Summary: Intervention & Options

Department /Agency:	Title:	
HM Treasury	Impact Assessment of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2010	
Stage: Final Proposal	**Version:**	**Date:** 15 January 2010

Related Publications: Legislative framework for the regulation of alternative finance investment bonds (sukuk); and summary of responses

Available to view or download at:

http://www.hm-treasury.gov.uk/consult_sukuk.htm

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What is the problem under consideration? Why is government intervention necessary?

At present, sukuk or Islamic bonds are regulated either as collective investment schemes (CIS) or conventional bonds. The application of CIS regulations is disproportionate and creates a higher regulatory burden. Informal consultation with industry has indicated that this is holding back the issuance of sukuk in the UK.

The main benefit of the proposals to treat AFIBs as conventional bonds is to provide clarity about the regulatory treatment and compliance costs for AFIBs and thus facilitate UK issuance of these instruments.

What are the policy objectives and the intended effects?

The objective is to ensure that innovative financial instruments are treated in a similar way to existing financial products with similar economic characteristics. In this instance, introducing the legislative change will ensure AFIBs are subject to proportionate regulatory treatment compared with conventional bonds.

What policy options have been considered? Please justify any preferred option.

Option 1: Introduce legislative amendments explicitly to exempt these instruments from CIS regulations and create a new specified investment under the Regulated Activities Order (RAO) , and introduce a unique regulatory definition of AFIBs for this purpose. This was the preferred option stated in two consultation phases, and has broad support from the industry.

Please see Annex A for justification and a list of the further options considered.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

HM Treasury will review the rules in two years' time in order to ensure that the regime is functioning as intended.

Ministerial Sign-off For SELECT STAGE Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: .... Sarah McCarthy-Fry

Date: 18 January 2010

Summary: Analysis & Evidence

Policy Option: 1	Description: Introduce legislative amendments explicitly to exempt these instruments from CIS regulations and create a new specified investment unde

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	FSA: Approximate £175,000 costs related to upgrading the FSA's technology platforms due to the creation of a new specified investment
£ 175,000	1	AFIB issuers: Approximate £10,000 one-off cost for issuers from being listed as a debt security.
Average Annual Cost (excluding one-off)		
£		**Total Cost** (PV) **£ 175,000**

Other **key non-monetised costs** by 'main affected groups' Consumers: Low risk of the legislative changes leading to regulatory arbitrage. It is proposed that AFIBs should be subject to a mandatory listing requirement as this will enhance transparency.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	AFIB issuers: Between £5,000 and £10,000 reduction in ongoing costs per issuance per annum. For an AFIB of duration five years, total cost savings for an issuance are estimated to be around £35,000.
£		
Average Annual Benefit (excluding one-off)		
£ 5,000 - 10,000		**Total Benefit** (PV) **£ 45,000 per issue**

Other **key non-monetised benefits** by 'main affected groups' Issuers: Greater flexibility in choice of assets, and greater scope to securitise assets. Benefits from no longer being classified as a CIS. Investors: extra opportunities to diversify asset porfolios.

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) **£ (175,000)-35,000per issue**	**NET BENEFIT** (NPV Best estimate) **£**

What is the geographic coverage of the policy/option?			All of the UK	
On what date will the policy be implemented?			24 February 2010	
Which organisation(s) will enforce the policy?			FSA	
What is the total annual cost of enforcement for these organisations?			£ no extra cost	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			Yes	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			Yes	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ Decrease of £ **Net Impact £**

Key: **Annual costs and benefits: Constant Prices**

Summary: Analysis & Evidence

Policy Option: 2	**Description: same as option 1 but AFIBs will be defined by the existing tax definition**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	FSA: Approximate £175,000 costs related to upgrading the FSA's technology platforms due to the creation of a new specified investment AFIB issuers: Approximate £10,000 one-off cost for issuers per issuance from being listed as a debt security.
£ **185,000**	1	
Average Annual Cost (excluding one-off)		
£		**Total Cost** (PV) £ **185,000**

Other **key non-monetised costs** by 'main affected groups' Consumers: Low risk of the legislative changes leading to regulatory arbitrage. It is proposed that AFIBs should be subject to a mandatory listing requirement as this will enhance transparency.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	AFIB issuers: Between £5,000 and £10,000 reduction in ongoing costs per issuance per annum. For an AFIB of duration five years, total cost savings for an issuance are estimated to be around £35,000.
£		
Average Annual Benefit (excluding one-off)		
£ **5,000 - 10,000**		**Total Benefit** (PV) £ **45,000 per issue**

Other **key non-monetised benefits** by 'main affected groups' Issuers: Greater flexibility in choice of assets, and greater scope to securitise assets. Benefits from no longer being classified as a CIS. Investors: extra opportunities to diversify asset porfolios.

