HM TREASURY

Consultation on contractual schemes for collective investment

January 2012

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ISBN 978-1-84532-932-7
PU1248

Subject of this consultation	The introduction of a tax-transparent fund vehicle in the UK.
Scope of this consultation	This consultation covers the statutory instrument through which a tax transparent fund will be legislated for in the UK, the regulatory implications and the treatment by HMRC of the vehicle.
Who should read this	HM Treasury would like to hear from businesses, investors, representative bodies and others interested in UK contractual schemes.
Duration	The consultation will run from 10 January 2012 to 19 March 2012.
Enquiries	For general enquiries regarding this consultation please contact Jonathan Gee at HM Treasury on 020 7270 6275, or jonathan.gee@hmtreasury.gsi.gov.uk.
How to respond	Please send responses to: Contractual Scheme Consultation Financial Regulation and Markets HM Treasury 1 Horse Guards Road SW1A 2HQ E-mail: taxtransparentfund@hmtreasury.gsi.gov.uk
Additional ways to be involved	Please indicate whether you are willing to discuss these issues with HM Treasury. HM Treasury will consider meeting interested parties to discuss issues raised during this consultation. The timing, format and venue of these meetings will be informed by expressions of interest received.
After the consultation	A response document will be published. Responses will influence any legislative changes taken forward. The intention is to introduce legislation in the Summer 2012.
Getting to this stage	Budget 2011 announced that the Government will legislate to introduce a tax transparent fund vehicle from 2012. The Government has proactively engaged with industry and other interested parties since this announcement, to prepare for this formal consultation, through a series of workshops on tax, legal and commercial aspects of the vehicle.

Contents

1 Introduction

1.1 The Government announced its intention in Budget 2011 to introduce a new, regulated, tax-transparent fund vehicle (the "contractual scheme") primarily to facilitate the setting up of pooled "Master Funds" under the Undertakings for Collective Investments in Transferable Securities IV Directive[1] (UCITS IV). Legislation allowing for the authorisation of such contractual schemes is intended to come into force next summer and will be effected through amendments made to regulatory legislation and consequential changes to tax legislation via Finance Bill 2012 and subsequent regulations. The aim of this consultation is to gather views and evidence on the costs and benefits of the contractual scheme, likely take up by industry and the tax and legal arrangements needed for the new fund vehicle to be deployed effectively.

1.2 A contractual scheme is a collective investment scheme that is taken to be tax transparent under which income and gains accrue to the investors directly as they arise. It is envisaged that there will be two contractual scheme types: the co-ownership scheme and the partnership scheme. The contractual scheme is not a legal entity and is broadly transparent for tax purposes.

1.3 The main objective of introducing contractual schemes is to ensure that the UK is able to compete to win an appropriate share of European pooled funds as UK domiciled funds and to consolidate the UK's position as the largest asset management centre in Europe.

1.4 Contractual schemes are expected to be attractive vehicles for UCITS funds to pool their investments cross-border in these UCITS IV Master Funds. In addition it is expected that other investors, such as pension funds and life companies, will also find contractual schemes attractive. Asset pooling provides economies of scale, reducing costs and potentially enhancing returns due to greater ability to diversify investments.

1.5 The tax status of the contractual scheme is of critical importance. The vehicle itself is not a taxable entity and suffers no tax directly. Tax transparency means that, for direct tax purposes, investors are treated as if they had invested directly in the underlying assets and are subject to tax accordingly. The scheme itself is not subject to corporation tax, income tax or capital gains tax.

1.6 This consultation document explains the background to the Government's proposals, the structure of the vehicles, the required regulatory and tax legislation and sets out the expected benefits of introducing the contractual schemes. Comments are invited on the proposals and draft regulations by 19 March 2012. Comments will help to inform the final shape of the proposals and the related legislation. The FSA will carry out a separate consultation on proposed rule changes to the FSA handbook in spring 2012.

[1] Directive 2009/65/EC of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities.

2 Why are we introducing UK contractual schemes?

2.1 This chapter explains the background to the proposals and the main drivers for change at this time. This chapter also seeks comments on the regulatory impact assessment, which is provided in Annex C, and the extent to which the likely benefits and costs have been appropriately assessed.

UCITS IV – the driver for change

2.2 The greatest part of collective investment management activity in European fund assets is performed through undertakings for collective investment in transferable securities (UCITS). These schemes comprise approximately €6 trillion of the €8 trillion European assets market[1]. This activity is governed by an EU directive transposed in the UK through domestic implementing regulations that amend the Financial Services and Markets Act 2000 (FSMA) as well as the OEIC Regulations and FSA rules.

2.3 The UCITS IV directive, which was implemented in July 2011, introduces the ability for UCITS funds to establish master-feeder arrangements. The advantages of asset pooling in this way relate to economies of scale achieved by the pooled fund in relation to *inter alia*, management fees, transaction costs, fund administration and investment diversification. However in order for a so called "master-feeder" structure to be attractive to investors on a cross-border basis the master fund needs to be a tax-transparent vehicle. As FSMA does not provide for the authorisation of tax-transparent collective investment schemes, it is currently not possible to have a tax-transparent UCITS master fund domiciled in the UK.

2.4 The measures outlined in this paper would allow for the authorisation of UK domiciled schemes established by contract and governed by the terms of a deed between the operator of the scheme and a depositary under which investing participants take a share by way of subscriptions. Such a 'contractual scheme' may take one of two forms: a co-ownership scheme or a limited partnership. These contractual schemes will be tax-transparent for UK tax purposes and will be capable of being used as UCITS vehicles, although it is not expected that this will be their exclusive application. The fund structure is explained in more detail in Chapter 3.

Benefits of UK domicile

2.5 The UK continues to be the largest single asset management centre in Europe. Net assets under management were valued at €3,783 billion as at December 2009 representing a market share of over 30% of the approximately €12 trillion of global assets that are managed in Europe. However, as a domicile the UK faces sustained competitive challenge. As at December 2010, UK authorised investment funds had a net asset value of €794 billion, representing only a 10% share of the approximate €8 trillion of investment funds under management in Europe of which approximately €6 trillion are UCITS funds[1].

[1] Source: IMA Annual Survey 2010-2011

2.6 Assets under management in the UK for overseas-domiciled funds already exceed those for UK-domiciled funds, accounting for an estimated 52% of total investment funds assets[2]

2.7 The European asset management industry is also facing significant regulatory change. The Alternative Investment Funds Managers Directive (AIFMD) and the Solvency II Directive will change the regulatory landscape for the UK asset management industry. Allowing for the possibility of UK authorised Tax Transparent Funds (TTFs), especially as similar vehicles are already available to the asset management industry in other EU jurisdictions, is important to ensure that the UK asset management industry can compete on a level playing-field.

2.8 The introduction of contractual funds is therefore intended to maintain and improve the competitiveness of the UK as a domicile of choice for investors. The legislative approach is explained in Chapter 3 and the tax implications of contractual funds are set out in greater detail in Chapter 4.

2.9 The importance of fund domicile was highlighted in a joint report by the IMA and KPMG in 2007[3]. It stated that there is "a strong link between the domicile of Funds and the location of *administration activity and other support functions*". Examples of the types of activity typically linked to the domicile of the fund include:

1. Transfer agency / investor servicing
2. Fund accounting
3. Depositary services
4. Audit services
5. Legal services

2.10 The study concluded that the equivalent of approximately 20 basis points of funds under management was spent on services in the country of domicile. There is therefore a potentially significant benefit to UK employment and corporate profits of retaining and attracting funds within the UK domicile. An estimate of the implications of this over a ten year period is included in the attached draft impact assessment.

2.11 The choice of the UK as a fund domicile for a greater share of European assets would also have the effect of reinforcing the UK's reputation as a 'pro-business' international financial centre.

Box 2.A: Questions 1 & 2

How important is it to the UK fund management industry to have a UK TTF option available and do you agree that an increase in funds domiciled in the UK will lead to further economic activity in the UK?

Do you agree that introducing a TTF would positively reinforce the UK's reputation as a financial centre?

[2] Source: IMA Annual Survey 2010-11

[3] www.investmentfunds.org.uk/assets/files/research/20080124jointimakpmgreport.pdf

Benefits to investors

Asset pooling

2.12 Additional benefits are likely to accrue to investors that pool assets. These benefits are currently available in the UK through opaque authorised funds which are not tax transparent, or through more complex unauthorised limited partnerships. Investors can access suitable tax-transparent asset pooling vehicles in other EU member states. The aim of the Government's proposal is to allow investors to achieve these benefits without having to invest in a fund that is domiciled outside of the UK. The benefits of asset pooling for investors will include:

1. Reduced management fees – achieved through the attractiveness to investment managers of asset pools that are larger in scale;
2. Greater investment diversity – a larger pool of assets can be diversified across a wider range of investments;
3. Enhanced returns – larger transaction sizes will deliver lower average transaction costs;
4. Reduced administration costs – by pooling many funds into a single master fund the associated administrative burden is likely to be reduced.

2.13 Therefore, given the availability of transparent vehicles in other EU jurisdictions, if assets currently invested in UK domiciled funds would benefit from further pooling then these assets could be transferred to a suitable tax-transparent master fund. In the absence of a UK TTF such master funds would necessarily be domiciled outside of the UK. Additionally, new investments that sought to utilise pooling structures would be established in similarly suitable tax-transparent vehicles outside the UK.

2.14 As explained in Chapter 3 Contractual Scheme Regulations will allow the FSA to authorise contractual schemes which are tax transparent as authorised collective investment schemes. Whilst the primary use of these authorised TTFs is expected to be marketing of cross-border UCITS schemes they may also have application as either non-UCITS retail schemes (NURS) or, more probably, as Qualified Investor Schemes (QIS). For example, companies with multiple funds that cannot be merged for contractual reasons but effectively pursue the same strategies may benefit from pooling into a TTF.

Box 2.B: Questions 3 to 6

What are the additional benefits of asset pooling for investors and investment managers? What levels of saving are achievable through asset pooling?

Do you believe that you or your clients would be able to benefit from an asset pooling scheme? If so what quantum of assets would you consider pooling? Would you consider investing in an asset pooling vehicle domiciled outside of the UK?

What, if any, are the reasons that a UK domiciled TTF would be preferable to a non-UK domiciled TTF?

