securities programme - and stopped issuing new commitments in 2004 after losses of some $2.7bn, as early-stage technology investments lost much of their value. Avoiding this requires the permanent capital structure we set out below.

Bpifrance

France took a different path, and the contrast is instructive. Its state investment bank, Bpifrance, invests directly and at scale across the whole life of a company, and is widely credited with building the French VC ecosystem - producing around thirty unicorns in a decade. But there are drawbacks to a state being so central to the market: at its height, Bpifrance accounted for around 40% of the capital in the seed funds it backed and, critics argue, helped keep alive weaker firms that commercial investors would have closed. Its remuneration structure does not include carried interest, making it harder to recruit and retain experienced investors against private funds. Moreover, critics argue that the state's flood of early money inflated valuations to the point where the next round became hard to fill.

We propose a National Investment Bank (NIB), modelled on ICFC, to bring direct investment and private-capital mobilisation together within a single commercially governed institution.

We propose a National Investment Bank (NIB), modelled on ICFC, to bring direct investment and private-capital mobilisation together within a single commercially governed institution. The distinction from the British Business Bank and other relevant PuFins is in institutional design: we propose a single, commercially governed bank, permanently capitalised from public and institutional sources rather than subject to the Treasury's spending review cycle - a National Investment Bank (NIB). This is the role the Industrial and Commercial Finance Corporation (ICFC) fulfilled after 1945.

ICFC was fully independent: though the banks and the Bank of England were its shareholders, it was run as a commercial business at arm's length from all of them, free to lend and take equity on its own judgement. It combined long-term loans with minority equity stakes in firms too big for a bank and too small for the market, and built a national network to reach them. Operating on purely commercial terms, it crowded in private capital until the market matured; as 3i, it floated on the London Stock Exchange in 1994 and joined the FTSE 100.

The NIB must heed the warnings from other state-backed investment institutions and schemes - notably the National Enterprise Board and, more recently, the Future Fund - about the need to preserve independent commercial discipline.

ICFC stands out because commercial discipline took precedence over state direction.

Notably, the National Enterprise Board was created in 1975 to take stakes in promising British industry. Within months it had been handed responsibility for British Leyland and Rolls-Royce - two failing giants it had not asked for - because the political imperative of the day was to protect jobs and national champions. It spent its energies propping up companies the market had already rejected; British Leyland alone absorbed several billion pounds of public money and went on losing market share regardless.

The Future Fund, established during the covid pandemic, matched private investment in eligible companies. A significant number of those companies have since failed[25].

The common lesson is the importance of independent commercial discipline, which was a core feature of the successful ICFC. A successor NIB must therefore be built with the necessary safeguards to ensure discipline as well as to mitigate political direction.

It must act as a privately governed institution, with an independent board and commercial incentives, as well as permanent capital.

The NIB must possess three safeguards:

1. An independent board, appointed by the NIB's shareholders: the government may have a say in the mandate (sectors, regions, firm types), but not on individual investment decisions, which belong to the board and portfolio managers, and are made on commercial grounds alone;
2. Commercial incentive: the NIB must be free to pay private-sector salaries and to tie performance pay (including carried interest) to returns; equally, the mandate is to make profitable investments, avoiding ESG and similar objectives which have accreted onto the existing public bodies;
3. Permanent capital: the NIB should be an evergreen vehicle that holds, recycles and compounds its returns - rather than returning capital to the Treasury.

The NIB sits within the Strategic Investment Vehicle we propose in Section 4.7, with the Vehicle as its cornerstone shareholder, providing its founding capital, and governed at arm’s length as discussed. The NIB operates under the same accountability framework we propose in Chapter 2, with a mandate letter defining its remit, the standing committee holding it to account, and a periodic review of whether it is still needed.

Its scope is limited to minority growth equity, third-party fund stakes, and guarantees to restore working capital to small firms. The size of the investments is weighed against the risk of crowding private capital out.

The NIB must avoid the temptation to try and do everything. Its remit should be limited to three areas:

1. Take minority equity stakes in growth-stage companies, investing directly and alongside private investors rather than in their place;
2. Back third-party venture and growth funds, capped at no more than a fifth of any one fund;
3. Guarantee working capital for the mass of ordinary small firms - chiefly the challenger banks' overdraft lending, rather than originating itself, on the model of the loan guarantees run by the US Small Business Administration (SBA), which would let the institution reach

[25] British Business Bank, Future Fund companies

hundreds of thousands of firms it would be unable to assess one by one. This builds on the existing Growth Guarantee Scheme, which the government expanded in July 2026 but which remains small by international standards.

Around all three, it should offer support such as introductions and expertise.

The caps should not necessarily be seen as a hard rule - while the purpose is to keep the NIB focused on where there is a clear market failure, it should not be obliged to decline a compelling proposition which private investors are unwilling to lead (though investments above any cap should be the exception rather than the norm).

Two objections arise: that state guarantees breed reckless lending, and that public money crowds out private credit.

Where the NIB guarantees lending rather than originating it, there are three safeguards: 1) a cap on how much any one lender can put at risk; 2) a requirement that the lender retains a share of any loss, as it does under the existing Growth Guarantee Scheme, so that it has capital at stake; and 3) a published record for each lender, so the worst lose their accreditation. The Bank should also report each year on whether its capital is drawing private money in or pushing it out.

It should be capitalised from a blend of public, institutional and, in time, retail money - seeded much as ICFC was - and not through mandation.

ICFC was seeded when the Bank of England helped organise the clearing banks to put up its founding equity. The modern equivalent is to ask a handful of the largest insurers, pension funds and banks to provide the initial subscription, alongside the Strategic Investment Vehicle outlined in Chapter 4.

Beyond the cornerstone subscription, the NIB’s ongoing capital comes from three primary sources:

First, existing government entities: consolidating the British Business Bank's direct-investment portfolio, alongside an expanded Growth Guarantee Scheme, where a state guarantee allows private capital to lend and invest at a multiple of its balance sheet.

Second, ongoing institutional co-investment: drawing in allocations from UK insurers and pension funds into the NIB's underlying growth funds and direct co-investment rounds. Capital should be attracted through commercial design rather than compelled.

Third, retail savers: an 'NIB Bond' provides a safer, higher-capacity alternative to traditional VCTs. By pooling investments across the NIB's entire balance sheet, rather than leaving investors exposed to a single, concentrated VCT fund, it delivers broader diversification and superior liquidity at far lower management costs. The bond must be issued only after the institution is established, not to fund its start-up: until a proven portfolio exists, retail money would be exposed to an undiversified book.

Over time, a successful institution relies less on any of these sources - like ICFC, it would fund itself increasingly from its own compounding returns and bond market issuances, with the potential, one day, to list on the public market.

The NIB should reach businesses through their professional services providers (accountants, solicitors), as well as banks; it should only build a regional presence once more established.

The NIB does not need branches in every town - it needs deal flow, and the cheapest and quickest way to get it is through networks which already exist.

For instance, accountants, solicitors and local advisers know which small firms are sound and which are raising money, and a referral fee will incentivise them to connect successful bidders to the NIB; 3i used professional and local networks to build its deal flow for decades.

Moreover, the banks can send sound borrowers in the direction of the NIB and co-originate deals, so that they keep the customer relationship and business while the NIB takes the equity or longer-term risk that the bank's balance sheet cannot hold. (The existing duty on banks to refer the borrowers they reject has achieved little).

Physical branches can come later: as the institution grows and proves itself, a network of regional offices could widen its reach, and signify that the NIB is a national institution.

As it grows, it should consolidate relevant functions from existing public bodies, with overlapping or superseded programmes phased out.

The NIB is not designed to be another addition to the crowded field of existing public development finance institutions. As it establishes itself, it should absorb relevant investment functions and programmes - for example, the British Business Bank's direct equity holdings and fund-investment programmes, alongside relevant Innovate UK finance programmes and regional investment funds. Overlapping or superseded programmes should be phased out.

The necessity for a National Investment Bank is partly a function of many of the problems set out across this report.

Whether the UK needs another state entity has been a matter for debate across the working groups. Several argued against: fix the prudential rules, and make domestic assets attractive through the tax reforms and reductions in state risk set out elsewhere in this report, and private capital should fill the gap by itself, while others cautioned that a state fund is prone to political capture. On the first, even if prudential reform fully frees capital for lending, there is still a scale-up gap in equity. On the second, the design proposed mitigates political capture, through a privately governed institution with an independent board, commercial incentives, and a deliberately narrow remit, in which the state participates rather than directs. Moreover, this is not a novel model - ICFC did this in Britain after 1945, and Germany's KfW and America's SBIC programme do so now, successfully.

3.5 - AIM reform

AIM was created to give growing British companies access to public capital, but years of additional regulation and tax changes have made it increasingly expensive and unattractive. Reform is needed so that more promising businesses can raise money, remain in Britain and grow into larger employers - rather than sell early or move overseas.

Key policy recommendations:

- → **Retain annual audited accounts, continuous market disclosure and the required half-year report, while making half-year reporting lighter and more proportionate to company size.**
- → **Build on the August 2026 reforms by ensuring smaller, founder-led companies have genuine discretion over board composition in practice.**
- → **Retain the Nomad regime while lowering its cost by standardising procedures, removing duplication with auditors and the exchange, ensuring the Exchange's recent guidance translates into proportionate practice, and widening the pool of eligible firms to increase fee competition.**
- → **Adapt AIM trading rules for illiquid stocks through matched-bargain trading and scheduled trading windows to concentrate liquidity.**
- → **Review tick sizes (minimum price increments) to allow spreads to tighten, and incentivise continuous market-making through broker exchange fee reductions, trading rebates, or designated-market-maker schemes with quoting obligations.**
- → **Extend proportionality to the Main Market by making board diversity reporting and sustainability reporting voluntary.**
- → **Restart the listing flywheel by bringing commercial state-owned assets to market.**

AIM now carries Main Market levels of cost and compliance (without the liquidity or valuations).

The Alternative Investment Market (AIM) was launched by the London Stock Exchange in 1995 as a lighter-touch venue for growing companies - a step between private ownership and the Main Market, governed by the exchange's own rules, with companies required to retain Nominated Advisers (Nomads) rather than operating under the full listing regime. At its peak in 2007 it had 1,694 companies. It now has fewer than 700, the lowest since 2001. In 2025, four times as many companies left as joined.

The first cause is regulatory accretion: each governance failure on AIM - Patisserie Valerie, Quindell, Globo - was followed by a tightening of the rules. Staying listed now costs a company upwards of £1.5m a year once Nomad and broker fees, audit and the independent directors are included - a largely fixed cost which smaller firms disproportionately bear. Around one delisting in ten is now blamed by the departing company on the cost of compliance.

Our working group discussions and industry engagement predate the exchange's August 2026 update to the listing rules. This update lightens the admission document by removing the requirement for a formal working capital statement, allows companies to link directly to existing public filings rather than re-printing the information, and accepts standard UK accounting rules (UK

GAAP) without forcing a conversion to international standards (IFRS). However, these changes principally target the cost of joining the market; the ongoing cost of remaining listed remains substantial.

Another cause is the tax regime - most notably recent changes to inheritance-tax relief. From April 2026, qualifying shares attract 50% business relief rather than 100%, removing much of the reason many held them. Looking further back, the 1997 abolition of the dividend tax credit removed a significant incentive for pension funds and insurers to buy and hold UK equities, initiating the multi-decade retreat of domestic institutions from the market.

The third is a shortage of liquidity, which is self-reinforcing. AIM trades on materially lower valuations than the larger UK indices. Spreads are wide, many institutional mandates exclude the market outright, and the economics of small-cap research have been undermined by the original MiFID II unbundling rules (which barred brokers from bundling investment research costs into trade execution fees, making coverage of small unquoted or junior listed companies commercially unviable).

Each of these factors worsens the others - thin trading widens spreads, which deepen discounts, which make raising capital expensive and dilutive, which deters new listings, which thins trading further - bringing the flywheel to a halt. This has also made AIM companies attractive takeover targets, including for overseas buyers attracted by relatively low valuations.

Our reforms restore proportionality rather than remove safeguards for market participants. We also argue that AI presents an opportunity to make oversight lighter and continuous.

We do not propose removing rules which protect investors from being defrauded, including prohibitions on market abuse and insider dealing, the duty to disclose material information as it arises, annual audited accounts, and the continuing role of the Nomad. However, we do propose removing the layer of scheduled, process-driven reporting that has emerged.

Consistent with the central theme of this report, a growth market must accept that young companies carry inherent risk and commercial volatility, which is a feature of market dynamics rather than a failure of regulation. The regime must not tolerate fraud or hidden insolvency; our reforms focus on the heavy process costs which suppress normal commercial risk. Indeed, the revised AIM Rules now describe AIM as a 'buyer beware' market.

Moreover, AI analysis of a company's disclosures, filings, market data and trading patterns can flag important anomalies as they appear, rather than waiting for the next scheduled (and resource-intensive) periodic report - both lighter for the company and quicker to identify problems than the current calendar-driven reporting process.

Reporting and governance should reflect the size of the company. We propose keeping annual audited accounts and continuous disclosure, while making half-year reporting lighter and more proportionate to company size, and reducing code-based board-composition expectations. The Nomad regime remains to maintain AIM's integrity, but is reformed to strip out the duplication and cost it imposes on companies.

A growing business with a small finance team cannot realistically take on the reporting burden of a FTSE 100 company. While we keep annual audited accounts, continuous market disclosure and the required half-year report, we propose reducing the burden of half-year reporting and financial disclosures that add cost without materially improving an investor's understanding of how the business is actually performing. Half-year reporting should be proportionate to the company's size, with disclosure focused on cash generation, liquidity, and how capital is deployed.

Similarly, some governance expectations can be a poor fit for a founder-led firm worth £30m. Code-based expectations around independent non-executive directors can represent a significant cost and are often a poor fit for an early-stage business. Smaller companies should have more discretion in how they compose their boards, and be judged on the competence and alignment of the people running them. Specifically, below a defined size threshold there should be no code-based expectation for a minimum number of independent directors, with the company instead disclosing its board structure and explaining why that structure suits its size and stage.

The exchange has also acted here: its August 2026 update removed the requirement for AIM companies to adopt a rigid corporate governance code on a comply-or-explain basis, allowing them instead to disclose their bespoke approach to board composition.

Nominated Advisers (Nomads) advise AIM companies on their obligations under the AIM Rules and owe separate obligations to the exchange, and we propose retaining this regime. However, our working-group discussions found that the regime had become costly and heavily compliance-focused in practice. The task is to retain oversight while making it far cheaper. The working groups discussed three changes: 1) standardising the Nomad's procedures and removing the points where they repeat the auditor's or the exchange's work; 2) giving clearer, proportionate guidance so Nomads stop demanding more than the rules require; and 3) widening the pool of firms able to act as Nomads, which has thinned to the point where weak competition keeps fees high.

Indeed, the Exchange's August 2026 reforms and accompanying guidance now recognise that the Nomad's role is not to 'police' an AIM company's compliance and emphasise its role as a corporate finance adviser. This is welcome; the test is whether practice changes accordingly.

AIM's trading rules should be changed to suit small, illiquid stocks, with a wider use of matched-bargain trading, lower tick sizes, more flexible trading windows, and incentives for market makers to quote continuously.

Many AIM shares do not trade regularly. When there is only a limited number of orders across a trading day, spreads widen and a single trade can significantly move the price.

Our first change is in how trades are matched: for a thinly traded company, it is better to gather the buyers and sellers together. We propose wider use of matched-bargain trading - where the exchange pairs a buyer directly with a seller rather than relying on a continuously quoted market - and greater use of scheduled trading windows for the least-liquid stocks, concentrating liquidity into windows where a 'real' price can form. In addition, tick sizes - the smallest increment by which a price is allowed to move - should be reviewed and set so that spreads can actually tighten, rather than being held artificially wide by the tick size.

Our second change is to incentivise the provision of liquidity: market makers should be given more of an incentive to make markets in smaller companies' stock, to reflect the inventory risk of holding illiquid shares. Exchange fee reductions, trading rebates, or a designated-market-maker scheme with quoting obligations can help maintain a continuous price.

The taxes that suppress demand for AIM shares - including the recent cut to inheritance-tax relief and the dividend credit abolished in 1997 - and the wider decline in pension-fund demand are addressed elsewhere in this report.

Many of the principles apply to the Main Market, including on the demand side, despite recent reforms. The exchange also needs fresh deal flow to restart the flywheel.

The 2024 listing reforms attempted to address many challenges on the Main Market: merging the premium and standard segments into a single commercial category to facilitate index inclusion, dropping mandatory three-year financial track records for eligibility, and removing mandatory shareholder votes on significant transactions that placed UK companies at a competitive disadvantage. But substantial ongoing reporting obligations remain. We propose that board diversity reporting and sustainability reporting become voluntary.

Any market also needs flow to keep the flywheel spinning. The privatisations of the 1980s created a supply of large, liquid listings, brought several million first-time shareholders into the market, and provided an ecosystem of brokers, analysts, and market-makers that served the UK financial sector for decades afterwards. Although the British state no longer has assets to sell on the scale of British Telecom or British Gas, the principle still applies, and there are assets in public hands that could be listed - for example, the commercial arm of the BBC. Regardless of any fiscal implications, the policy point is deal flow and the benefits that can follow, which the exchange cannot generate on its own.

3.6 - Pre-IPO reform - addressing the 'missing middle' challenge

Too many businesses fall into the 'missing middle': they need larger amounts of capital but lack an efficient route to raise it. Developing the new Private Securities Market into a standardised market for growth finance would help institutional capital reach more growing businesses before they are ready for a stock market listing.

Key policy recommendations:

- **Turn the Private Securities Market into a standardised platform for raising new growth capital, not only trading existing private company shares.**
- **Create common standards for growth debt and minority equity issuance, covering documentation, disclosure, valuation, and governance.**

→ **Build a national origination network (akin to the network we propose for the National Investment Bank) of accredited advisers, banks and professional-services firms to identify suitable growth companies and bring them to market.**

→ **Pay accredited originators through arrangement fees or upside participation, so regional advisers have a commercial reason to bring companies forward.**

The 'missing middle' of growth capital - between £20m and £200m - remains severely underfunded. Although the London Stock Exchange's new Private Securities Market provides a venue, this is not the same as a market.

While Section 3.4, above, introduces a National Investment Bank concept to address a scale-up gap at the lower end of the market, this section addresses the 'missing middle', the band from roughly £20m to £200m.

Britain is among the strongest countries in the world at the seed and early stages, and it holds some of the deepest pools of pension and insurance capital. What is broken is the transmission mechanism between the two. The funding gap is widest for businesses that offer solid, mid-tier returns - such as specialised manufacturing or healthcare - which are too capital-intensive and low-multiple for venture capital power-law models.

This is one reason why London, which only a decade ago hosted around half of Europe's flotations, has now slipped out of the world's top twenty markets for new listings altogether[26].

The structure is broken in three specific places:

1. There is no common route to market: deals are found through personal networks and individual brokers; a sound candidate company in Newcastle with no City connections may never get in front of the institutional capital that could otherwise back it;
2. There is no standardisation: legal documents, financial reporting, and valuation mechanisms are bespoke to every transaction, which makes the diligence on a single mid-sized deal too costly for a larger institution to bother with; and
3. There is no bridge for raising growth capital into the public markets: a growing company still faces a choice between raising capital privately and a full public listing, with the associated costs as outlined in Section 3.5; in practice, many take a third route and sell to private equity, which often results in control moving overseas.

The Private Securities Market begins to address the last of these. Approved by the FCA in 2025, it uses intermittent auctions to allow founders, employees, and early investors to sell. This provides a better alternative to selling out to private equity, delivering partial liquidity for early backers while maintaining company independence.

But while it represents progress, it remains a secondary venue for trading existing shares rather than a primary platform for injecting new capital into businesses. Turning a trading venue into a true capital market requires standardisation that reduces the cost of assessing individual transactions.

[26] Bloomberg, London Drops Out of Top 20 IPO Markets, 30 September 2025

Institutions are less likely to invest at scale where every deal requires bespoke documentation and assessment. Common standards can reduce these costs across documentation, disclosure, and underwriting.

The reason a pension fund or insurer will invest £200m in a listed company but not £20m each in ten private ones is as much the cost of determining what that risk is as the underlying risk. Listed companies are known entities: audited to common standards and market-priced shares. In contrast, a private mid-sized company is esoteric, with its value a matter of negotiation. The investor must carry out bespoke due diligence for each transaction, which for smaller tickets is often not worth the effort.

We propose a standardised framework for the issuance of growth debt and minority equity, the information a company must disclose, and the conventions by which it is valued and governed. For the prospective investor, this allows deals to be presented in a familiar way which can be assessed quickly and against peers, reducing the fixed cost that makes smaller transactions not worth doing.

> "Standardisation does not lower the bar;
> it lowers the cost of clearing it."

The Private Securities Market is well placed to accommodate this: the market already carries part of the infrastructure, including a disclosure portal, a rulebook setting out what companies must publish. If extended into a full standard and applied not only to secondary trading but also to primary transactions, it would give capital and companies a common portal.

Extending the PSM in this way will not remove the need for appropriate due diligence or, on its own, guarantee liquidity. It can, however, lower costs through standardisation, broaden distribution and create a more credible secondary exit route, while also supporting primary growth-capital raising. The NIB can also play a complementary role where these market mechanisms remain insufficient, particularly where specialist investment expertise and patient capital are required.

Deals reach the market through a national network of accredited advisers and banks paid to bring companies forward.

A standardised market still relies on effective origination. As with the National Investment Bank, we propose that firms with existing commercial relationships - banks, accountants, and advisers - should be accredited as origination partners. Accreditation means two things in practice: 1) each partner knows which deals to bring to the market; and 2) all partners record their pipelines in a standardised format so that deal flow is visible in one place. The standards and the pipeline sit within the common framework administered through the Private Securities Market, while due diligence and investment decisions remain with the institutions providing the capital. Deal sourcing is pushed out across the country to those who know these businesses best. Strong companies with no City contacts can now access institutional capital because their local professional advisers are part of the network.

As with the NIB, those who originate must be incentivised to do so: an originator should earn an arrangement fee and/or a share of the eventual upside. As outlined in Section 3.4, advisers can also bring forward smaller deals to the NIB.

On the demand side, improving market structure will not by itself create institutional appetite for private growth assets.

Pension funds and insurers are potential sources of capital at this scale, but whether they invest will ultimately depend on the risk, return and liquidity of the underlying opportunities. The reforms above can reduce transaction costs and improve access and exit opportunities, while wider pension and tax reforms can support demand and the regulatory treatment of PSM holdings should be kept under review.

A risk is that funding concentrates in London rather than reaching the whole country; the national origination network is designed to address this.

Growth capital of this kind naturally flows to London and the South East, where corporate advisers and investment funds are densest. Accrediting regional accountants, banks, and corporate finance advisers ensures viable deals are sourced, standardised, and brought to market across the whole country.

3.7 - Entrepreneur incentives and support

Britain must restore competitive incentives for entrepreneurs and founders, whose tax treatment has deteriorated from world-leading to internationally uncompetitive in just two decades. Successful founders should be encouraged to build their next business in Britain and reinvest their capital in the next generation of growing companies.

Key policy recommendations:

- **Merge EIS and SEIS into a single Enterprise Scheme, with one set of qualifying tests, one annual investor limit and one set of company limits, with a higher allowance for scale-up rounds. Retain the two relief rates: 50% for early-stage qualifying companies and 30% for established ones.**
- **Open the Enterprise Scheme to employees subscribing their own cash for shares in their employer, subject to safeguards against salary substitution.**
- **Raise the early-stage company limit, currently £250,000 under SEIS, to £500,000.**
- **Retain EMI as a separate share option scheme, raise the individual grant limit from £250,000 to £500,000, separate the EMI and CSOP limits, and allow good leavers to retain their options.**
- **Restore venture capital trust upfront income tax relief to 30%, and allow VCTs to invest in AIM shares on the secondary market.**
- **Make HMRC advance assurance binding once given and subject to a published response time, and give companies that breach a qualifying condition a period to correct it.**
- **Replace the Start Up Loans scheme with a German-style system of state-backed lending, coaching and independent viability checks.**
- **Create a volunteer ‘Backing British Business’ coaching network drawing on local business leaders and the accounting profession.**

- → **Build a French Tech-style network of regional founder hubs across the UK, overseas founder communities through the British diaspora and the Foreign Office network.**
- → **Create a single, clearer founder visa.**
- → **Create an annual government-backed list of Britain's leading scale-ups, modelled on France's Next40/120.**

Building a company in Britain has become steadily less rewarding over the last twenty years. As a result, founders are increasingly building businesses elsewhere.

For most of the past twenty years, taxes for founders selling their businesses was among the most competitive in the developed world. This is no longer the case. Before 2008, business asset taper relief reduced the effective rate on shares held for two years or more to 10%, with no lifetime limit. Its replacement, the relief now called Business Asset Disposal Relief (until recently, Entrepreneurs' Relief), charged a flat 10% on the gain, but on a capped lifetime allowance that rose to £10m. Since then it has been steadily reduced: the lifetime allowance was cut to £1m in 2020, and the rate raised to 14% in 2025 and to 18% in 2026. From April 2026 a basic-rate taxpayer does not benefit from the relief on gains falling within the basic-rate band.

The erosion of Entrepreneurs' Relief / Business Asset Disposal Relief, 2008-2026

Period	Lifetime allowance	CGT rate on qualifying gains
2008-2011	£1m, rising to £5m	10%
2011-2020	£10m	10%
2020-2025	£1m	10%
2025-2026	£1m	14%
2026 onwards	£1m	18%

Source: HMRC

Chapter 5 covers the wider tax treatment of founders and their gains. Crucially, what might seem like incremental changes to the tax code significantly influence whether a founder builds in Britain or in a lower-tax jurisdiction, whether they sell early to crystallise a gain before the next tax rise, and whether they reinvest their exit proceeds into the next British company or move both the capital and themselves abroad.

We now see that the country's wealthiest founders feature, each year, among those leaving. This matters all the more because Britain does not lack entrepreneurs - by most measures it is the strongest start-up nation in Europe. The problem is not producing founders; it is keeping them by rewarding the risks they take.

While Chapter 5 removes the main tax penalties on entrepreneurs, this section sets out reforms alongside this.

While Chapter 5 removes the main tax penalties on enterprise - including options to reintroduce indexation to, or outright abolition of, Capital Gains Tax, abolishing Inheritance Tax, and abolishing Stamp Duty on shares - this section sets out practical reforms alongside the tax code.

Specifically, we focus on three sets of measures to support a company along its growth journey:

1. A simpler and more generous suite of investment and equity schemes: consolidating the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) into a single Enterprise Scheme open to employees, expanding Enterprise Management Incentives (EMI) share options, and restoring Venture Capital Trust (VCT) relief to 30%;
2. Mechanisms to recycle exit proceeds: ensuring capital realised from successful exits is reinvested into the next generation of British scale-ups.
3. A continuous growth pathway: practical non-tax support across the entire founder journey.

