EXPLANATORY MEMORANDUM TO THE INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT NO. 3) REGULATIONS 2005

2005 No. 3350

1. This explanatory memorandum has been prepared by H.M. Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

2. Description

2.1 These Regulations amend the Individual Savings Account Regulations 1998 (S.I. 1998/1870) to (a) bring in a wider range of collective investment schemes authorised or recognised by the Financial Services Authority; (b) allow Credit Unions that are regulated by the Financial Services Authority to provide Individual Savings Account products within the cash component; (c) amend the application and provide further clarification on the operation of the 5% test now it has been applied to a wider range of investment products, and (d) allow Alternative Finance Arrangements to be qualifying investments for the cash component.

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

3.1 None

4. Legislative Background

4.1 Regulation 7 of the Individual Savings Account Regulations 1998 (S.I. 1998/1870) sets out the qualifying investment rules for the ‘stocks and shares’ component of the Individual Savings Account.

4.2 Regulation 8 of the Individual Savings Account Regulations 1998 (S.I. 1998/1870) sets out the qualifying investment rules for the ‘cash’ component of the ISA.

4.3 The Individual Savings Account (Amendment) Regulations 2003 (S.I. 2003/2747) amended the Individual Savings Account Regulations 1998 to apply the “5% test” to collective investment scheme products qualifying within an Individual Savings Account. Subsequently the Individual Savings Account (Amendment No. 2) Regulations 2004 (S.I. 2004/2996) and Individual Savings Account (Amendment No. 2) Regulations 2005 (S.I. 2005/2561) have applied that test to stakeholder savings, insurance and direct investments in shares and securities.

4.4 Chapter 5 of the Finance Act 2005 introduced the concept of ‘Alternative Financial Arrangements’.

5. Extent

5.1 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

7.1 The Financial Service Authorities New Collective Investment Schemes Sourcebook, which came into force in March 2004 introduced two types of authorised collective investment scheme for retail investors:

- UCITS schemes; and
- non-UCITS retail scheme.

7.2 Schemes that qualify as a UCITS scheme already qualify within the Individual Savings Account. These collective investment schemes satisfy the rules prescribed by the European Directive on undertakings for collective investment in transferable securities, which allow schemes to be sold across the European Community.

7.3 The new category of non-UCITS retail scheme covers all other types of retail collective investment schemes authorised by the Financial Services Authority for sale in Great Britain. These non-UCITS retail schemes can include products that:

- are very similar in nature to UCITS schemes or Fund of Fund Schemes, both of which already qualify for the Individual Savings Account; and
- were previously excluded from the Individual Savings Account, such as authorised property schemes.

7.4 After discussion with the industry it was agreed that both UCITS and non-UCITS retail schemes should have access to the Individual Savings Account, provided no greater restrictions were placed on savers rights to access their savings than are used for UCITS schemes. This is to provide equitable treatment across potentially very similar types of retail collective investment scheme.

7.5 These regulations bring all non-UCITS retail schemes in to the Individual Savings Account provided they do not restrict savers ability to access their funds by more than 2 weeks. This will affect providers aiming to use the Financial Services Authority rules on limited redemption or any amendment or waiver to more general redemption rules.

7.6 Chapter 5 of the Finance Act 2005 introduced the concept of alternative financial arrangements for savings products providing similar types of return to a deposit savings account. The provisions give those arrangements similar tax treatment to deposit accounts. It covers savings products such as Shari’a accounts. These regulations aim to provide those accounts with similar treatment within the Individual Savings Account by including them as qualifying products for the cash component of the Individual Savings Account.

7.7 November 2003 we first introduced the ‘5% test’ in to the Individual Savings Account Regulations to prevent those collective investment scheme products that manufacture or guarantee savers a cash-like return from qualifying for the ‘stocks and shares component’. Investments failing the test qualify for the cash component and its lower investment limits. In 2004 this test was extended to all investment based stakeholder saving and insurance products.

7.8 In 2005 this was further extended to direct investment in shares and securities. In extending the test we became aware that as currently drafted it excluded some types of security based investments that it was not intended to affect.

7.9 These regulations disapply the 5% test for securities until, in conjunction with the industry, we can accurately limit the test to those schemes it was intended to affect. They also simplify the wording of the test to provide financial institutions with greater clarity on when and how the test should be applied.

7.10 In order to align the Individual Savings Account rules with the Child Trust Fund, these regulations mirror the provisions set out in the Child Trust Fund (Amendment No.2) Regulations 2005 (SI. 2005/909). This will allow those Credit Unions that are regulated by the Financial Services Authority and subject to the Financial Services Compensation Scheme to provide Individual Savings Account cash component products.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it imposes no new impacts on business, charities or voluntary bodies.

8.2 The impact on the public sector is negligible.

9. Contact

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