Would you or your client be likely to transfer assets that are currently invested in unauthorised funds, AUTs or OEICs into a TTF authorised as a NURS or QIS rather than a UCITS scheme? If so what quantum of assets would be transferred?

Transparency

2.15 As explained in Chapter 4, certain institutional investors with tax-exempt status (e.g. pension funds and charities) may benefit from the creation of a TTF as it may reduce tax drag compared with investments into opaque non-exempt funds that may not be able to reclaim tax withheld by overseas tax jurisdictions. For example, exempt pension funds currently investing in these types of opaque funds would benefit from moving to the new TTF vehicle as their tax treatment would revert to the intended treatment for tax-exempt investors. For UK investors into a TTF this would provide the benefit of the UK's extensive double-taxation treaty network, preserving the ability to claim any favourable tax treatment (e.g. for pension funds) they may be entitled to for direct investment. It is also the case that the introduction of a TTF may create opportunities for fund-managers to market their funds to tax exempt investors that were averse to investing indirectly due to this tax drag. This may provide opportunities for such investors to access a broader range of investments.

Costs associated with the introduction of a UK contractual scheme

2.16 The legislation introduced to enable the authorisation of a UK TTF would not oblige any market participant to incur any involuntary costs.

2.17 Investment firms that chose to operate a TTF scheme would incur transitional costs relating to the set-up of the structure and on-going administration costs in relation to the scheme. An estimate of these costs is included in the attached draft impact assessment.

Box 2.C: Questions 7 to 10

Do you agree that, as set out in this consultation document, there would be no mandatory cost imposed on any UK businesses by the proposed legislation?

Do you agree that businesses that wished to utilise the opportunity provided by the legislation (either to set up and operate or access a TTF) would be able to reliably assess the cost:benefit equation for their organisation?

Do you agree that assumptions set out in the annexed draft impact assessment are reasonable? If not, for what reason and how should the assumption be adjusted?

Do you agree that micro-businesses should be able to utilise the contractual scheme as operators and therefore not be exempted from the scope of the legislation?

3 Contractual Scheme Regulations

3.1 This chapter explains the proposed legislation enabling contractual schemes to be established and authorised by the FSA. It sets out the main aspects of the legal structure of co-ownership and partnership schemes and raises questions for consultation.

Legislative approach

3.2 The Government proposes to lay draft affirmative regulations under section 2(2)(b) of the European Communities Act 1972. The draft statutory instrument is attached as Annex A and is entitled the Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2012 (the "Contractual Scheme Regulations").

3.3 The Contractual Scheme Regulations will exercise the right conferred by article 1.3 of the UCITS IV directive to set up undertakings for collective investment in transferable securities constituted in accordance with contract law (as common investment schemes managed by management companies). The intention is to lay the instrument before Parliament in time for coming into force, subject to approval, in summer 2012.

3.4 The UK implemented the UCITS IV directive by regulations under section 2(2) of the European Communities Act 1972, which came into force on 1 July 2011[1]. The regulations amended UK legislation, particularly FSMA and the OEIC Regulations[2]. The directive has also been implemented by means of rules made by the Financial Services Authority.

3.5 Chapter VIII of UCITS IV makes provision for UCITS funds to establish master-feeder arrangements. A master UCITS is a UCITS which (i) has among its unit-holders at least one feeder UCITS; (ii) is not itself a feeder UCITS; and (iii) does not hold units of a feeder UCITS. A feeder UCITS is a UCITS which invests at least 85% of its assets in units of the master UCITS. If the master UCITS has at least two feeder UCITS as unit-holders, the master UCITS may raise capital from the public. As tax transparent schemes, contractual schemes are likely to provide attractive alternative structures for master-feeder UCITS.

3.6 The Contractual Scheme Regulations make provision for two types of contractual scheme: the co-ownership scheme and the partnership scheme. In a co-ownership scheme the participants own the assets beneficially as tenants in common (in Scotland, the assets are the common property of the participants). The scheme is not legally separate from the participants, so that assets are acquired, managed and disposed of directly on their behalf by the manager, while the depositary holds legal title as a custodian. A partnership scheme is a limited partnership under the Limited Partnerships Act 1907.

3.7 Annex A explains that an authorised collective investment scheme, whether it is an authorised unit trust ("AUT") or an open ended investment company ("OEIC"), may be set up as a UCITS, a non-UCITS retail scheme ("NURS") or a qualified investor scheme ("QIS"), and may accordingly be subject to different rules about promotion to the public. An authorised

[1] The Undertakings for Collective Investment in Transferable Securities Regulations 2011 (S.I. 2011/1613)

[2] The Open Ended Investment Companies Regulations 2001 (S.I. 2001/1228)

contractual scheme, whether it is a co-ownership scheme or a partnership scheme, will similarly be available for NURS and QIS as well as UCITS.

3.8 UCITS schemes account for more than 75% of the total net assets of collective investment schemes in the EU, and the contractual scheme is being introduced as a new vehicle for UCITS, for both stand-alone schemes and for setting up master-feeder UCITS. At the same time it is important to avoid creating a distinct regime for UCITS. The advantages offered by the contractual scheme must be available for all investment strategies that may be pursued by an authorised collective investment scheme (i.e. for NURS and QIS as well as UCITS). This is essential in the interests of uniformity of treatment for tax and regulation for these three scheme types (as opposed to uniform treatment for different scheme structures) to avoid distorting the market in collective investments.

The regulations

3.9 Part 2 (regulation 2) of the Contractual Scheme Regulations amends FSMA, mainly by inserting new provisions in Part 17 of the Act (collective investment schemes). Section 235A is inserted to define the new types of scheme and who is responsible for operating them.

3.10 Other amendments, including provisions inserted as Chapter 3A of Part 17 (authorised contractual schemes), ensure that an authorised contractual scheme will be regulated in much the same way as an authorised unit trust scheme (for example, in relation to restrictions on promotion (section 238); information for feeder UCITS about matters relating to the master fund (section 261B); authorisation (new sections 261C to 261F); FSA rules (new sections 261H and 261I); and alterations, revocation of authorisation, FSA intervention and winding up (new sections 261O to 261Z3)).

3.11 Part 3 (regulations 3 and 4) makes provision for authorised contractual schemes by modifying other primary legislation: the Limited Partnerships Act 1907 and the Corporation Tax Act 2010.

3.12 Part 4 (regulations 5 to 9) of the Contractual Scheme Regulations makes provision for authorised contractual schemes by amending relevant secondary legislation.

3.13 Part 5 (regulation 10) of the Contractual Scheme Regulations makes provision for the review of regulations 2 to 9.

The contractual scheme – co-ownership

3.14 Regulation 2(4) inserts section 235A of FSMA to define a "contractual scheme" as a "co-ownership scheme" or a "partnership scheme".

3.15 New FSMA section 235A(2), (3) and (4) defines the co-ownership scheme. New Chapter 3A mostly applies without distinction to both kinds of contractual scheme which have been authorised for the purposes of Part 17 of FSMA. But sections 261L to 261N and 261Z4 and 261Z5 apply only to co-ownership schemes.

Co-ownership scheme – conditions

3.16 A co-ownership scheme is a collective investment scheme, which meets specified conditions (collective investment scheme is defined in section 235 of FSMA). The conditions are in new FSMA section 235A(3). One of the conditions is that the arrangements constituting the scheme are to be set out in a deed and provision is made about the required contents of the deed.

3.17 The other conditions are that a co-ownership scheme does not constitute a body corporate, a partnership or a limited partnership; and that the scheme property is held by a depositary and is beneficially owned by the participants as tenants in common. This means that the participants' interests or units in the scheme are shares in undivided property (i.e. no one can lay claim to particular assets) but are distinct from one another. The legal position is the same throughout the UK, but whereas in England, Wales and Northern Ireland assets held in this way are held by tenants in common, in Scotland they are called "common property". Legal title to the property is vested in the depositary.

3.18 The deed that constitutes a co-ownership scheme is made between the operator and the depositary. The scheme must be authorised before participants (investors) are able to acquire any interest in it, and they will be free to redeem their units at any time, subject to a direction from the FSA requiring the issue and redemption of units to cease. Participants will acquire rights by subscribing to units rather than by executing the deed. The deed must make provision for the issue and redemption of units and must prohibit the transfer of units except where transfer is permitted by FSA rules. Consideration will be given to the circumstances under which transfer might be permitted.

3.19 The deed must authorise the operator to acquire, manage and dispose of property for the purposes of the scheme and to enter into contracts for or in connection with the acquisition or disposal of property. As the participants own the assets, subject to the custodianship of the depositary, they have rights and liabilities under a contract made to acquire an asset or divest them of asset ownership. Contracts made within the scope of the operator's authority are binding on the participants.

3.20 As the authority given to the operator to bind the participants in contract includes authority to enter into contracts in connection with the acquisition or disposal of property, it is important to ensure that this fits industry practice. For example, fees payable for printing documents for an investment or for specialist advice in relation to investments of a particular description would be payable by the operator directly out of scheme property (and not out of the fees payable to the operator under the contractual scheme deed) on the basis that they were in connection with investment of property or the disposal of investments. This means that the operator is responsible as principal for contracts relating to the management of the scheme that cannot properly be regarded as connected with the acquisition or disposal of property.

3.21 The depositary holds legal title to the assets and exercises the regulatory functions of a depositary. The operator is responsible for decisions and contracts made for the management and investment of the participants' assets. Under the terms of the co-ownership scheme deed the depositary and the operator accept fiduciary duties which are compatible with co-ownership of the assets (as opposed to a purely monetary share in a trust fund) by the participants.

Box 3.A: Questions 11 to 14

Do you agree that the conditions laid down in new FSMA section 235A(3) are appropriate for a scheme which has no legal personality distinct from the participants, who collectively own the pooled property?

Do you agree that the prohibition on transfers of units in a co-ownership scheme should be qualified by contractual scheme rules made by the FSA? If you do, under what circumstances ought a unit-holder to be permitted to transfer units?

Are the respective rights of operator, depositary, participants and third parties in line with what is required for the commercial operation of such a scheme?

Does the scope of the operator's authority to enter into contracts for participants fit the practice of the industry for meeting the operator's costs?