EIS and SEIS should be merged into a single Enterprise Scheme and opened to employees investing their own money, with EMI and VCTs retained and improved alongside it. While the existing schemes have proven effective, their limits have fallen behind the cost of starting a business, and their rules are duplicative.

Britain has three tax-advantaged schemes for young companies (and a fourth, the venture capital trust - through which retail savers reach the same companies collectively):

- The Enterprise Investment Scheme (EIS) gives outside investors 30% income tax relief;
- The Seed Enterprise Investment Scheme (SEIS) gives 50% on early-stage companies;
- Enterprise Management Incentives (EMI) let employees hold tax-advantaged share options.

The three primary tax-advantaged schemes for young companies

Scheme	Open to	Relief	Limit per investor	Limit per company
EIS	Outside investors	30% income tax	£1m a year (£2m if knowledge-intensive)	£24m lifetime, £10m a year (£40m and £20m if knowledge-intensive)
SEIS	Outside investors, earliest stage	50% income tax	£200k a year	£250k lifetime
EMI	Employees, via share options	No Income Tax or NIC on grant	£250k of options	£6m of options

Source: HMRC; EIS company limits as expanded from 6 April 2026.

Each has its own qualification tests, contribution limits, and anti-avoidance rules. Together, they have become too complex.

We propose consolidating EIS and SEIS into a single Enterprise Scheme under a unified definition of a qualifying company and trade, one advance assurance process, a single claim procedure and one set of anti-avoidance rules, with one annual limit per investor across the entire scheme. Two relief rates are retained - 50% for early-stage companies and 30% for established and scale-up businesses - determined by a single test of company age, replacing the separate tests each scheme applies today. Company limits are structured into three distinct tiers: the early-stage limit rises from £250,000 to £500,000 to reflect the modern cost of starting a business; the established-company limit is maintained at £10m annually and £24m lifetime; and a dedicated scale-up tier offers £20m annually and £40m lifetime at the 30% rate. This scale-up tier extends the higher limits currently reserved for Knowledge-Intensive Companies to any business raising genuine growth capital, absorbing Knowledge-Intensive status and removing another layer of complexity from the tax code.

We propose retaining EMI as a standalone scheme, while expanding its capacity and flexibility. The individual EMI grant limit should rise from £250,000 to £500,000, and the EMI and Company Share Option Plan (CSOP) limits should be separated so that a grant under one no longer restricts the other. Crucially, the rules should be reformed to allow good leavers to retain their vested options until an exit, removing the 90-day tax cliff under which a departing employee can lose favourable EMI tax treatment if the option is not exercised.

Advance assurance can take weeks, and in complex cases longer, to obtain, and does not bind HMRC absolutely where relevant facts change or the information originally supplied proves incomplete. Advance assurance should bind HMRC on the facts disclosed at the time, except in cases of deliberate misrepresentation or a subsequent material change, and should carry a published statutory response deadline. Moreover, a company that inadvertently breaches a qualifying condition should be granted a defined period to rectify the issue, rather than triggering an immediate, automatic loss of relief for every investor.

The same logic applies to venture capital trusts (VCTs), the established retail route into unquoted companies. The November 2025 Budget cut their upfront income tax relief from 30% to 20%, and industry expects fundraising to fall sharply as a result. The 30% rate should be restored, and VCTs should be permitted to invest in AIM shares on the secondary market, improving liquidity.

We also propose extending the Enterprise Scheme to employees subscribing new cash for ordinary shares in their employer. They take the same risk as outside angels, but are currently excluded from relief. To prevent disguised remuneration, relief should require genuine cash subscriptions (prohibiting employer loans or salary sacrifice), while shares must rank equally with external investor shares, and controlling directors and their associates remain excluded. This allows recruits to receive EMI share options alongside the freedom to co-invest directly on the same tax terms as external angels.

In addition to tax incentives, founders need practical support to start and run a business. We propose replacing the Start Up Loans scheme with a German-style system of cheaper state-backed lending, coaching and an independent viability check.

Britain's main government-backed offer to a new founder is a single loan. Start Up Loans has lent around £1bn to more than 100,000 businesses, at an average of about £9,000 each, on a fixed rate of 7.5%, with twelve months of optional mentoring.

While useful, it is a relatively modest offer for someone trying to build a company from scratch.

Germany does a better job, through multiple channels:

- Larger loans on more favourable terms: KfW’s ERP-StartGeld provides up to €200,000 for businesses under five years old, including part-time ventures. KfW assumes 80% of the credit risk, easing access to bank lending. Larger SMEs can access up to €25m through KfW growth and investment loans, with maturities of up to 20 years and, in some cases, up to three repayment-free years.
- A grant for those coming from unemployment: the Gründungszuschuss supports unemployed individuals launching a viable business by paying their full unemployment entitlement

(roughly 60% of previous net earnings) plus €300 a month for six months, followed by €300 a month for a further nine months. It turns an unemployment safety net into a debt-free runway to build a company.

- Subsidised coaching and consulting: an unemployed founder can claim a voucher for professional start-up coaching.
- Proof of business competence: for certain regulated skilled trades, a founder may need the Meisterbrief - exams in bookkeeping, tax, employment law and business administration.

We do not propose that the UK copies Germany wholesale, but rather that a British founder is given access to the same pathways. The most efficient route is through the high-street banks, backed by the National Investment Bank to lend on StartGeld-like terms with the state absorbing the bulk of the credit risk, providing affordable corporate lending rather than forcing founders into expensive personal debt.

Two things matter over and above the cheaper loan. The first is an independent check that the business plan is viable, required as a condition before any money is committed: it works as a quality filter, and forces a founder to think the plan through. Because private advice can be costly and unevenly available, government-backed assessment can ensure that first-time founders without established professional networks are not excluded. The second is mentoring and coaching as a normal part of starting up: a volunteer scheme - Backing British Business - could draw on local business leaders and the accounting profession to provide it.

In addition to capital and support, founders need networks - to investors at home and to markets abroad. We propose building both, modelled on the networks France has used.

France has spent a decade connecting its founders to capital at home and abroad, under the label La French Tech. It began as a marketing campaign and has grown into something much more substantial.

La French Tech was launched in 2013 and later championed by Emmanuel Macron, growing into a three-part system:

1. At home: around 20 regional "Capitals" - Paris, Lyon, Toulouse, Grenoble and others - each a sector-focused entry point that gives founders contacts inside government to cut through bureaucracy, as well as links to angel investors, family offices and venture funds.
2. Abroad: dozens of volunteer-run "Communities" - groups of French entrepreneurs already living in foreign cities, carrying a government label renewed every three years but locally run and locally funded. They give a French founder arriving in a new market warm introductions to local investors, customers and talent.
3. At the top: an annual "Next40/120" cohort of the most promising scale-ups, with government endorsement.

Britain should build the same. At home, a network of around twenty-five regional hubs would give founders outside London a local route to capital and a way through the practical obstacles to growth. Abroad, Britain has a large diaspora of founders and executives, and a Foreign Office whose overseas infrastructure could be used to support them.

By way of caution, the French system is heavily dependent on state funding, more so than the self-sustaining ecosystems of the United States or Israel. Britain should copy the structure without the dependence on the government, whose involvement should be limited to establishing and seeding these networks.

Britain should also compete for founders and mark out its best companies: a single, clearer founder visa, and an annual list of its leading scale-ups.

The visa routes for founders already exist - the Innovator Founder visa, the Global Talent visa, and the Scale-up visa - but they are fragmented, and the main one runs through only a handful of approved endorsing bodies, which serves to effectively narrow eligibility. The gain from reform here is modest, and mostly a matter of signal: a single, clearly branded founder visa, with more capacity to endorse applicants, would say plainly that Britain wants founders - the signal France sends with its French Tech Visa, which it uses to recruit non-EU founders, employees and investors.

The second measure is a national-champions list, modelled on France's Next40/120. Each year, France names its 120 most promising scale-ups, with a top 40, and this government endorsement opens doors with international investors. Britain could do the same: an annual, government-backed list of its leading scale-ups, chosen with the investment community, to mark out the companies worth backing. While this is more signalling than a structural reform, it costs little and can serve as a clear signpost for investors and talent.

3.8 - ‘Sprint permissions’ for critical future industries

Britain is in a global race to attract the industries of the future, but is at risk of losing out because the state is too slow and inconsistent. ‘Sprint permissions’ would provide qualifying firms with a faster, lighter route through planning, regulation and other government processes, helping Britain secure investment and jobs before they go elsewhere.

Key policy recommendations:

- → **Create sprint permissions for globally mobile future industries, including AI, digital assets, quantum, life sciences, defence and others. Unlike freeports and enterprise zones, sprint permissions are activity-based rather than place-based.**
- → **Sprint permission = a faster, lighter regime to qualifying firms, including default-to-yes planning, guaranteed talent visas, limited employment-law easements, regulatory sandboxes and preferential tax treatment.**
- → **Put planning decisions for qualifying sites and infrastructure on a fixed approvals clock.**
- → **Use sprint permissions to unblock existing world-class clusters held back by housing, laboratories, water, power and other infrastructure constraints.**
- → **Apply sprint permissions to defence-industrial renewal where strategic speed is essential.**
- → **Sprint permissions are a temporary fast-start regime, after which successful firms move into the regular regime.**

Britain is in a global race for the industry clusters of the future, as financial services once were. These include AI, web3, quantum computing and life sciences, among others. Britain has the talent and the capital to win them, but lacks speed and certainty, without which it risks losing out to other countries.

Cluster economics means that once an industry establishes critical mass in a geography, its advantages compound. Specialist suppliers, top-tier talent, risk capital, and professional infrastructure cluster together until the ecosystem becomes self-sustaining and difficult to dislodge - as happened with the City of London in global finance.

Ireland also managed to attract a financial services cluster: in 1987, in the middle of an economic crisis, the government created the International Financial Services Centre (IFSC) on an abandoned dockland in Dublin, offering a preferential 10% corporation-tax rate and fast approval to international finance firms. The sector now employs tens of thousands of people and pays a large share of total corporation tax in Ireland, and hosts many of the world's leading financial firms.

The frontier sectors Britain must contest share three characteristics: they are growing exponentially, generate high-value jobs, and are currently mobile without a settled global home.

- Artificial intelligence - rapid deployment of compute and energy infrastructure is critical; whoever hosts the primary data centres, cheap power, and frontier research labs captures much of the downstream economic value;
- Web3 and digital assets - an agile, borderless industry actively choosing jurisdictions based on the speed and predictability of regulatory licensing;
- Quantum computing - capital and research intensive technologies bridging university research to commercial applications, requiring rapid university spin-out licensing, patient scale-up capital, and specialised cryogenic laboratory space;
- Life sciences - an established UK strength spanning genomics, drug discovery, and medical technology, but one currently constrained by severe shortages of laboratories, power grid capacity, and local water and housing infrastructure across key clusters like Oxford and Cambridge, or major manufacturing sites like AstraZeneca at Macclesfield;
- Defence and strategic manufacturing - a national resilience imperative as well as economics; rebuilding Britain's defence-industrial base requires rapid planning approvals, fast-track regulatory clearances, and agile recruitment.

Other critical areas, including nuclear power, advanced manufacturing and semiconductors - share the same dynamic.

To attract and secure these, it must address its known challenges with planning decisions, regulatory approvals, visa cases and tax rulings, which can take months or years, while an internationally mobile company chooses between jurisdictions in months or even weeks. If Britain does not urgently change, it will lose out.

The obvious objection is that these problems should be fixed for everyone, not for a designated few industries. While we would agree with the principle, reforming planning, tax administration and the visa system takes years, while these industries are choosing where to base themselves now. A sprint permission applies the necessary easements at the required urgency.

A 'sprint permission' should be available to firms in the designated industries: if they meet certain criteria, they move onto a faster, lighter regime - for example, default-to-yes planning, accelerated talent visas, and fast-track regulatory clearances.

Rather than pre-supposing the location of each potential cluster, we propose providing nationwide 'sprint permissions' to firms based on what they do, and let the free market decide where the clusters form - this mitigates inadvertently discriminating against one area of the country against another.

A company building in one of the aforementioned industries, and meeting defined criteria - for example, proof of a genuine operating business, anchored to a university or research base - would qualify.

Example reliefs under the sprint permissions regime include:

- Default-to-yes planning: replaces the presumption of delay with a presumption of consent, on a fixed deadline, for the sites and infrastructure these industries depend on e.g. laboratories, data centres, reservoirs, power connections etc.
- Talent visas: already exist, however permission is guaranteed for roles at firms holding a sprint permission, above a salary and skill threshold (the guarantee is of a fast, certain decision, not a lower bar);
- Some employment-law easements: to allow young companies room to hire and adjust as they find their feet;
- Regulatory sandboxes: as the FCA has done since 2016, lets firms test new products with real customers under close supervision;
- A more favourable tax regime: for example an immediate shift to the 15% corporation tax rate we propose phasing down to in Chapter 5, or income tax easements.

The aim is not a permanent special status but a fast start - after which successful firms join the ordinary regime.

Sprint permissions are distinct from freeports and enterprise zones.

Sprint permissions differ from freeports and enterprise zones in such that the latter designate a geographical area, within which firms receive tax breaks, customs easements or planning relief. Britain has tried versions of this for forty years, with mixed results, and incremental where positive. The OBR expects today's freeports to generate little new activity, with much of it displaced from other areas. A more generous freeport would not on its own encourage the cluster formation we are looking for.

Sprint permissions differ in two ways:

1. It attaches to the activity, not the place, so it does not bid one British town against another for a fixed pool of firms; and
2. It aims at industries that are currently internationally mobile, and choosing between Britain and Paris or Munich, not between Manchester and Edinburgh.

3.9 - Against mandation and ESG

Measures which mandate capital into politically designated asset classes should be unwound; instead, the focus must be on making UK assets genuinely attractive to invest in.

Key policy recommendations:

→ **Reject statutory mandation and Mansion House-style capital steering of pension or insurance capital into politically designated UK assets.**

→ **Remove non-material ESG constraints that deter investment in vital growth areas, notably energy, heavy industry, and defence.**

→ **Require explicit saver consent before pension savings are allocated to pursue non-financial ESG, ethical, or political objectives.**

→ **Protect default DC funds and the LGPS from non-financial screening, ensuring asset allocation is driven strictly by risk and return.**

→ **Reorient pension regulation from compliance to net investment returns, removing the disclosure and governance burdens that penalise domestic growth assets.**

Mandating pension and insurance capital into UK assets is the wrong answer: it forces worse returns onto savers to fix a problem which lies elsewhere.

For several years the government's approach was to encourage pension money towards UK investment by agreement.

Having watched the voluntary route fall short, the government has now legislated. The Pension Schemes Act 2026 gives ministers a reserve power to require up to 10% of assets in main DC default funds to be invested in specified qualifying assets, with any UK-specific requirement capped at 5% (albeit narrowed in Parliament so that it cannot be used before 2028 and can be used only once).

We strongly argue against this approach: a fund compelled to buy assets it would not otherwise choose earns lower risk-adjusted returns and runs directly contrary to fiduciary duty, and costs are ultimately borne by savers through smaller pension pots. Pension and insurance assets should not be treated as spare capital for the state to direct.

Moreover, the principle is now conceded - that Parliament has accepted that the government may direct where pension capital goes. Whatever the limits placed on this initial power, the precedent is established; any future government can seek to redirect the nation's savings towards its own priorities.

Part of the argument for mandation also assumes that British funds are uniquely underinvested at home. Yet against a global benchmark, in which UK equities account for around 4% of world markets, UK schemes are if anything overweight the indices. They look underweight only alongside the strong domestic bias of peers like Australia, where funds hold substantial domestic equity because tax incentives make domestic assets genuinely attractive. The problem is not an irrational allocation by trustees, but that market-weighted benchmarks direct capital abroad. The remedy is to make British assets worth holding on their investment merits, not to compel funds to hold them.

The Mansion House Compact and Accord

The government's preferred approach was initially voluntary persuasion. The 2023 Mansion House Compact saw eleven major pension providers agree to allocate 5% of their defined-contribution default funds to unlisted equities by 2030, while the 2025 Mansion House Accord expanded this target to 10% in private markets (half within the UK) across seventeen providers representing roughly £250bn. Neither initiative has meaningfully altered domestic allocations: both remain voluntary, and are explicitly subordinate to trustees' legal fiduciary duties to savers. Moreover, they run up against a shortage of investable UK assets.

Fix the reasons capital avoids the UK - tax, regulation and state risk - and it will flow here without being forced.

Why is capital not already flowing to UK assets? As argued throughout this paper, the answers lie in a tax system which penalises UK equity ownership, excessive regulation that deters institutional investment, and the 'state risks' outlined in Chapter 2.

"Make British assets attractive again."

Venture capital illustrates why mandation misunderstands the problem. UK venture is not weak: Britain boasts the largest VC ecosystem in Europe, capturing around a third of all funding, partly a function of its world-class universities.

Beyond venture, Australia demonstrates how to align capital through incentives. Its dividend imputation ('franking credit') system credits domestic investors for company tax already paid on domestic shares, contributing to one of the world's highest domestic equity allocations.

Non-financial screening - most notably ESG - lowers risk-adjusted returns for savers while diverting capital from critical growth sectors.

Non-financial ESG is a widespread method of screening capital by criteria other than risk and return. It operates as a complement to mandation: while mandation forces capital towards favoured assets, ESG screening excludes it from disfavoured ones. By artificially narrowing the investable universe, screening not only pushes a portfolio inside its 'efficient frontier', undermining expected risk-adjusted returns (which can conflict with the fiduciary duties of pension trustees), but it also starves growth companies in disfavoured sectors of capital.

This screening disproportionately affects sectors the UK can least afford to neglect - namely, domestic energy, heavy industry, and defence.

The objection is not to account for financially material risks. Real-world environmental or governance factors can affect long-term cash flows and must be assessed on their investment merits. The flaw is in allowing unelected rating agencies and asset managers - whose methodologies are notoriously inconsistent with one another - to apply contested, non-financial scorecards, deciding which productive sectors receive capital and which do not.

We propose that asset allocation should be driven strictly by risk and return, and make any departure from that explicit and chosen. Pension funds, including default DC and the Local Government Pension Scheme (LGPS), must be legally protected from non-financial screening, ensuring any non-pecuniary investment strategies are opt-in.

Beyond ESG, trustees' statutory duties create a compliance framework that penalises investment in productive growth.

While common-law fiduciary duty dictates acting in savers' best financial interests, the statutory architecture under which trustees operate prioritises procedural compliance over investment returns. Since the Pensions Act 1995, introduced following the Maxwell scandal, statutory duties have focused primarily on process: acting prudently, diversifying assets, and taking regulated advice. (This contrasts with Canada, where the CPPIB's governing statute explicitly requires a maximum rate of return without undue risk of loss.)

Three decades of subsequent regulation have added further governance and reporting obligations, including stewardship requirements, requirements to address financially material ESG factors, and climate-related reporting. In practice, a trustee faces immediate personal and regulatory liability for procedural lapses or reporting errors, but incurs no penalty for investment underperformance.

This asymmetry creates a structural ‘prudence trap’. Large-cap global indices and debt markets come with cheap, pre-packaged ESG and TCFD data which makes regulatory reporting requirements easier to satisfy. By contrast, unlisted UK growth companies rarely produce such disclosures. Because trustees face immediate regulatory penalties for reporting lapses but none for investment underperformance, they are incentivised to choose passive, low-hassle assets over productive domestic enterprise. Pension regulation must shift from an emphasis on compliance towards investment outcomes.

Chapter 4: Pensions and Savings Reform

4.1 - Diagnosis and principles of reform

The UK has a savings allocation problem, not a savings stock problem - producing inadequate retirement outcomes for individuals as well as insufficient capital for the economy.

4.2 - A Lifetime Investment Account, modelled off Australia's 'supers'

Auto-enrolment has been a success, but contribution rates remain too low to deliver adequate retirement income. It should evolve into a simpler, portable 'Lifetime Investment Account', with higher contributions, to improve retirement outcomes and increase the pool of long-term capital available to invest in Britain.

4.3 - How the State Pension evolves with the Lifetime Investment Account

As people build larger private pension pots, the State Pension can increasingly serve as a safety net rather than the main source of retirement income. This would create a more fiscally sustainable system whilst giving future retirees greater financial independence and choice.

4.4 - Financial literacy and education as essential economic infrastructure

Britain cannot become a nation of long-term investors if most people don't understand how investing works. Financial education and a culture of wider share ownership would strengthen household finances and help more people benefit from economic growth, and should be treated as part of the national infrastructure.

4.5 - LGPS and unfunded public sector pension schemes

The LGPS and unfunded public sector schemes risk becoming fiscally unsustainable, threatening to crowd out spending on frontline public services. Closing these schemes to new entrants and capping pensionable pay for higher earners will halt the open-ended accumulation of taxpayer liabilities and enable the public sector also to gradually move onto the Lifetime Investment Account.

4.6 - LGPS pooling reforms

The 2026 LGPS pooling reforms are a welcome step, but there is scope to build on them by strengthening performance, governance and accountability. More consistent governance and investment capability across the pools should support stronger net returns and productive investment.

4.7 - A UK Strategic Investment Vehicle

Britain's public investment capacity is scattered across several bodies, with their own separate mandates, boards and balance sheets, and dependent on periodic Treasury allocations. Consolidating them into a single Strategic Investment Vehicle would give the state one institution with permanent capital, commercial governance and scale.

4.1 - Diagnosis and principles of reform

The UK has a savings allocation problem, not a savings stock problem - producing inadequate retirement outcomes for individuals as well as insufficient capital for the economy.

The UK is not short of pension and household savings.

The UK remains one of the world's largest pension markets. The LGPS alone, at around £400bn, would rank roughly seventh globally if treated as a single fund. A further substantial pool sits in cash ISAs, while DC pension assets are projected to exceed £1tn by around 2030 and are expected to overtake DB assets around the end of the decade[27].

However, these savings have been steadily driven out of productive UK assets.

The domestic ownership of UK equities has fallen from around 85% in the mid-1990s to about 40% today, and UK pension-fund allocation to domestic equities has fallen from more than half around 25 years ago to about 4.4% today.

> "The result is simultaneously inadequate retirement outcomes for individuals and an insufficient pool of patient capital for the UK economy."

The difference is allocation - UK private-sector DB assets remain heavily tilted towards bonds, while only a small fraction of total UK pension assets is invested in UK equities. Australian superannuation funds, by contrast, maintain much larger allocations to equities and other growth assets.

This misallocation is the result of the same risk-aversion 'ratchet' diagnosed in Chapter 1 - applied to pensions.

This is not the result of active investor decisions; rather, it is the consequence of a series of policy decisions, which have cumulatively made UK equities less attractive to hold:

- Pension scandals in the 1990s led to Minimum Funding Requirements;
- The abolition of the dividend tax credit in 1997 reduced the relative attractiveness of UK equities for UK pension investors;
- FRS 17 (2001) required mark-to-market accounting using an AA-rated bond-yield discount rate, pushing DB schemes to match liabilities with bonds rather than seek equity returns;
- The Finance Act 2004 maintained a substantial tax charge on surpluses returned to sponsors, reinforcing the weak incentive to run schemes for upside; and

[27] Local Government Pension Scheme, About the LGPS; HM Government, Pension fund investment and the UK economy; Lumera, DC assets set to reach £1 trillion

- Solvency II in 2016 applied risk capital charges which significantly undermined insurance-company equity holdings.

As we have seen throughout this paper, each rule on its own may have been a reasonable response with respect to its own respective circumstance. However, the aggregate outcome - in this case, an effectively de-equitised UK savings system - was an emergent result, with no individual or body responsible.

Australia - compulsory, portable, default-driven saving

In the early 1990s, Australia faced a similar savings challenge to that faced by Britain today. In 1992, it introduced the Superannuation Guarantee, a compulsory, employer-funded retirement contribution, at 3% of earnings, increasing mandatory employer contributions incrementally to 12% across member-portable 'supers', while retaining the non-contributory Age Pension as a means-tested floor. Rather than relying on mandation, Australia built a roughly 30% domestic equity allocation through tax incentives - primarily through its dividend imputation ('franking credits') system - creating the world's fifth-largest pension pool on a population of just 27 million and delivering strong long-term returns across default funds. The difference in outcomes is not necessarily driven by superior fund-manager skill (major funds like Nest have matched or even outperformed Australian peers) - the differentiating factors are the scale of mandatory contribution and growth-oriented asset allocation, which together deliver both retirement adequacy and a substantial pool of domestic investment capital.

Applying the 'smart and safe' approach - what risks are acceptable versus not - should reconsider the trade-off between lower short-term volatility and savers reaching retirement with inadequate income (as well as under-deployed capital across the wider UK economy).

The 'smart and safe' framework set out in Chapter 1 distinguishes between acceptable risks (with specific upsides expected from embracing those risks) and unacceptable risks. In the context of savings, we reframe the key risk from the short-term volatility of a pension portfolio to the risk of savers reaching retirement with inadequate income. The latter risk should be seen as the unacceptable harm: many DC savers have accumulated only modest pension pots. Moreover, the opportunity cost of Britain's large pool of pension and household savings being only partly channelled into productive domestic investment should also be seen as a material harm.

None of the reforms in this chapter will work without trust: citizens need to trust that the government won't retrospectively change the rules in 20 years' time - this is another manifestation of the 'state risk' challenge.

Savers must trust that the goalposts won't change over the decades they invest: recent retrospective changes - including inclusion of pension pots in inheritance tax calculations - are a representative case of the 'state risk' problem diagnosed in this paper, which acts to undermine incentives to save and increases the cost of capital across the UK economy.

4.2 - A Lifetime Investment Account, modelled off Australia's 'supers'

Auto-enrolment has been a success, but contribution rates remain too low to deliver adequate retirement income. It should evolve into a simpler, portable 'Lifetime Investment Account', with higher contributions, to improve retirement outcomes and increase the pool of long-term capital available to invest in Britain.

