



HM TREASURY



Legislative framework for the regulation of alternative finance investment bonds (sukuk):

summary of responses

October 2009



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1

Introduction

1.1 This document provides feedback on and summarises the responses received to the joint HM Treasury and Financial Services Authority (FSA) “Consultation on the legislative framework for the regulation of alternative finance investment bonds (sukuk)”. The consultation paper (CP)¹ was published on 10 December 2008 and the consultation period closed on 4 March 2009. We received 20 responses from a broad range of interested stakeholders. HM Treasury and the FSA (the Authorities) are grateful to all those involved in the pre-consultation exercise as well as those who responded to the consultation.

1.2 This document contains the draft statutory instrument, set out in Annex A, which has been revised in light of the consultation process. The draft now also sets out consequential amendments to related legislation. If there are further comments on the revised statutory instrument (including the consequential amendments), please respond by 6 November 2009 (see page 6 for further details).

Background to consultation

Government’s objectives for Islamic finance

1.2.1 In December 2008, the Government set out its strategy and objectives for the development of Islamic Finance in the UK.² It raised awareness about the growth of Islamic Finance in the UK and highlighted barriers to future development. The paper set out the Government’s objectives of enhancing the UK’s competitiveness in financial services by establishing the UK as a gateway for international Islamic finance and ensuring that everybody, irrespective of their religious beliefs, has access to competitively priced financial products.

1.2.2 Since 2003, there have been several initiatives by the Authorities to create a ‘level playing field’ for Islamic finance. For example, in the 2009 Budget Report³ the Government introduced a number of tax changes for alternative finance investment bonds (AFIBs). In line with the aforementioned objectives and the wider objective of creating a level playing field for the UK financial services sector, our consultation paper considered the policy objectives and proposed a legislative framework for the regulatory treatment of AFIBs.

Islamic Finance and sukuk

1.3 The term Islamic finance encompasses any type of financial activity that is undertaken in accordance with Islamic law (Shariah). Sukuk is a generic term used to encompass a broad range of financial instruments designed to conform with the principles of Islamic law (Shariah). Although many sukuk structures are designed to replicate the economic function of conventional bonds, their legal structures are different. Classifying Islamic financial instruments, including sukuk, under existing regulatory frameworks has posed challenges in the UK and other jurisdictions. The proposed regulatory changes seek to introduce clarity and create a level playing field between comparable instruments.

¹ The Consultation Paper is available at http://www.hm-treasury.gov.uk/consult_sukuk.htm

² See document entitled, ‘The development of Islamic finance in the UK: the Government’s perspective’ at www.hm-treasury.gov.uk

³ For further information please see: www.hm-treasury.gov.uk

1.4 A number of sovereigns, corporates, financial institutions and others have issued sukuk to raise capital. According to market data⁴, global sukuk issuance was reportedly \$14.7bn in 2008 and to date \$16.9bn in 2009. For the purposes of the UK regulatory framework we refer to AFIBs as a subset of the wider sukuk market, i.e. AFIBs are those instruments which are broadly equivalent in economic terms to conventional bonds. AFIBs are not limited to those wishing to issue Shariah compliant sukuk.

1.5 In introducing legislative changes the Government is not extending special favours to the Islamic finance sector, nor is it supporting one minority interest over another. The Government is simply ensuring that economically equivalent financial instruments are afforded equivalent regulatory treatment. The Government believes that the growth of this industry will be beneficial to the UK's financial sector and the UK economy as a whole. In addition, individuals and institutions of all faiths can invest in and issue such products, and the entire market can benefit from an expanded choice of financial products.

Conclusions and overview of comments received

1.6 In the December 2008 consultation paper we set out four policy options:

- Option 1: introduce legislative amendments to exempt explicitly these instruments from CIS regulations and create a new specified investment under the Regulated Activities Order (RAO)⁵, 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 1 but include AFIBs under the existing specified investment of 'creating or acknowledging indebtedness'; and
- Option 4: do nothing.

1.7 We intend to implement option 1 which was the preferred option stated in the consultation document. The main benefit of regulating AFIBs in an equivalent manner to conventional debt securities is to provide clarity about the regulatory treatment and reduce compliance and legal costs for these instruments and thus facilitate their issuance in the UK.

1.8 A total of 20 responses to the consultation were received (a list of non-confidential respondents is provided in Chapter 3). The majority of respondents agreed with the preference for option 1. However, there was less agreement as to the precise regulatory definition of AFIBs. Please see chapter 2 for a detailed review of responses.

Exempting AFIBs from the CIS regime

1.9 Industry welcomed the Government's consultation and there was broad support for introducing legislative changes aimed at regulating AFIBs in an equivalent manner to conventional debt securities. Respondents acknowledged that the proposed legislative changes and amendments to tax regulations⁶ will facilitate the issuance of AFIB products in the UK. They considered these measures as being an important component of enhancing 'the UK's competitiveness in financial services by establishing the UK as a gateway for international Islamic finance'⁷.