Co-ownership scheme – participants' liability

3.22 It is important to ensure that the deed defines clearly the scope of the operator's authority to enter into contracts in the course of managing the scheme. The deed must not give the operator any authority to enter into contracts binding on the participants unless they are for or in connection with the acquisition or disposal of scheme property. Having given the operator proper scope to contract for the participants, it is necessary to make provision to deal with the risk that losses and liabilities might stem from authorised contracts.

3.23 New FSMA section 261M provides that the liability of participants in a co-ownership scheme in relation to debts arising from or in connection with the acquisition or disposal of scheme property is limited to the value of their units. It is important to ensure that such liability can arise only from the exercise of the operator's contractual authority. New FSMA section 261L provides that a person who proposes to enter into an authorised contract is deemed to have actual knowledge of the scope of that authority.

3.24 The intended effect of these provisions is that if a transaction is unauthorised, most probably because it falls outside approved investment policy, it will not be binding on the participants and the consequences for the investee and the operator will be determined under the general law. It is considered that this strikes the right balance of risk between participants and third parties, because the scope of the operator's authority is a matter of public knowledge, and the participants do not exercise control over the management of the property.

3.25 On the other hand, if a contract is authorised, the contract is binding on the participants and the investee or counter-party should not shoulder the risk of a challenge to the operator's authority based on a claim that an investor has no power to own a part of the investment. New FSMA section 261L provides that the validity of an authorised contract shall not be called into question on the ground that a participant lacks capacity to authorise the contract.

Box 3.B: Question 15

Do the provisions for the protection for participants and counterparties ensure that the balance of risk between them is fair and proportionate given the level of knowledge and expertise on each side?

Co-ownership schemes – insolvency

3.26 There is a risk that liability under an authorised contract could result in loss of such magnitude that the value of the scheme property is wiped out. As the value of the scheme property fixes the liability of the participants, it is necessary to make provision for insolvent winding up. New FSMA sections 261Z4 and 261Z5 amend the Insolvency Act 1986 and the Insolvency (Northern Ireland) Order 1989 to provide that an insolvent scheme shall be wound up as an unregistered company.

3.27 While a co-ownership scheme is not a legal entity or partnership, it is to be treated for the purpose of winding up by the court as an unregistered company within the meaning given to that expression by section 220 of the Insolvency Act 1986 (Article 184 of the Order). Parts 4 & 5 of that Act (Parts 5 and 6 of the Order) are applied with modifications to an insolvent co-ownership scheme.

3.28 The 1989 Order applies to an unregistered company which has a principal place of business in Northern Ireland (which must be deemed to be the registered office if the company also has a principal place of business in England, Wales or Scotland).

3.29 The modifications in sections 261Z4 and 261Z5 are the same. Section 223 of the 1986 Act (Article 187 of the Order) is omitted on the basis that a third party could erroneously institute proceedings against a member (participant) of the scheme for a debt owed by the participants collectively to the third party. No individual member nor the members collectively may be sued for the scheme's debts by virtue of new FSMA section 261L(2), but the modification ensures that the proceedings, while invalid, would not trigger winding up by the court.

3.30 The modification of section 129 of the 1986 Act (Article 109 of the Order) concerns the deemed date of commencement of winding up. It takes account of winding up by direction of the FSA or following the appointment of a person by the court. Part 4 of the 1986 Act (Part 5 of the Order) is modified in general terms to provide that a reference to a director or officer of the company includes a reference to the operator and the depositary of a co-ownership scheme.

3.31 Provision is made for umbrella schemes (see below). A sub-scheme of an umbrella scheme can be wound up independently and the winding up of the whole scheme would involve winding up each sub-scheme as though it were a separately authorised scheme.

Box 3.C: Questions 16 and 17

Do you agree that the most appropriate way for a co-ownership scheme to be wound up by the court in the case of insolvency is winding-up as an unregistered company?

Do you agree with the way in which Parts 4 & 5 of the Insolvency Act 1986 and Parts 5 & 6 of the Insolvency (Northern Ireland) Order 1989 have been modified for this purpose?

Co-ownership schemes – umbrella funds

3.32 Authorised unit trusts and open-ended investment companies may be constituted as umbrella schemes, under which sub-funds are set up and operated for different purposes by the trustee and manager or by the company and its ACD. This allows a single scheme to be authorised with flexibility to cover different investment strategies and scope for extending investment activity by setting up new sub-funds without independent authorisation.

3.33 HM Treasury has set out to make provision in the Regulations to offer the same advantages in the case of the co-ownership scheme. To facilitate the authorisation of sub-schemes of a single tax transparent umbrella co-ownership scheme, regulation 2(9) inserts a new FSMA section 261N (Pooling in relation to separate parts of the property). Sections 261L to 261N form a sub-part of new Chapter 3A which makes provision about the contracts and liabilities of participants in co-ownership schemes. This consultation seeks input from stakeholders as to the draft provision for umbrella schemes, and seeks views on the need for additional or different provision.

3.34 Note that no provision is contemplated for the authorisation of partnership schemes as umbrella schemes (see paragraphs 3.52 & 3.53).

3.35 In view of the importance of ensuring that sub-schemes of any collective investment scheme are segregated (for the reasons set out below), statutory provision is needed for the authorisation, operation and regulation of umbrella schemes. The principal measures include: (i) provision for single authorisation of a scheme with sub-schemes; (ii) regulation of umbrella schemes and its sub-schemes by the FSA; and (iii) segregation of sub-schemes (while allowing for free exchangeability of units between them).

3.36 It is anticipated that umbrella schemes would be subject broadly to the same tax and regulatory treatment laid down for co-ownership schemes which are not umbrella schemes. This means that sub-schemes would be treated as individual schemes for tax purposes. Also, if the umbrella scheme is to qualify as a single collective investment scheme, it is necessary to meet the requirement in section 235(4) of FSMA that units must be exchangeable between sub-schemes.

3.37 As the property of a co-ownership scheme is beneficially owned by all its participants, a single co-ownership scheme can only exist as an umbrella scheme if its sub-schemes are segregated, so that the property of each sub-scheme is beneficially owned by the participants in the sub-scheme. Segregation means that the operator is authorised to invest for the participants in a given sub-scheme rather than for the scheme as a whole, without preventing contracts for scheme management that do not amount to the investment of the sub-scheme property. It also means that the participants in each sub-scheme and their property are ring-fenced with respect to liability and winding-up.

3.38 It is important to ensure that a sub-scheme can be wound up without requiring the scheme as a whole to be wound up, and in the case of winding up by the court, that the same provisions apply (winding up as an unregistered company) in relation to the sub-scheme as would apply in relation to the winding up of a co-ownership scheme that was not an umbrella scheme. New FSMA section 261N(9) allows the FSA to direct the winding up of a sub-scheme. New FSAM section 261Z4(8) provides for the winding up of sub-schemes by the court (for schemes established in Northern Ireland equivalent provision for the winding up of sub-schemes by the court is in section 261Z5(8)).

3.39 There are understood to be sound commercial reasons for wanting the option of setting up umbrella schemes, and given that sub-schemes are commonly set up for non-UK tax transparent funds (as well as for UK opaque funds), the legislation aims to achieve effective segregation of sub-schemes within a framework that allows for single authorisation, regulation of the umbrella scheme and its sub-schemes by the FSA, and free exchangeability of units between sub-schemes. Responses will inform a final view on the shape of the provision required to achieve this aim, particularly to ensure that it gives all necessary protection for investors and is compatible with other provision made for co-ownership schemes.

Box 3.D: Questions 18 to 20

How important commercially is it that there is provision to facilitate the authorisation of co-ownership umbrella schemes? How far do the draft provisions meet commercial requirements?

Does new FSMA section 261N and corresponding provision for winding up by the court achieve effective segregation of sub-schemes within a framework that allows authorisation and regulation of the umbrella scheme, regulation of sub-schemes and free exchangeability of units between sub-schemes?

Are there any obstacles not addressed in this paper to the proposal to authorise co-ownership schemes as a vehicle for collective investment under Part 17 of FSMA 2000? If there are, how significant are they and how would you suggest addressing them?

The contractual scheme – limited partnership

3.40 New section 235A(5), (6) and (7) of FSMA defines the partnership scheme. New Chapter 3A applies to partnership schemes which have been authorised for the purposes of Part 17 of FSMA (with the exception of sections 261L to 261N and sections 261Z4 and 261Z5, which apply only to co-ownership schemes). Regulation 3 of the Regulations inserts a new section 18 into the Limited Partnerships Act 1907 in order to modify some of the provisions of that Act as they have effect in relation to partnership schemes.

Partnership scheme – conditions

3.41 A partnership scheme is a limited partnership under the Limited Partnerships Act 1907. Every limited partnership must be registered under that Act, and the certificate of registration is conclusive evidence that a limited partnership came into existence of the date of registration.

3.42 A partnership scheme is a collective investment scheme, which meets several conditions. One of the conditions is that the limited partnership is formed by deed. Another is that the limited partnership is formed with only one general partner (and only ever has one general partner), who will be the operator of the scheme. In the interests of clarity of management responsibility, it is important to ensure that a single person authorised under FSMA to manage a collective investment scheme should have the functions and liabilities of the manager and general partner.

3.43 The general partner may, of course, delegate management functions, but the appointment of a fund manager would not affect the contractual responsibilities of the general partner under the contractual scheme deed (the deed forming the limited partnership) or its regulatory responsibilities under FSMA or other legislation. By the time of authorisation, the general partner will be a person who meets all regulatory requirements.

3.44 The contractual scheme deed must provide that if an authorisation order is made by the FSA under new section 261D of FSMA, the scheme property will be partnership property held by the depositary, the limited partners (apart from the depositary – see paragraph 3.46) will be the participants in the scheme, and units will be issued in exchange for a contribution to the partnership.

3.45 By virtue of section 4 of the Limited Partnerships Act 1907 (as modified by the Regulations), the liability of the participants in a partnership scheme for the debts and obligations of the scheme is limited to the value of their units.

3.46 As the limited partnership must be formed and registered before an application for authorisation can be made, the partnership must have a limited partner before authorisation. At that time, the partnership will have no participants. Consequently, some other person must be the limited partner. HM Treasury proposes that this person should be the person appointed to be the depositary after authorisation. Of course, the proposed depositary, who becomes the scheme depositary on authorisation, may not always be the depositary. It is proposed that the depositary (whoever it is) must be a limited partner.