Key policy recommendations:

→ **Replace the current workplace pension architecture with a single Lifetime Investment Account - a portable, long-term investment account for every worker, modelled on Australia's superannuation system.**

→ **Increase auto-enrolment contributions in pre-announced steps of 0.5 percentage points a year to a minimum of 15% of earnings, with a longer-term target of up to 20%. Correspondingly, phase National Insurance down in lock-step.**

→ **Apply contributions from the first pound of earnings up to £50,270, with a graduated rate for lower earners, no opt-out, and the self-employed brought into the system through self-assessment.**

→ **Operate the Lifetime Investment Account on a 'pot follows member' basis, so each worker builds one portable account across their working life rather than accumulating a new pension pot with each employer.**

→ **Open a Lifetime Investment Account for every child at birth, seeded by the state with an indicative £1,000 and retained as the same investment account throughout life.**

→ **Lock the Lifetime Investment Account until retirement, subject only to narrow exceptions e.g. for serious illness, sustained involuntary unemployment and severe financial hardship.**

→ **Consolidate the existing ISA system into a single Investment ISA, withdraw the cash ISA allowance on a forward-looking basis, require a 50% minimum allocation to UK assets to unlock the full allowance, and uprate and index the allowance thereafter.**

→ **Enact a statutory principle of pensions stability to protect accrued rights and ensure tax and regulatory changes apply strictly to future contributions.**

Auto-enrolment is Britain's most successful recent savings reform, but contributions remain far too low to deliver adequate retirement outcomes.

Following the introduction of auto-enrolment, which defaults eligible workers into a workplace defined contribution (DC) pension, membership of DC occupational schemes rose from 0.9 million in 2011 to 10.6 million in 2019. Across all scheme types, some 21.7 million eligible employees - 89% of those covered - were saving into a workplace pension by 2024[28].

However, auto-enrolment contribution rates fall well below what is required to deliver adequate income in retirement. Among those aged 50 to 64 with defined contribution savings, the median pot is around £33,500. The IFS finds that around five million people are on course to fall short of the PLSA's (Pensions and Lifetime Savings Association) minimum standard, rising to two-thirds among

[28] House of Commons Library, Pensions: automatic enrolment; Department for Work and Pensions, Workplace pension participation and savings trends of eligible employees, 2009 to 2024

the lowest-earning quarter. The DWP puts the number of working-age adults undersaving for retirement at 14.6 million, or 43%[29].

The primary factor is that too little is being contributed into pension pots: the auto-enrolment default is 8% (3% from the employer + 5% from the employee) and applies only to qualifying earnings between £6,240 and £50,270. By contrast, Australia's superannuation guarantee is a total of 12% paid by the employer on in-scope earnings.

Contribution rates should rise incrementally, in pre-announced steps of 0.5% per annum, to a minimum of 15% (and ideally a target of up to 20%) on earnings.

Evidence suggests that the current 8% contribution rate is not enough. The Pensions Policy Institute (PPI) finds that a median earner needs 11-14% of band earnings for a two-thirds chance of an adequate income, and that at 8% a median earner has less than a 50% chance of maintaining their standard of living in retirement. The IFS likewise argues that contributions should rise materially above current minimums[30].

We propose a total contribution of 15% (minimum), and a target range of ideally 15-20%.

Adequacy depends on three factors:

1. The age at which a retiree is expected to be financially independent of work;
2. The proportion of pre-retirement earnings provided by retirement income; and
3. How this proportion varies by income - for example, a minimum-wage worker may need to ‘replace’ all of their earnings, while a high earner will likely need to replace materially less.

While we propose a single rate in this paper, some in the working groups have argued that the contribution rate should be age-related - namely, a lower rate for those early in their careers, when earnings are low relative to outgoings. However, we prefer a flat rate for simplicity of communication and administration, and because earlier contributions benefit more from compounding effects.

We propose that the auto-enrolment rate is raised in increments of 0.5% a year, published in advance to allow employers to plan, broadly consistent with how auto-enrolment was introduced, and indeed how Australia raised its superannuation guarantee from 3% to 12%. Unlike under the current regime, there is no opt-out, and the self-employed are brought in on the same terms, via self-assessment (see Chapter 5).

Contributions should apply from the first pound of earnings, removing the current £6,240 lower limit though keeping the upper limit of £50,270. We recognise the trade-off between adequate retirement outcomes and low earners contributing 15-20% of their salaries; with this in mind, we recommend graduating the contribution rate.

---

[29] Institute for Fiscal Studies, How important are defined contribution pensions for financing retirement?; Institute for Fiscal Studies, Adequacy of future retirement incomes; Department for Work and Pensions, Analysis of future pension incomes 2025

[30] Pensions Policy Institute, response to the 2017 review of automatic enrolment; Institute for Fiscal Studies, Automatic enrolment: trends in employer pension contributions and the impact of potential reforms

The pension pot must follow the member, rather than the employer - so that a worker has one account, not one for every job.

Under the current system, each new employer enrols the worker into a pension plan of the employer's choosing, which means twelve pension pots for a median worker who changes jobs eleven times over their career, which are small and often forgotten. There are now 3.3 million lost pension pots in the UK, with £31.1 billion in assets[31]. Moreover, savers do not have a consolidated view across their pots.

Australia solved this with a 'pot follows member' approach: a worker chooses a fund, and each employer pays into it, which follows them across a working life. Today in the UK, a pension provider sells to an employer's HR department; under a 'pot follows member' regime, the market shifts to a business-to-consumer model, with providers competing on net returns and service, rather than on procurement relationships and cost.

While this resolves the fragmented pot challenge going forward, it does not for the existing millions of lost pots that must still be traced and consolidated. We do not address this in detail here, however there is a case for automatic consolidation of the smallest (as the DWP has proposed for pots under £1,000), and the forthcoming Pensions Dashboards infrastructure will be helpful in tracing lost savings, even if a mature 'pot follows member' architecture eventually makes it redundant.

Simplicity and relevance come from an account that is portable, invested by default, and holds assets people can see and understand.

Most workers do not choose how their pension is invested: they are enrolled into a default fund and stay invested in it. Therefore, the design of the default, including asset mix, fees, and its exposure to growth, is the key determinant for the outcome for the vast majority of savers.

However, we argue that savers with visibility over their investments are more likely to engage with it and contribute to them. Balances are currently reported infrequently and opaquely, in annual statements that many don't read.

> "The key is to make saving simple and relevant."

Australia's success relies on a single portable account, well-designed defaults, and visibility; there is no reason why these can't be replicated in Britain.

The choice of name is crucial: 'pension' implies something distant and dull, while 'savings' implies cash; we advocate for a 'Lifetime Investment Account'.

The term 'pension' signals something remote and irrelevant to a worker in their twenties, who is arguably the principal target audience for this policy; not many 22-year-olds engage with 'pension'. Moreover, a pension is a regular payment; a DC pot is not a promise of future income but a lump sum of money owned by the saver which they are responsible for. The name should reflect what the account now is: a single, portable pot held across a working life - we propose a 'Lifetime

[31] Pensions Policy Institute, Lost Pensions 2024

Investment Account'. This is not just optics; rather, it is an essential part of making the policy relatable.

The account should run from birth, seeded by the state - reviving the principle of the Child Trust Fund, but remaining the same account for life.

The Lifetime Investment Account should be opened at birth. The state makes an initial contribution - we propose an indicative £1,000 - into an account in the child's name, invested in a default fund and locked until retirement. Because this initial seed is funded by the taxpayer, we make an exception to our core 'no mandation' principle: on this occasion, the state directs how this seed is invested until the individual reaches adulthood.

This revives the principle of the Child Trust Fund (CTF), abolished in 2011. The original CTF was undermined by the fact that capital became accessible at 18 and was often spent immediately, while hundreds of thousands of matured accounts - at over £1.5 billion in assets - remain unclaimed because individuals lost track of them[32]. In contrast, the Lifetime Investment Account is held for life and remains locked on the same terms as the rest of the pension pot.

Due to compounding, even a modest seed becomes substantial over a working lifetime. It also establishes the account as a 'fact of life' - an asset the individual has always owned, rather than a financial product they must be persuaded to open in their twenties.

Reintroducing a seeding at birth scheme entails a fiscal cost: £1,000 per birth for each of approximately 650,000 births per annum is approximately £650m p.a.

Invest America

In July 2026, the United States launched 'Trump Accounts' - a long-term investment account for every American child born between 2025 and 2028, seeded with $1,000 from the Treasury, invested in a low-cost US index fund and locked until age 18. Originating from a private campaign, Invest America, these accounts are notable for the scale of private capital they have catalysed - families and employers may contribute up to $5,000 a year in total, while more than fifty companies including JP Morgan Chase, Uber and Dell have pledged to match contributions for employees' children. Moreover, Michael Dell and his wife committed $6.25 billion to seed accounts for 25 million lower-income children. Whether a UK version could attract private contributions similarly, and whether wealth generated in Britain might be encouraged to seed the next generation's accounts, is also worth pursuing.

Savings are locked until retirement, with some limited early access exceptions.

The Lifetime Investment Account is locked until retirement, ensuring that assets compound over decades.

---

[32] HM Government, Government steps up drive to reconnect young people with £1.6 billion in unclaimed savings

However, a strictly limited set of exceptions is warranted - for example:

- Serious illness or terminal medical diagnosis;
- Sustained involuntary unemployment beyond a defined duration; and
- Severe financial distress, as defined under a statutory hardship test.

The list should be kept narrow, as each exception reduces the final pot and invites political pressure for the next one.

Access for a first home purchase was a point of debate within the working groups:

- In favour: for many, a deposit is the biggest barrier to home ownership, which is itself a significant component of retirement security - without home ownership, a pensioner must dedicate a substantial share of their retirement income to rent.
- Against: early withdrawals would sacrifice decades of compounding and further inflate the housing market.

ISAs should be consolidated into a single Investment ISA, with the cash allowance withdrawn and a minimum allocation to UK assets to unlock the full £20k allowance.

There are five types of ISA - cash, stocks and shares, innovative finance, lifetime, and the Junior ISA for under-18s - each with its own rules. We object to this complexity, and propose consolidation into a single Investment ISA, with the Junior ISA folded into the child account proposed in this chapter.

We also propose withdrawing the cash ISA allowance: over £300 billion sits in cash ISAs, lent overwhelmingly against property rather than invested in growth - we object to subsidising that allocation through the tax system. The government has recognised this, but tackled it by cutting the cash allowance to £12,000 for savers under 65 and taxing idle cash within investment ISAs, which is a half-measure relative to what is needed, and potentially even adds to complexity. Withdrawing the cash allowance outright and moving to a single ISA is cleaner. Note: this would apply to future subscriptions only.

To address the domestic allocation problem, a minimum share of the Investment ISA - we propose 50% - should be held in UK assets in order to unlock the full £20,000 allowance (again, applied on a forward-looking basis).

While a robust policy, our objective is to ensure savers benefit from compounding market returns while simultaneously channelling domestic capital into UK enterprise and growth. This was one of the more contested proposals across the working groups, with members raising both behavioural and political concerns. Behaviourally, withdrawing the cash allowance risks deterring cautious savers who might otherwise disengage from ISAs completely; politically, some 14 million people hold Cash ISAs. On the first, we acknowledge there is a trade-off, but argue that the tax system should no longer actively subsidise the holding of cash over productive investment. On the second, existing cash ISA pots remain protected.

The allowance itself, which has been frozen at £20,000 since 2017 and has since lost around a quarter of its real value, should also be uprated. Had it been indexed to inflation, it would stand at roughly £27,000 today. There is a modest fiscal cost to uprating the allowance and indexing it, as only a minority of savers use the full limit each year.

Sweden - simplicity facilitates retail demand

In the early 1990s, Sweden faced a retail savings landscape similar to Britain's today - high holdings of cash, high transaction taxes, and low retail equity participation. After abolishing its financial tra nsaction tax in 1991, Sweden launched the Investeringssparkonto (ISK) in 2012 - a radically simple investment account that replaced capital gains, dividend, and income taxes with a single, low annual charge on account value, which is pre-filled for tax returns. Swedish households hold only around 12% of financial assets in currency and deposits, the lowest share among OECD peer countries including Denmark, France, Germany, the Netherlands and the UK[33]. In contrast to our proposal, cash can be held in an ISK - but the charge applies to the whole balance regardless of holding.

None of this works without trust: savers must believe the rules will not be changed at some point in the future.

The reforms in this chapter ask citizens to lock away substantial capital for decades, which requires confidence that future governments will not retrospectively rewrite the rules to their detriment. Trust has, however, been undermined by repeated, unpredictable policy shifts - including the continuous changes to the lifetime allowance and tax-free lump sum limits, as well as the decision to bring unused pension pots into inheritance tax from 2027. This unpredictability is a classic presentation of the state-risk challenge diagnosed throughout this paper and one that, in this case, undermines the long-term incentive to save.

Unfortunately, no government can bind its successors against future changes to the Lifetime Investment Account. However, a statutory principle of pensions stability, where Parliament would have to explicitly vote to override accrued rights, can, albeit in an inherently limited way, protect accrued pots from retrospective raids.

None of the above reforms address the challenges faced by those on 'DC 1.0' pensions who are close to retirement.

The reforms in this chapter are designed for those who are early on in their careers, with decades left of saving and investing ahead of them. Unfortunately, they do not help those now approaching retirement on the first generation of defined contribution pensions ('DC 1.0') - broadly, workers who entered the labour market as final-salary schemes were closing but too late to accumulate a full pot under auto-enrolment.

This cohort faces a significant adequacy shortfall, as they have saved into DC pensions at low contribution rates for only part of their careers, often without a defined benefit (DB) pension behind them, and have too few years left for higher future contributions to make much difference. Many do not realise the shortfall until they reach retirement.

Potential solutions were considered in the working group discussions:

- A one-off window allowing members of this cohort to make additional tax-advantaged contributions, including transfers of existing assets in specie, in the years before retirement (this of course only helps those with assets to contribute);

[33] OECD, The Swedish Equity Market: Assessment and Policy Recommendations 2026

- Accepting that, for many in this cohort, little can be done in the time remaining, and that the existing State Pension - which they retain in full, as the wind-down in tandem with auto-enrolment scale-up (as outlined in Section 4.3) does not affect this age group - is what they will primarily rely on.

A third possibility was raised in discussion: directing a share of corporate defined benefit surpluses, which across UK schemes now run into the tens of billions, towards the DC pots of the same generation, though we decided against this - scheme surpluses are governed by scheme rules and pensions law and are subject to future performance.

4.3 - How the State Pension evolves with the Lifetime Investment Account

As people build larger private pension pots, the State Pension can increasingly serve as a safety net rather than the main source of retirement income. This would create a more fiscally sustainable system whilst giving future retirees greater financial independence and choice.

Key policy recommendations:

→ **Evolve the State Pension from the primary source of retirement income into a non-contributory, means-tested floor modelled on Australia's Age Pension (with existing State Pension Accruals preserved).**

→ **Phase National Insurance down in lock-step with the phasing up of auto-enrolment.**

→ **Use the 'triple lock' as the default uprating formula for accrued State Pension entitlements, subject to a cap at the growth of the working-age tax take to prevent runaway liabilities (with a floor of zero).**

→ **Uprate the new statutory floor by inflation and benchmark it against average earnings.**

As the Lifetime Investment Account system is introduced, the State Pension evolves from a primary source of retirement income into a means-tested floor (with existing accruals preserved).

The Lifetime Investment Account is designed to deliver retirement adequacy through funded savings and compounding returns rather than fiscal transfers, reducing the burden on future taxpayers. As auto-enrolment contributions phase up, the role of the State Pension as the primary source of income should phase down.

As in Australia, the State Pension's role will evolve into a non-contributory, means-tested floor designed to protect against old-age poverty if an individual's Lifetime Investment Account underperforms. Eligibility will be determined by income and asset tests, tapering payments down as private pension wealth increases. Entitlements already accrued under the legacy National Insurance system remain guaranteed, as the new means test applies on a forward-looking basis.

Retaining a floor also learns from Chile's reforms of the 1980s, which replaced the public PAYG system with mandatory private accounts but left only limited safety-net provision. Weak coverage and inadequate pensions among lower-income workers ultimately prompted the introduction of a much broader 'solidarity pension' in 2008. Australia's Age Pension is means-tested, concentrating public support on retirees with lower incomes and assets.

In any case, the contributory principle of the UK State Pension has become in part obsolete, as the gap between the full new State Pension and the means-tested Pension Credit guarantee is only a few pounds a week, meaning decades of contributions buy little over the welfare minimum.

The mechanics of how National Insurance phases down as auto-enrolment rises, and the pace at which this happens across age cohorts, are set out in Chapter 5, which covers tax.

The triple lock can be retained on accrued State Pension entitlements, but capped at the growth of the tax take, while the new statutory floor is uprated by inflation and benchmarked to average earnings.

The triple lock - which raises the State Pension each year by the highest of earnings growth, inflation, or 2.5% - has increased in cost faster than the tax base and will continue to do so under current projections. We do not propose scrapping it, which entails a political cost out of proportion to the fiscal saving; rather, we propose capping its annual growth at the growth in the working-age tax take, ensuring that its cost cannot rise faster than the tax base. This retains the reassurance of the triple lock whilst mitigating the risk that associated liabilities spiral out of control. If the working-age tax take falls (for instance, during a recession), the cap is set to zero rather than triggering a cash cut to the State Pension.

The evolved State Pension floor - modelled on Australia's Age Pension - should instead be uprated by inflation and benchmarked to average earnings. This ensures the safety net rises in step with prevailing living standards across the real economy, protecting low-income pensioners from poverty in a way that is sustainable.

The State Pension age was a subject of active debate across the working groups. One view argued that the deteriorating state of the public finances necessitates raising the age significantly and quickly, while others cautioned against the use of a blunt age increase without addressing the sharp disparities in healthy life expectancy across occupations and regions. In particular, for workers in manual labour who experience shorter healthy lifespans and generally lower salaries, uniform age hikes transfer wealth from poorer to wealthier cohorts while simply displacing fiscal costs onto working-age sickness and disability benefits. Under our proposed architecture, retirement adequacy is achieved through decades of compounding effects through the Lifetime Investment Account, reducing long-term dependence on state pension age adjustments alone.

4.4 - Financial literacy and education as essential economic infrastructure

Britain cannot become a nation of long-term investors if most people don't understand how investing works. Financial education and a culture of wider share ownership would strengthen household finances and help more people benefit from economic growth, and should be treated as part of the national infrastructure.

Key policy recommendations:

- → **Make financial education a core, assessed part of the mathematics curriculum from primary age in every school, including academies and free schools.**
- → **Build and deliver the curriculum alongside the Bank of England and a broad cross-section of the financial industry, modelled on Denmark's Money Week, ensuring pupils learn about investing rather than just saving.**
- → **Include a Swedish-style 'run a business' module, so pupils learn enterprise, investment, customers and capital.**
- → **Require completion of a short online financial management course as a precondition to taking out a student loan.**
- → **Require universities to provide practical business, self-employment, and personal finance guidance as part of their courses.**
- → **Build on the Lifelong Learning Entitlement by making financial and enterprise training an accessible credit adults actively draw on throughout their working lives, modelled on Singapore's SkillsFuture model.**
- → **National campaigns such as Savvy the Squirrel should only follow once the Lifetime Investment Account and ISA reforms elsewhere in this report are in place (not before).**

The reforms outlined in this chapter will have limited impact if half of UK adults continue to struggle with financial literacy and perceive investing as 'gambling'.

On the standard international measure, around 44% of UK adults - some 23 million people - have poor financial literacy.

This shows in investing behaviour: UK households hold just 8% of their wealth in equities and mutual funds. This is the lowest share in the G7, compared with 33% in the United States and around 14% across the other G7 countries.[34]

Although cash feels 'safe', over a working life it is not. Over recent decades, cash on deposit has lost significant value in real terms, while a diversified portfolio of shares and gilts has delivered strong positive real returns - caution is expensive.

The barrier is not only knowledge, but also perception: that investing in shares is seen as a form of gambling, and that the only safe places for wealth are a current account and a house. Surveys

[34] Aberdeen Group PLC, written evidence to the House of Commons Treasury Committee, Financial Inclusion Strategy inquiry

confirm that a lack of confidence in investment knowledge is a major barrier keeping savers out of the market.

This is not just a household wealth problem: money sitting in cash means growth capital is not reaching the UK economy.

The gap is widest among the young - in one recent survey, fewer than one in ten of those aged 18 to 24 could pass a basic test of financial knowledge.

Financial and business education should be valued as a vital part of the national infrastructure, to be taught at school from primary age, with the curriculum built with the involvement of the Bank of England and private sector. Denmark and Sweden demonstrate what can be achieved with such an approach.

In 2014, after a campaign by Martin Lewis, who argued that in one of the world's most competitive consumer economies people get "no buyers' training", financial education was added to the national curriculum. It was placed in citizenship, for ages 11 to 16, but unfortunately achieved little.

Academies and free schools, which are most secondary schools, did not have to follow it; where it was taught it was a low-status subject with no dedicated teacher training and no compulsory assessment. Teaching was limited to personal finance only, not covering investment or growth.

The Curriculum and Assessment Review in 2025 returned to this issue, recommending that citizenship be made compulsory from primary school, with financial literacy as part of it. While this represents some progress, it remains lower status by virtue of being kept inside citizenship rather than integrated into core numeracy.

Denmark and Sweden demonstrate what can work:

- Denmark: integrates financial education into school teaching, including through maths. Moreover, schools across Denmark take part each year in Danish Money Week, supported by the financial sector, with the National Bank directly involved, including sending staff into schools.
- Sweden: goes further into entrepreneurship. Upper-secondary students spend a full year running a real company - real goods or services, money and customers - guided by a trained teacher through five stages, from finding a market need and writing a plan through to raising capital, selling, and finally winding the company up and paying out shareholders. In 2023-24, nearly 40,000 students took part; nearly 600,000 have done so since 1980, and one in three Swedish school-leavers has now run a UF company.

Our proposal for Britain follows from these examples, as well as lessons from 2014:

- Financial education should sit in maths, not citizenship, and with the status of a core subject;
- It should be compulsory and assessed - in every school including academies, from primary age;
- Built and delivered with institutions such as the Bank of England, major commercial banks, asset managers, wealth managers and accounting firms - as in Denmark, making it a more 'real' experience for students;

- Include the Swedish element of building a business, not only managing a budget;
- A UK Finance and Business Week would give it an annual focus.

Financial learning should continue beyond school, including being a precondition to obtaining a student loan, through university, and across working life.

The first time many young people make a large financial decision is when they take out a student loan - often the biggest commitment of their life so far, made at eighteen and with little guidance. A short online course in financial management should be a condition of taking one out.

Most university courses, during which students live away from home and take on debt, teach almost nothing about money or business. For example, an art student receives no training in how to price their work, build a sales channel or run the small business that, in practice, every self-employed artist is. Universities should provide this guidance, and curricula exist - see, for example, the Open University's course on starting a business and managing money, including Martin Lewis's Academy of Money.

Beyond university, we make the case for retaining a lasting entitlement to learn. Singapore's SkillsFuture gives every adult a credit - S$500 to start, rising to S$4,000 in mid-career - to spend on approved training, including business management and courses for the self-employed. England is now introducing its own Lifelong Learning Entitlement which, from the 2026-27 academic year, will give adults a flexible four-year entitlement to post-18 study, with an online account showing their balance, usable across their working lives. However, the British scheme is a loan (to be repaid), whereas Singapore's is a credit. Nevertheless, with the infrastructure now in place, the question is whether part of it can become an entitlement adults actually draw on.

Education or campaigns alone will not change whether people invest - fundamental changes to incentivise investment are also needed, as Sweden has demonstrated.

Britain's current answer to low investment is a campaign: in April 2026 the government and around twenty of the largest financial firms launched Invest for the Future, fronted by a cartoon mascot, Savvy the Squirrel, to nudge cash savers into the market. While the aim is laudable, the premise is that the problem is simply one of awareness. In contrast, the 'Tell Sid' campaign of the 1980s was effective because it was backed by something tangible: the opportunity for citizens to participate in the privatisation of British Gas.

Sweden's ISK, as outlined above, has had a substantial effect, with around 40% of Swedes now holding an ISK account, with households keeping more than half their financial savings in shares. By contrast, while a similar share of Britons hold an ISA, two-thirds of that sits in cash ISAs - so the true British equivalent of Sweden's 40% is closer to 15%. Poland has recently announced an ISK-style account, and the European Commission is encouraging wider European adoption.

It is important to note that Sweden did not build an investing culture by telling people to invest: the behavioural change followed a design change. Britain should adopt three policy changes before launching any form of campaign:

1. Remove the frictions - abolish stamp duty on share purchases (see Chapter 5) and simplify tax wrappers (see above);

2. Reduce the advantage cash holds over investment in the tax system (see above); and
3. Build the habit early, through compulsory school education (see above).

Only then should a campaign such as Savvy the Squirrel follow.

4.5 - LGPS and unfunded public sector pension schemes

The LGPS and unfunded public sector schemes risk becoming fiscally unsustainable, threatening to crowd out spending on frontline public services. Closing these schemes to new entrants and capping pensionable pay for higher earners will halt the open-ended accumulation of taxpayer liabilities and enable the public sector also to gradually move onto the Lifetime Investment Account.

Key policy recommendations:

- → **Require HM Treasury and GAD to publish stress-tested scenarios alongside each quadrennial scheme valuation, rather than relying on a single central projection.**
- → **Close the LGPS and unfunded public-sector pension schemes to new entrants.**
- → **Place all new public-sector employees into the Lifetime Investment Account.**
- → **Allow existing employees to continue accruing DB pension rights, subject to a pensionable pay cap of between £50,000 and £75,000, with employers able to make additional contributions to a private scheme above this threshold where necessitated by recruitment or retention.**
- → **All accrued pension rights are honoured.**

Public sector DB pensions are rapidly becoming a serious fiscal risk.

Public-sector pension schemes account for an increasingly significant share of public spending and an even larger share of long-term liability accrual. The total liability of the unfunded schemes - including the NHS, Civil Service, teachers, armed forces and police schemes - ranges from roughly £1.4 trillion to multiples of that, depending on the discount rate used, and rises with longevity and inflation. The schemes are 'unfunded' in that future pension payments are to be met from future general taxation; there are no assets to match the liabilities, in contrast to the funded Local Government Pension Scheme (LGPS).

While the LGPS is itself funded, it also has inflation-linked obligations to around 7 million members. If the assets underperform, or if liabilities rise faster than expected, the shortfall would also fall on the taxpayer.

Not only do these schemes present a material fiscal challenge, rising pension costs (both present contributions and payments to retirees) will increasingly crowd out spending on public services. Indeed, employer contribution rates in the unfunded schemes have risen sharply over the past decade, driven largely by changes to the SCAPE discount rate to reflect lower long-term GDP growth forecasts from the OBR.

"The private sector settled the DB affordability question years ago; the public sector now needs the same conversation."

The private sector dealt with this problem years ago: around 90% of private-sector DB schemes have closed to new entrants and/or future accrual. Politicians have long avoided addressing the same challenge in the public sector.

The affordability of these schemes has not been comprehensively stress-tested, limiting independent challenge.

The Treasury's position is that the schemes are affordable; however, this depends on assumptions for GDP growth, earnings growth, inflation, longevity and SCAPE (the discount rate), set within a Treasury-led framework. While the Government Actuary's Department (GAD) publishes valuations based on these estimates, the government does not publish comprehensive macroeconomic scenario modelling or stress tests of overall affordability.

