

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (COLLECTIVE
INVESTMENT SCHEMES) (AMENDMENT) ORDER 2008

2008 No. 1641

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Description**

Operators of collective investment schemes (CISs) are required to be authorised by the FSA except where the arrangements qualify for a statutory exemption. This order amends the terms of one of those exemptions which is designed to exempt arrangements carried out in the course of an existing business. It aims to allow those setting up arrangements greater freedom to use special purpose vehicles.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

None

4. **Legislative Background**

Section 235 of the Financial Services and Markets Act 2000 (FSMA) defines a collective investment scheme (CIS). Section 51 of the FSMA 2000 (Regulated Activities) Order 2001 ('the RAO') requires anyone who establishes, operates or winds up a collective investment scheme to be authorised by the Financial Services Authority (FSA). The FSMA 2000 (Collective Investment Schemes) Order sets out types of arrangement which fall within the Section 235 definition of a CIS but which are exempted from CIS status. Paragraph 9 of the CIS order exempts arrangements set up in the pursuit of an existing business (where that business is not a specified regulated activity). This order amends paragraph 9 to allow arrangements which involve special purpose vehicles set up for the purposes of the transaction to benefit from the exemption, provided they meet the other terms of the exemption. It also allows for participants in arrangements to elect unanimously not to benefit from the exemption and for participants in arrangements which are not exempt under the current rules but which would be under the new rules to elect to benefit from the new exemption.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

Establishing, operating or winding up a CIS is an FSA regulated activity. This is because participants in CISs generally rely on the scheme operator to keep the scheme assets safe and to administer the scheme appropriately. However, in certain instances this regulation is not required, particularly for arrangements between businesses where general contract law gives adequate protection on its own. A set of statutory exemptions sets out the circumstances under which arrangements which meet the definition of a CIS may be operated without FSA regulation. One of these exemptions is aimed at joint ventures and other arrangements concluded between businesses. This exemption is widely used. However, the Government received representations that it was unduly inflexible in relation to arrangements involving special purpose vehicles (SPVs). Where SPVs were set up specifically for the purposes of the transaction, the arrangements may not be within the terms of the current exemption as the SPV cannot be said to have an “existing business” as required. There was no policy justification for this as the participation of an SPV does not affect the fundamental nature of the arrangements for regulatory purposes. This Order would address this by allowing the participation of an SPV provided the other conditions are met.

This order has been the subject of two consultations. A number of responses to the first consultation were received highlighting a problem with the impact of the proposals on existing arrangements. These issues were addressed in a revised proposal which was the subject of further consultation. Following further consultation responses, the proposal was further revised to remove requirements that the arrangements should always have met the terms of the exemption in order to benefit from it which were deemed unduly burdensome. The Government believes the revised proposal addresses all major concerns raised by respondents to the consultation.

8. Impact

A Regulatory Impact Assessment is attached to this memorandum.

9. Contact

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Regulatory Impact Assessment

Title of proposal

a) Amendment of the Schedule to the FSMA Collective Investment Schemes Order 2001¹ (henceforth the Exemption Order) to clarify its application to certain types of property transaction involving Special Purpose Vehicles (SPVs) or where there are multiple transactions.

Purpose and intended effect

b) Section 235(1) of the Financial Services and Markets Act 2000 (FSMA) defines a Collective Investment Scheme (CIS) as “any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income”. There is a general prohibition on establishing, operating or winding up a CIS without prior authorization from the Financial Services Authority (FSA)². The Schedule to the Exemption Order lists certain cases in which arrangements which would otherwise be considered CISs under section 235 of FSMA are exempt and can therefore be established without FSA authorisation.

c) Certain types of property transactions may qualify as CISs under the definition in section 235. They therefore rely on the exemptions in the Schedule to the Exemption Order to avoid the requirement for FSA authorization. Paragraph 9 of the Schedule to the Exemption Order exempts certain arrangements entered into for commercial purposes related to an existing business. This paragraph would usually be expected to exempt commercial transactions between businesses. However, for transactions involving SPVs in many cases the paragraph 9 exemption may not apply. This may prevent transactions from being structured in the most commercially efficient way or force participants to pay an FSA authorised operator to oversee the arrangements. However, certain arrangements also use SPVs specifically in order to fail the exemption in paragraph 9 and so maintain CIS status and secure the tax treatment afforded to CISs.