⁴ Figures cited from Morgan Stanley research (September 2009)

⁵ The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

⁶ As set out in the Finance Act 2009

⁷ Government objective, as stated in 'The development of Islamic finance in the UK: the Government's perspective', at www.hm-treasury.gov.uk

1.10 The structure of certain sukuk instruments means that for regulatory purposes they appear to fall within the definition of a Collective Investment Scheme (CIS). Respondents agreed that this leads to additional regulatory burdens in comparison to comparable conventional debt securities. We believe the treatment of sukuk with similar economic and risk characteristics to conventional bonds or asset-backed securities (ABS) as CIS is not appropriate as it does not reflect the true economic nature of these products.

Scope of the legislative proposals

1.11 Several respondents were unclear about the scope of the legislative framework. 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 that are structured to have similar economic characteristics to conventional debt instruments.

1.12 It is not the purpose of this legislation nor that of the regulatory authorities to determine whether an instrument is Shariah compliant or not. A review of instruments hitherto issued by the market indicates that the vast majority are structured to be similar in economic nature to debt based instruments. The legislation is designed to capture a broad range of sukuk instruments which are similar in economic terms to conventional debt securities. The majority of sukuk issued globally to date are of the AFIB type, and anecdotal evidence indicates that there will be strong demand from both issuers and investors for this type of instruments. The assets or class of assets which the bond-issuer acquires need not be restricted to physical or tangible assets, but can be any asset acquired for the purpose of 'generating incomes or gains directly or indirectly'. We believe the breadth and complexity of potential sukuk structures means our approach of focusing on this segment of the sukuk market, the segment that the industry has asked us to focus on, is the right approach. Please see paragraph 2.3 for more details.

1.13 We have also sought to maintain the distinction between conventional private and public debt securities for AFIBs and have inserted relevant provisions in article 77A and 78 to achieve this. We also propose that article 77 and 77A are mutually exclusive. For further details please refer to paragraphs 2.22 – 2.23.

1.14 If the market evolves and new structures emerge that do not fit with the existing regulatory framework or are subject to legislation that is not commensurate with their economic and risk profile, we may review these developments and consider whether any additional legislative action is required. A more detailed description of the scope of the legislation will be set out in the FSA's perimeter guidance manual (PERG)⁸.

Next steps

Timetable and process for changes to legislation and FSA's handbook

1.15 The revised statutory instrument is set out in Annex A. The instrument includes amendments to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001, article 77 and 78 of the RAO and inserts a new article 77A into the RAO. The statutory instrument also includes consequential amendments to relevant UK legislation.

1.16 We would welcome any further comments on the revised statutory instrument (including the consequential amendments). As we have already conducted a full three month consultation, we will allow for a further period of approximately one month for any additional comments to be sent. Please provide any comments by 6 November 2009.

⁸ The draft text of the PERG guidance is set out in chapter 3 of the FSA's October 2009 Quarterly CP, please see <http://www.fsa.gov.uk/Pages/Library/Policy/CP/index.shtml>

1.17 We prefer comments to be sent electronically to: Islamic.finance@hm-treasury.x.gsi.gov.uk
If this is not possible please post comments to:

Aviva Rosen

Room 3/W2

Financial Services Strategy

HM Treasury

Horse Guards Road

London

SW1A 2HQ

1.18 The Regulatory Impact Assessment (RIA) published as part of the December 2008 consultation paper remains unchanged.

1.19 The FSA has published consequential amendments to their handbook in chapter 3 of the Quarterly Consultation Paper, which was published on 6 October 2009.

1.20 Upon finalising the statutory instrument, this legislation will be submitted for consideration at the earliest possible date in the parliamentary calendar. The next session of parliament commences in November 2009, and it is anticipated that this measure would be included in that session. It is intended that the legislation, as well as changes to the FSA's handbook, will come into force by early 2010.

2

Responses to the Questions and Government Conclusions

2.1 In this chapter we outline the responses to each of the questions set out in the Consultation Paper. We also provide feedback on our thoughts and the implications for the regulatory framework.

Question 1: Do you agree that AFIBs which have similar economic characteristics to conventional debt instruments should be regulated in the same way as those conventional debt instruments, where appropriate?

2.2 Most respondents agreed with this. However, a few respondents stated that the scope of the regulatory framework should be extended to cover a wider variety of sukuk, such as equity-based sukuk or sukuk where the asset purchased may not be linked to the underlying return paid (i.e. where payment is linked to indices, contractual rights, or other independent sources).

Our view

2.3 AFIBs that have similar economic characteristics to conventional debt securities should be regulated in an equivalent manner. As we have mentioned, not all sukuk are covered by this legislation. The range of instruments caught have been tightly circumscribed to ensure that only those arrangements that grant debt-like returns are captured, otherwise this could have the effect of undermining the regime for regulating collective investment schemes. However, as set out in paragraph 2.10, the concept of 'asset' or 'class of assets' under 77A(2)(b) is not as restrictive as many have respondents perceived.