Nor is each assumption published as a range with comprehensive sensitivities, despite the liability's high sensitivity to variables, especially the discount rate. Between 2021-22 and 2022-23, Whole of Government Accounts (WGA) showed public service pension liabilities falling from £2.6 trillion to £1.4 trillion largely as a result of rising market discount rates[35]. In contrast, independent estimates of the long-term commitment are far higher - see, for example, the work of Neil Record, who calculates the figure at up to £5.8 trillion.

The volatility of the liability estimate is itself part of the issue, and it is difficult based on publicly available information to discern between two widely different estimates. Indeed, the National Audit Office's 2021 review of public service pensions stated that it made no judgement on affordability, on the grounds that this is a policy decision.

We believe that it is reckless for a public liability of this magnitude to rely on a central projection without comprehensive stress-testing.

Our first recommendation is therefore for HM Treasury and GAD to be required to publish, alongside each quadrennial scheme valuation, a comprehensive scenario analysis of the cost of the unfunded schemes as well as the LGPS. This must model total liabilities and projected cash flows under a range of GDP growth paths - including the UK's actual economic performance over the past two decades rather than only central OBR projections - as well as under varying earnings, inflation, and longevity assumptions; the explicit sensitivity of the headline figures to the discount rate; and a direct comparison with the cost of providing equivalent defined-contribution benefits to expose the cost of the schemes.

[35] HM Treasury, Whole of Government Accounts 2024-25; House of Lords, Pension Schemes Bill debate, 23 February 2026

Our preferred position is to protect accrued rights while limiting the future growth of liabilities, which can be achieved by closing public sector schemes to new entrants, who join the new Lifetime Investment Account scheme.

Any reform must honour the accrued rights of public sector workers and retirees. Whilst we accept this is expensive, the objective is to mitigate a continual exponential rise in the liabilities. Moreover, we argue that existing members continue to accrue DB benefits on future service (so long as this remains affordable), as the social and political cost of changing this would be too severe. Liabilities then only grow for existing members, and then run off gradually over subsequent decades.

New public-sector employees should join the new Lifetime Investment Account outlined earlier in this chapter.

As a further brake on future accruals, we also recommend a cap on the pay that can count towards DB accrual for existing members, applied uniformly across the LGPS and the unfunded schemes. Pay above it would continue to be paid as salary but would no longer generate further inflation-linked DB accrual; employers could instead contribute to the employee's Lifetime Investment Account (or another private pension pot), including where recruitment or retention makes that necessary.

We recommend setting the cap at between £50,000 and £75,000; £50,000 would affect a materially larger share of the public-sector workforce and therefore more robustly halt the compounding fiscal liability, whereas £75,000 would concentrate the reform on higher earners but be less effective fiscally; above this level, the cap is of little practical use. The objective is not to prevent senior public sector professionals from being competitively remunerated, but to halt the accumulation of uncontrolled liabilities on higher earnings.

In addition to capping pensionable pay, the working groups recommend removing above-inflation revaluations during active service. At present, while pensions in payment are indexed to CPI, active accruals in several schemes are revalued above inflation each year - notably CPI + 1.5% in the NHS and CPI + 1.6% for Teachers. We recommend eliminating these above-inflation additions.

It should be noted that these proposals interact with the 25-year commitment made following the Hutton Review to protect key elements of the reformed public sector pension schemes. While closing the schemes to new entrants does not breach this undertaking (as it affects only prospective hires rather than existing members), applying a pensionable pay cap or capping revaluation terms for existing staff would alter their accrual terms and could require enhanced consultation and parliamentary reporting requirements.

Closure of the schemes cannot occur until the Lifetime Investment Account system is in place and, since today’s contributions meet payments for today's pensioners (for the unfunded schemes), the policy will result in a gradually accruing cash flow cost (even as the overall liability position becomes more sustainable) as the share of employees remaining in those schemes declines. The scale of this cost depends on factors such as the number and earnings profile of new entrants in each year, and especially on the employer contribution rate set for new entrants under the Lifetime Investment Account, which are beyond the scope of this paper. Nevertheless, to illustrate the order of magnitude, recent work by Policy Exchange (modelling a comparable reform in which new public-sector employees join a funded scheme with a 10% employer and 5% employee contribution, excluding the armed forces) estimates additional spending of around £1.1 billion in the first year, peaking at £3.4 billion six years after adoption, with break-even after fourteen years and savings accruing thereafter[36].

The universe of alternative options is as follows:

- Assume the schemes are affordable and change nothing - this is the current Treasury position, which we argue relies on sustained growth (which has been lacking since 2008), and assumes pay and inflation remain controlled;
- Cease all future DB accrual, for existing members as well as new entrants - while this would control liabilities much more effectively and would not be 'taking away' already-accrued pension rights, workers would experience this as a significant change to their employment terms, and would risk strikes by key workers (including civil servants, upon which we would depend for the measures outlined in this paper to be delivered);
- Reduce accrued entitlements - which we also do not advocate.

We argue against the first as, while we very much hope a future government can deliver 2-3% real GDP growth indefinitely, relying on this is a macroeconomic gamble.

The only justification for moving from our current position to the second would be in the event of a severe fiscal crisis, including a loss in confidence in UK sovereign debt. The third illustrates a worst-case scenario if public finances are not controlled - see, for example, changes made to pensions in Greece following the Eurozone sovereign debt crisis in 2012.

4.6 - LGPS pooling reforms

The 2026 LGPS pooling reforms are a welcome step, but there is scope to build on them by strengthening governance and accountability. More consistent governance and investment capability across the pools should support stronger net returns and productive investment.

Key policy recommendations:

→ **Complete the 2026 LGPS pooling reforms, then strengthen pool performance incentives and accountability.**

→ **Apply open, competitive appointments, market-rate pay and a common performance framework to the LGPS pools.**

→ **Recruit and pay investment boards at market rates, with expertise comparable to large institutional asset owners.**

→ **Set each pool a long-term real return target, indicatively 3.5% real per annum.**

→ **Link investment-board compensation and the option of consolidation to long-term performance under this framework.**

[36] Policy Exchange, Public Sector Pension Reform: Modelling a shift to a funded Defined-Contribution scheme, 2026

- **Build on the 2026 reporting requirements with more comparable reporting across all pools covering asset allocation, performance against benchmarks and fees paid, drawing on Canada's CPP Investments.**
- **Strengthen standardised cost transparency and benchmarking, including through providers such as ClearGlass**
- **Remove non-financial ESG criteria and de-risking bias from pool mandates, focusing asset allocation solely on long-term risk-adjusted returns.**

The 2026 LGPS pooling reforms should be completed; the next task is to build on them by strengthening performance and governance.

We support the objectives of the 2026 LGPS pooling reforms, which complete the process of moving investment implementation away from 86 separate administering authorities and formally delegating it to six larger pools.

However, there is scope to strengthen governance arrangements, improve comparable reporting and better align incentives with long-term performance. The pools should operate on a basis comparable with other large institutional asset managers.

Retain the six existing pools, but strengthen their governance through open, competitive appointments for pool chairs and investment boards remunerated at market rates, with consolidation retained as a backstop in cases of persistent underperformance.

The six-pool structure preserves a useful local link to the underlying authorities and beneficiaries, while still creating the scale needed for institutional investment management.

However, each pool should operate with the governance and accountability expected of a large institutional asset manager. The chair of each pool should be appointed through an open, competitive process led by the Department for Economic Growth with specialist executive-search support, with fixed terms, market-rate compensation and clear performance objectives. The appointment process should draw on the principles used for senior public financial roles.

The investment boards supporting the chairs should also be recruited and remunerated at market rates, ensuring a consistent depth of experience and expertise across the pools comparable to that found at large institutional investors such as Canada's CPP Investments or Australia's Future Fund.

While the working group values the diversity of investment strategies across competing pools, some argued for an immediate consolidation from six pools to three to maximise scale. However, retaining six balances local links with critical mass, and ensures that any potential consolidation is driven by future performance.

Set a common long-term performance framework for each pool, with pay and potential consolidation linked to performance against it.

Each pool should be assessed over the long term against return objectives, relevant market benchmarks and an indicative 3.5% real target. This would provide a common basis for comparison while recognising that pools implement different mandates. CPP Investments similarly reports performance both in absolute terms and against explicit benchmarks. By comparison, the Wellcome Trust targets an annual long-term real return of at least 4%.

Investment board compensation should be linked to long-term risk-adjusted performance. Pools that materially underperform over a defined period face the risk of consolidation into a stronger-performing pool.

Given the mandate and investment horizon, the pools should have maximum latitude in their asset allocation. They should be free to hold UK equities, AIM, growth capital, infrastructure and other productive assets where the risk-adjusted return case is strong (though without being mandated to do so).

Build on the 2026 reforms by making performance, asset allocation and cost reporting directly comparable across all six pools.

Each pool's annual report should present information on a common, directly comparable basis. This should include strategic asset allocation, performance against the long-term real return target and relevant market benchmarks, and investment costs.

Historically, inconsistent reporting has made like-for-like comparison difficult, weakening performance measurement and accountability, and making it harder to assess whether higher fee structures are justified by superior net returns.

Fee disclosure should be explicit: the existing LGPS cost-transparency framework should be strengthened with consistent benchmarking, including through providers such as ClearGlass. This would make it easier to assess whether higher fee structures are justified by superior net returns.

Like-for-like transparency would also more effectively inform any future consolidation decisions.

Reverse ESG drift and de-risking bias.

The pools' investment decisions should be driven by long-term risk-adjusted returns, not political alignment. ESG factors should be considered where they are financially material to investment risk and return, but non-financial ESG criteria should not form part of the investment mandate, as we outline in Section 3.9.

The same applies to de-risking. Once the proposed Treasury guarantee (see Section 4.7) is made explicit, de-risking becomes less defensible, as the primary purpose of the pools shifts to maximising long-term risk-adjusted returns.

4.7 - A UK Strategic Investment Vehicle

Britain's public investment capacity is scattered across several bodies, with their own separate mandates, boards and balance sheets, and dependent on periodic Treasury allocations. Consolidating them into a single Strategic Investment Vehicle would give the state one institution with permanent capital, commercial governance and scale.

Key policy recommendations:

- → **Establish a Strategic Investment Vehicle, consolidating the state's fragmented investment capacity into a single institution with permanent capital.**
- → **Organise it into three sleeves: the National Investment Bank set out in 3.4, Frontier Programmes (for technologies before a commercial market exists) and Strategic Projects (for assets which have a market but cannot yet be financed privately).**
- → **Seed the Vehicle with up to £50bn of deployable capital, from consolidated PuFin assets and cornerstone institutional commitments into the NIB.**
- → **Grow its capital base from retained commercial returns and an 80% share of LGPS returns above target (set at 3.5% real), in exchange for the Treasury explicitly underwriting accrued LGPS liabilities.**
- → **Protect the capital base through a Singapore-style spending rule, capping drawdowns at 50% of expected long-run real returns to prevent fiscal raiding and mitigate inflation risks.**
- → **Govern it at arm's length from the Treasury, reporting to the Department for Economic Growth, with performance measured by capital recycled rather than held.**
- → **Scale up long-term investment via a separate multi-tranche vehicle using contingent state mezzanine support to crowd in private institutional debt and equity once a project pipeline matures.**

The current geopolitical climate strengthens the case for a government-backed Strategic Investment Vehicle, capable of supporting commercially viable projects in areas of national importance. Britain already holds the public capital to do this, but it is spread across many bodies, none of which has the scale or permanence to deploy it strategically.

Many peer countries use state-backed investment vehicles to maintain patient capital for long-term national priorities, while insulating individual investment decisions from political direction. Britain’s existing institutions are comparatively fragmented and remain dependent on Treasury funding cycles, limiting their scale and investment horizon.

The reforms proposed below create a way forward for Britain: consolidating the capital already held across these fragmented public bodies provides the Vehicle with its starting balance sheet, while commercial performance and compounding returns will allow this capital to grow significantly.

The Vehicle should be organised into three sleeves - National Investment Bank, Frontier Programmes and Strategic Projects.

The Vehicle acts as a holding entity, with capital deployment undertaken via three independent sleeves beneath it:

1. The National Investment Bank (NIB): as outlined in Section 3.4, the NIB focuses on minority growth equity, stakes in third-party venture and growth funds, and loan guarantees to restore working capital to small firms, absorbing the British Business Bank's direct portfolio and British Patient Capital's fund-investment programmes; (Note: the NIB is jointly owned by the Vehicle as the key shareholder, alongside institutional investors, including insurers, pension funds, and commercial banks)
2. Frontier Programmes: focuses on technologies before a market for them exists, funded through developmental grants, innovation procurement contracts, and milestone-linked payments, and absorbs Innovate UK's late-stage commercialisation programmes (Innovate UK's growth-capital schemes pass instead to the NIB); (Note: this does not duplicate ARIA: while ARIA funds high-risk research and development, Frontier Programmes provides the capital required for technical qualification, licensing, and first commercial deployment; discovery science and research council budgets remain separate and outside the Vehicle)
3. Strategic Projects: focuses on assets which have a market but cannot yet be financed privately, such as energy generation, grid transmission, advanced industrial plant, and major transport links, deploying development capital, cornerstone equity, construction guarantees, and project-level special purpose vehicles (SPVs), subsuming the National Wealth Fund and relevant government commercial assets.

The three sleeves between them absorb the functions of the existing bodies set out in Section 3.4. For example, British Patient Capital's fund investment programmes move to the NIB sleeve alongside the British Business Bank's direct portfolio, and the National Wealth Fund's project portfolio can pass to Strategic Projects; the National Security Strategic Investment Fund's investment functions and Innovate UK's growth-capital schemes could pass to the NIB.

Illustrative case study - taking a small modular reactor programme from early development to private ownership

Small modular reactors are a useful case study because they are hard to finance at every stage until they are operational. No small modular reactor has yet been built and operated in Britain, and the leading designs remain in the regulatory approval phase, so the technology cannot yet be financed commercially.

Once a reactor is built and operating under a long-term contract, this dynamic reverses, and becomes attractive to investors such as closed DB pension funds and insurers as an inflation-linked, annuity-type investment.

This is therefore a useful exemplar for each sleeve of the Strategic Investment Vehicle:

- Frontier Programmes funds the design and regulatory approval phase;

- The National Investment Bank finances companies across the supply chain (the technology company itself, and manufacturers supplying components, many of which are likely to be scale-up businesses);
- Strategic Projects finances the first plant through a ring-fenced project vehicle;
- Pension funds and insurers then take the operational assets off the SIV, with the proceeds funding the next programme.

The state's role is limited to funding stages rather than the whole project, with exposure capped and disclosed at each stage, and limited to what it can control. Independent safety regulation sits with the regulator.

Stage		Purpose	SIV sleeve(s)	Illustrative instrument	Graduation test
1	**Technology option**	Design feasibility, licensing path, core engineering	Frontier Programmes	Grants, innovation contracts and milestone payments	Technical milestones, credible regulatory path, proof of concept
2	**Regulatory and manufacturing validation**	Detailed design, supply chain, cost range	Frontier Programmes funds design NIB finances technology company and its component suppliers	Matched funding, preferred equity, released against milestones	Regulatory progress, validated manufacturing plan and costs, identified sites
3	**First-of-a-kind project**	Construction, site, revenue and financing risk	Strategic Projects, through SPV	Sponsor equity, strategic co-investors, capped first-loss support, guarantees	Robust contracts, allocated risks, funded contingencies
4	**Early fleet build-out**	Repeatability, construction learning, supply-chain capacity	Strategic Projects, syndicating to private investors	Syndication to infrastructure investors	Construction and operating performance, pipeline capable of attracting conventional capital
5	**Institutional participation**	Valuation, diversification, liquidity	Strategic Projects	Pension and insurer take-out, project or fleet-company refinancing	Technical and construction risks mitigated, credible revenue prospect
6	**Exit and recycling**	Whether continued state ownership remains necessary	Strategic Projects	Orderly sell-down, refinancing, strategic sale or public-market disposal	Project operates without continuing state capital

HM Treasury should formalise the effective state covenant by underwriting the liabilities of the LGPS, replacing the implicit guarantee that already exists and allowing the scheme to maintain a long investment horizon despite closure to new entrants.

The state already backs LGPS liabilities in all but name, which are nominally backed by individual local authorities.

We recommend introducing an explicit Treasury guarantee and formally underwriting LGPS liabilities. Other than a formal guarantee, members experience no difference: they keep their promised pension benefits, annual statements and existing administration.

Formalising the guarantee also enables the scheme to maintain a long investment horizon, despite closing to new entrants as outlined in Section 4.5.

Rating agencies may review the decision to guarantee LGPS liabilities, though we consider the inherent risk to be low: local government pension obligations have been consolidated within the Whole of Government Accounts since 2011, so this is principally a recognition of effectively an existing exposure.

In exchange for the explicit guarantee, the SIV should take a defined share of any performance surplus generated above the target return.

A straightforward way to grow SIV capital without significant Treasury funding is to take a defined share of any LGPS performance surplus generated above the target return. For example, if the target return is set at 3.5% real, 80% of returns above that target could flow to the SIV, with 20% retained by the scheme.

The target return should be set higher than the baseline investment returns assumed in regular actuarial valuations, ensuring that performance surplus sharing only begins once a fund has generated the returns necessary to fully cover its pension promises and funding requirements.

The 20% share retained by the LGPS provides an extra funding cushion and can be used to fund discretionary member benefits as part of the agreement, such as enhanced death-in-service terms or funeral support.

The state's 80% share flows directly into the SIV, creating a growing capital base for strategic UK investment.

A Singapore-style spending cap would prevent future governments from raiding the capital base.

An understandable objection to a vehicle of this kind is that future governments might raid accumulated capital. We address this through a spending rule, modelled on Singapore's Net Investment Returns framework, which permits the government to spend up to half the expected long-run real return on its net assets.

Under this framework, the state could withdraw only a defined share - indicatively capped at 50% of the long-run expected real return - with the remaining returns retained within the SIV to preserve and compound its permanent capital base. Ultimately, the purpose of the SIV is to build a permanent capital base for strategic UK investment, not to fund current expenditure.

The rule also mitigates the inflation 'firehose' challenge: if surplus flows grow over time, a spending cap prevents the government from pushing too much excess capital into the economy at once, reducing inflation risk.

The Vehicle should operate at arm's length, reporting to the new Department for Economic Growth.

It is important that the Vehicle operates at arm's length from HM Treasury, reporting to the new Department for Economic Growth introduced in Chapter 2. This is necessary because its mandate and horizon do not align with the institutional short-termism of the Treasury. The Vehicle and each of its sleeves should be governed by professional boards, on the terms set out for the National Investment Bank in Section 3.4, applying to the institution as a whole and across its other sleeves. Nest demonstrates that a state-established vehicle can operate this way, insulated from political direction, to deliver institutional returns.

Accountability should come through the Parliamentary standing committee outlined in Chapter 2, as well as the NAO and independent performance reporting. Performance should be measured on capital recycled and redeployed rather than capital held, as the SIV exists to take risk which the market will not yet take.

The SIV architecture must be complemented by supply-side reforms that make UK assets attractive to all investors, not just to the state.

The Vehicle should complement the wider supply-side reforms set out in this report, not substitute for them nor be forced to invest in otherwise unattractive assets.

This matters most for infrastructure and UK growth capital: as Chapters 2 and 3 outline, while there is money available, too many UK projects are made unattractive by planning risk, regulatory risk, tax treatment, a weak stock market and uncertainty over policy consistency. This is the basis on which the SIV and its sleeves, LGPS pools, insurers, banks, retail investors and overseas investors, should be encouraged to deploy capital into UK assets on commercial terms.

A separate multi-tranche investment vehicle can scale up strategic investment once the pipeline grows, using contingent state credit support to crowd in private capital.

Once the pipeline of investible UK projects expands, the Vehicle can establish a separate multi-tranche financing structure to crowd in large-scale private capital. This would combine a senior debt tranche, a government mezzanine or credit-support tranche, and a first-loss equity tranche.

The senior tranche would be structured for commercial banks, insurers, pension funds, and international institutional investors seeking highly rated, liquid exposure to productive UK infrastructure and growth assets. Where retail participation is offered at all, it belongs only in this senior tranche and only once the structure has established a track record, following the same reasoning set out for the NIB Bond in Section 3.4.

The government's role would be limited to contingent credit support through the mezzanine tranche. This would help the senior tranche achieve a high rating without requiring the Treasury to fund the vehicle upfront or guarantee all losses. The Treasury exposure would be triggered only after the equity tranche had been wiped out.

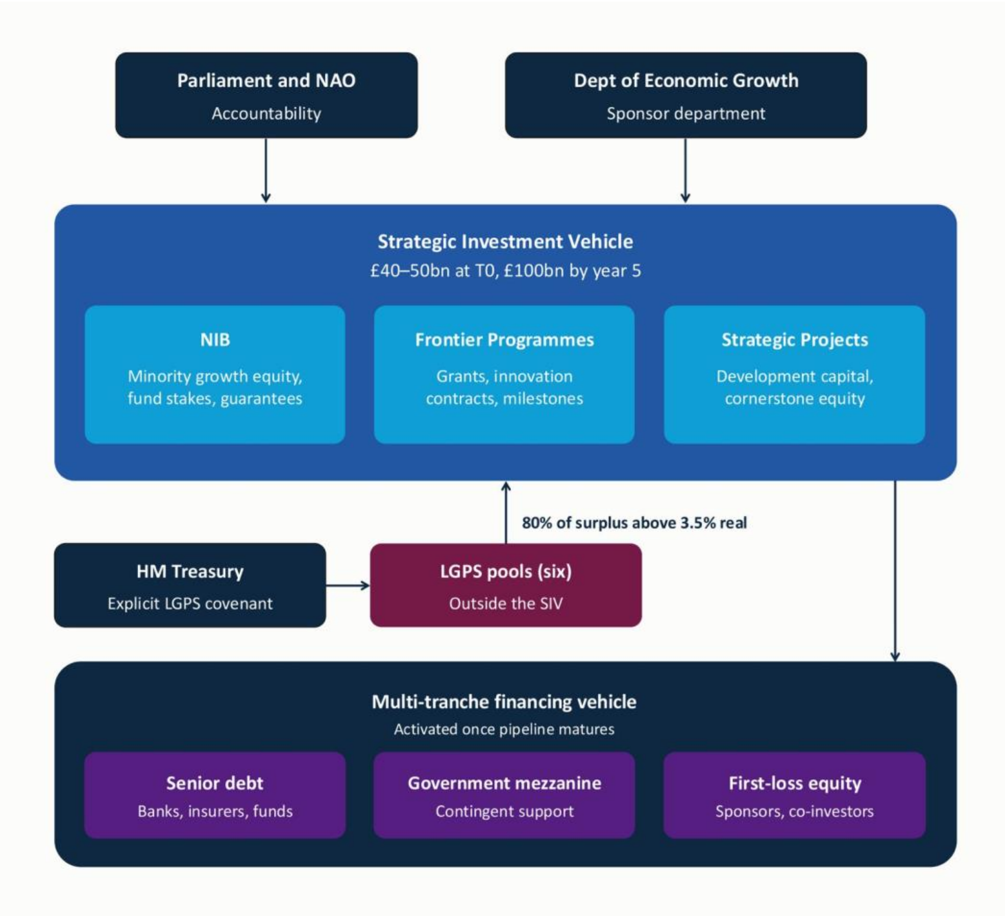
This is not a 'day one' commitment: Britain does not yet have the stock of investible projects this structure is designed to finance, and will not until the planning, tax, and regulatory reforms set out elsewhere in this report take effect and a pipeline emerges. The first priority is to establish the SIV, consolidate existing public development capital, and deploy funds into viable strategic projects. The multi-tranche vehicle should be activated only once demand for project financing exceeds what the SIV can supply from its own balance sheet.

We estimate that the Strategic Investment Vehicle can scale from as much as £50bn at T0 to £100bn over five years.

We estimate that the SIV can start at around £40-50bn, comprising £25-30bn in consolidated PuFin balance sheet assets and statutory allocations, alongside £15-20bn in cornerstone institutional commitments into the NIB, and grow through investment returns and the Treasury's share of LGPS outperformance above the target, alongside capital recycled and redeployed, to £100bn over its first five years.

For the same reasons, we do not set up the multi-tranche vehicle above from day one, as we consider a £50bn starting vehicle to be sufficient.

Strategic Investment Vehicle organisation chart



Chapter 5: Tax Simplification and Reform

5.1 - Diagnosis and principles of reform

Britain's tax system has become dysfunctional: excessively complex, full of anti-growth distortions, and relying on punitive marginal rates which undermine growth and therefore the tax base. While the tax system must raise revenue for public services, its structure must be fundamentally reformed and simplified to unlock growth, while also recognising Britain's precarious fiscal position.

5.2 - Income Tax reforms to target the most damaging distortions

Britain's income tax system has become unnecessarily complex, with cliff edges and hidden marginal tax rates that discourage work and aspiration. It must be drastically simplified, starting with the features that do the greatest damage to growth.

5.3 - National Insurance - phase down with Auto-Enrolment phase-up and merge with Income Tax

National Insurance is a parallel tax on income in all but name. Alongside the introduction of the Lifetime Investment Account system in Chapter 4, NI should be phased down and merged into income tax.

5.4 - Reforming and abolishing the most distortionary secondary taxes

Britain levies a series of so-called 'small' taxes that raise marginal revenue relative to the significant damage they inflict on the underlying economy. Where these distortions actively undermine investment and productive activity, we propose radically reforming or abolishing them.

5.5 - Capital Gains Tax - addressing one of Britain's most complex and destructive taxes

Capital Gains Tax traps capital in existing assets, discourages entrepreneurship, and reduces investment in growing businesses. It is one of the UK's most destructive and complex taxes. Fundamental reform or outright abolition would help more savings flow into productive UK enterprise and increase wages, and support a stronger tax base for the future.

5.6 - Corporation Tax - phase-down and radical simplification

Britain's Corporation Tax has become unnecessarily complex and internationally uncompetitive. A lower rate and simpler system (like Estonia's model, which only taxes disbursements) would encourage more businesses to invest, expand and locate in the UK, and dramatically reduce tax complexity.

5.7 - Australia-style franking credits to encourage investment in UK equities

Profits should not be taxed twice. Restoring a dividend imputation system, similar to Australia's system of franking credits, would rebuild domestic investment in British businesses and support long-term economic growth.

5.8 - A VAT-equivalent rate for Insurance Premium Tax

People should not be taxed more heavily for protecting themselves against risk. Reducing Insurance Premium Tax to a VAT-equivalent rate, while exempting private medical insurance, would make insurance more affordable and help reduce pressure on the NHS.

5.9 - What if Britain rebuilt the tax code from scratch?