Box 3.E: Questions 21 to 24

How far is the legal framework for a limited partnership, having regard to the respective roles of general partner, limited partners (participants) and depositary, suitable for the commercial operation of a collective investment fund?

Do you agree that a limited partnership would provide a suitable vehicle for open-ended collective investment? How do you see this working in relation to the subscription for units by investors?

Are there any obstacles not addressed in this paper to the formation of a limited partnership as a vehicle for collective investment under Part 17 of FSMA 2000? If there are, how significant are they and how would you suggest addressing them?

Do you agree that the depositary should be a limited partner?

Partnership scheme – modification of the Limited Partnership Act 1907

3.47 A partnership scheme, once authorised for the purposes of Part 17 of FSMA, will be governed by the general law of partnerships, which is based on the law of contract, by the provisions of the Limited Partnerships Act 1907, by Part 17 of FSMA and by contractual scheme rules made by the FSA. Regulation 3 of the Regulations amends and modifies the 1907 Act in relation to partnership schemes to ensure that a partnership scheme can be formed under the Limited Partnerships Act 1907 in a way that makes it suitable for effective operation as an authorised collective investment scheme.

3.48 Section 4(3) of the 1907 Act prevents a limited partner from drawing out or receiving back any part of its contribution to the partnership, and provides that if it does so it shall be liable for the partnership's debts and obligations up to the amount drawn out or received back. Provision substituted for section 4(3) enables participants to redeem units in the scheme without retaining liability for any debts of the partnership, and limits the liability of participants who hold units when debts fall to be discharged to the value of their units.

3.49 Section 6(5) of the 1907 Act allows a limited partner, with the consent of the general partners, to assign its partnership share. This is modified to prohibit the assignment of partnership shares (the transfer of units) except where assignment is permitted by FSA rules. Consideration will be given to the circumstances under which assignment might be permitted. This is in line with provision made for the transfer of units in relation to co-ownership schemes.

3.50 Section 6 is also modified so that no agreement between the partners may alter provision which allows the assignment of limited partners' shares, allows the introduction of new limited partners without the consent of existing ones, and disentitles a limited partner from dissolving the partnership by notice.

3.51 Other modifications made by new section 18 of the 1907 Act concern the depositary. Section 4 is modified to provide that the limited partner who is the depositary does not make a contribution to the partnership. Section 6 is modified to ensure that the depositary does not infringe the requirement that a limited partner shall not take part in the management of the partnership business. While the general partner (the operator) is intended to be wholly responsible for managing the scheme, the depositary is not a sleeping partner and has a distinct business role that could be regarded as participation in managing the business for the purposes of the 1907 Act.

3.52 Finally, section 18 modifies section 9 of the 1907 Act so that it is not necessary to register with the registrar of limited partnerships any changes in the identity of the limited partners of a partnership scheme or the sums that limited partners contribute to the scheme.

Box 3.F: Questions 25 to 27

Do you agree that regulation 3 makes appropriate provision for the amendment and modification of the Limited Partnerships Act 1907?

Do you agree that the prohibition on transfers of units in a partnership scheme should be qualified by contractual scheme rules made by the FSA? If you do, under what circumstances ought a unit-holder to be permitted to transfer units?

Does the Act need to be amended or modified in any other respect in relation to a partnership scheme?

Partnership scheme – umbrella schemes

3.53 HM Treasury takes the view that there is unlikely to be significant commercial demand for authorisation of partnership schemes as umbrella schemes. In view of the importance of ensuring that sub-schemes of any collective investment scheme are segregated, the regulations would have to make further, complicated provision to facilitate the authorisation of such schemes. Segregation would be essential to ensure that participants had limited liability at the level of the sub-scheme rather than in relation to the authorised scheme as a whole, and to avoid the risk of contagion between sub-schemes on winding up.

3.54 Consequently, the Regulations exclude the option of authorising partnership schemes with sub-schemes. This is achieved by providing that one of the conditions to be met by a partnership scheme is that the limited partnership deed does not provide for such pooling as is mentioned in section 235(3)(a) in relation to separate parts of the property.

Box 3.G: Question 28

Do you agree that there is no commercial need for umbrella partnership schemes and that in view of the complications that could arise from the authorisation of such schemes, legislative provision should exclude the option of establishing partnership schemes with sub-schemes? (See new FSMA section 235A(6)(c))

4 Tax Treatment

Introduction

4.1 Contractual schemes will be fiscally transparent. Fiscal transparency means that, for direct tax purposes, investors are treated as if they had invested directly in the underlying assets and are subject to tax accordingly. The scheme itself is not subject to corporation tax, income tax or capital gains tax.

4.2 If assets liable to UK stamp taxes are acquired by the scheme for the benefit of its participants then there will be a charge to the relevant stamp tax which will be paid directly by the operator on behalf of the scheme participants. There will be no charge to tax under Schedule 19 of the Finance Act 1999 and consideration will be given to further reliefs from stamp taxes in certain circumstances deemed necessary (see 4.18 below).

4.3 It is intended that authorised contractual schemes will be for "special investment funds" for VAT purposes. This means that charges made by the operator for its management services will be exempt from VAT.

Tax treatment of investors in contractual schemes

UK resident investors

4.4 Income arising to a contractual scheme will be treated as arising directly to the investor and the UK investor will be taxable on that income as it arises.

4.5 This tax transparency means that the investors will require detailed information about the source and timing of their share of the income arising to the scheme in order to meet their income or corporation tax obligations. It is recognised that the management costs of providing this information may make direct investment in transparent schemes uneconomic for most individual investors and for smaller corporate investors. However, retail investors are likely to have interest in these schemes indirectly through holdings in feeder funds that may be structured as AUTs or OEICs.

UK resident investors – treatment of capital gains

4.6 The fiscal transparency of contractual schemes would mean that, in the absence of tax legislation providing otherwise, the investor must 'look through' the fund for capital gains purposes in the same way as for income.

4.7 In the case of a co-ownership scheme it is intended to amend the rules for tax on capital gains, so that the asset held by the investor is treated as being their interest in the co-ownership scheme and not their share of the underlying assets. This means that a capital gain or loss may be realised on disposal of that interest. A capital gain or loss will not be attributable to the investor when a disposal is made by the scheme nor when the investors' precise share of a scheme asset increases or decreases through the contraction or expansion of the scheme. This treatment is consistent with the treatment of similar funds based outside of the UK.

4.8 It is not intended to make similar provision for partnership schemes. This means that in such a scheme the asset held by the investor will be their share of underlying assets and any alteration in those assets (such as a disposal of an asset by the scheme) may give rise to a capital gain or loss. This is consistent with the current UK tax treatment of limited partnerships.

Insurance companies

4.9 It is proposed to amend Section 212 of TCGA so that a holding of an insurance company in a co-ownership scheme will be included within that section, with the result that the company is deemed to dispose of and to reacquire the holding annually as is already the case with holdings of insurance companies in other authorised funds and offshore funds. The net chargeable gain arising from section 212 deemed disposals is spread over seven years.

Investors not resident in the UK

4.10 Non-resident investors will be treated for UK tax purposes as receiving income from the underlying source as it arises. In most cases this means that they will not be taxable in the UK on that income. Except as indicated in the paragraph below no UK tax will be withheld from any accumulations or distributions of the fund.

4.11 An exception to that is in any case where the income arises from real property situated in the UK, in which case a non-resident is liable to UK income tax on the income. The manager of the scheme must deduct income tax at the basic rate and account to HMRC for that tax.

4.12 The liability of non-resident investors in their own country of residence will be determined by the tax laws of that country.

Tax withheld by other jurisdictions

4.13 As a contractual scheme will be fiscally transparent, will not have any legal personality, and will not be a taxable person, neither the fund nor its managers acting on its behalf will be able to assert any rights under a UK tax treaty.

4.14 In any case where withholding tax is levied by the source state on any income or gains arising then it will be for the investor to consider whether any double taxation agreements between the investor's state of residence and the source state for the income enable reclaim of any withholding tax or set off of that tax against taxation in the investor's home state and to make any appropriate claims.

4.15 Certain institutional investors with tax-exempt status (e.g. pension funds and charities) may benefit from the introduction of the contractual scheme as it may reduce tax drag compared with investments into opaque non-exempt funds. The tax drag is the foreign withholding tax that an opaque and non-exempt fund would suffer before making distributions back to the tax-exempt investor. It has been demonstrated that investment funds structured in this inefficient manner over the past ten years would potentially have cumulatively foregone 5.8% of gains to overseas tax authorities as a proportion of the initial investment. Exempt funds currently investing in these types of opaque funds would benefit from moving to the contractual scheme. It is also the case that the introduction of the contractual scheme may create opportunities for fund-managers to market these schemes to tax exempt investors that were averse to investing indirectly due to this tax drag. This may provide opportunities for such investors to access a broader range of investments.

Box 4.A: Questions 29 and 30

To what extend do tax-exempt investors give up the benefit of their tax-exempt status by investing in non-exempt opaque funds?

As a tax exempt investor, would you consider investing through a transparent fund that achieved limited tax-drag? If so, what would be the driver of the decision (e.g. access to expertise in relation to an unfamiliar territory)?

Setting up a new contractual scheme – some tax implications

4.16 In certain circumstances setting up a new contractual scheme by seeding it with existing assets may give rise to tax liabilities being crystallised for the existing holder of those assets. This would however not be the case for UK authorised schemes wishing to transfer assets 'up' to a newly created transparent master fund as the authorised scheme will itself be exempt from corporation tax on chargeable gains.

4.17 Where assets are held by the long term fund of an insurance company then it is proposed that there will be a relief where assets are used to 'seed' a co-ownership scheme such that any latent chargeable gain in those assets falls into charge under section 212 TCGA and not immediately on transfer to the fund.

4.18 In light of the objective of ensuring that the UK can compete as a fund domicile for tax transparent funds, it is also proposed to provide relief from stamp duty and Stamp Duty Reserve Tax (SDRT) in certain circumstances:

1. The acquisition by a contractual fund of securities in exchange for issuing units in itself;
2. the acquisition by a contractual scheme of securities where the fund can and does only have charitable investors.

4.19 Consideration will also be given to the appropriate stamp duty and SDRT treatment of specific circumstances that may be identified as part of the consultation process – in particular, relating to umbrella schemes and where it is determined that transfer of units should be permitted by FSA rules. TTFs will be outside the charge to SDRT under Schedule 19 to the Finance Act 1999.