Question 2: Do you agree that including them as a specified investment under the Financial Services and Markets Act 2000 (Regulated Activities Order) 2001 and amending the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001, affords these instruments a similar regulatory treatment to conventional debt instruments?

2.4 There was broad agreement that option 1 is preferable as it would achieve the objective of regulating AFIBs in an equivalent manner to conventional debt securities. Option 1 entails amending the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 and creating a new specified investment⁹ set out in article 77A of the RAO. We have also made changes to article 77 and 78 to clarify the treatment of publicly-issued AFIBs: see paragraph 2.22.

Our view

2.5 We will proceed with option 1 as proposed in the Consultation Paper (CP). This will achieve our stated objectives, by clarifying the regulatory treatment of these instruments and avoiding legal uncertainty, and reducing legal and compliance costs.

⁹ Creating a new category of instruments either as a new specified investment under a new Article 77A, or by amending the existing specified investments under Articles 77 and 78.

Question 3: Do you believe the provisions above are sufficient for defining an AFIB for regulatory purposes?

2.6 There were mixed views on whether to employ the tax definition of AFIBs for regulatory purposes or create a unique regulatory definition. On balance, most respondents felt that a unique regulatory definition would be preferable as not all provisions in the tax definition were relevant in the regulatory context.

2.7 More generally, some respondents considered that the definition of an AFIB as set out in the draft statutory instrument was too restrictive and there were additional regulatory requirements which were not applicable to conventional debt securities (article 77 instruments). Others felt that the definition resembled the tax definition¹⁰ too closely and some also felt that another naming convention instead of AFIBs should be used to distinguish between the tax and regulatory definitions.

Our view

2.8 For the sake of consistency we will use the term alternative finance investment bond (AFIB) for regulatory purposes, even though the definitions for tax and regulatory purposes differ. Feedback on specific provisions of the definition of an AFIB is set out below:

Identification of assets

2.9 Respondents indicated that sukuk instruments are not always based on (an) identifiable physical asset(s); others also alluded to the fact that in some sukuk structures the assets purchased are not linked to the underlying return paid (i.e. where the repayment is linked to an index, contractual right or other independent sources, etc.). One respondent suggested that 77A(2)(b) should be amended so that the definition refers to assets which the bond issuer “will acquire for the purpose of declaring a trust in favour of the bond holder” as the trust is integral to the nature of sukuk.

Our view

2.10 We agree that sukuk are not always based on a physical or tangible asset. We believe that the reference to asset or class of assets is not as restrictive as many respondents envisaged. The assets or class of assets which the bond-issuer acquires need not be restricted to physical or tangible assets, but includes any asset acquired for the purpose of ‘generating incomes or gains directly or indirectly’. This could cover contractual rights or other non-tangible but identifiable assets used to provide an ownership interest in the sukuk. Consequently we do not intend to amend provision 77A(2)(b), nor do we intend to add the phrase “declaration of trust” as this is included in the interpretive provision (77A(3)(c)) of the instrument.

Specification of bond term

2.11 A majority of respondents suggested that the ‘specification of a bond term’ was unduly restrictive and discriminatory, as this would render perpetual or undated sukuk as being outside of the scope of the legislation. This was felt to be inappropriate as these types of sukuk are commonly used (similar to the existence of undated instruments in the conventional bond market).

¹⁰ As in Section 48A of the Finance Act 2005.

Our view

2.12 It was not our intention to exclude perpetual or undated sukuk. We agree that AFIBs that are perpetual or undated should be permissible under the definition and have reflected this within the redrafted legislation. As suggested by one respondent, instead of amending 77A(2)(c) to reflect this, we have added an interpretive provision 77A(3)(d) stating that a sukuk that is terminable at the option of the bond issuer falls within article 77A(2)(c) even if there is no fixed repayment date.

Redemption payment and additional payment

2.13 Some respondents suggested that the use of the word 'repayment' may be construed as implying the need for a debt claim that must be repaid, which is not always the case with sukuk. Another respondent suggested that a term such as "return of capital" would be more appropriate.

Our view

2.14 We believe the inclusion of "redemption payment" is necessary to ensure that the regulatory framework covers debt-like structures. However the interpretive provision 77A(3)(h) allows for the redemption to not equal the capital amount originally paid. The terms 'redemption payment' and 'return of capital' are similar and we believe replacing the former with the latter would change the intended effect.

2.15 Some respondents indicated that in a sukuk structure the 'originator' is not necessarily the 'issuer', as the issuer is usually a special purpose vehicle (SPV). These structures generally involve the originator making a repayment of capital to the issuer who holds the assets in trust for AFIB holders and makes payments to trust certificate holders. We consider that the term 'bond issuer' is relevant in this context as the payment is made by the issuer even though the original source of the cash may be the originator. We do not believe that it is necessary to define the terms 'bond issuer' and 'originator' in the legislation, but would appreciate views to the contrary.