While the reforms in this chapter would roughly halve the existing tax code, half of a huge tax code is still huge. A genuinely simple tax code would require writing a new one from scratch; incorporating our reforms, we estimate this could be around a fifth in length of the current code.

5.1 - Diagnosis and principles of reform

Britain's tax system has become dysfunctional: excessively complex, full of anti-growth distortions, and relying on punitive marginal rates which undermine growth and therefore the tax base. While the tax system must raise revenue for public services, its structure must be fundamentally reformed and simplified to unlock growth, while also recognising Britain's precarious fiscal position.

Key policy recommendations:

- **Given the poor state of the public finances and with the experience of 2022 in mind, for any tax measure with an upfront fiscal cost to proceed, savings in public spending of equivalent magnitude must first be identified. This applies regardless of any dynamic or 'Laffer' effects expected to follow later.**
- **We therefore present these measures as a menu rather than a single package. While implementing the full set delivers the greatest reduction in unproductive work, economic distortion and uncertainty, a government must weigh those gains against the political cost of the spending reductions.**
- **We argue that the state should be smaller in any case. Public spending now stands at around 45% of GDP. Indeed, returning to just its pre-pandemic level would release considerably more than the measures in this chapter require.**

The tax system is excessively complex, imposing enormous compliance costs on businesses and individuals.

The UK tax code is generally accepted as the longest in the world: the standard practitioner handbooks now run to over 20,000 pages and roughly ten million words, against a few hundred pages for Hong Kong's, one of the world's most streamlined and competitive regimes.

Excessive compliance with the tax code, including interpretation and filing, is economically unproductive activity. Similarly, HMRC needs more staff, guidance, and capacity to handle disputes and litigation.

Moreover, it creates the same barriers to entry as discussed in Chapters 2 and 3: large firms can afford specialist advice, while small businesses and individuals cannot. Crucially, the burden stems not only from the complexity of the code, but from the sheer volume and range of separate taxes with which businesses have to comply.

Many taxes produce perverse incentives - either suppressing receipts (through Laffer Curve effects) or driving behaviour that is the opposite of what the tax intends.

Some taxes sit on the wrong side of the ‘Laffer curve’, where rate reductions can *increase* revenues through dynamic economic effects. Corporation Tax is a prime example where lower, competitive rates encourage domestic investment and attract international capital.

Other taxes drive behaviour contrary to their original purpose. High rates of Landfill Tax incentivise illegal waste disposal and fly-tipping, while Air Passenger Duty (APD) encourages travellers to route long-haul flights through European hubs.

A further distortion arises from cliff edges and steep tapers. If a relief is withdrawn over a narrow band or a tax liability is triggered at a cliff edge, marginal tax rates become punitive, causing economic activity to cluster artificially just below the respective threshold. The £100,000 personal allowance withdrawal (creating a 60% marginal income tax rate), the High Income Child Benefit Charge from £60,000, and the £90,000 VAT registration threshold are classic examples of where extra work and business growth are actively discouraged.

The consequences to the economy are material: capital flight, fewer businesses forming, lower investment, and a shrinking tax base.

The combined effect of these tax burdens on investment and productivity is significant. Capital investment is the main driver of improvements in productivity and thus higher wages, which have in recent years stagnated. The burden of taxes raises the cost of capital, leading to lower investment and, as a consequence, lower productivity and living standards. The contrast with low-tax, high-productivity countries such as the USA is stark.

The effects of high taxation are visible across the economy:

- Firms grow more slowly as cash flows are diverted away from productive capital expenditure to pay taxes;
- Within firms, management time and resources are redirected into tax compliance and planning;
- High earners, founders and mobile wealth-holders leave for jurisdictions with simpler, lower-burden regimes (a trend accelerated by the abolition of the non-domiciled tax regime);
- Elevated hurdle rates mean fewer long-term projects are approved.

The resulting narrower tax base, even assuming public spending remains unchanged, forces higher rates onto the businesses and workers who remain, reinforcing the incentive for capital and talent to leave.

This dysfunction has the same origin as the problems diagnosed throughout this paper: in this case, a risk-averse state defaults to adding complexity rather than accepting the political cost of simplification.

The tax code and the regulatory rulebook are products of the same governance failure diagnosed in Chapters 1 and 2. Each exemption or relief may be a rational response to a specific problem, but no one is responsible for the aggregate complexity. As with regulation, the incentive is one-way - towards rule accretion.

And, as with regulatory simplification, the tax code cannot simply be fixed line by line, as each relief will simply be defended individually on its own terms.

Tax reform must start from a clear set of principles, against which each tax can then be assessed.

The tax system is ultimately there to fund public services, but it should raise what the state needs at the least cost to the underlying economy. Taxation is not inherently bad; rather, different taxes differ greatly in the wider economic impact they cause for each pound raised.

We have assessed reforms in this chapter against the following five principles:

1. Simplicity: minimise time spent understanding and reporting (and disputing) tax - unproductive compliance work which falls disproportionately on small businesses;
2. Revenue-positive: ensure taxes do not suppress the underlying economic activity upon which they depend;
3. Neutrality: ensure a tax does not distort commercial behaviour unless designed to;
4. Consistency: treat similar economic activities with a similar tax burden;
5. Stability: maintain a predictable tax environment for businesses and households.

Sometimes, the simplest way to simplify a tax is to abolish it, which is what we propose for taxes that create the most complexity or distortion relative to what they raise.

For taxes where the economic cost cannot be justified by revenue, or where adjustment would preserve the underlying distortion, we propose abolition as the cleanest policy option. Removing a tax immediately removes the associated rules, reliefs, guidance and compliance. Several of the taxes considered fall into this category.

No credible tax reform can be implemented without reference to the UK's fiscal reality: All of the measures outlined in this chapter are conditional on the identification of savings equal to each measure's expected fiscal cost.

This project is primarily concerned with governance, risk and the flow of capital rather than with fiscal policy. That said, delivering substantial tax reform within a revenue-neutral assumption is not feasible. Given the current state of the public finances, all of the measures outlined in this chapter are conditional on identifying matching spending savings upfront. Moreover, we in any case argue that lower public spending and a smaller state is a vital ingredient for growth.

Our approach to funding is deliberately conservative, mindful of the fiscal backdrop and the need to preserve market confidence. We take the expected fiscal costs of each measure on its own as the funding requirement, without taking account of the likely additional growth flowing from the combined effect of the group of reforms. None of these measures should commence until public spending savings of equivalent value have been identified and a clear plan exists to deliver them. Where tax reductions are phased, if the corresponding spending measures take longer to deliver than planned, the tax measures should themselves be paused. Identifying the specific corresponding savings to public spending is beyond the scope of this paper.

Fiscal cost estimates in this chapter are based principally on HMRC and OBR projections, supplemented by additional modelling where appropriate.

Even though we argue that the size of the state must in any case shrink, we accept it is a major assumption that politicians will have the political capital (or the will) to implement the necessary spending reductions.

Spending reductions on this scale are politically difficult. If there is no willingness to implement spending reductions, many of the measures in this chapter should not proceed, even notwithstanding any expected dynamic or Laffer effects, which take time to materialise and cannot be relied upon to close the gap in the intervening years.

A note on scope:

For what is necessarily a focused project, we have chosen not to address several significant taxes which deserve to be considered in a subsequent phase, or as standalone projects in their own right - specifically: VAT and energy taxation, as well as property taxation beyond stamp duty.

VAT is the clearest omission. It raises more revenue than any tax other than income tax and National Insurance, creates significant distortions (notably the registration-threshold cliff) and is an obvious candidate for simplification. However, its scale, administrative complexity and interaction with international commitments mean that it requires a dedicated programme of work.

Energy taxation is being considered in a separate project run by Centre for a Better Britain.

Property taxation likewise requires a dedicated programme. We propose the abolition of stamp duty in Section 5.4, but council tax and business rates cannot be reformed in isolation from the wider local-government funding settlement.

5.2 - Income Tax reforms to target the most damaging distortions

Britain's income tax system has become unnecessarily complex, with cliff edges and hidden marginal tax rates that discourage work and aspiration. It must be drastically simplified, starting with the features that do the greatest damage to growth.

Key policy recommendations:

- → **Abolish the withdrawal of the personal allowance above £100,000, eliminating the 60% effective marginal tax rate, and remove the associated childcare cliff edge.**
- → **Universalise Child Benefit and remove the High Income Child Benefit Charge to eliminate the single-earner distortion and the steep marginal income tax rate between £60,000 and £80,000.**
- → **Abolish the pension annual allowance, money purchase limits, and complex accrual rules. Introduce an automatic HMRC reporting flag to identify potential abuse.**
- → **Abolish Making Tax Digital for income tax, removing mandatory quarterly reporting and software costs for small businesses and the self-employed.**
- → **The total expected cost of these policies is £6.7 billion for 2027-28 (0.5% of TME[37]), falling to £6.5 billion by 2031-32, and is conditional on the identification of equivalent savings to public spending.**

The withdrawal of the personal allowance above £100,000 creates an effective marginal tax rate of 60% or more, penalising high earners the UK needs to encourage - it should be abolished.

The personal allowance - the tax-free first £12,570 of earnings - is withdrawn at a rate of £1 for every £2 of income above £100,000, tapering to zero at £125,140. Because earnings in this band are taxed at the 40% higher rate while simultaneously losing the allowance at a rate of 50%, the

[37] Total Managed Expenditure

effective marginal rate is 60%, rising to 62% once employee National Insurance is included, and 71% for those repaying a student loan.

The taper was introduced by Alistair Darling in the 2009 Budget and, by virtue of the £100,000 threshold having been frozen since, has dragged hundreds of thousands into the band through fiscal drag.

Moreover, the £100,000 threshold also determines eligibility for tax-free childcare and for the 30 hours of funded childcare in England, which are withdrawn rather than tapered down. Therefore, an extra pound of income can result in the forfeiture of thousands of pounds in support, so that a working parent with young children can be incentivised to decline a pay rise or avoid taking on extra work.

IFS researchers have found evidence of bunching just below the threshold, even before the introduction of the childcare cliff, while many earners predictably avoid the tax by managing their taxable income back down to £100,000, largely through pension contributions.

We recommend abolishing the taper.

The upfront cost for this is £4.2bn for 2027-28 (0.3% of TME), and £3.9bn in 2031-32, with a further £0.4bn and £0.2bn respectively for removing the associated childcare cliff edge. Once further dynamic effects are included, we expect the cost to fall further as the policy would eliminate a 60%-plus marginal rate on skilled, internationally mobile workers (such as senior doctors, engineers, and tech contractors), which will remove a major barrier to extra work and career progression.

The High Income Child Benefit Charge penalises single-earner families and creates a steep marginal rate between £60,000 and £80,000 - it should be reformed or removed.

Child benefit (£27.05 a week for the first child and £17.90 for each additional child) is clawed back through the High Income Child Benefit Charge once an earner's adjusted net income exceeds £60,000, tapering to zero at £80,000.

The charge is assessed on the highest individual earner rather than total household income. Consequently, the charge does not apply to a couple where both partners earn £59,000 each (or £118,000 combined), but a single-earner household on £80,000 loses the entire benefit.

Moreover, the effective marginal tax rate within the taper becomes excessive - reaching around 55% for a family with two children, before accounting for any student loan repayments or the withdrawal of other support.

We discussed three reform options:

1. Raise and index the threshold to inflation or earnings - this is the lowest-cost option, but leaves the underlying single-earner distortion untouched;
2. Pay Child Benefit to all families and fund it from general taxation, removing the charge, the self-assessment administrative burden, and the household distortion entirely - this is the simplest, but most expensive, option;
3. Introduce a fixed childcare voucher or entitlement that targets the early years when childcare costs are highest - requires a redesign beyond the scope of this paper.

Consistent with the principles of this project, the second option provides the most effective simplification mechanism.

This option is the costliest of the three, with an expected fiscal cost of £1.6bn in 2027-28 (0.1% of TME) and £1.8bn in 2031-32.

The pension annual allowance and its associated rules should be abolished, with an automatic HMRC reporting flag introduced in their place.

The standard annual allowance for tax-relieved pension saving is £60,000. This allowance tapers away for higher earners - by £1 per £2 of income above £260,000, down to a floor of £10,000.

On top of this, tax relief is separately capped at 100% of relevant UK earnings. For defined benefit (DB) schemes, annual accrual must be converted into a notional contribution via a statutory formula to test against the allowance, while the abolition of the lifetime allowance in 2024 introduced two new overlapping lump-sum allowances rather than a clean deregulation.

A stark and relatable consequence is the impact on senior NHS doctors. Consultants taking on extra work can breach the annual allowance, triggering tax charges on notional pension growth that mean a consultant can be *worse off* compared to not taking on the work. This incentivises them to reduce their hours, turn down extra shifts, or take early retirement - worsening NHS waiting lists.

We recommend abolishing the annual allowance and its associated taper and accrual formulas entirely, replacing them with a single HMRC reporting flag: annual contributions above a set figure would be automatically reported for compliance review rather than restricted. Relief would remain strictly limited to income earned, and the 25% tax-free lump sum would retain its existing cash cap (currently £268,275) to prevent permanent tax avoidance.

A potential objection is that uncapped relief represents a windfall for the wealthy. However, pensions operate on an exempt-exempt-taxed (EET) model: contributions and growth are exempt from tax, but become taxed as standard income once withdrawn, and cannot be accessed before the normal minimum pension age (rising to 57 in 2028).

We estimate a fiscal cost of £0.5bn (<0.1% of TME) in 2027-28 and £0.6bn in 2031-32.

To TEE or not to TEE?

Under the current exempt-exempt-taxed (EET) system, pension contributions enter tax-free and grow free of tax, but are taxed as income when drawn. We considered switching to a taxed-exempt-exempt (TEE) system, where contributions are made from taxed income, with growth and withdrawals remaining tax-free (mirroring how ISAs operate). This model offers two main attractions: it removes the need to enforce front-end tax relief, and taxing contributions immediately rather than decades later brings forward substantial tax revenue for the Exchequer. However, we decided against it, as taxing contributions upfront leaves less initial capital to compound over time, and the promise of tax-free withdrawal over decades relies on future governments not changing the rules. Crucially, the transition would require running legacy EET and the new TEE systems side-by-side for decades - significantly increasing complexity.

Making Tax Digital has begun imposing quarterly reporting and software costs on small businesses and the self-employed - it should be abolished for income tax.

Making Tax Digital (MTD) requires taxpayers to keep digital records and file through approved commercial software. It has applied to VAT since 2019 and, after repeated delays, began extending to income tax in April 2026 - initially for sole traders and landlords with gross income above £50,000, before falling to £30,000 in 2027 and £20,000 in 2028. For those in scope, it adds four quarterly digital updates to the annual Self Assessment process, obliging millions of small businesses and self-employed individuals to use compatible software.

The rationale is to reduce errors and close the tax gap (the difference between tax owed and collected), though this has never been convincingly shown to justify the cost. The National Audit Office found that the programme will cost around five times its original forecast, and that HMRC's business case excluded approximately £1.5bn of forecast costs to taxpayers from its cost-benefit analysis; on the NAO's assessment, a complete analysis would have shown the combined costs to HMRC and taxpayers exceeding the additional revenue expected. HMRC's own estimates put the transitional cost at around £320 per business, with around £110 a year of ongoing costs[38].

The burden lies in the frequency of filing rather than in digital record-keeping *per se*. Information is already gathered annually, and accounting software has improved rapidly; what MTD adds is the requirement to file four interim summaries a year, for which there is little practical purpose for non-VAT-registered taxpayers, as the final liability is still calculated only at year-end.

Separately, the regime obliges taxpayers to use third party software, which hands pricing power to a small number of software providers, while the (largely fixed) costs fall proportionately hardest on the smallest businesses.

We considered three policy options:

- Pause the remaining rollout for a proper review of costs and benefits before the £30,000 and £20,000 thresholds take effect;
- Keep digital record-keeping but drop the quarterly reporting requirement;
- Abolish Making Tax Digital for income tax altogether, leaving it for VAT, where it is established and where quarterly reporting already existed.

We recommend the third option as the cleanest. Abolition removes the quarterly obligation and the software requirement together, and, on the analysis above, at relatively limited net fiscal cost. If a future government wishes to mandate digital filing for income tax, it should first provide a free filing route for small and simple businesses and demonstrate the case for reporting more frequently than annually.

A series of smaller 'fiddly' features impose unnecessary complexity relative to what they raise, many of which will in any case be resolved by the National Insurance consolidation we propose in Section 5.3.

There are a number of further anomalies which cumulatively add to overall complexity, many of which arise because National Insurance, a parallel tax on income, has its own separate thresholds and rules. For example:

---

[38] National Audit Office, Progress with Making Tax Digital; HM Revenue & Customs, Making Tax Digital for Income Tax Self Assessment for sole traders and landlords

- National Insurance is assessed on weekly or monthly pay periods, whereas income tax is assessed annually;
- Employees pay no NI or income tax until £12,570, yet employers begin paying employer National Insurance once earnings exceed £5,000;
- NI is assessed per job rather than per person - someone with multiple small jobs can avoid NI when someone on the same total income from one job pays it;
- A series of employer NI reliefs, including for under-21s, apprentices, veterans and freeport employees, each have their own rules.

We do not propose to tackle these individually, many of which in any case fall away once National Insurance is merged with income tax, which is our intended long-term destination - see Section 5.3.

5.3 - National Insurance - phase down with Auto-Enrolment phase-up and merge with Income Tax

National Insurance is a parallel tax on income in all but name. Alongside the introduction of the Lifetime Investment Account system in Chapter 4, NI should be phased down and merged into income tax.

Key policy recommendations:

→ **Merge employer and employee National Insurance into a single charge shown on the payslip, with salaries grossed up (by law) so take-home pay is unchanged.**

→ **Replace IR35 with a statutory test of self-employment, then phase down the tax gap between employment and self-employment.**

→ **Bring the self-employed into auto-enrolment and the Lifetime Investment Account through Self Assessment, with contributions collected by nominated pension providers.**

→ **Phase out National Insurance cohort-by-cohort over a generation, with cohort boundaries set to soften the cash flow impact across the implementation cycle. Illustratively, NI falls by 0.5 percentage points a year in lockstep with rising auto-enrolment contributions for workers under 40, the legacy system is retained for those over 55, and a phased transitional band applies for those aged 40-54.**

→ **Consolidate any residual balance of National Insurance not absorbed by target auto-enrolment contributions directly into income tax, fully abolishing National Insurance as a standalone tax system.**

→ **As outlined in Chapter 4, evolve the State Pension into a non-contributory, means-tested floor for the younger cohort (with proportionate treatment for the transitional cohort), while preserving all existing accrued entitlements.**

→ **Estimated transition cost £3-5 billion in 2027-28, rising to £15-20 billion by 2031-32, reflecting the cost of running two retirement systems in parallel.**

National Insurance is simply a separate tax on income, adding further complexity.

National Insurance is the UK's second-largest tax, raising over £200 billion a year, behind only income tax. Like income tax, it falls on income, but only from employment and self-employment - not on savings, dividends, rental or pension income.

National Insurance began as a contributory scheme, but the principle survives only notionally in the form of the National Insurance Fund, into which receipts are paid to meet current state pension and benefit liabilities, with a portion going to the NHS.

Around two-thirds of the total burden is paid directly by employers and is therefore largely invisible to workers, who nonetheless bear the cost through lower wages.

From day one, employer and employee National Insurance should be merged into a single charge shown on the payslip, with salaries grossed up so that take-home pay is unchanged and the true tax on employment becomes visible.

We propose merging employer and employee National Insurance into a single charge, levied on the employee and visible on the payslip. To keep employee take-home pay unchanged, every salary would be grossed up (by law) to reflect the prior employer NI contribution.

Implementation needs care in three respects:

1. The gross-up must not trigger accidental income tax liabilities (i.e. the statutory gross-up required to capture employer NI must be excluded from the taxable earnings base for income tax and student loans, ensuring take-home pay remains unchanged);
2. The two current starting thresholds - £5,000 for employers and £12,570 for employees - need to be reconciled into a single threshold, accepting minor variances on the employer side;
3. The various NI features - the Employment Allowance (which discounts up to £10,500 of employer NI for small firms), reliefs for younger workers and veterans, and the separate employee-NI treatment of workers over State Pension age - must each be integrated or replaced (so that existing targeted discounts and exceptions are maintained without creating unintended cliff edges).

It should be noted that this a presentational and simplification measure and does not represent an increase in employer’s total labour costs.

IR35 should be replaced immediately with a statutory test of self-employment. The NI gap between employed and self-employed treatment is then phased down until the test itself becomes redundant.

IR35 exists to stop workers and firms from avoiding payroll taxes by disguising employment through intermediary companies. For a worker earning £50,000, total National Insurance depends on the legal status of the work: an employee and their employer face the combined marginal 23% rate, whereas a self-employed worker pays 6% with no employer levy. This discrepancy creates a strong incentive to present employment as self-employment, generating massive compliance complexity.

The government’s attempt to tackle this has backfired. The off-payroll reforms of 2017 and 2021 shifted liability for determining status onto hiring firms. Faced with heavy penalties for errors, many businesses imposed blanket ‘inside IR35’ determinations - taxing contractors as employees (whilst not providing them with usual employment rights like holiday or sick pay). This has driven skilled contractors out of the labour market and in some cases prompted firms to offshore projects.

We propose two changes:

First, on day one, replace IR35 and the off-payroll rules with a clear statutory test of self-employment. Rather than relying on decades of ambiguous case law and forced client assessments, primary legislation would establish clear and objective criteria (such as a right of substitution, commercial financial risk, and control over delivery), assessed by the worker. This restores commercial certainty by removing the fear of retrospective penalties and immediately ends defensive blanket determinations.

Second, phase down the gap itself (between employee and self-employed NI). We propose tapering away the former employer-side levy on employment until the tax treatment of employed and self-employed work fully converges, rendering the statutory test redundant over time.

We argue that this gap should be closed downwards by cutting payroll taxes on employment, rather than upwards by increasing taxes on the self-employed. While this involves a fiscal cost to be absorbed through public spending savings, it forms a natural, foundational component of the broader 40-year phase-down of National Insurance set out in this section.

Should the tax system explicitly reward the risk the self-employed take?

A natural objection to equalising the tax treatment of employment and self-employment is that the self-employed take on risk that an employee does not, including forgoing guaranteed income, sick or holiday pay, as well as an employer pension - and that a lower tax is thus fair. There were two views within the working group. On one hand, the market (on average) already compensates for this risk: the self-employed set their own rates and, where they take on more risk, command higher gross pay for it, so the tax system does not need to compensate them - on a risk-adjusted basis, the tax system should be neutral between ways of working and allow the market to price the risk. On the other hand, the tax code should actively reward risk-taking and enterprise, treating the difference in tax rates as deliberate encouragement rather than a distortion. Our recommendation to close the employed vs. self-employed gap downwards renders these two viewpoints redundant; however, these would be consequential should a government choose to taper up the contributions of the self-employed.

The self-employed are also brought into pension auto-enrolment and the Lifetime Investment Account outlined in Chapter 4 - identified through self-assessment, with contributions collected by their pension provider.

Auto-enrolment has transformed pension saving for employees but left the self-employed behind, as they have no employer to enrol them or contribute on their behalf. As a result, only around one in five of the self-employed save into a pension, against roughly four in five employees[39].

There are some 4.4 million self-employed workers, many heading towards retirement fully reliant on the state pension.

[39] Institute for Fiscal Studies, Pension saving plummets when employees move into self-employment

We recommend that the self-employed should be brought into a system of automatic pension saving facilitated through self-assessment, where the state already interfaces with them. HMRC would identify eligible individuals and calculate a default contribution - a set percentage of profits above a threshold, consistent with the rates set out in Chapter 4 - while contributions would ordinarily be collected directly by the individual's nominated pension provider (with NEST as the default provider if necessary).

Auto-enrolment has to reflect the realities of self-employment, including the irregular nature of profits, and tightness of cash flow - rather than assume a smooth monthly salary. This means:

- Contributions calculated on annual profits through self-assessment, with the option to pay provisionally in-year and reconcile at year end (so the amount tracks what is earned);
- The ability to take a contribution holiday in lean periods, rather than a fixed monthly obligation.

The reform should not be introduced until equivalent treatment has been designed for controlling company owner-managers, so that the choice between sole trading and incorporation is not materially distorted.

Over a generation, National Insurance is phased out in its entirety for younger workers, with each reduction matched in tandem with the phase-up of auto-enrolment.

Our proposal phases National Insurance down to zero for younger cohorts over the course of a generation, replacing it with the Lifetime Investment Account funded by higher auto-enrolment contributions. Each reduction in NI is matched by an equal rise in auto-enrolment (0.5% per annum as outlined in Chapter 4) so that take-home pay remains unchanged. Any residual balance of the charge not absorbed by the final auto-enrolment rate is consolidated directly into income tax, completing the merger and eliminating National Insurance as a separate tax system.

The wind-down proceeds cohort by cohort, with a transitional band, to partly mitigate the fiscal cost of running two systems at once.

National Insurance is largely pay-as-you-go: the £200 billion it raises each year largely funds current benefits, predominantly State Pensions, making the process of unwinding this regime hard. If National Insurance were switched off for everyone at once, the state would still have to fund today's pensioners, with no NI revenues as the working population diverted its contributions into auto-enrolment.

Phasing by cohort helps to mitigate this:

- The youngest workers move fully to the new system - NI falls to zero and auto-enrolment replaces it, keeping state pension entitlements already accrued, but with no further accruals when they are paying no NI and building their Lifetime Investment Accounts (with the option to convert their existing accrual into their pot - mechanism to be developed);
- Older workers, closer to retirement and with entitlements already built up, stay on the existing system, with their contributions still funding current pensioners until the legacy system runs off;
- A transitional band on phased rates, avoiding a cliff edge between individuals born only days apart.

We do not yet specify where these boundaries should be drawn, given the detailed actuarial and fiscal modelling required, which is for a future phase of work. However, as an illustrative base case assumption:

- Younger cohort: under 40 years old;
- Older cohort: over 55 years old;
- Transitional cohort: 40-54 years old.

The state pension's role evolves from a primary source of retirement income into the floor set out in Chapter 4.

While the reforms in this paper place Britain's retirement provision on a sustainable long-term footing, there is an initial cash flow cost of running two retirement systems in parallel.

Because National Insurance is pay-as-you-go, the state must continue meeting existing pension entitlements while a growing share of workers direct their contributions into their own funded accounts. On our illustrative cohort assumptions the cost is in the order of £3-5 billion in 2027-28, rising to £15-20 billion by 2031-32, though these are highly sensitive to the cohort boundaries.

Several 'edge cases' are acknowledged but left for follow-up work.