Key Assumptions/Sensitivities/Risks The definition of an AFIB could change for tax-specific reasons. It would not be possible to make regulation-specific changes to the definition. There would be a risk of future regulatory and legal uncertainty, reducing the incremental benefit to issuers.

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) £ **(175,000)-35,000per issue**	**NET BENEFIT** (NPV Best estimate) £

What is the geographic coverage of the policy/option?	All of the UK			
On what date will the policy be implemented?	24 February 2010			
Which organisation(s) will enforce the policy?	FSA			
What is the total annual cost of enforcement for these organisations?	£ no extra cost			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	Yes			
What is the value of the proposed offsetting measure per year?	£ N/A			
What is the value of changes in greenhouse gas emissions?	£ N/A			
Will the proposal have a significant impact on competition?	Yes			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ Decrease of £ **Net Impact** £

Key: **Annual costs and benefits:** **(Net) Present**

Summary: Analysis & Evidence

Policy Option: 3	Description: same as option one but include AFIBs under the existing specified investment of 'creating or acknowledging indebtedness'

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	AFIB issuers: Approximate £10,000 one-off cost for issuers per issuance from being listed as a debt security. With this option, there would be no costs associated with upgrading the FSA's technology platforms.
£ 10,000 per issue	1	
Average Annual Cost (excluding one-off)		
£		**Total Cost** (PV) **£ 10,000 per issue**

Other **key non-monetised costs** by 'main affected groups' Consumers: Low risk of the legislative changes leading to regulatory arbitrage. It is proposed that AFIBs should be subject to a mandatory listing requirement as this will enhance transparency.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	AFIB issuers: Between £5,000 and £10,000 reduction in ongoing costs per issuance per annum. For an AFIB of duration five years, total cost savings for an issuance are estimated to be around £35,000.
£		
Average Annual Benefit (excluding one-off)		
£ 5,000 - 10,000		**Total Benefit** (PV) **£ 45,000 per issue**

Other **key non-monetised benefits** by 'main affected groups' Issuers: Greater flexibility in choice of assets, and greater scope to securitise assets. Benefits from no longer being classified as a CIS. Investors: extra opportunities to diversify asset porfolios.

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) £	**NET BENEFIT** (NPV Best estimate) **£ 35,000 per issue**

What is the geographic coverage of the policy/option?			All of the UK	
On what date will the policy be implemented?			24 February 2010	
Which organisation(s) will enforce the policy?			FSA	
What is the total annual cost of enforcement for these organisations?			£ no extra cost	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			Yes	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			Yes	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £	Decrease of £	**Net Impact**	£

Key: **Annual costs and benefits:** **(Net) Present**

Summary: Analysis & Evidence

Policy Option: 4	Description: do nothing

COSTS			
ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' N/A	
One-off (Transition)	**Yrs**		
£ N/A			
Average Annual Cost (excluding one-off)			
£ N/A		**Total Cost** (PV)	**£ 0**
Other **key non-monetised costs** by 'main affected groups' N/A			

BENEFITS			
ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' N/A	
One-off	**Yrs**		
£ N/A			
Average Annual Benefit (excluding one-off)			
£ N/A		**Total Benefit** (PV)	**£ 0**
Other **key non-monetised benefits** by 'main affected groups' N/A			

Key Assumptions/Sensitivities/Risks N/A

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?			All of the UK	
On what date will the policy be implemented?			N/A	
Which organisation(s) will enforce the policy?			FSA	
What is the total annual cost of enforcement for these organisations?			£ 0	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £	Decrease of £	**Net Impact** £

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

Summary of Analysis & Evidence

Option 1: Introduce legislative amendments explicitly to exempt these instruments from CIS regulations and create a new specified investment under the Regulated Activities Order (RAO), and introduce a unique regulatory definition of AFIBs for this purpose