Reasonable commercial rate of return clause

2.16 A large proportion of respondents believed this provision would be restrictive and possibly discriminated against complex sukuk structures (for example where a return is linked to an underlying index or equity). Others indicated that returns on conventional debt securities can vary significantly from returns on a loan, even if the loan was of the same amount and to the same borrower. Furthermore, many felt the application of the rule could be problematic as it would be difficult to predict the regulator's interpretation of the provision (especially in the context of day-to-day changes in market conditions). Other respondents felt the exclusion of arrangements where the returns are linked to the profits of a business, and are in economic terms more like CIS, could be achieved by a specific exclusion of such instruments from the proposed definition.

Our view

2.17 We acknowledge the aforementioned concerns, however we consider this clause necessary as it seeks to ensure only instruments that display the characteristics of debt security can be AFIBs. As with any financial instrument the 'reasonable commercial rate of return' is not itself inflexible and can vary depending on the issuer, value, duration and other economic circumstances prevalent at the time of issue. Further guidance on this clause is published in the FSA's Perimeter Guidance (PERG) which is set out in the FSA's Quarterly Consultation Paper (6 October 2009) available at www.fsa.gov.uk.

2.18 This clause will help to ensure structures that are economically equivalent to partnership or conventional CIS are excluded from the definition of the AFIB. We believe that the alternative suggestion of an explicit exclusion of CIS-like instruments may inadvertently open up the exclusion beyond what is desirable and create a loophole within the CIS rules.

Security transferability

2.19 One respondent suggested there was an inconsistency between the CP and the proposed statutory instrument. The CP stated that the bond-holder is able to 'transfer the rights' under the arrangements to another person (who thereby becomes the bond-holder) but this was not reflected in the draft article 77A. Other respondents suggested that while not an inherent feature of an article 77 investment, the bond-holders' right of transfer could be a helpful addition to the definition. It was also suggested that the inclusion of a transferability right would not adversely limit the sukuk market and that this is a feature that might help distinguish between AFIBs and CIS. One respondent commented that it was important that the legislation reflected the right for AFIBs to be held by multiple bond-holders, in a similar fashion to conventional instruments that are sold to multiple parties. A further respondent suggested that the transferability requirement is not relevant in the context of conventional bonds and should not be included.

Our view

2.20 We agree that AFIBs should have the right to be transferred to other parties, but we do not believe that an explicit clause in article 77A is required to permit this. We believe the MiFID definition of transferable securities- which refers to "those classes of securities which are negotiable on the capital market such as shares, securities equivalent to shares, bonds or other forms of securitised debt" - already captures sukuk and therefore there is no need to have an explicit provision within the legislation¹¹

Question 4: Do you believe there are any additional provisions that should be included for the regulatory definition of an AFIB?

2.21 There was a general consensus that there were no additional provisions required to define an AFIB for regulatory purposes. One respondent did however note that although conventional bonds issued by sovereigns are dealt with separately from other conventional bonds, the same distinction has not been followed through for sukuk.

Our view

2.22 We do not intend to include any additional provisions in the legislation in relation to the definition of an AFIB, other than those discussed in this document. However, based on comments from some respondents we have decided to preserve the distinction between public and non-public financial instruments as is the case with conventional debt securities. Accordingly, we have amended draft article 77A(1) and article 78(2) of the RAO to achieve this. Note article 78(3) ensures that the definition of public securities in article 78 captures the kind of private securities covered by new article 77A, except that public securities do not have to meet the listing provisions set out in article 77A(2)(f). This amendment will ensure that public debt of any sort, including AFIBs issued by the UK or by other governments, will fall into article 78.

2.23 We have also sought to make articles 77 and 77A mutually exclusive by including an amendment to article 77(1) and we have added article 77(2)(e) to ensure that AFIBs do not fall within article 77 by simply not adhering to the commercial rate of return or mandatory listing

¹¹ The FSA's October 2009 quarterly CP adds article 77A instruments to the list of transferable securities under MiFID

provision. We would be particularly interested in your views on amendments to draft article 77A(1), and articles 77 and 78 as we have not previously consulted on these changes.

Question 5. Do you believe that the mandatory listing requirement is relevant for the reasons stated above?

2.24 Most respondents believed this provision was discriminatory as no such requirement exists for conventional debt. Some respondents did indicate this provision may not be as burdensome as perceived, as listing on a recognised stock exchange was pre-requisite to qualify for tax treatment of sukuk¹². Others agreed that this provision would enhance transparency in the market and minimise the risk of regulatory arbitrage; they were also reassured that HM Treasury intend to review the proposed rules in two years' time to ensure the regime is functioning as intended. Responses covered a range of specific issues:

- Treatment of AFIBs relative to conventional debt securities;
- Listing requirements for tax purposes;
- Risks of regulatory arbitrage;
- Listing required on a Recognised Investment Exchange or Recognised Stock Exchange; and
- Impact on secondary markets.