We acknowledge a number of loose ends that are left for a later phase of work - for example:

- Contributory benefits: NI covers not only the state pension, but also a set of contribution-based benefits, including Maternity Allowance, bereavement support, and contribution-based Jobseeker's Allowance and Employment and Support Allowance; as NI winds down, these accrued entitlements will need an alternative funding and eligibility structure;
- Employment status: even with the proposed statutory test, some workers will remain borderline, including owner-managers operating through their own companies (who are simultaneously shareholder, director, and employee);
- Legacy features: specific historical provisions - such as the married women's reduced rate, the special treatment of groups like share fishermen, and voluntary Class 3 contributions - will require managed run-off rules.

5.4 - Reforming and abolishing the most distortionary secondary taxes

Britain levies a series of so-called 'small' taxes that raise marginal revenue relative to the significant damage they inflict on the underlying economy. Where these distortions actively undermine investment and productive activity, we propose radically reforming or abolishing them.

Key policy recommendations:

→ **Abolish Stamp Duty Land Tax. The tax undermines geographic and social mobility, and traps commercial property in unproductive uses. (2027-28 cost: £17.1bn, or 1.2% of TME)**

→ **Abolish Stamp Duty on Shares, which depresses UK equity valuations and liquidity, and raises the cost of growth capital for British businesses. (2027-28 cost: £2.8bn, or 0.2% of TME)**

→ **Abolish Inheritance Tax, a source of significant tax complexity and which drives capital flight, discourages investment and continues to disrupt family businesses. (2027-28 cost: £10.4bn, 0.7% of TME)**

→ **Abolish Air Passenger Duty. The levy taxes passenger journeys rather than pricing actual emissions, making direct routes from regional UK airports unviable and encouraging long-haul travellers to connect through European hubs instead. (2027-28 cost: £1.5bn, 0.1% of TME)**

→ **Abolish the Digital Services Tax, or restore its threshold to reflect recent inflation. The tax passes its costs directly onto domestic consumers and small business advertisers who have no viable alternatives, while undermining UK-US trade relations. (2027-28 cost of abolition: approx. £1bn, <0.1% of TME)**

→ **Abolish Landfill Tax, the Aggregates Levy, Packaging Extended Producer Responsibility (pEPR), and the Plastic Packaging Tax. These levies fail to price externalities accurately and impose heavy and duplicative compliance burdens, and work against their stated purposes, including fuelling industrial-scale fly-tipping. (2027-28 cost: £0.7bn, <0.1% of TME)**

→ **If environmental externality pricing is to be retained, our secondary proposal is to consolidate pEPR and PPT and reset Landfill Tax and the Aggregates Levy to more proportionately reflect their environmental costs.**

Stamp Duty Land Tax (SDLT) suppresses housing, commercial, and labour mobility. We propose abolition.

Stamp Duty was a relatively straightforward tax up until 1997, operating broadly as a 1% charge on property purchases over £60,000. Since then, rates and thresholds have been altered frequently by successive governments. Residential rates now range from 0% to 12% across progressive bands, supplemented by surcharges for additional properties and partial reliefs for first-time buyers. Non-residential and mixed-use property faces a tiered system of 0% up to £150,000, 2% from £150,000 to £250,000, and 5% thereafter, alongside a separate SDLT charge of up to 2% on the net present value (NPV) of rents on newly granted commercial leases.

SDLT raised approximately £15 billion in 2025-26.

Transaction taxes on property are exceptionally distortionary because they penalise the act of moving. This significantly undermines housing progression, not least because SDLT cannot be financed through mortgage lending, requiring buyers to fund the liability entirely from post-tax equity. First-time buyers must save for the tax alongside their deposit, while existing homeowners face prohibitive upfront costs to move up the housing ladder. Taxing property transfers additionally creates a direct barrier to geographic relocation, discouraging workers from moving to higher-productivity jobs.

SDLT also creates severe friction in the commercial property market, imposing high upfront costs on capital reallocation, refinancing, and corporate restructuring. HMRC's own evaluation indicates that a 1-percentage-point change in the effective commercial tax rate is associated with an 11.7% change in transaction volumes; these elevated transaction costs deter marginal deals, conversions, and distressed sales, leaving commercial space trapped in less productive uses. Furthermore, levying SDLT on commercial lease NPVs adds disproportionate complexity while also directly penalising businesses seeking to expand, downsize, or relocate into better-suited premises. Removing this charge accelerates tenant turnover in vacant offices and high streets and lowers upfront entry costs for start-ups[40].

For residential property, simplification options - such as a 1% flat rate on primary residences and 3% on second homes - would retain revenue while cutting administrative complexity. For non-residential property, we estimate that reducing the progressive tiered rates to 0% up to £150,000, 1% from £150,000 to £250,000, and 2% thereafter would retain roughly 56% of non-residential receipts after accounting for behavioural volume increases. However, partial reforms preserve the underlying distortions of transaction taxes.

We therefore recommend abolishing SDLT on residences and on commercial property, including the lease NPV charge.

We estimate the fiscal cost of immediately abolishing residential SDLT to be £12.6bn in 2027-28 (0.9% of TME), falling to £10.7bn in 2031-32 as transaction volumes recover. For commercial property, we estimate the fiscal cost for 2027-28 to be £4.5bn (0.3% of TME), and £5.5bn in 2031-32.

Stamp Taxes on Shares (STS) are charged to pension funds and ISAs when they buy a share in a British company, depressing UK valuations and the retirement savings invested in them. We recommend abolition to lower the cost of capital and rebuild domestic demand for UK shares.

Stamp Duty and Stamp Duty Reserve Tax (together, Stamp Taxes on Shares), are charged on the purchase of UK shares. The standard rate is 0.5%. STS raised approximately £4.3bn in 2024-25, up from £3.2bn the prior year. It raises only a small share of total tax revenue, but it undermines ownership of equity in British companies and makes them less attractive than overseas equities.

In addition to the cost faced by buyers of shares, STS creates wider spreads and lower valuations. Lower valuations mean a higher cost of equity for British companies, which makes it more expensive to raise capital in the UK, reinforces the long retreat from domestic equity ownership, and gives companies a further reason to favour debt, private capital or overseas markets over public equity in London.

[40] HM Revenue & Customs, [Responsiveness of commercial transactions to Stamp Duty Land Tax]

The Government has started to accept this issue. It has introduced a temporary stamp duty holiday for newly listed companies, under which investors do not pay the 0.5% charge when buying shares in a company during its first three years on the London market.

AstraZeneca's US listing shows how large UK issuers can reduce their exposure to the UK stamp-duty charge without formally leaving London. The immediate fiscal effect is a loss of receipts - reportedly up to £200m a year in AstraZeneca's case - but the deeper problem is with the market structure: if more trading migrates into stamp-duty-free overseas or depositary structures, liquidity follows it, the UK tax base shrinks, and London becomes a less natural venue for global equity trading.

Most comparable markets either do not impose a tax of this kind or impose it at a lower rate. The United States and Germany impose no equivalent tax. Only Ireland, at 1%, has a higher rate, while France, Hong Kong, Singapore, Spain and Italy impose lower rates than the UK. Sweden abolished its equivalent in 1991 after finding that the tax reduced trading volumes, reduced capital gains tax receipts and caused trading to migrate offshore.

Modelling for the Centre for Policy Studies by Oxera estimates that abolition would raise long-run GDP by 0.2-0.7%, increase annual business investment by FTSE All-Share companies by up to £6.8bn, and increase the size of a representative DC pension fund by around £6,000. The same analysis estimates higher dynamic tax receipts of £2.1-£6.8bn a year, potentially offsetting the expected revenue loss[41].

We do not advocate for partial exemptions, as this would create administrative and enforcement complexity. We instead recommend that STS should be removed, immediately.

We estimate the fiscal cost to abolish STS for 2027-28 to be £2.8bn (0.2% of TME), falling to £0.1bn by 2031-32 as the dynamic effects described above accumulate - by which point the measure is close to self-financing.

High Inheritance Tax is a source of significant complexity, and has driven capital flight, discouraged investment and continues to disrupt family businesses. We recommend full abolition.

Inheritance Tax applies at 40% on the taxable value of an estate above the nil-rate band, currently £325,000. Estates can also claim an additional allowance of up to £175,000 where a home is left to children or grandchildren, although this is tapered away for estates worth more than £2 million. The regime has become steadily more expansive: from April 2026, business and agricultural assets above a £2.5m combined cap face an effective 20% IHT charge, while AIM-listed shares also face an effective 20% charge. From April 2027, unused pension assets will be brought within the estate for IHT purposes, facing the standard rate.

The tax raises little relative to others, despite its political saliency: IHT raised £8.2 billion in 2024-25 - less than 1% of total tax receipts. Moreover, IFS modelling suggests that by 2032-33 around 12% of people will have IHT due either on their own death or that of their spouse or civil partner, rising to 23% in London[42]. From 2027-28, HMRC estimates that bringing unused pensions into estates will make a further 10,500 estates liable to IHT that otherwise would not have been[43].

[41] Centre for Policy Studies, Stamp Duty on Shares is a Tax on Growth, 2024
[42] Institute for Fiscal Studies, Reforming inheritance tax
[43] HM Revenue & Customs, Inheritance Tax - unused pension funds and death benefits

IHT drives three key economic distortions:

First, capital flight: The UK's non-dom regime existed to make Britain an attractive base for internationally mobile high-net-worth individuals who would not otherwise locate here, and the 2024 reforms changed this - particularly by bringing worldwide assets into IHT. The consequent loss of revenue to the Exchequer from the departure of a significant number of non-doms is not only IHT upon death, but also other taxes including income tax and VAT, as well as investment activity and business formation that the UK now misses out on. Moreover, analysis of Companies House filings by Rathbones suggests that nearly 6,000 owners of high-growth businesses left the UK over the past two years[44].

Second, business continuity: The 2024 Budget restrictions on Business Property Relief (BPR) and Agricultural Property Relief (APR) impose an upfront succession tax on asset-rich but cash-poor family enterprises. Where businesses lack liquidity to meet the liability, they are forced to defer investment, extract dividends, increase corporate borrowing, or sell assets. In many cases, businesses are sold to private equity or overseas buyers with bigger balance sheets. This distorts commercial planning years in advance and is effectively a tax on business continuity. Research by CBI Economics for Family Business UK found that 55% of BPR-affected businesses and 49% of APR-affected farms have paused or cancelled investment, projecting a £14.8bn loss in gross value added (GVA) over five years[45].

Third, domestic capital formation: Inheritance often funds deposits and start-ups, with around 20% of new businesses relying on inherited money. This matters particularly in an economy like the UK where bank lending to small firms is constrained (see Chapter 3). IHT has stripped an estimated cumulative £150bn from the UK's productive capital stock[46]. Moreover, bringing pensions into scope will further undermine the supply of growth capital.

Internationally, many developed economies do not apply an inheritance tax, including Australia, Canada, New Zealand, Norway, and Sweden, while the United States maintains a far higher federal estate-tax threshold of $15m for individuals and $30m for married couples.

Restoring the previously more competitive regime would be better than the current system, but it would not address the underlying complexity challenge: relief and exemption-based regimes are inherently complex, politically fragile and reversible, sustaining a whole anti-avoidance industry.

We therefore recommend full abolition.

We estimate the fiscal cost for 2027-28 to be £10.4bn (0.7% of TME), and £10.7bn in 2031-32.

Note: this section does not address whether inherited wealth should be taxed, but whether the UK's current regime is worth its economic cost. We considered aligning the threshold with the US federal exemption of around £10m per individual, but this would still leave anti-avoidance complexity and would still deter mobile capital.

---

[44] Rathbones, Tech sector leads exodus of 6,000 business owners
[45] CBI Economics and Family Business UK, The Economic & Fiscal Impacts of BPR & APR, 2025
[46] Working group analysis

Air Passenger Duty damages regional competitiveness and connectivity, while doing little to reduce emissions. We recommend abolition.

Air Passenger Duty (APD) is a tax on passengers flying from UK airports, paid to HMRC by airline operators. It was introduced by Chancellor Ken Clarke in 1994 and has since become the largest aviation tax of its type in the world.

Rates are high: in particular, medium- and long-haul economy travellers pay around 50% more in APD than their equivalents in France or Germany, while long-haul business fares attract APD of up to £253. The UK accounts for around 3% of global air passenger journeys, but generates around 8.9% of total aviation taxes.

APD raised £4.1bn in 2024-25, around 0.4% of the UK's total tax receipts.

The tax drives three harms in particular:

1. Distortion of route economics: APD creates a cliff edge effect that does not correspond to the economic or environmental cost of travel. For example, an economy passenger to Cyprus pays £15, while an economy passenger to Egypt (only a few hundred miles further) pays £102, making marginal routes uneconomic.
2. Regional underservice: long-haul connectivity is already heavily concentrated in London. The consequence is fewer direct routes from regional airports, with more journeys routed through London or European hubs such as Amsterdam and Paris.
3. Economic impact: PwC modelling, first produced in 2013 and updated in 2015, estimated that abolishing APD could raise GDP by around 0.5% in the first year and leave it around 0.1% higher in the long run, with additional receipts from other taxes potentially offsetting the direct revenue loss within two fiscal years[47].

There is also a supply chain effect, as around 70% of UK air cargo is transported in the holds of passenger aircraft.

Ireland abolished its air travel tax in 2014, after which more than 20 new routes were added, while Sweden abolished its equivalent in July 2025. By contrast, Germany increased its aviation tax by 25% in 2024, before reversing course after recognising the harmful effect on its domestic aviation industry and connectivity.

Moreover, the environmental case for APD is also weak, as APD taxes passengers, not flights, fuel burn or emissions. It therefore does not incentivise cleaner or fuller aircraft, shorter routes, sustainable aviation fuel or lower-emission operations. Furthermore, UK aviation is already covered by more direct emissions instruments, including the UK Emissions Trading Scheme (UK ETS), the UN's international aviation carbon scheme (CORSIA), and sustainable aviation fuel (SAF) mandates.

Our recommendation is therefore full abolition.

We estimate the fiscal cost of abolition at £1.5bn in 2027-28, falling to zero by 2031-32[48]. The forgone receipts are progressively offset by higher passenger volumes, restored regional route economics and the recapture of traffic currently connecting through European hubs.

---

[47] House of Commons Transport Committee, written evidence on aviation taxation
[48] Working group analysis

The Digital Services Tax raises little revenue, is passed through to UK businesses and consumers, and damages UK-US trade relations. It should either be abolished, or its revenue thresholds should be increased to their original real value and indexed to inflation going forward.

The UK's Digital Services Tax (DST) is a 2% tax on the revenues of search engines, social media services, and online marketplaces that earn revenue from UK users. It was announced in 2018 and came into force in April 2020. It applies to groups with worldwide in-scope revenues above £500m and UK digital-services revenues above £25m.

DST raised £944m in 2025-26 (approximately 0.1% of total HMRC receipts). It is a narrow, targeted tax on a small number of firms, with only around 50 firms within scope.

Firstly, DST is often presented as a tax on Big Tech, but much of the cost is passed through to UK businesses and consumers:

- Google added a 2% surcharge to UK advertising invoices on day one;
- Amazon increased fulfilment and storage fees;
- Apple adjusted App Store developer commissions;
- Meta announced a 2% 'location fee' from July 2026.

This matters for SMEs, around 64% of which invest in paid digital advertising, with SMEs accounting for 34-45% of UK digital advertising spend. For many small businesses, there is no plausible substitute.

Secondly, DST is charged on turnover (rather than profit). This not only makes it more distortive than a profits-based tax as it applies before costs and investments, but also imposes an additional tax on businesses already paying Corporation Tax on profits from the same activity.

Moreover, as liability thresholds have been frozen since 2018, the significant inflation that has since occurred has eroded their real value by more than 20% and brought more firms into scope, including firms such as Deliveroo and Auto Trader, with Rightmove and Trainline close to the threshold.

Thirdly, the tax undermines Britain's trading relationship with the United States, whose Trade Representative has formally found the UK DST to be discriminatory against US firms, with DST also reported as one point of contention around the December 2025 suspension of the Technology Prosperity Deal.

Our primary recommendation is to abolish DST outright. Alternatively, the worldwide threshold can be reset to £700m, broadly restoring the threshold in real terms and capturing only the largest business groups, and subsequently indexed.

We estimate the fiscal cost of outright abolition to be around £1bn (<0.1% of TME) in 2027-28.

ENVIRONMENTAL TAXES

Landfill Tax has long since moved beyond pricing an externality and now encourages organised waste crime.

Landfill Tax is an environmental levy on waste disposed of at licensed landfill sites, charged by weight. It was introduced in 1996 as Britain's first dedicated environmental tax. It operates with two tiers: a standard rate for active waste and a lower rate for inert waste (such as rocks and soil).

The tax was originally intended to reflect the environmental costs of disposal. However, the standard rate has escalated from £7 per tonne in 1996 to £130.75 today, while the lower rate recently rose from £4.05 to £8.65. The standard charge is now far above any plausible estimate of the environmental externality: as the Mirrlees Review noted, while the original £7 rate was broadly calibrated to contemporary estimates of the external cost of active landfill, even when the rate was £40 it was already 'several times greater than any reasonable estimate' of those costs[49].

Rather than functioning as an efficient price signal, the tax is now so punitive that it creates a powerful incentive for evasion, driving industrial-scale fly-tipping across the UK. In 2024-25, the Environment Agency identified 749 new illegal waste sites, an increase of over 75% on the previous year.

Landfill Tax raised nearly £500m in 2024-25, representing just 0.05% of total UK tax receipts. Yet the Environment Agency estimates that waste crime costs the wider economy around £1bn annually. The financial consequences are asymmetric: Operation Cesium involved the illegal dumping of more than 26,000 tonnes of waste, leaving landowners facing estimated clean-up costs of more than £3.2m, while compensation orders totalled £65,000[50].

Aggregates Levy can tax the reuse of quarry waste and make secondary aggregate uneconomic.

The Aggregates Levy is a tax on the commercial exploitation of rock, sand, and gravel. It was introduced in 2002 to internalise the environmental costs of quarrying and incentivise the use of recycled materials.

In practice, the tax creates the opposite incentive. While intended to discourage virgin extraction, the levy applies when certain quarry by-products are commercially exploited for reuse. At over £2 per tonne on low-value bulk materials, this tax charge frequently exceeds the commercial margin of recycling the stone, which penalises reuse and leaves millions of tonnes of usable material in spoil heaps.

Packaging Extended Producer Responsibility (pEPR) raises consumer prices, penalises recyclable glass and operates as a hidden tax on food, drink and household goods.

Packaging Extended Producer Responsibility came into force on 1 January 2025. Administered by PackUK within DEFRA, it charges producers per tonne of packaging placed on the UK market, with proceeds passed to local authorities. Total producer liability is estimated at over £1bn annually.

---

[49] Institute for Fiscal Studies, Tax by Design: The Mirrlees Review
[50] Environment Agency, Environment Agency investigation sees three individuals convicted for dumping 26,000 tonnes of illegal waste

The scheme is presented as producer responsibility, but is in substance a tax, with mandatory charges, set administratively, legally required compliance, and proceeds used to fund public services.

We identify five issues:

1. Pass-through to consumers: the British Retail Consortium estimates an 80% pass-through rate, while the Bank of England has identified pEPR as a source of upward pressure on food prices. Because packaging-heavy essentials (food, drink, and personal care) consume a larger share of lower-income budgets, the Regulatory Policy Committee explicitly warned the levy is regressive.
2. Hidden costs: consumers do not see pEPR on receipts, so this acts as a stealth tax on food, drink and household goods.
3. Penalises use of recyclable glass: the weight-based formula penalises dense materials such as glass, although fees are now also modulated according to recyclability.
4. Proceeds not ringfenced for recycling: local authorities have no legal obligation to spend pEPR proceeds on recycling infrastructure or improved waste services. The Local Government Association has confirmed that funds will not be ringfenced.
5. Compliance burden: small producers face registration fees, data-reporting obligations and specialist compliance costs. Belvoir Farm reportedly found that pEPR-related costs could almost eradicate the previous year's profits, while Valpak, a compliance advisory firm, reported 19,000 business queries on data-reporting complexity in one year.

The UK is not unusual in adopting an EPR principle, but it is among the more burdensome.

Plastic Packaging Tax adds a second charge and compliance regime on top of wider packaging regulation, while doing little to expand UK recycling capacity.

Plastic Packaging Tax (PPT) is a charge on plastic packaging containing less than 30% recycled content, applied to manufacturers and importers handling more than 10 tonnes per year. Introduced in 2022, the rate is £228.82 per tonne in 2026-27.

Aside from overlapping charges alongside pEPR, producers face heavy operational friction. Businesses must maintain end-to-end chain-of-custody documentation, obtain foreign-supplier certification, and register even when their packaging exceeds 30% recycled content and there is no tax liability. For many producers, the administrative burden exceeds the tax itself.

There is also the cliff edge effect where packaging with 29% recycled content incurs the full tax liability, while packaging with 31% recycled content incurs no tax (and there is no incremental benefit to increasing the share of recycled content), which incentivises artificial clustering at 30%. And the levy has failed to expand domestic recycling infrastructure - instead, increased demand for recycled plastic has been met largely through cheaper overseas imports, while UK reprocessing capacity has fallen due to high energy and sorting costs. As with pEPR and Landfill Tax, revenues are not ring-fenced to support domestic recycling capacity.

We considered two approaches to these charges - 1) outright abolition; or, 2) if environmental costs are to continue to be priced, merging the two packaging regimes and restoring the other two to a level which is proportionate to their original purpose.

The four taxes above were each introduced to price an environmental cost, but have produced significant economic and indeed policy distortions. Each tax has its own legislation and administration, so a producer can face multiple compliance regimes for what is essentially a single policy objective.

This is not a judgement that environmental costs do not exist; rather, it is that these four taxes do not price them accurately or proportionately.

Option 1: Abolish the taxes

Our first and preferred approach is abolition, which directly removes the compliance burden and economic distortions:

- Landfill Tax: Abolish and replace with a punitive fines and enforcement regime targeted directly at illegal dumping (which should in any case fall with the abolition of the tax);
- Aggregates Levy: Raises negligible revenue, creates perverse incentives against recycling, and makes the commercial processing of quarry waste unviable - abolish;
- Packaging Extended Producer Responsibility (pEPR): a regime ostensibly intended to improve recycling is simply increasing consumer prices, penalising recyclable glass, weakening UK manufacturing competitiveness, and operating as a hidden levy on household essentials. If recycling infrastructure is the genuine objective, the government should fund and enforce that directly - abolish.
- Plastic Packaging Tax (PPT): imposes a duplicate regime to pEPR, creates cliff edge effects at 30%, and relies on imported recycled materials rather than building domestic recycling capacity - abolish.

For our preferred approach, full abolition of the four taxes, we estimate a combined fiscal cost of around £0.7bn (<0.1% of TME) in 2027-28.

Option 2: Consolidate the packaging regimes and align Landfill Tax and the Aggregates Levy with their original environmental objectives

pEPR and PPT can both apply to the same plastic packaging and, in some cases, the same firms, through two separate regimes:

- Merge PPT into pEPR, so that recycled content incrementally attracts a lower pEPR fee rather than a separate tax with a 30% cliff edge, and removes the second registration, chain-of-custody documentation and the artificial clustering at the threshold;
- Rebase the pEPR fee away from weight, so that dense but recyclable materials such as glass are not penalised relative to lighter materials that are harder to recycle;
- Reduce the Landfill Tax standard rate to a level defensible as an externality charge, in the order of £15-30 per tonne, relying on enforcement and criminal penalties (while the incentive for illegal disposal should itself fall with a lower tax);
- Exempt quarry by-products and other secondary aggregate from the levy where they are reused as aggregate, removing the tax penalty on productive reuse (noting the boundary risk which would need to be managed - namely, what qualifies as secondary material versus primary stone).

Our objection to this approach, and why we prefer Option 1, is that just reforming the taxes preserves the compliance burden.

5.5 - Capital Gains Tax - addressing one of Britain's most complex and destructive taxes

Capital Gains Tax traps capital in existing assets, discourages entrepreneurship, and reduces investment in growing businesses. It is one of the UK's most destructive and complex taxes. Fundamental reform or outright abolition would help more savings flow into productive UK enterprise and increase wages, and support a stronger tax base for the future.

Key policy recommendations:

- → **Option 1 (preferred): Abolish Capital Gains Tax in two stages - initially exempting assets held for over three years, followed by full abolition supported by anti-avoidance rules to protect the income-tax base.**
- → **Option 2: Retain the existing CGT framework while reinstating inflation indexation, lowering rates for early-stage and growth equities, and expanding rollover/deferral relief.**
- → **Estimated 2027-28 cost of abolition: £10.4bn (0.7% of TME).**

Capital Gains Tax raises little revenue but imposes a large economic cost, including a 'lock-in' effect which prevents capital from moving to higher-productivity uses.

CGT was introduced in the UK in 1965, despite the 1955 Royal Commission on the Taxation of Profits and Income recommending that capital gains should remain untaxed.

The CGT regime is disproportionately complex for what is a tax which raises only a small share of total receipts (approximately £13bn in 2024-25, or 1.4% of the total), as taxpayers face record-keeping costs, accountant fees, software and valuation costs, and penalties for error.

Moreover, a large part of many taxable gains reflects inflation rather than an increase in real wealth. In many cases, the inflationary element can form more than 50% of the taxable gain. The Tax Foundation found that a US taxpayer who bought an average stock in 1999, 2000 or 2007 and sold in 2013 would have been taxed entirely on inflation[51].

A key economic harm of CGT is the 'lock-in' effect: people hold assets they would otherwise sell in order to avoid triggering a tax liability. Capital thus becomes illiquid and remains tied up rather than moving to its most productive use. The higher the rate, the stronger the incentive not to realise gains.

Workers also suffer through lower productivity and thus pay, as CGT lowers the post-tax return on capital, which reduces investment, in turn reducing productivity growth and wages.

Evidence shows that lower CGT increases investment, productivity, and wages.

Empirical evidence agrees with the economic theory: lower capital gains taxes increase the incentive to invest and recycle realised gains into new ventures.

---

[51] Tax Foundation, Inflation Can Cause an Infinite Effective Tax Rate on Capital Gains

Bank of England research by Alex Kontoghiorghes found that after AIM shares became eligible for ISAs in 2013, capital expenditure relative to pre-reform PPE increased by 43 percentage points and total pay relative to pre-reform revenue by 8 percentage points[52].

International evidence is also supportive: a Korean study found that companies experiencing a substantial CGT reduction increased corporate investment substantially within five years. Similarly, research across Swiss cantons by Kugler and Lenz found that cantons that abolished local capital gains taxes saw real income levels rise by 2.2% in the short run and 3.1% in the long run relative to cantons that retained them (with no evidence that the gains were merely driven by inter-cantonal relocation).

The revenue evidence is also consistent: higher CGT suppresses realisations and often reduces receipts.

Evidence on tax receipts is equally supportive: higher CGT rates suppress realisations and thus revenue.