4.20 It is important that the stamp taxes regime for contractual schemes is not subject to abuse as this might ultimately undermine their legitimate use. The stamp taxes reliefs will therefore be subject to an anti-abuse rule. This is likely to be in the form of a tax avoidance purpose test but we would be interested in views on the best way of protecting the reliefs, taking into account the competitiveness of the scheme and the effectiveness of the protection.

Box 4.B: Questions 31 to 36

Do you agree that a co-ownership scheme may properly be regarded as tax transparent – i.e. that profits and income arising from the acquisition, holding, management and disposal of scheme property should not be chargeable to corporation tax as profits of the scheme, and investors in the scheme will be liable to tax on their share of the fund's income and on capital gains on disposal of their interest in the scheme?

Given that UK partnerships are already widely understood to be tax transparent, would you expect them to offer any tax benefits to investors that differ from those expected to be derived from investment in co-ownership schemes?

Do you consider that a UK contractual scheme would have tax advantages or disadvantages when compared with tax transparent funds established outside the UK?

Do you consider that the reliefs outlined ("Setting up a new contractual scheme") are necessary and also sufficient to enable and encourage contractual schemes to be set up?

Taking into account the TTF design, including the proposed umbrella structure and issues of transferability, in what other circumstances might relief/exemption be appropriate?

We would be interested in views on what the best way of protecting the reliefs, taking into account the effectiveness of the protection and competitiveness of the fund.

5 Updating FSA rules for contractual schemes

Introduction

5.1 The Regulatory framework for authorised investment funds (AIF) is set out in FSMA and the OEIC Regulations 2001, further supported by the FSA Handbook.

Structure of funds

5.2 Currently authorised collective investment schemes can be structured as AUTs or OEICs depending on whether the fund is set up as a trust or a body corporate. FSMA will now allow for authorised collective investment schemes to take the form of contractual schemes as either a co-ownership scheme or partnership scheme.

5.3 All authorised collective investment schemes (whichever legal form they take) will fall into one of the three categories of authorised funds defined by the FSA: UCITS, NURS or QIS. Consequently, contractual schemes may be established as UCITS, NURS or QIS.

COLL rules

5.4 The FSA handbook contains a number of different parts. The most pertinent for the operation of collective investment schemes is the COLL sourcebook which contains rules on matters including:

1. Fund constitution;
2. Relations with and rights of investors (e.g. when changes to the funds are proposed);
3. Qualitative and quantitative controls on funds' investment powers
4. Fund valuation, pricing, and dealing; and
5. Powers and responsibilities of funds' managers and depositaries.

5.5 Subject to consideration of a number of contractual scheme specific requirements, it is envisaged that the COLL sourcebook would apply in its entirety to contractual schemes wherever possible, i.e. treating contractual schemes in the same way as AUTs or OEICs. The contractual scheme regulation will enable the FSA to legislate accordingly to accommodate these tax transparent vehicles in COLL. Please note that the FSA will carry out a separate consultation on its proposed rule changes in spring 2012.

5.6 Discussions with industry groups have highlighted some areas of the COLL rules that may need to be amended for a contractual scheme. For example, the winding up rules in Chapter 7, the appointment and replacement of the authorised fund manager and depositary (see COLL 6.5), title and registers (see COLL 6.4) and the instrument constituting the scheme (see COLL 3.2).

Other FSA rules

5.7 The other parts of the FSA Handbook cover issues including systems and controls, prudential requirements and conduct of business requirements. Frequently they reflect the requirements of various European Directives (including UCITS IV). Because these provisions are aimed at the manager or depositary of the fund rather than the fund itself, many of them may already apply when an FSA authorised firm is involved with a contractual scheme.

Box 5.A: Questions 37 and 38

Are there any areas of the COLL rules and / or guidance where it would be inappropriate to treat contractual schemes in the same way as AUTs and OEICs? If so, which areas and why?

Are there any specific additional requirements needed in COLL to deal with the specificities of contractual schemes?

6 Consultation Process

How to respond

6.1 This document provides details on the proposed introduction of a tax transparent fund vehicle in the UK through the introduction of Contractual Scheme Regulations. Responses to the consultation should be sent by 19 March 2012.

By e-mail to taxtransparentfund@hmtreasury.gsi.gov.uk

By post to Contractual Scheme Consultation, Financial Regulation and Markets, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ

Please be aware that all responses may be shared with the Financial Services Authority.

6.2 All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

6.3 When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people or businesses you represent.

Confidentiality

6.4 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

6.5 If you want the information that you provide to be treated as confidential, please be aware that, under FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury or the Financial Services Authority.

6.6 HM Treasury and the Financial Services Authority will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A Authorised Funds

A.1 The types of collective investment scheme that may be promoted to the public under section 238 of FSMA (restrictions on promotion) are: an authorised unit trust scheme ("AUT"); a scheme constituted by an authorised open-ended investment company ("OEIC"); and a recognised scheme, which includes collective investment schemes constituted in another EEA State that satisfy requirements prescribed under other provisions of FSMA.

A.2 An authorised collective investment scheme, whether it is an AUT or an OEIC, may take on one of the following types of authorised fund and may accordingly be subject to different rules about promotion to the public:

1 Undertaking for Collective Investment in Transferable Securities (UCITS):

A UCITS scheme must meet the criteria and requirements laid down in the UCITS IV Directive and COLL. The Directive has been implemented by the Undertakings for Collective Investment in Transferable Securities Regulations 2011 (S.I. 2011/1613).

A UCITS is the only type of authorised collective investment scheme that, once authorised in one European member state, may market its units in any member state of the EU or EEA. The UCITS IV directive ensures that there is consistent regulation of such schemes throughout the EU.

2 Non-UCITS Retail Scheme (NURS):

A NURS is a scheme that may be promoted to retail investors, but does not fall within the scope of the UCITS directive. Consequently a NURS will not benefit from the cross-border passporting rights conferred by the UCITS directive on a UCITS scheme.

A NURS has investment and borrowing powers that permit investment in assets restricted or prohibited by the UCITS IV directive (including real estate, gold and certain funds of funds).

3 Qualified Investor Scheme (QIS):

A QIS is open to investment only by "qualified investors" for example corporations, institutions and sophisticated individuals who can reasonably be expected to understand the risks involved in a wider range of investments and investment strategies.

A QIS has wide investment and borrowing powers, which are constrained to some extent by Chapter 8 of COLL. The breadth of permissible investment is proportionate to the competence of its permitted investors to understand the scheme strategy and appreciate the risks involved.

A.3 Chapter VIII of UCITS IV introduces the ability for UCITS funds to establish master-feeder arrangements. A master UCITS is defined as: a UCITS which has among its unitholders at least one feed UCITS, is not itself a feeder UCITS and does not hold units of a feeder UCITS. If the master UCITS has at least two feeder UCITS as unitholders (which invest at least 85% of their assets in units of the master UCITS) the master UCITS has the choice as to whether or not to raise capital from the public.

B Regulations

B.1 The following pages contain the draft statutory instruments for The Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2012.

Draft Regulations laid before Parliament under paragraph 2 of Schedule 2 to the European Communities Act 1972, for approval by resolution of each House of Parliament.

D R A F T   S T A T U T O R Y   I N S T R U M E N T S

2012 No. 000

FINANCIAL SERVICES AND MARKETS

The Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2012

Made - - - -	***
Coming into force - -	***

The Treasury are a government department designated(**a**) for the purposes of section 2(2) of the European Communities Act 1972(**b**) in relation to collective investment in transferable securities and other liquid assets, and to measures relating to investment firms and the provision of investment services.

The Treasury make the following Regulations in exercise of the powers conferred on them under section 2(2) of the European Communities Act 1972.

A draft of these Regulations has been laid before and approved by a resolution of each House of Parliament in accordance with paragraph 2 of Schedule 2 to the European Communities Act 1972.

PART 1

CITATION AND COMMENCEMENT

1. These Regulations may be cited as the Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2012, and come into force on [ ] 2012.

PART 2

AMENDMENTS TO THE FINANCIAL SERVICES AND MARKETS ACT 2000

Amendments to the Financial Services and Markets Act 2000

2.—(1) The Financial Services and Markets Act 2000(**c**) is amended as follows.

(**a**) S.I. 1993/2661; S.I. 2002/2840.
(**b**) 1972 c.68. Section 2(2) was amended by section 27(1)(a) of the Legislative and Regulatory Reform Act 2006 (c.51) and the European Union (Amendment) Act 2008 (c.7), Schedule, Part 1. Paragraph 1A of Schedule 2 was inserted by section 28 of the Legislative and Regulatory Reform Act 2006 and amended by the European Union (Amendment) Act 2008, Schedule, Part 1.
(**c**) 2000 c.8.

(2) In section 140 (restriction on managers of certain collective investment schemes)—

(a) in subsection (1)(**a**), after paragraph (a) omit "or" and insert—

"(aa) the operator of an authorised contractual scheme, or"; and

(b) after subsection (2) insert—

"(2A) In this section "authorised contractual scheme" and "the operator" in relation to such a scheme have the same meaning as in section 237.".

(3) In section 148 (modification or waiver of rules), in subsection (2)(**b**), for "or section 248 (scheme particulars rules)" substitute ", section 248 (scheme particulars rules), section 261H (contractual scheme rules) or section 261I (contractual scheme particulars rules)".

(4) After section 235 (collective investment schemes) insert—

"**235A.—Contractual schemes**

(1) In this Part "contractual scheme" means—

(a) a co-ownership scheme; or

(b) a partnership scheme.

(2) A "co-ownership scheme" is a collective investment scheme which satisfies the conditions in subsection (3).

(3) The conditions are—

(a) that the arrangements constituting the collective investment scheme are contractual;

(b) that they are set out in a deed that is entered into between the operator and the depositary and meets the requirements of subsection (4);

(c) that the scheme does not constitute a body corporate, a partnership or a limited partnership; and

(d) that the property subject to the scheme—

(i) is held by a depositary; and

(ii) is beneficially owned by the participants as tenants in common (or, in Scotland, is the common property of the participants).