2.25 Treatment of AFIBs relative to conventional debt securities: Respondents suggested that article 77A(2)(f) is discriminatory and unduly burdensome as conventional bonds are not subject to a mandatory listing in order to qualify as a 'specified investment' under the RAO.

2.26 Listing required for tax purposes: Although mandatory listing is required to qualifying for beneficial tax treatment, most respondents felt that regulatory issues (such as determining the perimeter and the scope of authorised firms' permissions) need to be considered independently from tax law.

2.27 One respondent noted that in spite of the mandatory listing requirement under tax rules not all sukuk issuers will necessarily seek a listing as the tax provisions cover both the issuer and the holders and is not relevant for non-UK incorporated issuers.

2.28 Risk of regulatory arbitrage: Some respondents were unclear about the reasons set out to justify the inclusion of this clause i.e. listing would enhance the level of transparency in the market and would limit the risk of regulatory arbitrage.

2.29 Listing required on a Recognised Investment Exchange or Recognised Stock Exchange: Some respondents queried whether restricting listing to a recognised investment exchange would be too narrow a requirement. Some indicated that the concept of an RIE (s.285 FSMA 2000) was a narrower definition than a "recognised stock exchange" (used in the tax provisions).

2.30 Impact on secondary markets: Some respondents asked if there was a distinction being made between sukuk being 'underwritten' and 'arranged' in the UK and 'dealing' and 'advising' on sukuk issued and listed outside of the UK.

Our view

2.31 We believe the mandatory listing provision is necessary to limit the risk that the legislative changes could lead to regulatory arbitrage (i.e. the risk that the exclusion from being classified

¹² As included within the definition in FA 2005 s48A paragraph 1(h).

as a CIS is exploited by instruments not intended to be excluded). Avoiding these regulations would be inappropriate and could lead to consumer detriment. We acknowledge that the risk of regulatory arbitrage may be low, but nevertheless exposing consumers to inappropriate risks must be avoided.

2.32 Given that the tax regime also requires a listing, the additional burden for issuers may not be as great as envisaged. We have decided to widen the scope of provision to include an 'official stock exchange listing', trading on a 'regulated market' or any 'recognised investment exchange'. This is wider than the tax definition and also does not discriminate against issuance within the EEA, which fits within the broader objective of the European Union's Financial Services Action Plan (FSAP)¹³ of creating a single European market.

2.33 We do not envisage these regulatory changes affecting the functioning of the secondary market as non-EEA issued sukuk will be treated as they are currently treated and firms advising or dealing with EEA-issued sukuk will have their regulatory permissions automatically extended. We will review the regime after a period of 2 years to ensure the rules are functioning as intended.

Question 6: Do you agree that, although the regulatory definition of an AFIB should generally be the same as the definition of AFIBs for tax purposes and as set out in section 48A of the Finance Act 2005, it is not appropriate simply to cross-refer to section 48A?

2.34 Most respondents agreed that although the definition should be consistent, simply cross-referring the tax definition is inappropriate as not all tax provisions are relevant in the regulatory context.

Our view

2.35 Although we agree that the regulatory definition should be consistent with the tax definition we do not think it is appropriate to use the tax definition¹⁴ for regulatory purposes. The regulatory definition is more flexible and ensures that the regulatory regime is not unintentionally affected by changes to or interpretations of tax legislation

¹³ The FSAP is available at http://ec.europa.eu/internal_market/finances/actionplan/index_en.htm

¹⁴ i.e. simply to cross-refer to section 48A of the Finance Act 2005.

3

List of Respondents

3.1 HM Treasury and the FSA are grateful to the following organisations for their responses to the consultation document. Two individuals, Abdullah Yunis and Khairul Arifah also responded.

- Allen and Overy LLP
- Ashurst LLP
- Association of Chartered Certified Accountants
- Association of Friendly Societies
- Bank of London and The Middle East plc
- Christian Concern for our Nation and the Christian Legal Centre
- Clifford Chance
- Euroclear UK and Ireland
- European Islamic Investment Bank PLC
- International Capital Markets Association
- Islamic Finance Council
- London Stock Exchange
- SJ Berwin
- Muslim Council of Britain
- Norton Rose
- Price Waterhouse Coopers
- The Bank of New York Mellon
- The City of London Law Society



Statutory Instrument

Order made by the Treasury and laid before Parliament under section 22(2) of, and paragraph 26 of Schedule 2 to, the Financial Services and Markets Act 2000, for approval by resolution of each House of Parliament during the period of 28 days (ignoring periods of dissolution, prorogation or adjournment of either House for more than 4 days) beginning with the day on which the Order is made.