The UK's own history is demonstrative: in 1988, the Conservative government raised the top CGT rate from 30% to 40%; receipts fell sharply over the following five years. During Tony Blair's government, CGT on business assets was progressively cut to 10%; revenues more than doubled by 2000-01.

Internationally, Ireland halved CGT from 40% to 20% in 1997, with net receipts rising from £132.4m in 1997 to £193.1m in 1998. The United States provides further evidence of this elasticity: the 2003 rate cut from 20% to 15% was followed by capital gains revenues rising from $56bn in 2003 to $110bn by 2006.

What makes CGT receipts so sensitive to the tax rate is that taxpayers control the timing of when gains are realised.

While outright, immediate abolition would incur a day-one fiscal cost, Adam Smith Institute modelling suggests that the tax will, over time, turn revenue-positive, once the effect on national income and wider tax receipts is incorporated.

CGT is especially damaging for start-ups, founders and growth companies.

Founders and growth companies depend on equity incentives. Early-stage companies often cannot compete with large incumbents on salary - they must attract founders, employees and investors by offering equity upside, which CGT reduces. This directly undermines entrepreneurship and risk-taking, as founders who take risk, forgo salary, build companies and eventually sell their stakes are taxed on the capital gain. Employees who accept equity or share options in lieu of higher cash salaries also see their potential upside eroded. Investors who back early-stage firms also face a lower post-tax return.

Countries without CGT protect their income-tax bases through specific anti-avoidance rules.

The main objection to CGT abolition is that taxpayers can simply convert income into capital gains. Countries without CGT manage this income-capital boundary through targeted rules. Moreover,

---

[52] Alex Kontoghiorghes, Do personal taxes affect investment decisions and stock returns?, Bank of England Staff Working Paper No. 988

the 'protection of the income tax base' argument is empirically weak, as countries without CGT do not generally have eroded income tax bases - see, for example, New Zealand, Switzerland, Singapore and Hong Kong.

The rules are targeted and well understood:

- Trading and profit-making schemes are treated as ordinary income, as in Singapore and Hong Kong;
- 'Badges of trade' tests - frequency, holding period, intent, financing and enhancement - are used to enforce the boundary between investment and trading;
- General anti-abuse rules and contemporaneous documentation requirements, including board minutes, investment memos and business plans, help distinguish genuine from disguised capital investment.

Targeted rules should apply where re-classification risk is high: property flipping, employment equity, high-frequency trading, and companies declaring labour income as dividends or capital proceeds. For example, Hong Kong provides a worked design example by offering upfront certainty for qualifying equity disposals.

Changes to CGT are not a 'tax cut for the rich' - they are supply side reform, which we expect to significantly increase productivity and wage growth.

While many may criticise CGT abolition as a tax cut for the rich, we reject this: Britain simply needs more investment, higher productivity and higher wages.

Indeed, both major parties have in the past reduced CGT. Tony Blair's reduction preceded a period of strong UK capital-markets activity, while Ken Clarke said in 1996 that "the Government [is] committed to reducing and then abolishing capital gains tax and inheritance tax".

Moreover, the political left has also not been uniformly hostile internationally: President Kennedy argued in 1963 that the tax on capital gains directly affects investment decisions, the mobility and flow of risk capital, and the ability of new ventures to obtain capital.

Furthermore, we reiterate that lower taxes on capital gains increase capital per worker, which in turn raises productivity and wages.

Option 1 (preferred): Abolish CGT in two phases, with anti-avoidance rules in place before full abolition.

One option, discussed at the working groups, is simply full abolition, in two phases to give time for anti-avoidance rules to be in place:

- Phase 1: gains on investments held for more than three years should be exempt from CGT, which immediately reduces lock-in for long-term investment and distinguishes investment from short-term trading, whilst also giving HMRC and the Treasury time to finalise anti-avoidance rules before full abolition;
- Phase 2: one year later, CGT should be abolished entirely, accompanied by the aforementioned anti-avoidance rules - badges-of-trade tests, the General Anti-Abuse Rule, documentation requirements, and rules for property flipping, employment equity, high-frequency trading in shares and crypto, and close-company income extraction.

We prefer this option for three reasons: 1) it removes a significant source of complexity in the tax code as well as economic distortion; 2) it addresses each of lock-in, taxation of inflationary gains; and 3) it offers certainty necessary to attract capital back to the UK (reliefs which depend on qualifying conditions can be narrowed or withdrawn by a future government, in contrast to abolition).

We estimate the fiscal cost of full abolition to be £10.4bn (0.7% of TME) in 2027-28, falling to £5.6bn by 2031-32 as realisations and the wider tax base respond[53].

Option 2: Retain the current CGT regime, but allow for indexation and provide further conditional reliefs.

A less costly alternative discussed across the working groups was to introduce a series of targeted reforms to the existing CGT regime. We considered the following measures:

- Indexing Capital Gains to Inflation: Reintroducing indexation, broadly mirroring the UK system between 1982 and 1998, so that purely inflationary paper gains are not taxed;
- Targeted Rate Reductions for Early-Stage and Growth Equities: Lowering the CGT rate across all investors backing early-stage ventures, unquoted growth companies, and AIM-listed businesses;
- Capital Gains Rollover and Deferral Relief: Allowing investors to defer CGT where proceeds are reinvested within a set timeframe into newly issued qualifying growth securities, with tax becoming due only when the replacement asset is sold (unless rolled over again), and offering more favourable treatment the longer an asset is held.

However, each of these targeted interventions has inherent limitations:

- Indexation offers little to dynamic growth: While straightforward for single, fixed assets like real estate, calculating indexation is significantly more complex for equity acquired in multiple tranches over time. More importantly, indexation does little for company founders: the vast majority of the equity value realised on an exit reflects genuine commercial growth and increased profitability rather than general inflation, meaning its benefits accrue primarily to long-term holders of physical property;
- Targeted rate differentials create distortion and instability: Carving out preferential rates for specific company tiers introduces arbitrary cliff edges and boundaries into the tax code;
- Rollover relief excludes key market participants: Deferral mechanisms benefit only existing asset owners who have already achieved an exit and wish to reinvest;
- Conditional rules undermine long-term confidence: Complex eligibility and qualification tests reintroduce the administrative burden and compliance overhead this report seeks to eliminate.

Rather than adding further layers of complexity to an already distorted regime, the simpler Option 1 provides the certainty required to unlock dynamic investment across the UK economy.

[53] Working group estimate to adjust for recently elevated receipts

5.6 - Corporation Tax - phase-down and radical simplification

Britain's Corporation Tax has become unnecessarily complex and internationally uncompetitive. A lower rate and simpler system (like Estonia's model, which only taxes disbursements) would encourage more businesses to invest, expand and locate in the UK, and dramatically reduce tax complexity.

Key policy recommendations:

- → **Phase 1: Reduce the headline corporation tax rate from 25% to 15% over eight years, following the Osborne pattern of pre-announced annual reductions.**
- → **Bring the corporation tax calculation closer to accounting profit, reducing the need for businesses to maintain a separate tax version of their accounts and departing from accounting standards only for defined anti-avoidance purposes.**
- → **Broaden and accelerate investment reliefs for new productive infrastructure, including factories, laboratories, data centres and energy assets.**
- → **Phase 2: From Year 8, transition to an Estonian-style distributed-profits model, taxing profits only when they are distributed rather than when they are retained and reinvested.**
- → **Calibrate the distributed-profits tax at an effective 15% rate (with Pillar Two top-up taxes retained for in-scope firms where applicable).**
- → **Protect pre-reform profits from double taxation via a retained earnings register, and provide transitional credits for existing trading losses and unrelieved capital allowances.**
- → **Introduce strict anti-avoidance rules for owner-managed companies, disguised distributions, owner loans, buybacks, capital reductions and conversion of income into capital.**
- → **Estimated 2027-28 cost of £19.5bn (1.3% of TME), and £20.2bn by 2031-32. Conditional on identification of savings of equivalent scale.**

UK corporation tax at 25% is internationally uncompetitive, fiscally suboptimal and hostile to reinvestment because it taxes profits before they can be retained and deployed for growth.

The UK's 25% headline corporation tax rate is uncompetitive. It places the UK in the upper tier of advanced-economy corporate tax rates, and well above the rate needed to remain attractive under the OECD Pillar Two framework.

This is fiscally suboptimal as well as economically damaging. For example, Ireland raises materially more corporation tax per head with a much lower headline rate, while after the United States cut its federal corporate tax rate from 35% to 21% in 2017, receipts initially dipped but then recovered above their pre-reform level. The UK's own Osborne-era reductions from 28% to 19% also showed that corporation tax receipts can grow despite the rate falling. The 2023 reversal back to 25% was therefore a mistake.

A more damaging issue is that the current system taxes profits annually before they can be retained and reinvested back into the business, for example through working capital, hiring, equipment, R&D or acquisitions.

The objective should be to move from a high-rate, complex-relief system to a lower-rate and simpler system. The 15% destination aligns the UK with the Pillar Two floor for large multinationals.

Phase 1 should reduce the headline corporation tax rate from 25% to 15% over eight years, following the Osborne pattern of pre-announced annual reductions.

Phase 1 should reduce the headline corporation tax rate from 25% to 15% over eight years. The reduction should be pre-announced, following the Osborne pattern of annual rate reductions between 2010 and 2017.

An indicative trajectory would reduce the rate from 25% to 22% at the start of Year 1, from 22% to 19% over Years 3-5, and from 19% to 15% over Years 5-8. This first reverses the 2023 increase, then moves the UK towards the 15% destination needed for international competitiveness and the later distributed-profits model we propose (see below).

A phased reduction is preferable to an immediate cut. An immediate move to 15% would create a very large upfront revenue cost: corporation tax raised nearly £100bn in 2025-26. Phasing spreads that cost across the period, allows dynamic effects to build, and gives businesses confidence that the direction of travel will be sustained.

Phasing also allows the simplification of reliefs, allowances and corporate gains to be sequenced alongside the rate cuts.

During Phase 1, the rate reduction should be accompanied by a series of simplifications to remove distortions and broaden investment reliefs.

The gradual rate cut should not ignore the complexity of the existing corporation tax regime, which should be addressed before Phase 2. The UK should move from a high-rate system with multiple reliefs, allowances and sector-specific carve-outs to a lower-rate system with a broader and simpler base.

<u>Legacy and sectoral reliefs</u>

At 25%, there is a stronger case for reliefs that reduce the effective tax burden on investment, intellectual property or favoured sectors. At 15%, much of this becomes less necessary.

The existing relief architecture - the Patent Box, creative industry reliefs, the R&D credit regime and various sector-specific carve-outs - should be reviewed against the 15% destination, as many of these schemes operate as payable credits rather than simple reductions in a tax liability, removing them in exchange for a lower headline rate could leave pre-profit and loss-making innovators worse off, since these mechanisms are better understood as subsidies delivered through the tax system. Whether to make them explicit subsidies is beyond the scope of this paper, though lower rates and fewer reliefs would nonetheless make the system more predictable.

<u>Aligning tax and accounting profits</u>

Corporation tax should also rely more heavily on accounting profit, rather than requiring businesses to maintain a separate tax version of their accounts. Estimates put the administrative burden of computing trading profits at around £350m a year, capital allowances at around £130m a year, and separately reporting property and investment income at around £70m a year[54].

[54] Office of Tax Simplification, Review of the competitiveness of the UK tax administration, 2014

Accounting treatment should be followed for tax purposes unless there is a clear reason to diverge, such as for anti-avoidance provisions, transfer pricing, the Corporate Interest Restriction (CIR), hybrid mismatch rules, and standard public-policy disallowances.

The change should be phased:

- Categorise existing tax adjustments by their policy purpose;
- Remove unnecessary adjustments where accounting treatment is sufficient - including repairs, renewals, low-value capital items, ordinary commercial provisions and unnecessary income streaming;
- Require future Finance Bills to justify new departures from accounting treatment.

HMRC should retain the power to challenge and override accounting treatments designed primarily to avoid tax, mandate the disclosure of material changes in accounting policy, and enforce robust connected-party, transfer-pricing, and general anti-avoidance rules.

Extending full expensing to productive structures and facilities

At the same time, investment reliefs should be broadened and accelerated for productive assets such as factories, laboratories, data centres, logistics facilities, and energy infrastructure. To ensure the tax system rewards genuine additions to the capital stock, relief should be reserved for new construction rather than acquired facilities. This should be targeted at productive business investment, not speculative assets such as residential property, land acquisition, passive letting and speculative development, which should remain outside the relief.

Phase 2, from Year 8, should transition to an Estonian-style distributed-profits model, taxing profits only when they leave the company, and not when they are retained and reinvested.

From Year 8, the UK should transition to an Estonian-style distributed-profits model. Under this approach, corporation tax is charged only when profits exit the company and are distributed to shareholders, not when they are retained inside the business. Tax is only triggered when value leaves the company through dividends, buybacks, deemed distributions or shareholder benefits.

For the UK, the distribution tax should be calibrated to an effective rate of 15%, matching the Phase 1 endpoint and the Pillar Two floor for large multinationals. This makes the transition fiscally manageable and avoids moving below the effective minimum rate applying to in-scope groups.

Year 8 is the right point for transition - not only will the headline rate have fallen to 15%, but it allows sufficient time for preparation for the new regime.

Pre-Year-8 retained earnings should be protected from double taxation. Profits already taxed under the annual system should not be taxed again when distributed after the transition. A retained earnings register would distinguish pre-reform tax-paid earnings from post-reform profits subject to the new distribution tax.

We argue for a distributed-profits model because it removes the tax drag on reinvestment and makes much of the existing corporation tax code redundant.

Under the current system, retained profits are taxed annually whether or not they are distributed, which undermines cash resources for working capital, hiring, equipment, R&D and acquisitions.

Under a distributed-profits model, retained earnings are not taxed until they leave the company. This removes the tax drag on reinvestment and gears the tax system towards increasing business investment, productivity and growth.

The simplification gain is equally important, as large parts of the existing corporation tax code become redundant - for example, many capital allowances, timing disputes, depreciation adjustments and relief structures.

The distributed-profits model only works with strict anti-avoidance rules with tough penalties, especially for owner-managed companies, disguised distributions, owner loans and the conversion of income into capital.

The main risk is that companies retain profits indefinitely and later extract them in another form, or extract value without declaring a formal dividend.

This is particularly acute for owner-managed companies, where owners could retain profits beyond the needs of the business, lend money to themselves, extract benefits through the company, or sell a company with accumulated earnings and treat the return as capital rather than income.

The rules should therefore tax disguised distributions as distributions. This should include owner loans not repaid within a short period, benefits provided to shareholders, transactions at undervalue, excessive remuneration, dividend stripping and restructurings designed to convert income into capital - with tough penalties for avoidance.

The Year 8 transition must protect accrued tax assets and close avoidance routes.

A retained earnings register should ensure profits taxed under the legacy regime are not taxed a second time upon distribution.

Existing trading losses and unused capital allowance pools also require protection; the cleanest approach is a time-limited transitional tax credit against future distribution liabilities.

To prevent tax avoidance, share buybacks and capital reductions must be classified as distributions. Similarly, anti-diversion and controlled foreign company (CFC) rules will be retained so multinational groups cannot use the regime to park profits untaxed in offshore entities.

The UK model must be calibrated around Pillar Two, using 15% as the effective floor for large multinationals while allowing the distributed-profits model to operate fully for smaller companies.

Pillar Two imposes a 15% effective minimum tax rate on large multinational groups.

For large groups, the model would need to operate alongside the Pillar Two regime, which under current rules may impose top-up tax on retained profits before distribution.

For businesses outside Pillar Two, including most UK companies by number, the distributed-profits model can operate more fully. Retained profits are untaxed until distribution, allowing smaller and growing companies to reinvest without an annual corporation tax bill.

International precedent suggests that distributed-profits models can strengthen corporate liquidity and reduce reliance on debt financing.

While jurisdictions like Ireland have long demonstrated how lower headline rates attract internationally mobile capital, Estonia shows that moving to a distributed-profits model matters just as much as the rate itself. Since Estonia introduced the distributed-profits model in 2000, empirical evidence has shown higher firm-level liquidity and reduced reliance on debt financing, with some evidence of positive effects on investment and productivity.

We estimate a fiscal cost of £19.5bn (1.3% of TME) in 2027-28 and £20.2bn by 2031-32, comprising both the rate reduction and the broadened investment reliefs. The rate reduction becomes progressively more expensive as the rate falls, though this is partly offset by the unwinding of the front-loaded expensing cost and by the wider revenue recovery building over time.

5.7 - Australia-style franking credits to encourage investment in UK equities

Profits should not be taxed twice. Restoring a dividend imputation system, similar to Australia's system of franking credits, would rebuild domestic investment in British businesses and support long-term economic growth.

Key policy recommendations:

- → **Introduce an Australian-style regime of refundable franking credits for UK pension funds receiving dividends from UK-resident companies from Year 1, crediting them for corporation tax already paid on distributed profits.**
- → **Phase in economy-wide refundable franking for all UK-resident retail shareholders from Year 8, alongside the transition to the 15% distributed-profits corporation tax model.**
- → **Estimated 2027-28 cost of the first phase: £0.5-1bn (<0.1% of TME).**

The UK currently double-taxes distributed corporate profits (through corporation and dividend taxes), which suppresses demand for UK equities.

Corporate profits in the UK are taxed twice: first through corporation tax on the company's profits, and then through income tax when those profits are distributed to shareholders as dividends.

This creates a high combined effective tax rate on distributed UK corporate income. For 2026-27, the combined rate is approximately 33% for basic rate shareholders, and over 50% for higher rate and additional rate shareholders. The corporation tax reductions proposed above reduce this burden materially, but do not eliminate the double taxation effect.

The current system weakens demand for UK equities. Retail investors face a higher combined tax burden on UK dividends than they would under an integrated system, while pension funds receive dividends paid out of post-tax corporate profits. Although pension funds are exempt from income tax on the dividends they receive, they no longer receive the refundable dividend tax credits available to them before 1997.

The current regime is one reason why UK pension funds have disengaged from UK equities. The 1997 reform was not the only cause of this decline, but it removed a major tax reason for pension funds to hold UK shares.

Recent attempts to increase pension-fund investment in UK assets have relied on mandation or quasi-mandation, which we oppose. The franking architecture we propose creates an *incentive* for UK savers and pension funds to own UK equities.

If the UK wants domestic capital to support domestic companies, it should make UK equity ownership more attractive for UK savers. Australia shows the effect of this kind of regime: its superannuation system invests around 30% of assets in Australian equities, in part because franked Australian dividends are inherently more tax-efficient for Australian investors than foreign equities.

Australia uses, and the pre-Brown UK system used, franking architectures to prevent both corporation and dividend taxes from applying to the same profits.

Australia has operated a dividend imputation system since 1987. When an Australian company pays corporation tax, the tax paid is attached to the dividend as a franking credit. The shareholder is taxed on the grossed-up dividend, but receives credit for the corporation tax already paid.

For example: a company earns £100, pays £25 corporation tax and distributes the remaining £75, the shareholder receives £75 in cash plus a £25 franking credit. The shareholder is treated as having received £100 of income, with £25 of tax already paid. If the shareholder’s tax liability is below £25, the excess credit can be refunded (if under a refundable system).

The UK operated a similar architecture before the Brown reforms. Under the Advance Corporation Tax system, companies paid tax when dividends were distributed, and shareholders received a dividend tax credit. Tax-exempt investors, including pension funds, could reclaim the credit as cash.

The 1997 reform removed pension funds’ ability to reclaim dividend tax credits, and ACT itself was abolished in 1999. The Australian system is therefore the closest modern comparator.

At the start, UK pension funds should receive a refundable franking credit for dividends paid by UK-resident companies.

Dividends paid by UK-resident companies to UK pension funds should carry a franking credit equal to the corporation tax paid on the underlying profits. The credit should be refundable, meaning HMRC pays cash to the pension fund where the credit exceeds the fund’s tax liability.

Companies maintain a franking account, recording corporation tax paid. When a dividend is declared, the company designates it as ‘franked’. The dividend voucher then shows the cash dividend, the franking credit and the grossed-up taxable amount.

The pension fund treats the franking credit as tax already paid. Because pension funds are generally tax-exempt, the credit will usually exceed any tax liability and be refunded as cash.

The credit should apply to UK occupational pension funds, both DB and DC, LGPS funds, and the Lifetime Investment Account we propose in Chapter 4.

The initial fiscal cost is modest, estimated at approximately £0.5-1bn per year[55]. This is a fraction of the dividend tax credits then paid to pension schemes and insurance companies before the 1997 reform, reflecting how dramatically pension allocations to UK shares have shrunk in the intervening decades.

This first phase should not apply to individual investors holding shares directly, non-UK shareholders, ISAs or other tax-exempt vehicles. Extending refundability beyond pension funds at the current 25% corporation tax rate would make the fiscal cost unaffordable for early implementation.

The long-run destination is economy-wide refundable franking, phased in from Year 8, once the Estonian corporation tax model is in place.

The long-run destination is an economy-wide refundable franking system for UK-resident shareholders.

Under this model, dividends paid by UK-resident companies carry a franking credit equal to the corporation tax paid on the underlying profits. UK-resident shareholders include both the cash dividend and the franking credit in taxable income, then use the credit against their personal tax liability. Where the credit exceeds the tax due, the excess is refunded.

The wider system should not begin on day 1. At the current 25% corporation tax rate, an economy-wide refundable system would cost significantly more than the pension-fund-only version. However, this cost falls as the corporation tax rate itself declines.

Wider coverage should therefore be phased in only once the corporation tax rate has fallen to 15%. At that point, the franking credit is materially cheaper per pound of dividend than it would be at the current 25% rate. It also aligns with the timing of the long-run distributed-profits model set out above, under which tax is paid when profits are distributed rather than while they are retained inside the company.

Foreign shareholders should not receive refundable franking credits, as the policy objective is to improve the tax treatment of UK savers investing in UK equities. This also limits the fiscal cost, given the large foreign ownership share of UK listed equities. The transition is therefore:

- Years 1-7: Refundable franking credits for UK pension funds only;
- Year 8: Corporation tax reaches 15%, distributed-profits model begins, refundable franking credits extend to UK-resident shareholders.

Could a credit system entrench 'dividend Britain?'

It is sometimes argued that relieving the double taxation of dividends would encourage companies to distribute cash rather than reinvest in growth, entrenching a low-investment, high-payout corporate culture. However, penalising distributions does not spur productive investment; it merely traps capital inside mature companies that lack high-return projects. An imputation system ensures surplus cash can be returned to domestic savers and pension funds without a punitive double-tax, allowing capital to be recycled across the wider market into new, high-growth opportunities.

[55] Working group estimate, based on current UK pension allocations to domestic equities

5.8 - A VAT-equivalent rate for Insurance Premium Tax

People should not be taxed more heavily for protecting themselves against risk. Reducing Insurance Premium Tax to a VAT-equivalent rate, while exempting private medical insurance, would make insurance more affordable and help reduce pressure on the NHS.

Key policy recommendations:

- → **Reduce the standard IPT rate progressively from 12% to a VAT-equivalent rate of around 3%.**
- → **Reduce IPT on travel insurance to 3%, and retain the 20% higher rate only where it serves its original anti-avoidance purpose.**
- → **Exempt private medical insurance from Insurance Premium Tax.**
- → **Estimated cost: £1.9bn in 2027-28, rising to £7.0bn in 2031-32, including the exemption of private medical insurance.**

Insurance Premium Tax has drifted from a VAT-equivalent charge into a high under-the-radar tax on prudence.

Insurance Premium Tax was introduced by Kenneth Clarke in 1993, taking effect in October 1994, at a standard rate of 2.5%.

The rate has since drifted upwards: successive chancellors have raised the standard rate, which covers core personal and commercial lines such as motor, home, healthcare, liability and commercial property insurance, from 2.5% to 4%, 5%, 6%, 9.5%, 10% and then 12%. The higher rate, originally introduced as an anti-avoidance measure against value-shifting from VAT-able goods into lower-taxed insurance and applying to travel insurance as well as warranties and insurance sold alongside vehicles and domestic electrical appliances, is 20%.

Date effective	Standard rate	Higher rate
Oct 1994	2.5%	-
Apr 1997	4.0%	17.5%
Jul 1999	5.0%	17.5%
Jan 2011	6.0%	20.0%
Nov 2015	9.5%	20.0%
Oct 2016	10.0%	20.0%
Jun 2017	12.0%	20.0%

The current standard rate now bears little relation to the VAT-equivalent rationale. IFS evidence to the Treasury Select Committee in 2016 argued that 12% was far above a reasonable proxy for VAT on insurance[56]. The current 12% rate is roughly five times the original level. The tax has become attractive to chancellors because it is poorly understood.

The tax is also administratively non-trivial: firms must determine whether contracts are taxable or exempt, apply either the standard or higher rate, apportion premiums where policies cover risks with different treatments, determine the location of risk, register within 30 days of intending to receive taxable premiums, file periodic returns, and manage interest and penalty exposure for errors or lateness. HMRC's own 2020 consultation on IPT administration acknowledged the burden and the case for simplification.

IPT suppresses insurance take-up, leaving households and businesses more exposed to shocks.

The core economic objection to IPT is that it discourages insurance take-up.

When premiums rise, households reduce coverage, raise excesses or stop insuring completely, leaving them more exposed to shocks. Smaller insurance pools also mean less risk-sharing across society.

This effect also applies to businesses: around £4.7bn of annual IPT falls on UK businesses. During 2025, 35% of SMEs reduced their insurance cover to save money[57].

Cyber insurance is a particular challenge: in 2025, 43% of UK businesses reported experiencing a cyber breach or attack in the previous year, while only 45% reported having some form of cyber insurance[58].

IPT can also affect business location and structure decisions. The working group discussed one case in which IPT was reported to have influenced a UK travel-insurance business's decision to relocate part of its sales operation to Ireland.

IPT is regressive and especially damaging for SMEs, where under-insurance can create wider economic risks.

IPT is regressive because it applies disproportionately to widely held compulsory or near-compulsory cover, particularly motor and home insurance. These are not luxury purchases.

The burden therefore falls hardest on lower-income households. Research published in 2022 estimated that the poorest decile of UK households spent 6.4% of disposable income on insurance, more than three times the share among the richest.[59]

This matters because, if households are priced out of cover, they become more vulnerable to theft, flood, fire, vehicle loss and other shocks. These costs re-emerge through arrears, public support, uninsured losses, lender losses, landlord disputes and slower recovery after adverse events.

The same issue applies to SMEs, which are less able to self-insure or absorb shocks.

[56] House of Commons Treasury Committee, oral evidence on Insurance Premium Tax, 2016
[57] British Insurance Brokers' Association, written evidence to Parliament, 2025
[58] Department for Science, Innovation and Technology, Cyber Security Breaches Survey 2025
[59] Association of British Insurers, IPT - A Tax on Protection, 2022

The UK's IPT rate is high by European standards, and its treatment of private medical insurance is unusually punitive. PMI should be exempted to reduce pressure on the NHS and support workplace productivity.