d) The proposed redrafting of paragraph 9 aims to allow the use of SPVs in new transactions while avoiding disruption to arrangements set up under the current rules. It is intended that this should:

- clarify and extend the scope of the exemption for eligible arrangements wishing to avoid CIS status, permitting greater certainty, reduced legal and administrative expenditure and greater freedom to structure transactions according to commercial imperatives;
- reduce the probability of arrangements being designed inadvertently in a way which does not benefit from the exemption, implying a risk of legal challenge by one of the participants or enforcement action by the FSA.

Consultation

e) The drafting of this consultation and the development of the options for reform have been informed by informal consultation with stakeholders in and outside Government and by two formal

¹ SI 2001/1062.

² See sections 19 and 22 of FSMA and article 51(1) of the FSMA (Regulated Activities) Order 2001 (SI 2001/544).

written consultation processes. The final draft Statutory Instrument addresses the majority of concerns raised by respondents.

OPTIONS

Option 1: amend paragraph 9 of the Schedule to the Exemption Order to clarify application to SPVs and multiple transactions

f) Option 1 is to redraft paragraph 9 so that arrangements involving SPVs may benefit from the exemption. The freedom to include SPVs would apply by default to new arrangements. Arrangements first entered into before the date of the amending statutory instrument would continue to be assessed under existing rules. There would be provision to opt out of the exemption and so maintain CIS status where arrangements meet the CIS definition in s235 of FSMA and do not qualify for any other exemption. There would also be provision for participants in arrangements which did not qualify for the current paragraph 9 exemption but which would qualify under the revised exemption to agree to benefit from the new exemption.

g) The proposed amending Statutory Instrument is at Annex A.

Option 2: do nothing

h) The Government could leave the legislation unamended.

COSTS AND BENEFITS

Sectors and groups affected

i) The proposal would affect mainly participants in property transactions. However, it could also affect participants in other arrangements which currently benefit from the exemption in paragraph 9. However, the Government believes that the proposed draft does not materially narrow the scope of the exemption or adversely affect the treatment of pre-existing arrangements so there should be no additional costs for these groups.

Benefits

j) There are 3 main benefits from Option 1:

- greater legal certainty over the interpretation of paragraph 9;
- greater freedom to design property transactions according to commercial imperatives rather than in order to fit in with legal definitions; and
- less legal advice required in designing arrangements.

k) The first two benefits are hard to quantify. However, it is possible to estimate a range of quantitative benefits from the third. Assuming the price of an hour of a commercial lawyer's time is £250 and that on average under the new proposed arrangements 50 fewer lawyer hours would be required for each transaction, the benefits from the proposals would be £12,500 per transaction. Of course in practice the costs and time saved for every transaction will be different. However, the Government believes this is a reasonable estimate of the average. The Government does not have access to accurate statistics on the number of affected transactions. Assuming there are between 5 and 50 per year, the annual benefits could be between £62,500 and £625,000. Given the lack of central

data on arrangements of this type, the range of possible benefits is necessarily very broad. The Government would welcome any feedback on the validity of the assumptions used. However, the Government is confident that the benefits would be large enough to be material.

Costs

l) The Government does not believe that there would be any additional costs once the new arrangements were bedded down – the new exemption is not designed to prevent any arrangements from benefiting which would have benefited under the existing arrangements. There may be some small transitional costs in law firms and other market participants coming to grips with the new arrangements. However these are likely to be small.

Small Firms Impact Test

m) The proposal is unlikely to have any significant impact on small firms as participants in the types of arrangements discussed tend to be larger firms or other organisations.

Competition assessment

n) Any impact on competition should be positive since the proposal would permit greater flexibility in the design of joint ventures allowing a greater focus on commercial and competitive, rather than legal, issues.

Enforcement, sanctions and monitoring

o) The CIS border will continue to be enforced and monitored by the Financial Services Authority under any of the options.