Benefits: The main benefit of treating AFIBs as conventional bonds is to provide clarity about the regulatory treatment and compliance costs for AFIBs and thus facilitate UK issuance of these instruments. Using the existing regime as the baseline, introducing legislation would enable AFIB issuers to benefit from savings as the AFIBs would not be captured by the on-going requirements of CIS regulations. In terms of costs, AFIB issuers would be subject to marginally higher one-off costs from being listed as a debt security (approximately £10,000 per issuance[1]), but marginally lower on-going costs (between £5,000 and £10,000 per issuance per year). For example, in present value terms, for an AFIB of duration five years, total cost savings for an issuance are estimated to be around £35,000.[2]

Key non-monetised benefits: If cost savings are achieved it is likely that additional products will be introduced into the market. This will provide potential issuers, especially Islamic financial institutions, with greater flexibility over the instruments which they hold as assets on their balance sheets, and greater scope to securitise assets. Investors will benefit from additional opportunities to diversify their portfolio of assets. Legal clarity would be of benefit to issuers for a number of reasons. Principally, it would remove the potential legal risks arising for issuers unintentionally not adhering to CIS regulations, which could potentially result in enforcement action being taken by regulatory bodies. There would also be additional benefits from not being classified as a CIS, such as avoiding the stricter controls on operating duties and responsibilities which would be inappropriate for this type of instrument.

Costs: The FSA has investigated the costs related to upgrading the FSA's technology platforms due to the creation of a new specified investment, and predicts that these costs will be around £175,000.

Key non-monetised costs: There is a small possibility that the legislative changes could lead to regulatory arbitrage (i.e. the risk that the exclusion from classification as a CIS is exploited by instruments not intended to be excluded). This risk is considered to be low, but arbitrage could nonetheless expose consumers to inappropriate risks. To mitigate this, it is proposed that AFIBs should be subject to a mandatory listing requirement as this will enhance transparency. HM Treasury will review the rules in two years' time in order to ensure that the regime is functioning as intended.

Option 2: same as option 1 but AFIBs will be defined by the existing tax definition

The costs and benefits of this option would be similar to option 1. The main risks are that the definition of an AFIB could change for tax-specific reasons; and, conversely, that it would not be possible to make regulation-specific changes to the definition. This means that there would be a risk of future regulatory and legal uncertainty, which reduces the incremental benefit to issuers.

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[1] Based on an issuance of £300 million.

[2] As set out in the FSA's Collective Investment Schemes (COLL) Handbook.

Option 3: same as option one but include AFIBs under the existing specified investment of 'creating or acknowledging indebtedness'

The costs and benefits of this option for market participants would be similar to option 1. The main difference is that there would be no costs associated with upgrading the FSA's technology platforms, which would be required if a new specified investment category is created.

Option 4: do nothing

The regulatory situation would not be expected to change, with legal uncertainty remaining. Using the existing UK regime as the baseline, there would be no additional benefits or costs.

Evidence base

Background

AFIBs are innovative instruments with similar characteristics to conventional debt securities, and there are no explicit provisions in the existing regulatory regime designed to accommodate these products. As a result, the regulatory classification of instruments such as sukuk is dependent on the interpretation of existing legislation. HM Treasury are seeking to introduce legislation to ensure that AFIBs are treated in a similar manner to conventional debt securities for regulatory purposes.

Sukuk have become an increasingly popular mechanism for raising funds, particularly in the Middle East and Asia. Total global issuance to date is in excess of $822 billion. Non-traditional issuers such as Toyota and Tesco have issued sukuk in Malaysia, and General Electric recently issued a corporate sukuk in the USA. There is evidence to suggest UK & European corporates are keen to tap markets in the Middle East and Asia to diversify their funding and access new sources of liquidity. There have been 20 sukuk issuances on the London Stock Exchange, with a total value of $11 billion. Currently all sukuk listed in the UK are from issuers based outside the EEA.

Sukuk is a generic term used to encompass a broad range of financial instruments designed to conform with the principles of Islamic law (Shariah). In general, Shariah prohibits the use of interest in financial transactions. AFIBs are therefore structured in such as way as to replicate the function of conventional bonds or asset-backed securities, using innovative techniques to conform to Shariah.

Classifying Islamic financial instruments under existing regulatory frameworks has posed challenges. Although sukuk are designed to replicate the economic function of conventional financial products, their legal structures are different and it has therefore proved difficult to map these products into the existing legal framework. The industry and the FSA have raised concerns that this could lead to the application of disproportionate regulations to issuers of these securities (by treating them as CIS rather than debt).[3] This issue was highlighted in the FSA's November 2007 paper.[4] Under the current legislative framework, sukuk are classified on a case-by-case basis.