The UK standard rate of 12% is high by European standards.

The UK is also unusual in how it taxes private medical insurance (PMI):

- Germany, the Netherlands, Poland, Switzerland, the Czech Republic and Estonia impose no tax on health insurance;
- Spain, Ireland and Hungary exempt health insurance from IPT, though they apply a small, separate levy;
- The UK applies the full 12% standard IPT rate to PMI.

The case for exempting PMI is especially strong, given the direct effects on the NHS and labour market productivity:

- NHS pressure: PMI take-up reduces NHS demand - a CEBR study estimated that past IPT rises caused around 200,000 people to drop health insurance and move onto NHS care, with each additional one percentage-point rise in IPT producing approximately 31,500 cancellations and £21.5m of additional NHS cost[60];
- Workplace productivity: PMI is a significant workplace benefit, supporting faster diagnosis, treatment and return to work; IPT raises the cost to employers of providing this benefit, and smaller employers are particularly likely to drop it as premiums rise;
- Double taxation: employer-provided PMI is already taxed as a benefit-in-kind;
- International outlier: exempting PMI from IPT would align the UK with most comparable European countries.

Our recommendation is immediate PMI exemption. The working-group estimate of the gross cost is approximately £800m per year. We expect the cost to be partially offset by reduced NHS demand.

The standard rate should be phased down to around 3%, with the higher rate retained only for its anti-avoidance purpose.

The longer-run direction for the standard rate should be a VAT-equivalent rate. The IFS analysis suggests this is in the low single digits (around 2.5% or slightly above).

The reduction should be phased:

- From the current 12% standard rate, the rate should fall by 2 percentage points a year for four years, and by a final point thereafter, reaching 3% in the fifth year;
- We prefer phasing to an immediate cut to the standard rate given the expected fiscal cost. A phased approach aligns the reform with the broader fiscal trajectory of this chapter and allows the take-up response to build over time;
- We do not recommend full abolition: a VAT-equivalent rate of around 2.5-3% for IPT is intellectually defensible as a rough charge on the *services* component of insurance premiums (but there is no intellectual case for taxing insurance at 12%);

---

[60] Centre for Economics and Business Research, analysis of the impact of Insurance Premium Tax on private health insurance

- The higher (20%) rate should be retained only for insurance sold alongside VAT-able goods, where it prevents value-shifting out of the VAT base. Travel insurance should fall to 3%.

We estimate the cost of the package at £1.9bn in 2027-28, rising to £7.0bn in 2031-32.

5.9 - What if Britain rebuilt the tax code from scratch?

While the reforms in this chapter would roughly halve the existing tax code, half of a huge tax code is still huge. A genuinely simple tax code would require writing a new one from scratch; incorporating our reforms, we estimate this could be around a fifth in length of the current code.

Key policy recommendations:

→ **Establish a time-limited Tax Code Commission to draft a replacement code from first principles.**

→ **Replace the existing tax statutes with a small number of streamlined Acts.**

→ **Enact a General Tax Act to cover common definitions, the general framework, and anti-avoidance.**

→ **Policy support should be delivered through direct spending and should no longer rely on the tax system.**

→ **Phase the implementation tax by tax over a realistic multi-Parliament horizon to match likely speed of HMRC delivery.**

The reforms above remove major distortions and complexities from the existing tax code and could reduce it by around 40-50%. However, half of a vast tax code is still vast.

We have reviewed key taxes to assess which legislation would fall away under the reforms proposed in this chapter.

Our indicative estimate[61] is that these changes we propose could reduce the length of the existing tax code by approximately 40-50%.

While halving the statute book represents a radical shortening of the current tax code, it would still leave Britain with half of one of the longest and most complicated tax codes in the world. Fifty per cent of 20,000-plus pages is still 10,000-plus pages.

A total redesign is likely the only way to get to a genuinely simple tax code.

We have therefore asked what the minimum legislation required is for Britain to raise the revenue it needs, taking into account our proposals above. Rather than continuing to amend legacy statutes, this means redrafting a new tax code from first principles: defining each tax base clearly, applying a small number of rates, harmonising definitions across the code, and legislating only the essential rules needed to calculate liabilities and prevent abuse.

[61] Working group analysis, AI assisted

A replacement code would be a fraction of the length of the current one - our indicative estimate is roughly a fifth.

Our indicative estimate[62] for the length of a redesigned tax code is:

- The core Acts of Parliament: 700-1,100 pages;
- The whole tax rulebook (rules underneath the Acts): 3,300-4,800 pages.

Note we assume the OECD's global minimum tax framework and Transfer Pricing Guidelines remain unchanged in a new tax code. Together, these comprise approximately 2,000 pages in length.

One possible architecture could comprise eight statutes, in place of the current tax Acts and the decades of subsequent Finance Acts:

1. A General Tax Act - with details such as common definitions, penalties, appeals, taxpayer protections and anti-avoidance; then short Acts for each of
2. Personal income;
3. Business profits;
4. International tax;
5. VAT;
6. Duties and charges;
7. Property and local taxes; and
8. Devolved administrations.

It should be noted that the largest component of the residual material is international - the OECD's global minimum tax rules (including associated commentary and guidance), and the OECD Transfer Pricing Guidelines - at around 2,000 pages, which Britain cannot unilaterally materially change.

This should not become an exercise in shortening primary Acts only to shift text into secondary legislation; the overall volume of statutory rules would fall by an equivalent scale. Furthermore, the residual body of binding guidance should be small, at a few hundred pages of clear safe harbours and clearances, rather than creating a shadow tax code (a vast second tier of HMRC interpretation manuals).

A programme of this ambition requires a clear implementation and transition plan.

Delivering this overhaul without disrupting the process of revenue collection will depend on the following steps:

- A time-limited Tax Code Commission, responsible for producing the replacement tax code;
- A scope of which taxes will remain before drafting begins;
- A core General Tax Act as well as the separate shorter Acts, as outlined above;
- The parallel redesign of HMRC systems, forms and data requirements;

[62] Working group analysis, AI assisted

- Safe harbours, combined with harder sanctions for deliberate avoidance;
- Phased implementation, tax by tax.

On timing, a key constraint is HMRC's delivery capacity rather than Parliamentary drafting. However, Parliament can provide the overarching framework while HMRC phases in the new systems tax by tax over a realistic transition period.

Chapter 6: Implementation

6.1 - Sequencing of reforms

Many of the reforms in this paper depend on others being in place first. A clear implementation plan will significantly increase their chances of success.

6.2 - Quick and effective legislation

Parliamentary time is a scarce resource: preparing legislation in advance and making greater use of existing powers will maximise the chances of delivering most of the reforms within a single Parliament.

6.3 - Civil Service capabilities and incentives

Delivering an ambitious reform agenda requires shifting Civil Service culture away from procedural caution, and providing it with the specialist capabilities and performance incentives needed to execute the reforms in this paper.

> "Government cannot be a place where good ideas simply wither away."

6.1 - Sequencing of reforms

Many of the reforms in this paper depend on others being in place first. A clear implementation plan will significantly increase their chances of success.

Key policy recommendations:

→ **Deliver reforms in three phases: 'day one' administrative actions, first-session primary legislation, and longer-term multi-year transitions.**

→ **Complete legislative drafting and institutional engagement before taking office, so implementation can begin from day one.**

Most of the reforms in this paper can be pursued in parallel, but there are a number of critical dependencies to manage.

While many of the reforms in this paper can be legislated and pursued in parallel, there are several critical dependencies that will dictate the order of execution.

Key dependency groups include:

- Pensions and savings: the Lifetime Investment Account system (introduced in Chapter 4) is a critical dependency: public-sector schemes cannot be closed to new entrants until the Account infrastructure is in place, while the State Pension's role cannot evolve toward a means-tested floor until higher auto-enrolment rates can be expected to deliver adequate retirement income. Similarly, the Strategic Investment Vehicle cannot start to accept revenue from the LGPS pools until the Treasury covenant and pooling reforms are ready.
- Demand side: the effectiveness of the pre-IPO and AIM reforms will largely depend on the demand side reforms proposed throughout the project, especially the tax reforms as set out in Chapter 5 (franking credit, corporation tax, capital gains tax, inheritance tax).
- Institutional reform: regulators cannot move from a precautionary approach to an outcomes-based regime until Parliament establishes its explicit risk appetite framework and ministers issue binding mandate letters.
- Tax: measures such as the Estonian distributed-profits model for corporation tax depend on the preceding eight-year corporation-tax transition down, while the statutory test of self-employment which replaces IR35 cannot itself fall away until the differential with employed NI is phased out.
- Fiscal discipline and spending savings: no major tax measure which incurs an upfront cost can commence until equivalent public spending reductions have been formally identified and scheduled (Chapter 5).

Such primary dependencies form the basis of the delivery plan set out in this chapter.

Split the reforms into measures which 1) can take effect almost immediately, 2) require first-session primary legislation, and 3) take place over at least the length of the Parliament.

The reforms can be delivered across three phases, depending on the type of legislation required:

- What can be done on or close to day one without primary legislation, such as the publication of the mandate-letter framework as policy intent, the pause to Making Tax Digital, and freefloating Civil Service pay (see below). Several of the 'day one' tax measures also fall here, announced immediately and legislated in the first Finance Bill.

- First-session legislative programme - reforms which need primary legislation and can realistically reach Royal Assent within two years. Examples include the financial regulation bill carrying the risk-appetite framework, mandate letters and establishment of the Parliamentary standing committee, the LGPS reform bill, and Treasury split. The limiting constraint is Parliament's time, with reforms dependent on a quick and effective legislative process.
- Reforms that are implemented over the course of a Parliament or longer - such as the eight-year corporation-tax glide path, and the ramp of auto-enrolment contributions and the corresponding taper down of National Insurance and the State Pension. Some reforms will be completed over decades.

Much of the preparatory work can be done before enacting it in office - this includes engaging the regulators and Civil Service (within the limits convention allows), in order that institutions are ready and legislation is drafted to implement the agenda.

Each of the four working groups is strongly of the view that, for this project to be worthwhile and implementable, that preparation should take place before it is implemented in office. This includes drafting the legislation and engaging with the institutions it will depend on.

Indeed, much of the necessary preparation does not require legislation nor access to office: regulators can be engaged on the reforms that affect them, not only to refine the proposals but also build the goodwill to facilitate early delivery.

Unless the serving government wishes to adopt the proposals set out in this paper, civil servants cannot be tasked with developing them for an opposition. Pre-election access talks can, however, be used to brief officials on likely organisational or policy changes ahead of a general election. The serving government could choose to relax this - for instance by permitting recorded, published contact with opposition teams.

Undertaking this preparation work is essential to making what is an extensive scope of reforms credible for delivery.

Keir Starmer's government of 2024-26 illustrates the cost of not preparing: it took office without a worked-up delivery plan (as its own advisers have since acknowledged) and spent its opening months developing policy rather than implementing it.

Universal Credit reform and the need to prepare for Civil Service engagement
The experience of Universal Credit is instructive. Iain Duncan Smith arrived at the Department for Work and Pensions in 2010 with detailed policy work, but this had been developed without formal input of the officials who would later be responsible for implementation. The department was therefore required to absorb a large body of externally developed work after the 'clock' had already started, with a limited number of special advisers available to help officials understand it. Effective delivery depends not only on the Civil Service having the necessary capability, but also on a future government entering office with a worked-up delivery plan - prepared in opposition using operational and legislative drafting expertise, as well as authorised pre-election contacts where available.

6.2 - Quick and effective legislation

Parliamentary time is a scarce resource: preparing legislation in advance and making greater use of existing powers will maximise the chances of delivering most of the reforms within a single Parliament.

Key policy recommendations:

→ **Draft core bills and drafting instructions prior to entering office (or adopting the agenda if in office), using experienced parliamentary counsel and AI to mitigate risks of pre-legislative delays.**

→ **Reserve primary legislation for only major reforms and maximise the use of administrative action and order-making powers. Provide for amendable statutory instruments to mitigate House of Lords resistance while preserving delivery speed.**

→ **Secure upper-house passage by being explicit about policy intentions and trade-offs in a manifesto.**

A future government should prepare its legislation in advance, closing the gap between taking office (or adopting this agenda) and introducing its first bills, while protecting scarce parliamentary time by delivering as much of the programme as possible through secondary legislation and administrative action.

Parliamentary time is a key limiting factor. Indeed, the last session of Parliament ran out of time to deliver the government's agenda. Two principles are essential to ensure a future government can deliver its objectives without running out of time:

- Reserve primary legislation for only where it is absolutely necessary - much can be achieved without it through administrative action (ministerial remit letters, published guidance, policy directions, and operational changes under existing executive powers) or through secondary legislation and statutory instruments made under powers which already exist.
- Enter office with legislation already substantially drafted - using external legislative drafting expertise before taking office, reducing the delay that can otherwise arise before a bill is ready to introduce. (This does not speed a bill's passage through the two Houses, which is addressed separately, below.)

Securing order-making powers early lets a government make later changes without fresh primary legislation each time. Any potential resistance from the Lords can be mitigated by allowing the subsequent orders to be amended.

If protecting scarce parliamentary time is a key objective in this chapter, how can a government make later changes without returning to Parliament each time? We argue that a government should take 'order-making' powers in the first session - provisions in an initial Act that authorise ministers to make specified later changes by secondary legislation, without returning to Parliament for a fresh bill on each occasion.

However, the House of Lords is likely to be instinctively resistant, understandably viewing this as the executive reserving the ability to make significant changes without proper scrutiny.

This is addressable by an amendable statutory instrument (a statutory instrument is normally unamendable, as either Parliament approves or rejects it). However, enabling legislation can provide for statutory instruments to be amendable: offering the Lords the ability to scrutinise and amend the orders made under these powers allows them to scrutinise whilst allowing the government to make fast reforms.

While drafting legislation in advance is specialist work, a small team of experienced parliamentary counsel using AI can prepare a programme of this scale, quickly.

Drafting legislation is highly specialist work, and the expertise sits overwhelmingly inside the Office of the Parliamentary Counsel (OPC), which is only available to a serving government. Preparing a programme of this scale might therefore seem beyond reach for an external policy team.

However, the necessary expertise can be recruited: some OPC lawyers move on to private practice, and a small number of these can be brought in to lead the work. Moreover, the raw material of the work is in the public domain: the whole body of existing legislation and the full record of parliamentary debate are freely available, which means AI can now perform a substantial share of the preparatory analysis which would previously have consumed most of a specialist's time.

Can AI help with legislative drafting?

The raw material of legislative drafting is all in the public domain: existing legislation can be sourced at legislation.gov.uk, while the full record of parliamentary debate is on Hansard, which means a small team of ex-OPC experts with access to AI can begin work. Two tasks in particular can be accelerated: 1) Mapping the consequential amendments a reform might need, to establish which existing provisions elsewhere in legislation would need to be amended as a result, where AI can produce a first pass for lawyers to review; 2) anticipating the amendments a bill will attract in passage: because Hansard records how both Houses amended past bills, AI could be trained to recognise those patterns and war-game a new bill's likely challenges before it is introduced to help the lawyers plan accordingly.

Putting as much of the agenda as possible into a manifesto is the most reliable way to secure passage through the Lords, even if this means being candid about trade-offs.

While the unelected House of Lords can obstruct a government's legislative agenda, the most reliable protection against this is via a manifesto on which the programme is taken to the electorate - by convention, the Lords will not block measures on which a government has been explicitly elected. We thus argue against the temptation to keep a manifesto short and to leave the difficult or technical detail for later.

It follows that trade-offs should be stated in a manifesto rather than implied, as this programme contains several potentially controversial measures for which trade-offs will need to be stated and sold to the public.

However, we see candour not only as a virtue but as a vital part of implementing these reforms successfully and bringing the public along.

(If a serving government wishes to adopt any of the measures in this paper, this protection does not apply; the government will need to build cross-party consensus and argue each reform on its merits to secure passage through Parliament.)

Delivering a programme of this scale also demands effective direction from the centre - this requires decisive Prime Ministerial authority, a Cabinet Office minister driving the legislative timetable, and a designated senior minister personally accountable for the passage of each key bill.

A programme of this scope will inevitably come up against inertia and competing demands for time - delivery will depend on three factors:

1. The Prime Minister's buy-in - must regard it as central to the government's mission - without this, core policies risk being traded away as difficult political choices arise;
2. A powerful minister in the Cabinet Office - responsible for driving the legislative programme and trusted by (and with direct access to) the Prime Minister - the Cabinet Office is the natural home for this, with a central role in the government's legislative programme, with a senior minister there driving the programme through and resolving conflicts;
3. A senior minister accountable for each major bill - given the volume of legislation, each of the principal bills needs a minister who takes ownership of it to argue its case through both Houses of Parliament.

6.3 - Civil Service capabilities and incentives

Delivering an ambitious reform agenda requires shifting Civil Service culture away from procedural caution, and providing it with the specialist capabilities and performance incentives needed to execute the reforms in this paper.

Key policy recommendations:

→ **Reform Civil Service leadership, training and incentives so officials are rewarded for successful delivery rather than risk avoidance and process compliance.**

→ **Recruit and retain specialist capability through market-competitive pay, with strong performance management.**

→ **Reduce churn and departmental silos by rewarding long-term ownership and developing deeper expertise.**

The current Civil Service system must evolve from one which incentivises process over ownership and risk.

Most if not all of the reforms throughout this paper depend on successful delivery by the Civil Service. However, under the current incentive structure, success is often defined as avoiding error

- consistent with the wider institutional risk aversion we outline in Chapter 1. Rational individuals therefore do less and act more cautiously than what is required to deliver the reforms outlined in this paper.

While this paper does not and cannot attempt a full Civil Service reform programme - a priority for a separate paper - the working groups repeatedly outlined the importance of a minimum set of changes in order to maximise the likelihood of successful delivery.

This is first and foremost a matter of leadership and training: ministers and civil servants alike must become comfortable with weighing risk (including that of inaction) and reward.

Civil Service terms and conditions are mostly not statutory, and can be changed by the government. In addition to new legislation, success is dependent on leadership. This means ministers and permanent secretaries should be explicit in their expectation that officials weigh the risk of inaction as seriously as the risk of acting.

The core problem is that risk is assessed on one side only: officials identify what might go wrong with a course of action, but not the cost of doing nothing - even though there is often greater risk associated with inaction.

This is also a training question: civil servants need to assess risk proportionately, rather than listing everything that might go wrong regardless of likelihood, while ministers need to take ownership of their decisions alongside engaging with official advice. But there is precedent for resistance to such training: a 1990s proposal to train incoming ministers was reportedly blocked by permanent secretaries reluctant to cede control.

If the reforms are framed as freeing capable civil servants to do their jobs more effectively, support for the reforms can be achieved. The greatest obstacle is a culture of caution.

The reforms must be presented as they are intended - namely, freeing capable civil servants to do their jobs and rewarding those who deliver. They must not be presented as an attack on the workforce.

The greater obstacle is instinctive caution - officials anticipating what ministers want. This is why building positive buy-in is more effective than merely managing any anticipated resistance: ministers must engage senior civil servants early and demonstrate how these reforms will give them the autonomy and authority needed to deliver.

Our reform programme depends on specialist roles, and thus pay must compete with the regulators and the private sector. Moreover, higher pay must come with effective performance management.

Several reforms in this paper require specialist skills the Civil Service currently lacks in sufficient depth - for example, writing and evaluating regulator mandates, LGPS reform, structuring the Strategic Investment Vehicle, and initiating the DC super system. Yet, the current Civil Service pay scale does not match those of the regulators and private sector, despite competing with them for resources.

Regulators which have been held to Civil Service pay have suffered. In contrast, Singapore is demonstrative of a successful model, which pays senior public roles at parity with the private sector. As Civil Service pay is a convention (rather than law), market-rate compensation for specialist roles can be a ‘day one’ reform.

Of course, higher pay is only defensible if matched by effective performance management. Working-group participants reported that removing an underperformer can involve a line manager, HR officer, a lawyer and a caseworker and take 12-18 months. Underperformance is thus worked around rather than addressed. Equally, selection for key roles cannot be built around criteria such as behavioural competencies, rather than demonstrated experience.

The same applies to non-executive appointments. Board fees at public bodies are effectively held to around £600 per day (though this is a convention which is applied selectively, since HS2 and many local authorities pay well above this).

The Civil Service's system of silos, and the churn of ambitious staff who must change jobs to progress, must be reformed so that expertise can deepen and a culture of responsibility for the reforms can develop.

A known challenge with the Civil Service is silos, where work is divided between departments in ways that prevent the cross-departmental coordination the success of this programme will depend on.

An additional challenge is churn - civil servants are not rotated by design, but since a common route to progress or earn more is to change jobs, the ablest keep moving and rarely build deep expertise.

Churn also blurs accountability: when many people pass through a project, nobody owns it, with the title ‘Senior Responsible Owner’ only loosely applied. The solution is to make staying and ownership worthwhile - including progression and higher pay within a role, bonuses deferred and tied to a specific project so reward tracks eventual success, as well as a named senior owner.

Again, much of this requires no new legislation - the required changes are administrative. Equally, the Civil Service's effective monopoly on policy is, likewise, convention: the government can and must bring in external teams to work alongside officials on legislation prepared in advance - provided, as Universal Credit showed, the two are integrated early rather than handed over cold.

Further sources

The primary source for this report is the experience and expertise contributed through the project's working groups. The publications, official materials and other sources listed below are a non-exhaustive selection that informed many working group discussions. They are included to acknowledge relevant external ideas. Sources already cited in footnotes or identified directly in the body text are generally not repeated here.

- Allica Bank - Rebooting SME Finance
- Asian Monetary Monitor, Section II (1977)
- Australian Government Treasury - Understanding the economy-wide efficiency and incidence of major Australian taxes (2015)
- Bank for International Settlements - Credit to the non-financial sector database
- Bank of England / PRA - MREL Statements of Policy
- Bank of England / PRA - SME and infrastructure lending adjustments / Basel 3.1, including PS7/25
- Barclays - Fiscal Headroom (April 2026)
- Boston Consulting Group - The UK Financial Services Sector Has Lost Its Edge - Here's How to Win It Back (25 May 2026)
- Brunel University, Department of Economics - Tax complexity: impact on UK competitiveness and growth (2026)
- Business Growth Fund - impact data, investment milestones and parliamentary submissions
- British Private Equity and Venture Capital Association - Performance Measurement Survey; Report on Investment Activity; Venture Capital in the UK; Pensions & Private Capital material
- Corfe, Scott; Hyde, Richard; and Rana, Kishan – Insuring a Return: A role for health and protection insurance in helping the long-term sick get back to work, Social Market Foundation (2021)
- Eurostat - Economic and financial-sector data
- FATF - United Kingdom Follow-Up Report (2022) and related assessments
- Fabian Review - Treasury on Trial (Summer 2014)
- Frontier Economics - The Impact of Air Passenger Duty on Airline Route Economics (2018)
- GOV.UK - Lord Maude review (2023)
- Haigh, Louise - A new fiscal framework to renew Britain, Renewal, Volume 34, Special Issue
- Hansard - Economic Affairs / George Brown (4 November 1964)
- Hansard - Stafford Cripps as Minister for Economic Affairs (23 October 1947)
- Henide, Karim - The overlooked costs of ESG investing: The societal consequences of ESG-driven investment distortions, CFABB
- HM Treasury - Post-implementation review of the Bank Referral Scheme (2024)
- House of Commons Business and Trade Committee - Investing in the UK Economy
- House of Commons Business and Trade Committee - Industrial Strategy (2025)
- House of Lords Financial Services Regulation Committee - Private markets: Unknown unknowns and related evidence
- House of Lords Science and Technology Committee - scale-up/public investment bodies (2025)
- Investment Association - Investment Management in the UK surveys
- IPPR - analysis of UK business investment as a share of GDP and capital intensity
- IPPR - Why we need a British Investment Bank (19 September 2012)
- Kerslake Review - Rethinking the Treasury (February 2017)
- KfW - programme materials and comparative analysis
- KPMG - European/UK banks profitability analyses, including State of the Banks reports
- Labour Party - A National Investment Bank for Britain (2017)
- Liberal Democrats - Department for Growth proposal (11 February 2026)

- Lowry, Sean - Digital Services Taxes: Policy and Economic Analysis, Congressional Research Service Report R45532 (2019)
- National Audit Office - The administrative cost of the tax system (2025)
- New Financial - analyses of UK pension funds' domestic equity allocations
- New Financial - The New Financial International Financial Centres Index (July 2026)
- OECD - Inheritance Taxation in OECD Countries, OECD Tax Policy Studies No. 28 (2021)
- OECD - Structural Analysis (STAN) Database
- OECD - Taxation of Capital Gains of Individuals: Policy Considerations and Approaches, OECD Tax Policy Studies No. 14 (2006)
- Oxford Economics - Assessing the impact of proposed reforms to the non-dom regime (2024)
- Oxera - Stamp duty: its impact and the benefits of its abolition (2007)
- Palmer, Mitchell - Stamped Out: The Economics of Abolishing Stamp Duty on Primary Residences, Adam Smith Institute (2025)
- Parsons, Mark - The Effect of Corporate Taxes on Canadian Investment: An Empirical Investigation, Department of Finance Canada (2008)
- Patient Capital Review - Sir Damon Buffini (2017), and subsequent British Patient Capital evaluations
- PoliticsHome - Jonathan Rutherford / Blue Labour (3 May 2025)
- PwC - The economic impact of air taxes in Europe (2017)
- Schratzenstaller, Margit - Behavioural Responses to Inheritance Taxation: A Review of the Empirical Literature, WIFO Working Papers 668/2023 (2023)
- Tax Policy Associates - How to reform income tax: end the high marginal rate scandal (2024)
- TaxPayers' Alliance - Digital services tax (2025)
- TheCityUK with PwC - No Time to Lose: Reasserting UK Leadership in Financial and Related Professional Services
- TheCityUK - Mobilising private capital at scale to plug the UK's infrastructure investment gap
- UK Finance - Business Finance Review, 2025 Q4
- UK Finance - Plan for Growth: From Strategy to Delivery
- US Small Business Administration - Small Business Investment Company programme materials
- WPI Economics - The costs of increasing Insurance Premium Tax (2025)
- Young, Peter - Trimming Taxes: The Case for Cutting Capital Gains Tax, Adam Smith Institute (October 2024)

About CFABB – Centre for a Better Britain

CFABB - Centre for a Better Britain is an independent think tank dedicated to developing practical, world-class policy ideas to support a stronger, more prosperous United Kingdom.
Through research, discussion and collaboration with policymakers, industry leaders and experts, CFABB aims to contribute credible policy solutions that promote economic growth, innovation and long-term national success.

www.cfabb.uk