STATUTORY INSTRUMENTS

2009 No.

FINANCIAL SERVICES AND MARKETS

The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 3) Order 2009

<i>Made</i>	- - - -	***
<i>Laid before Parliament</i>		***
<i>Coming into force</i>	- -	***

In the opinion of the Treasury, one of the effects of the following Order is that an activity which is not a regulated activity (within the meaning of the Financial Services and Markets Act 2000⁽¹⁵⁾) will become a regulated activity;

The Treasury make the following Order in exercise of the powers conferred on them by sections 22(1) and (5), 426, 427 and 428(3) of, and paragraph 25 of Schedule 2 to, the Financial Services and Markets Act 2000:

Citation, commencement and interpretation

1.—(1) This Order may be cited as the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 3) Order 2009.

(2) This Order comes into force on [].

(3) In this Order, “the Act” means the Financial Services and Markets Act 2000 and “the Principal Order” means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001⁽¹⁶⁾.

Amendment of the Principal Order

2.—(1) The Principal Order is amended as follows.

⁽¹⁵⁾ 2000 c.8.

⁽¹⁶⁾ S.I. 2001/544.

- (2) In article 77 (instruments creating or acknowledging indebtedness)—
- (a) in paragraph (1), for “article 78” substitute “article 77A or 78”;
 - (b) in paragraph (2), after sub-paragraph (d) insert—
 - “(e) an instrument which does not fall within article 77A by reason only of failing to meet the requirements of either sub-paragraph (e) or (f) (or both) of paragraph (2) of that article.”
- (3) After article 77 insert—

“Alternative finance investment bonds

77A.—(1) Rights under an alternative finance investment bond, to the extent that they do not fall within article 78.

(2) For the purposes of this article, arrangements constitute an alternative finance investment bond if—

- (a) the arrangements provide for a person (“the bond-holder”) to pay a sum of money (“the capital”) to another (“the bond-issuer”);
- (b) the arrangements identify assets, or a class of assets, which the bond-issuer will acquire for the purpose of generating income or gains directly or indirectly (“the bond assets”);
- (c) the arrangements specify a period at the end of which they cease to have effect (“the bond term”);
- (d) the bond-issuer undertakes under the arrangements—
 - (i) to make a repayment of the capital (“the redemption payment”) to the bond-holder during or at the end of the bond-term (whether or not in instalments); and
 - (ii) to pay to the bond-holder other payments on one or more occasions during or at the end of the bond term (“the additional payments”);
- (e) the amount of the additional payments does not exceed an amount which would be a reasonable commercial return on a loan of the capital; and
- (f) the arrangements are a security admitted to—
 - (i) an official list (in accordance with the provisions of Directive 2001/34/EC of the European Parliament and of the Council on the admission of securities to official stock exchange listing and on information to be published on those securities)⁽¹⁷⁾; or
 - (ii) trading on a regulated market (within the meaning of Article 4.1(14) of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments)⁽¹⁸⁾ or on a recognised investment exchange (within the meaning of section 285 of the Act).

(3) For the purposes of paragraph (2)—

- (a) the bond-issuer may acquire the bond assets before or after the arrangements take effect;
- (b) the bond assets may be property of any kind, including rights in relation to property owned by someone other than the bond-issuer;
- (c) the identification of the bond assets mentioned in paragraph (2)(b) and the undertakings mentioned in paragraph (2)(d) may (but need not) be described as, or accompanied by a document described as, a declaration of trust;
- (d) the reference to a period in paragraph (2)(c) includes any period specified to end upon the redemption of the bond by the bond-issuer;
- (e) the bond-holder may (but need not) be entitled under the arrangements to terminate them, or participate in terminating them, before the end of the bond term;
- (f) the amount of the additional payments may be—
 - (i) fixed at the beginning of the bond term;
 - (ii) determined wholly or partly by reference to the value of or income generated by the bond assets; or

⁽¹⁷⁾ OJ L184, 6.7.2001, p.1.

⁽¹⁸⁾ OJ L145, 30.4.2004, p.1.

- (iii) determined in some other way;
 - (g) if the amount of the additional payments is not fixed at the beginning of the bond term, the reference in paragraph (2)(e) to the amount of the additional payments is a reference to the maximum amount of the additional payments;
 - (h) the amount of the redemption payment may (but need not) be subject to reduction in the event of a fall in the value of the bond assets or in the rate of income generated by them; and
 - (i) entitlement to the redemption payment may (but need not) be capable of being satisfied (whether or not at the option of the bond-issuer or the bond-holder) by the issue or transfer of shares or other securities.”
- (4) In article 78(2), before the words “There are excluded” insert “Subject to paragraph (3),”.
- (5) After article 78(2) insert—
- “(3) Paragraph (2)(a) does not exclude an instrument which meets the requirements set out in subparagraphs (a) to (e) of article 77A(2).”

Amendment of the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001

3.—(1) The Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001⁽¹⁹⁾ is amended as follows.

- (2) In paragraph 5(1)(a) after “77” insert “or 77A” and for “(instruments creating or acknowledging indebtedness)” substitute “(debt instruments)”.

Consequential amendments

- 4. The Schedule (which contains consequential amendments) has effect.