There are differences in cost depending on whether an instrument is treated as debt or as a CIS. CIS regulations include being authorised and regulated by the FSA, and rules on marketing. CIS issuers incur an authorisation cost and periodic fees. Listed bonds incur the cost of listing, with both one-off and on-going payments, and the cost of producing an annual report. The result if that issuers of bonds are subject to marginally higher one-off costs from being listed as a debt security, but marginally lower on-going costs. The FSA has conducted a detailed assessment to estimate the costs associated with the changes to its systems following from these changes, and forecasts these to be around £175,000.

To date, no UK issuers have issued sukuk. There are a number of sukuk listed in the UK but these issuers are from non-EEA jurisdictions. The Government believes that legal uncertainty as well as tax and operational issues are an obstacle to the development of this market.

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[3] CIS as set out in the Financial Services and Markets Act 2000.

[4] http://www.fsa.gov.uk/pubs/other/islamic_finance.pdf

The aforementioned obstacles are problematic for Islamic financial institutions as institutions are unable to raise finance via traditional securities markets and commonly issue sukuk for this purpose. Recent reports indicated that up to 26.2% of global issuance is from Islamic financial institutions and they are an important source of wholesale funding for these institutions.

Legislative proposals and options

HM Treasury are seeking to introduce new legislation to ensure that AFIBs are treated in a similar manner to conventional debt securities for regulatory purposes. This policy and impact assessment is informed by dialogue between HM Treasury, FSA, relevant trade associations and industry, and reinforced by two formal consultation phases.

The first option is to introduce legislative changes so that AFIBs are afforded a similar regulatory treatment to conventional bonds. The mechanism by which to achieve this would be to implement a set of related legislative changes.

The first component of this is to include AFIBs under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 on the same basis as instruments creating or acknowledging indebtedness (as set out in articles 77 and 78 of the RAO). There are two alternatives to achieve this: creating a new specified instrument (article 77A), or including AFIBs in the list of financial instruments under an existing specified investment (articles 77 and 78).

The second component is explicitly to exempt AFIBs from the Collective Investment Scheme regulations. S235(5) of the Financial Services and Markets Act 2000 gives HM Treasury the power to exclude certain arrangements from the definition of a Collective Investment Scheme. Accordingly, the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 should be amended to ensure that such instruments are excluded. This set of legislative changes will align the regulatory treatment with that of conventional bonds. There are difficulties in defining AFIBs for regulatory purposes because these instruments can have a wide range of underlying legal structures. The definition should therefore be wide enough to capture a range of different AFIBs but not so wide that other instruments (e.g. equity-type instruments) are inadvertently captured. For option 1 it is proposed that a unique regulatory definition of an AFIB be created. The characteristics of the definition should be consistent with the relevant tax legislation[5].

It is proposed that AFIBs will be subject to a mandatory listing requirement. The intention of this provision is to enhance transparency and reduce the likelihood of regulatory arbitrage. This provision is not considered unduly burdensome as issuers are likely to seek a listing because this is a pre-requisite for the improved tax treatment.

The proposed regulatory framework is not intended to cover all types of sukuk (some of which are more akin to equity or equity-indexed instruments). The legislation is intended to cover sukuk which are structured to have similar economic characteristics to conventional debt instruments. The majority of sukuk issued globally to date are of the AFIB type, and anecdotal evidence indicate that there will be strong demand from both issuers and investors for this type of instruments.

The second option is similar to the first option in that it introduces the same set of legislative changes as outlined above except that the existing tax definition is used. This will ensure that there are no inconsistencies between tax and regulatory rules, but could lead to inflexibility.

The third option is similar to option 1, except that instead of creating a new specified investment (under article 77A), AFIBs will be included in the list of financial instruments under an existing specified investment (articles 77 and 78 of the RAO).

The final option is to do nothing. No formal legislative amendments would be made. The regulatory treatment of these instruments would be dependant on the interpretation of existing legislation, which market participants are concerned leads to regulatory and legal uncertainty.

[5] As set out in Section 48A – Alternative Finance Instrument Bond (AFIB)

Benefits

Option 1: The main benefit of treating AFIBs in a similar way to conventional bonds is that it provides clarity about the regulatory treatment and compliance costs for AFIBs, and thus facilitate UK issuance of these instruments. However, the extent to which UK issuers will issue AFIBs in the future is unclear.