(4) The deed—

(a) must make provision for the issue and redemption of units;

(b) must prohibit the transfer of units, except where transfer is permitted by contractual scheme rules;

(c) must authorise the operator—

(i) to acquire, manage and dispose of property for the purposes of the scheme; and

(ii) for the purposes of, or in connection with, any acquisition or disposal of property, to enter into contracts which are binding on the participants;

(d) subject to that, must not authorise the operator to enter into contracts; and

(e) must specify the conditions under which the operator and depositary are required to wind up the scheme.

(5) A "partnership scheme" is a collective investment scheme which satisfies the conditions in subsection (6).

(6) The conditions are—

(a) that the scheme is a limited partnership;

(b) that the limited partnership—

(**a**) Section 140(1) was substituted by S.I. 2003/2066.
(**b**) Section 148(2) was substituted by S.I. 2007/1973.

(i) is formed by deed;

(ii) at any time has only one general partner; and

(iii) on formation, has only one limited partner, who is the proposed depositary;

(c) that the deed does not provide for such pooling as is mentioned in section 235(3)(a) in relation to separate parts of the property; and

(d) that the deed provides that if an authorisation order is made in respect of the limited partnership under section 261D—

(i) the partnership property subject to the scheme is to be held by a depositary;

(ii) the depositary must be a limited partner;

(iii) every other limited partner is to be a participant in the scheme; and

(iv) units are to be issued to participants in exchange for a contribution to the partnership.

(7) In this section "general partner", "limited partner" and "limited partnership" have the same meaning as in the Limited Partnerships Act 1907.

(8) In this Part "contractual scheme deed" means—

(a) in relation to a co-ownership scheme, the deed referred to in subsection (3)(b); and

(b) in relation to a partnership scheme, the deed forming the limited partnership.".

(5) In section 237 (other definitions)—

(a) in subsection (1), at the end insert ", except that it does not include a contractual scheme";

(b) in subsection (2), in the definition of "the operator"(**a**), after paragraph (a) insert—

"(aa) in relation to a co-ownership scheme, means the person who is responsible under the terms of the contractual scheme deed for the management of the scheme and the property subject to the scheme;

(ab) in relation to a partnership scheme, means the general partner;"; and

(c) in subsection (3)—

(i) after the definition of "an authorised unit trust scheme" insert—

""an authorised contractual scheme" means a contractual scheme which is authorised for the purposes of this Act by an authorisation order in force under section 261D;"; and

(ii) in the definition of "UK UCITS"(**b**), after "which is a feeder UCITS of an authorised unit trust scheme" insert ", an authorised contractual scheme".

(6) In section 238 (restrictions on promotion), in subsection (4), after paragraph (a) insert "(aa) an authorised contractual scheme;".

(7) In section 249 (disqualification of auditor for breach of trust scheme rules), in subsection (1), after "unit trust scheme" insert ", authorised contractual scheme".

(8) In section 261B(**c**) (information for feeder UCITS), in subsection (1), after "feeder UCITS of an authorised unit trust scheme" insert ", an authorised contractual scheme".

(9) After section 261B insert—

(**a**) This definition was substituted by S.I. 2011/1613.
(**b**) This definition was inserted by S.I. 2011/1613.
(**c**) Section 261B was inserted by S.I. 2011/1613.

“CHAPTER 3A

AUTHORISED CONTRACTUAL SCHEMES

Applications for authorisation

261C.—Applications for authorisation of contractual schemes

(1) Any application for an order declaring a contractual scheme to be an authorised contractual scheme must be made to the Authority by the operator and depositary, or proposed operator and depositary, of the scheme.

(2) The application—

(a) must be made in such manner as the Authority may direct;

(b) must state the corporate name and registered or principal office of the depositary or proposed depositary; and

(c) in the case of a partnership scheme, must be accompanied by a copy of the certificate of registration as a limited partnership under the Limited Partnerships Act 1907 certified in accordance with section 16(2) of that Act.

(3) At any time after receiving an application and before determining it, the Authority may require the applicant to provide it with such further information as it reasonably considers necessary to enable it to determine the application.

(4) Different directions may be given, and different requirements imposed, in relation to different applications.

(5) The Authority may require an applicant to present information which it is required to give under this section in such form, or to verify it in such a way, as the Authority may direct.

261D.—Authorisation orders

(1) If, on an application under section 261C in respect of a contractual scheme, the Authority—

(a) is satisfied that the scheme complies with the requirements set out in this section,

(b) is satisfied that the scheme complies with the requirements of the contractual scheme rules, and

(c) has been provided with a copy of the contractual scheme deed and a certificate signed by a solicitor to the effect that it complies with such of the requirements of this section or those rules as relate to its contents,

the Authority may make an order declaring the scheme to be an authorised contractual scheme.

(2) If the Authority makes an order under subsection (1), it must give written notice of the order to the applicant.

(3) In this Chapter “authorisation order” means an order under subsection (1).

(4) The operator and the depositary must be persons who are independent of each other.

(5) The operator and the depositary must each be a body corporate incorporated in the United Kingdom or another EEA State, and the affairs of each must be administered in the country in which it is incorporated.

(6) The depositary must have a place of business in the United Kingdom, and the operator must have a place of business in the United Kingdom or in another EEA State.

(7) If the operator is incorporated in another EEA State, the scheme must not be one which satisfies the requirements prescribed for the purposes of section 264.

(8) The operator and the depositary must each be an authorised person, and the operator must have permission to act as operator and the depositary must have permission to act as depositary.

(9) The operator must be a fit and proper person to manage the scheme to which the application relates.

(10) The name of the scheme must not be undesirable or misleading.

(11) The purposes of the scheme must be reasonably capable of being successfully carried into effect.

(12) The participants must be entitled to have their units redeemed in accordance with the contractual scheme deed at a price—

(a) related to the net value of the property to which the units relate; and

(b) determined in accordance with the contractual scheme deed.

261E.—Determination of applications

(1) Subject to subsection (2), an application under section 261C must be determined by the Authority before the end of the period of six months beginning with the date on which it receives the completed application.

(2) An application under section 261C for authorisation of a contractual scheme which is a UCITS must be determined by the Authority before the end of two months beginning with the date on which it receives the application.

(3) The Authority may determine an incomplete application if it considers it appropriate to do so; and it must in any event determine such an application within twelve months beginning with the date on which it first receives the application.

(4) The applicants may withdraw their application, by giving the Authority written notice, at any time before the Authority determines it.

Applications refused

261F.—Procedure when refusing an application

(1) If the Authority proposes to refuse an application made under section 261C, it must give the applicant a warning notice.

(2) If the Authority decides to refuse the application—

(a) it must give the applicant a decision notice; and

(b) the applicant may refer the matter to the Tribunal.

Certificates

261G.—Certificates

(1) If the operator of a contractual scheme which complies with the conditions necessary for it to enjoy the rights conferred by any relevant EU instrument so requests, the Authority may issue a certificate to the effect that the scheme complies with those conditions.

(2) Such a certificate may be issued on the making of an authorisation order in respect of the scheme or at any subsequent time.

Rules

261H.—Contractual scheme rules

(1) The Authority may by rules (“contractual scheme rules”) make in relation to authorised contractual schemes provision corresponding to that which may be made under section 247 in relation to authorised unit trust schemes.

(2) For the purposes of subsection (1), section 247 is to be read with the following modifications—

(a) a reference to trust scheme rules is to be read as a reference to contractual scheme rules;

(b) a reference to authorised unit trust schemes is to be read as a reference to authorised contractual schemes;

(c) a reference to the manager is to be read as a reference to the operator;

(d) a reference to the trustee is to be read as a reference to the depositary; and

(e) a reference to the trust deed is to be read as a reference to the contractual scheme deed.

(3) The Treasury's power by order under section 247(5) to modify the Authority's power to make trust scheme rules shall also be exercisable in relation to the Authority's power to make contractual scheme rules.

(4) For the purposes of subsection (3), section 247(5) is to be read as if the reference to authorised unit trust schemes were a reference to authorised contractual schemes.

261I.—Contractual scheme particulars rules

(1) The Authority may by rules "contractual scheme particulars rules" make in relation to authorised contractual schemes provision corresponding to that which may be made under section 248 in relation to authorised unit trust schemes.

(2) For the purposes of subsection (1), section 248 is to be read with the following modifications—

(a) a reference to scheme particulars rules is to be read as a reference to contractual scheme particulars rules;

(b) a reference to scheme particulars is to be read as a reference to contractual scheme particulars; and

(c) a reference to the manager of an authorised unit trust scheme is to be read as a reference to the operator of an authorised contractual scheme.

261J.—Disqualification of auditor for breach of contractual scheme rules

(1) If it appears to the Authority that an auditor has failed to comply with a duty imposed on the auditor by contractual scheme rules, it may disqualify the auditor from being the auditor for any authorised unit trust scheme, authorised contractual scheme or authorised open-ended investment company.

(2) Subsections (2) to (5) of section 345 have effect in relation to disqualification under subsection (1) as they have effect in relation to disqualification under subsection (1) of that section.

261K.—Modification or waiver of rules

(1) In this section "rules" means—

(a) contractual scheme rules; or

(b) contractual scheme particulars rules.

(2) The Authority may, on the application or with the consent of any person to whom rules apply, direct that all or any of the rules—

(a) are not to apply to that person as respects a particular scheme; or

(b) are to apply to that person, as respects a particular scheme, with such modifications as may be specified in the direction.

(3) The Authority may, on the application or with the consent of the operator and depositary of a particular scheme acting jointly, direct that all or any of the rules—

(a) are not to apply to the scheme; or

(b) are to apply to the scheme with such modifications as may be specified in the direction.

(4) Subsections (3) to (9) and (11) of section 148 have effect in relation to a direction under subsection (2) as they have effect in relation to a direction under section 148(2) but with the following modifications—

(a) any reference to the person is to be read as a reference to the person mentioned in subsection (2); and

(b) subsection (7)(b) is to be read, in relation to a participant in the scheme, as if the word "commercial" were omitted.

(5) Subsections (3) to (9) and (11) of section 148 have effect in relation to a direction under subsection (3) as they have effect in relation to a direction under section 148(2) but with the following modifications—

(a) subsection (4)(a) is to be read as if the words "by the person" were omitted;

(b) subsections (7)(b) and (11) are to be read as if references to the person were references to each of the operator and the depositary of the scheme;

(c) subsection (7)(b) is to be read, in relation to a participant in the scheme, as if the word "commercial" were omitted;

(d) subsection (8) is to be read as if the reference to the person concerned were a reference to the scheme concerned and to its operator and depositary; and

(e) subsection (9) is to be read as if the reference to the person were a reference to the operator and depositary of the scheme acting jointly.