Date

Signed
Signed
Two of the Lords Commissioners of Her Majesty’s Treasury

SCHEDULE Article 4

Consequential Amendments

The Insolvency Act 1986

1. Part 1 of Schedule A1 to the Insolvency Act 1986⁽²⁰⁾ (moratorium where directors propose voluntary arrangement) is amended as follows—

- (a) in paragraph 4E(1)(a) after “article 77” insert “or 77A”;
- (b) in the definition of “bond” in paragraph 4F(3) for “article 77” substitute “articles 77 and 77A”.

2. Schedule 2A to the Insolvency Act 1986⁽²¹⁾ (exceptions to prohibition on appointment of administrative receiver: supplementary provisions) is amended as follows—

- (a) in paragraph 2(1)(a) after “article 77” insert “or 77A”;
- (b) in the definition of “bond” in paragraph 3(2) for “article 77” substitute “articles 77 and 77A”.

⁽¹⁹⁾ S.I. 2001/1062, amended by S.I. 2006/3384; there are other amending instruments but none is relevant.

⁽²⁰⁾ 1986 c. 45; Schedule A1 was inserted by the Insolvency Act 2000 (2000 c.39), s.1, Sch 1, paras 1,4; paragraphs 4A to 4K were inserted by S.I. 2002/1990, reg 3(1), (3).

⁽²¹⁾ Schedule 2A was inserted by the Enterprise Act 2002 (2002 c.40), s. 250, Sch 18.

The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

3. The Principal Order is amended as follows—

- (a) in article 18(2)(b) for “or 77” substitute “, 77 or 77A”;
- (b) in article 25D(2)(a)⁽²²⁾ after “77,” insert “77A,”;
- (c) in article 71(6)(a)(i) for “or 77” substitute “, 77 or 77A”;
- (d) in article 71(6)(a)(ii) for “and 77” substitute “, 77 and 77A”;
- (e) in article 72F(1)⁽²³⁾ after sub-paragraph (a)(ii) in the definition of “Business Angel-led Enterprise Capital Fund” insert—
 - “(iia) article 77A, being rights under an alternative finance investment bond issues by an unlisted company;”;
- (f) in article 79(1) after “77” insert “, 77A”.

The Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001

4.—(1) The Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001⁽²⁴⁾ is amended as follows.

- (2) In article 1(2)(c) for “or 77” substitute “, 77 or 77A”.

The Financial Services and Markets Act 2000 (Exemption) Order 2001

5. Paragraph 41(3)(a)(i) of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001⁽²⁵⁾ is amended as follows—

- (a) for “or 77” substitute “, 77 or 77A”;
- (b) after the words “instruments creating or acknowledging indebtedness” in brackets insert “or alternative finance investment bonds”.

The Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003

6.—(1) The Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003⁽²⁶⁾ are amended as follows.

- (2) In paragraph 8(2)(w) of Schedule 2 after “77(1)” insert “, 77A”.

The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005

7. The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005⁽²⁷⁾ is amended as follows—

- (a) in the following articles for “or 15”, wherever those words occur, substitute “, 15 or 15A”—
 - (i) article 3(3)(c);
 - (ii) article 41(2)(a) and (b);
 - (iii) article 43(3)(a);
 - (iv) article 52(2)(c);
 - (v) article 59(4)(a);
 - (vi) article 60(1)(a);
 - (vii) article 69(1)(a);

⁽²²⁾ Article 25D was inserted by the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment No. 3) Order 2006, S.I. 2006/3384, arts 2 and 13.

⁽²³⁾ Article 72F was inserted by the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 2) Order 2005, S.I. 2005/1518, art 2(1) and (3).

⁽²⁴⁾ S.I. 2001/1177, to which there are amendments not relevant to this Order.

⁽²⁵⁾ S.I. 2001/1201, to which there are amendments not relevant to this Order.

⁽²⁶⁾ S.I. 2003/1633, to which there are amendments not relevant to this Order.

⁽²⁷⁾ S.I. 2005/1529, to which there are amendments not relevant to this Order.

- (b) in article 35(c) after “paragraph 15” insert “or 15A”;
- (c) in article 44(1)(d), (2)(b) and (d) after “paragraph 15”, wherever those words occur, insert “15A.”;
- (d) after article 48(8)(b) insert—
 - “(ba) it is an investment falling within paragraph 15A of Schedule 1 being an investment constituting an alternative finance investment bond issued by an unlisted company.”;
- (e) after article 50A(8)(b) insert—
 - “(ba) it is an investment falling within paragraph 15A of Schedule 1 being an investment constituting an alternative finance investment bond issued by an unlisted company.”;
- (f) in Part 2 of Schedule 1—
 - (i) in paragraph 15(1) for “paragraph 16” substitute “paragraph 15A or 16”;
 - (ii) in paragraph 15(2) after paragraph (d) insert—
 - “(e) an instrument which does not fall within paragraph 15A by reason only of failing to meet the requirements of either paragraph (e) or (f) (or both) of sub-paragraph (2) of that paragraph.”;
 - (iii) after paragraph 15 insert—

“Alternative finance investment bonds

15A.—(1) Rights under an alternative finance investment bond, to the extent that they do not fall within paragraph 16.