The advantage of this approach is that it sets out a clear definition, consistent with the tax definition. This would enable the growth of the market and a variety of different products. Islamic financial institutions could access new sources of finance as they do not issue conventional bonds.

The proposed changes would enable AFIB issuers to benefit from not being subject to CIS regulations, such as being authorised and regulated by the FSA, and rules on marketing. In terms of costs, AFIB issuers are subject to marginally higher one-off costs from being listed as a debt security (approximately £10,000 per issuance), but marginally lower on-going costs (between £5,000 and £10,000 per issuance per annum).

Option 2: A separate definition for AFIB would not be created, using the existing tax definition instead. The benefits are similar to those of option 1. However, there is a risk of future legal and compliance cost uncertainty compared to option 1 because of changes in the definition for tax rather than regulatory reasons, reducing the incremental benefit to issuers. Furthermore, the risk of differences in the interpretation of certain provisions between the relevant authorities (in this case HM Revenue and Customs and the FSA) could create uncertainty for market participants, again limiting the extent of benefits.

Option 3: Same as option 1.

Option 4: We would not expect any change in benefits.

Costs

Option 1: Since a new specified investment would be created, there are costs associated with upgrading the FSA's technology platforms. The FSA has various systems which capture the scope of permissions of regulated firms. Creating a new specified investment could mean widening the scope of permissions for certain firms and the various systems linked to this would need to be upgraded. The FSA has conducted a detailed assessment of potential costs to their systems as a result of the proposed legislative changes and estimates these to be approximately £175,000.

There is a risk that the legislative changes could lead to regulatory arbitrage (i.e. there is a risk that the exclusion from being classified as a CIS is exploited by instruments to intended to be excluded). This risk is considered to be low, but arbitrage could nonetheless expose consumers to inappropriate risks. In such cases, investors may experience risks from the lack of oversight and control over their investments. This is more likely to be a problem for retail investors, who are less experienced market participants. To mitigate this, AFIBs will be subject to a mandatory listing requirement. HM Treasury will review the rules in two years' time to ensure that the regime is functioning as intended.

Option 2: Similar to option 1. Although this would ensure regulatory and tax definitions are consistent, many of the tax provisions are irrelevant for regulatory purposes. Subsequent changes to the tax definition may be inappropriate for regulatory purposes.

Option 3: Same as option 2, but it would not be necessary to upgrade the FSA's technology platforms.

Option 4: Without Government intervention, the regulatory treatment would be determined by interpreting existing legislation, with no change in compliance costs.

Competition assessment

Options 1, 2 and 3 remove a barrier to entry in the form of legal uncertainty, although option 2 does so to a lesser extent since there may be subsequent changes to the definition of an AFIB due to tax reasons. However, we are unsure of the extent of entry into the market and new issuance.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Annex A: Policy Options Considered (continued)

Four options have been considered:

- Option 1: introduce legislative amendments explicitly to exempt these instruments from CIS regulations and create a new specified investment under the Regulated Activities Order (RAO)[6], and introduce a unique regulatory definition of AFIBs for this purpose;
- Option 2: same as option 1 but AFIBs will be defined by the existing tax definition;
- Option 3: same as option one but include AFIBs under the existing specified investment of 'creating or acknowledging indebtedness'; and
- Option 4: do nothing.

We intend to implement option 1 which was the preferred option stated in the consultation document. The majority of respondents to the two consultation phases agreed with the Government in this preference. Option 1 was preferred as it will align the regulatory treatment of AFIBs with that of debt securities. This approach removes the legal risks related to the uncertainty of the existing framework. It also removes the risk that changes to tax legislation could create unintended consequences for the regulatory framework (as set out in option 2). Option 1 achieves the desired outcome in a simple and flexible manner, which will create legal certainty. It has several advantages over option 3, for example it avoids the creation of a lengthy article covering a number of different instruments, and AFIBs do not have to be defined in a separate section of the RAO. Although option 1 is the simpler option, option 3 could ultimately achieve the same result.

The Authorities are cognisant of the possible additional costs associated with option 1 and undertook to assess relevant alternative options (such as that outlined in option 3) if these costs were found to be burdensome. The FSA have conducted a detailed assessment of potential costs to their systems as a result of the proposed legislative changes and have estimated these costs to be around £175,000. By way of indication, the implementation of MiFID, a much larger exercise than that proposed under option 1, cost £1 million.

[6] The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.