Co-ownership scheme: contracts and liability of participants

261L.—Contracts

(1) In this section "authorised contract" means a contract which—

(a) is entered into by the operator of an authorised contractual scheme which is a co-ownership scheme; and

(b) is binding on the participants in the scheme.

(2) The operator of such a scheme (but no other person) may on behalf of the participants in the scheme—

(a) take and defend proceedings for the resolution of any matter relating to an authorised contract; and

(b) take action in relation to the enforcement of any judgment given in such proceedings.

(3) A person who enters into an authorised contract with the operator is deemed to have actual knowledge of the scope of the authority given to the operator by the contractual scheme deed.

(4) The validity of an authorised contract shall not be called into question on the ground that a participant lacks capacity to authorise the operator to enter into such a contract.

(5) This section does not apply to a co-ownership scheme to which section 261N applies.

261M.—Limited liability

(1) A participant in an authorised contractual scheme which is a co-ownership scheme shall not be liable for debts arising from the acquisition, management or disposal of the property subject to the scheme beyond the amount which, at the time when any debts fall to be discharged, is equal to the value at that time of the participant's units.

(2) This section does not apply to a co-ownership scheme to which section 261N applies.

261N.—Pooling in relation to separate parts of the property

(1) This section applies to an authorised contractual scheme which is a co-ownership scheme and is constituted by arrangements that provide for such pooling as is mentioned in section 235(3)(a) in relation to separate parts of the property.

(2) In this section—

"authorised contract" means a contract which—

(a) is entered into by the operator of an umbrella scheme; and

(b) is binding on the participants in a sub-scheme;

"umbrella scheme" means a scheme to which this section applies; and

"sub-scheme", in relation to an umbrella scheme, means one of the separate parts of the property in relation to which provision is made for such pooling as is mentioned in section 235(3)(a).

(3) The property subject to a sub-scheme is beneficially owned by the participants in that sub-scheme and must not be used to discharge any liabilities of the participants in any other sub-scheme.

(4) Any liability of the participants in a sub-scheme arising from the acquisition, management or disposal of the property subject to the sub-scheme shall be discharged solely out of that property.

(5) A participant in an umbrella scheme shall not be liable for debts arising from the acquisition, management or disposal of the property subject to a sub-scheme in which the participant has units beyond the amount which, at the time when any debts fall to be discharged, is equal to the value at that time of the participant's units in that sub-scheme.

(6) The operator (but no other person) may on behalf the participants in a sub-scheme—

(a) take and defend proceedings for the resolution of any matter relating to an authorised contract; and

(b) take action in relation to the enforcement of any judgment given in such proceedings.

(7) A person who enters into an authorised contract with the operator is deemed to have actual knowledge of the scope of the authority given to the operator by the contractual scheme deed.

(8) The validity of an authorised contract shall not be called into question on the ground that a participant lacks capacity to authorise the operator to enter into such a contract.

(9) The Authority may give a direction under section 261V(2) in relation to a sub-scheme as if the sub-scheme were an authorised contractual scheme, but this subsection does not empower the Authority to apply to the court for an order under section 261W.

(10) Where such a direction is given, the reference to the scheme in section 261Y(6) is to be read as a reference to the sub-scheme concerned.

Alterations

261O.—Alteration of contractual schemes and changes of operator or depositary

(1) The operator of an authorised contractual scheme must give written notice to the Authority of any proposal to make an alteration to the scheme, other than an alteration—

(a) to which section 261Q applies; or

(b) to which Part 4 of the Undertakings for Collective Investment in Transferable Securities Regulations 2011(**a**) (mergers) applies.

(**a**) S.I. 2011/1613.

(2) Any notice given in respect of a proposal to alter the scheme involving a change in the contractual scheme deed must be accompanied by a certificate signed by a solicitor to the effect that the change will not affect the compliance of the deed with the contractual scheme rules.

(3) The operator of an authorised contractual scheme must give written notice to the Authority of any proposal to replace the depositary of the scheme.

(4) The depositary of an authorised contractual scheme must give written notice to the Authority of any proposal to replace the operator of the scheme.

(5) Effect is not to be given to any proposal of which notice has been given under subsection (1), (3) or (4) unless—

(a) the Authority, by written notice, has given its approval to the proposal; or

(b) one month, beginning with the date on which the notice was given, has expired without the operator or the depositary having received from the Authority a warning notice under section 261P in respect of the proposal.

(6) The Authority must not approve a proposal to replace the operator or the depositary of an authorised contractual scheme unless it is satisfied that, if the proposed replacement is made, the scheme will continue to comply with the requirements of section 261D(4) to (9).

261P.—Procedure when refusing approval of a proposal under section 261O

(1) If the Authority proposes to refuse approval of a proposal under section 261O to replace the depositary or operator of an authorised contractual scheme, it must give a warning notice to the person by whom notice of the proposal was given under section 261O(3) or (4).

(2) If the Authority proposes to refuse approval of a proposal under section 261O to alter an authorised contractual scheme, it must give separate warning notices to the operator and the depositary of the scheme.

(3) To be valid the warning notice must be received by the person to whom it is given before the end of one month beginning with the date on which notice of the proposal was given.

(4) If, having given a warning notice to a person, the Authority decides to refuse approval—

(a) it must give that person a decision notice; and

(b) that person may refer the matter to the Tribunal.

261Q.—Proposal to convert to a non-feeder UCITS

(1) This section applies where the operator of an authorised contractual scheme which is a feeder UCITS proposes to make an alteration to the scheme which—

(a) involves a change in the contractual scheme deed, and

(b) will enable the scheme to convert into a UCITS which is not a feeder UCITS.

(2) The operator must give written notice of the proposal to the Authority.

(3) Any notice given in respect of such a proposal must be accompanied by—

(a) a certificate signed by a solicitor to the effect that the change will not affect the compliance of the deed with the contractual scheme rules; and

(b) the specified information.

(4) The Authority must, within 15 working days after the date on which it received the notice under subsection (2), give—

(a) written notice to the operator of the scheme that the Authority approves the proposed amendments to the contractual scheme deed, or

(b) separate warning notices to the operator and depositary of the scheme that the Authority proposes to refuse approval of the proposed amendments.

(5) Effect is not to be given to any proposal of which notice has been given under subsection (2) unless the Authority, by written notice, has given its approval to the proposal.

(6) If, having given a warning notice to a person, the Authority decides to refuse approval—

(a) it must give that person a decision notice; and

(b) that person may refer the matter to the Tribunal.

(7) Subsection (8) applies where—

(a) the notice given under subsection (2) relates to a proposal to amend the contractual scheme deed of a feeder UCITS to enable it to convert into a UCITS which is not a feeder UCITS following the winding-up of its master UCITS; and

(b) the proceeds of the winding-up are to be paid to the feeder UCITS before the date on which the feeder UCITS proposes to start investing in accordance with the new investment objectives and policy provided for in its amended contractual scheme deed and contractual scheme rules.

(8) Where this subsection applies, the Authority may only approve the proposal subject to the conditions set out in section 283A(5) and (6).

(9) In this section "specified" means—

(a) specified in rules made by the Authority to implement the UCITS directive, or

(b) specified in any directly applicable Community regulation or decision made under the UCITS directive.

Exclusion clauses

261R.—Avoidance of exclusion clauses

Any provision of the contractual scheme deed of an authorised contractual scheme is void in so far as it would have the effect of exempting the operator or the depositary from liability for any failure to exercise due care and diligence in the discharge of its functions in respect of the scheme.

Ending of authorisation

261S.—Revocation of authorisation order otherwise than by consent

(1) An authorisation order may be revoked by an order made by the Authority if it appears to the Authority that—

(a) one or more of the requirements for the making of the order are no longer satisfied;

(b) the operator or depositary of the scheme concerned has contravened a requirement imposed on the operator or depositary by or under this Act;

(c) the operator or depositary of the scheme has, in purported compliance with any such requirement, knowingly or recklessly given the Authority information which is false or misleading in a material particular;

(d) no regulated activity is being carried on in relation to the scheme and the period of that inactivity began at least twelve months earlier; or

(e) none of paragraphs (a) to (d) applies, but it is desirable to revoke the authorisation order in order to protect the interests of participants or potential participants in the scheme.

(2) For the purposes of subsection (1)(e), the Authority may take into account any matter relating to—

(a) the scheme;

(b) the operator or depositary;

(c) any person employed by or associated with the operator or depositary in connection with the scheme;

(d) any director of the operator or depositary;

(e) any person exercising influence over the operator or depositary;

(f) any body corporate in the same group as the operator or depositary;

(g) any director of any such body corporate;

(h) any person exercising influence over any such body corporate.

261T.—Procedure for revoking authorisation order

(1) If the Authority proposes to make an order under section 261S revoking an authorisation order ("a revoking order"), the Authority must give separate warning notices to the operator and the depositary of the scheme.

(2) If the Authority decides to make a revoking order it must without delay give each of them a decision notice and either of them may refer the matter to the Tribunal.

261U.—Requests for revocation of authorisation order

(1) An authorisation order may be revoked by an order made by the Authority at the request of the operator or depositary of the scheme concerned.

(2) If the Authority makes an order under subsection (1), it must give written notice of the order to the operator and depositary of the scheme concerned.

(3) The Authority may refuse a request to make an order under this section if it considers that—

(a) the public interest requires that any matter concerning the scheme should be investigated before a decision is taken as to whether the authorisation order should be revoked; or

(b) revocation would not be in the interests of the participants or would be incompatible with an EU obligation.

(4) If the Authority proposes to refuse a request under this section, it must give separate warning notices to the operator and the depositary of the scheme.

(5) If the Authority decides to refuse the request, it must without delay give each of them a decision notice and either of them may refer the matter to the Tribunal.