(2) For the purposes of this paragraph, arrangements constitute an alternative finance investment bond if—

- (a) the arrangements provide for a person (“the bond-holder”) to pay a sum of money (“the capital”) to another (“the bond-issuer”);
 - (b) the arrangements identify assets, or a class of assets, which the bond-issuer will acquire for the purpose of generating income or gains directly or indirectly (“the bond assets”);
 - (c) the arrangements specify a period at the end of which they cease to have effect (“the bond term”);
 - (d) the bond-issuer undertakes under the arrangements—
 - (i) to make a repayment of the capital (“the redemption payment”) to the bond-holder during or at the end of the bond-term (whether or not in instalments); and
 - (ii) to pay to the bond-holder other payments on one or more occasions during or at the end of the bond term (“the additional payments”);
 - (e) the amount of the additional payments does not exceed an amount which would be a reasonable commercial return on a loan of the capital; and
 - (f) the arrangements are a security admitted to—
 - (i) an official list (in accordance with the provisions of Directive 2001/34/EC of the European Parliament and of the Council on the admission of securities to official stock exchange listing and on information to be published on those securities); or
 - (ii) trading on a regulated market (within the meaning of Article 4.1(14) of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments) or on a recognised investment exchange (within the meaning of section 285 of the Act).
- (3) For the purposes of sub-paragraph (2)—
- (a) the bond-issuer may acquire the bond assets before or after the arrangements take effect;
 - (b) the bond assets may be property of any kind, including rights in relation to property owned by someone other than the bond-issuer;
 - (c) the identification of the bond assets mentioned in sub-paragraph (2)(b) and the undertakings mentioned in sub-paragraph (2)(d) may (but need not) be described as, or accompanied by a document described as, a declaration of trust;
 - (d) the reference to a period in sub-paragraph (2)(c) includes any period specified to end upon the redemption of the bond by the bond-issuer;

- (e) the bond-holder may (but need not) be entitled under the arrangements to terminate them, or participate in terminating them, before the end of the bond term;
- (f) the amount of the additional payments may be—
 - (i) fixed at the beginning of the bond term;
 - (ii) determined wholly or partly by reference to the value of or income generated by the bond assets; or
 - (iii) determined in some other way;
- (g) if the amount of the additional payments is not fixed at the beginning of the bond term, the reference in sub-paragraph (2)(e) to the amount of the additional payments is a reference to the maximum amount of the additional payments;
- (h) the amount of the redemption payment may (but need not) be subject to reduction in the event of a fall in the value of the bond assets or in the rate of income generated by them; and
- (i) entitlement to the redemption payment may (but need not) be capable of being satisfied (whether or not at the option of the bond-issuer or the bond-holder) by the issue or transfer of shares or other securities.”;
- (iv) in paragraph 16(2), before the words “There are excluded” insert “Subject to sub-paragraph (3),”;
- (v) after paragraph 16(2) insert—

“(3) Sub-paragraph (2)(a) does not exclude an instrument which meets the requirements set out in paragraphs (a) to (e) of paragraph 15A(2).”

The Money Laundering Regulations 2007

- 8.—**(1) The Money Laundering Regulations 2007⁽²⁸⁾ are amended as follows.
- (2) In regulation 12(2)(a) after “article 77” insert “or 77A”.

⁽²⁸⁾ S.I. 2007/2157, to which there are amendments not relevant to this Order.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order inserts a new article 77A into the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) (“the Principal Order”) to make alternative finance investment bonds a specified investment for the purposes of the Financial Services and Markets Act 2000 (c.8) (“the Act”).

New article 77A(2) provides that arrangements fall within article 77A if they meet a number of conditions, as set out in sub-paragraphs (a) to (f).

New article 77A(3) expands upon and qualifies the conditions set out in new article 77A(2), allowing for a range of types of alternative finance investment bond.

Article 2(1) of the Order amends article 77 of the Principal Order to ensure that (a) an instrument cannot fall within both article 77 and article 77A and (b) instruments do not fall within article 77 if the only reason they do not fall within article 77A is because they do not satisfy the commercial rate of return or mandatory listing conditions (article 77A(2)(e) and (f)).

Article 2(4) and (5) of the Order amend article 78 of the Principal Order to ensure that public debt of any sort, including an alternative finance investment bond, will fall within article 78.

Article 3 of this Order amends the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (S.I. 2001/1062) (“the Collective Investment Schemes Order”) so that alternative finance investment bonds that satisfy the conditions of the new article 77A of the Principal Order are afforded the equivalent treatment to conventional bonds which are specified investments under article 77 of the Principal Order.

The Schedule to the Order contains consequential amendments to primary and secondary legislation the broad aim of which is to treat alternative finance investment bonds in the same manner as conventional bonds.

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