Powers of intervention

261V.—Directions

(1) The Authority may give a direction under this section if it appears to the Authority that—

(a) one or more of the requirements for the making of an authorisation order are no longer satisfied;

(b) the operator or depositary of an authorised contractual scheme has contravened, or is likely to contravene, a requirement imposed—

(i) by or under this Act; or

(ii) by any directly applicable Community regulation or decision made under the UCITS directive;

(c) the operator or depositary of such a scheme has, in purported compliance with any such requirement, knowingly or recklessly given the Authority information which is false or misleading in a material particular; or

(d) none of paragraphs (a) to (c) applies, but it is desirable to give a direction in order to protect the interests of participants or potential participants in such a scheme.

(2) A direction under this section may—

(a) require the operator of the scheme to cease the issue or redemption, or both the issue and redemption, of units under the scheme;

(b) require the operator and depositary of the scheme to wind it up.

(3) If the authorisation order is revoked, the revocation does not affect any direction under this section which is then in force.

(4) A direction may be given under this section in relation to a scheme in the case of which the authorisation order has been revoked if a direction under this section was already in force at the time of revocation.

(5) If a person contravenes a direction under this section, section 150 applies to the contravention as it applies to a contravention mentioned in that section.

(6) The Authority may revoke or vary a direction given under this section, either on its own initiative or on the application of a person to whom the direction was given, if it appears to the Authority—

(a) in the case of revocation, that it is no longer necessary for the direction to take effect or continue in force;

(b) in the case of variation, that the direction should take effect or continue in force in a different form.

261W.—Applications to the court

(1) If the Authority could give a direction under section 261V, it may also apply to the court for an order—

(a) removing the operator or the depositary, or both the operator and the depositary, of the scheme; and

(b) replacing the person or persons removed with a suitable person or persons nominated by the Authority.

(2) The Authority may nominate a person for the purposes of subsection (1)(b) only if it is satisfied that, if the order was made, the requirements of section 261D(4) to (9) would be complied with.

(3) If it appears to the Authority that there is no person it can nominate for the purposes of subsection (1)(b), it may apply to the court for an order—

(a) removing the operator or the depositary, or both the operator and the depositary, of the scheme; and

(b) appointing an authorised person to wind up the scheme.

(4) On an application under this section the court may make such order as it thinks fit.

(5) The court may, on the application of the Authority, rescind any such order as is mentioned in subsection (3) and substitute such an order as is mentioned in subsection (1).

(6) The Authority must give written notice of the making of an application under this section to the operator and depositary of the scheme concerned.

(7) The jurisdiction conferred by this section may be exercised by—

(a) the High Court;

(b) in Scotland, the Court of Session.

261X.—Winding up or merger of master UCITS

(1) Subsection (2) applies if a master UCITS which has one or more feeder UCITS which are authorised contractual schemes is wound up, whether as a result of a direction given by

the Authority under section 261V, an order of the court under section 261W, rules made by the Authority or otherwise.

(2) The Authority must direct the operator and depositary of any authorised contractual scheme which is a feeder UCITS of the master UCITS to wind up the feeder UCITS unless—

(a) the Authority approves under section 283A the investment by the feeder UCITS of at least 85% of the total property which is subject to the collective investment scheme constituted by the feeder UCITS in units of another UCITS or master UCITS; or

(b) the Authority approves under section 261Q an amendment of the contractual scheme deed of the feeder UCITS which would enable it to convert into a UCITS which is not a feeder UCITS.

(3) Subsection (4) applies if a master UCITS which has one or more feeder UCITS which are authorised contractual schemes—

(a) merges with another UCITS, or

(b) is divided into two or more UCITS.

(4) The Authority must direct the operator and depositary of any authorised contractual scheme which is a feeder UCITS of the master UCITS to wind up the scheme unless—

(a) the Authority approves under section 283A the investment by the scheme of at least 85% of the total property which is subject to the collective investment scheme constituted by the feeder UCITS in the units of—

(i) the master UCITS which results from the merger;

(ii) one of the UCITS resulting from the division; or

(iii) another UCITS or master UCITS;

(b) the Authority approves under section 261Q an amendment of the contractual scheme deed of the scheme concerned which would enable it to convert into a UCITS which is not a feeder UCITS.

261Y.—Procedure on giving directions under section 261V or 261X and varying them on Authority's own initiative

(1) A direction under section 261V or 261X takes effect—

(a) immediately, if the notice given under subsection (3) states that that is the case;

(b) on such date as may be specified in the notice; or

(c) if no date is specified in the notice, when the matter to which it relates is no longer open to review.

(2) A direction may be expressed to take effect immediately (or on a specified date) only if the Authority, having regard to the ground on which it is exercising its power under section 261V, considers that it is necessary for the direction to take effect immediately (or on that date).

(3) If the Authority proposes to give a direction under section 261V, or gives such a direction with immediate effect, it must give separate written notice to the operator and depositary of the scheme concerned.

(4) The notice must—

(a) give details of the direction;

(b) inform the person to whom it is given of when the direction takes effect;

(c) state the Authority's reasons for giving the direction and for its determination as to when the direction takes effect;

(d) inform the person to whom it is given that representations may be made to the Authority within such period as may be specified in it (whether or not the matter has been referred to the Tribunal); and

(e) inform the person to whom it is given of the right to refer the matter to the Tribunal.

(5) If the direction imposes a requirement under section 261V(2)(a), the notice must state that the requirement has effect until—

(a) a specified date; or

(b) a further direction.

(6) If the direction is given under section 261V(2)(b) or section 261X(2) or (4), the scheme must be wound up—

(a) by a date specified in the notice; or

(b) if no date is specified, as soon as practicable.

(7) The Authority may extend the period allowed under the notice for making representations.

(8) If, having considered any representations made by a person to whom the notice was given, the Authority decides—

(a) to give the direction in the way proposed, or

(b) if it has been given, not to revoke the direction,

it must give separate written notice to the operator and the depositary of the scheme concerned.

(9) If, having considered any representations made by a person to whom the notice was given, the Authority decides—

(a) not to give the direction in the way proposed,

(b) to give the direction in a way other than that proposed, or

(c) to revoke a direction which has effect,

it must give separate written notice to the operator and the depositary of the scheme concerned.

(10) A notice given under subsection (8) must inform the person to whom it is given of the right to refer the matter to the Tribunal.

(11) A notice under subsection (9)(b) must comply with subsection (4).

(12) If a notice informs a person of that person's right to refer a matter to the Tribunal, it must give an indication of the procedure on such a reference.

(13) This section applies to the variation of a direction on the Authority's own initiative as it applies to the giving of a direction.

(14) For the purposes of subsection (1)(c), whether a matter is open to review is to be determined in accordance with section 391(8).

261Z.—Procedure: refusal to revoke or vary direction

(1) If on an application under section 261V(6) for a direction to be revoked or varied the Authority proposes—

(a) to vary the direction otherwise than in accordance with the application, or

(b) to refuse to revoke or vary the direction,

it must give the applicant a warning notice.

(2) If the Authority decides to refuse to revoke or vary the direction—

(a) it must give the applicant a decision notice; and

(b) the applicant may refer the matter to the Tribunal.

261Z1.—Procedure: revocation of direction and grant of request for variation

(1) If the Authority decides on its own initiative to revoke a direction under section 261V it must give separate written notice of its decision to the operator and depositary of the scheme.

(2) If on an application under section 261V(6) for a direction to be revoked or varied the Authority decides to revoke the direction or vary it in accordance with the application, it must give the applicant written notice of its decision.

(3) A notice under this section must specify the date on which the decision takes effect.

(4) The Authority may publish such information about the revocation or variation, in such way, as it considers appropriate.

261Z2.—Information for home state regulator

(1) Subsection (2) applies if, in accordance with rules made by the Authority to implement Article 66 of the UCITS directive, the Authority is informed by the operator of an authorised contractual scheme which is a master UCITS that a feeder UCITS which invests in units of the scheme is an EEA UCITS.

(2) The Authority must immediately inform the home state regulator of the feeder UCITS of the investment made by that UCITS in the master UCITS.

261Z3.—Information for feeder UCITS

(1) The Authority must immediately inform the operator of any authorised contractual scheme which is a feeder UCITS of an authorised unit trust scheme, an authorised contractual scheme or an authorised open-ended investment company (the master UCITS) of—

(a) any failure of which the Authority becomes aware by the master UCITS to comply with a provision made in implementation of Chapter VIII of the UCITS directive;

(b) any warning notice or decision notice given to the master UCITS in relation to a contravention of any provision made in implementation of Chapter VIII of the UCITS directive by or under any enactment or in rules of the Authority;

(c) any information reported to the Authority pursuant to rules of the Authority made to implement Article 106(1) of the UCITS directive which relates to the master UCITS, or to one or more of its directors, or its management company, trustee, depositary or auditor.

(2) The Authority must immediately inform the operator of any authorised contractual scheme which is a feeder UCITS of an EEA UCITS of any information received from the home state regulator of the EEA UCITS in relation to—

(a) any failure by the EEA UCITS to comply with any requirement in Chapter VIII of the UCITS directive;

(b) any decision or measure imposed on the EEA UCITS under provisions implementing Chapter VIII of the UCITS directive;

(c) any information reported to the home state regulator pursuant to Article 106(1) of the UCITS directive relating to the EEA UCITS, its operator, depositary or auditor.

(3) Where the Authority has the information described in subsection (1)(a), (b) or (c) in relation to an authorised contractual scheme which is a master UCITS for one or more feeder UCITS which are EEA UCITS, the Authority must immediately give that information to the home state regulator of each feeder UCITS established outside the United Kingdom.

Co-ownership scheme: winding up by the court

261Z4.—Winding up as an unregistered company under the Insolvency Act 1986

(1) In this section—

“the 1986 Act” means the Insolvency Act 1986;

“sub-scheme”, in relation to an umbrella scheme, means any of the separate parts of the property in relation to which provision is made for such pooling as is mentioned in section 235(3)(a); and

“umbrella scheme” means a scheme to which section 261N applies.

(2) Part 5 of the 1986 Act applies to—

(a) a co-ownership scheme which is not an umbrella scheme, and

(b) a sub-scheme of an umbrella scheme,

as if each were an unregistered company within the meaning given by section 220 of that Act.

(3) Where a co-ownership scheme which is not an umbrella scheme is wound up as an unregistered company under Part 5 of the 1986 Act, the provisions of that Act which are applicable to the scheme by virtue of section 221 of that Act are to be read with the following modifications.

(4) Part 5 of the 1986 Act has effect as if section 223 were omitted.

(5) If, before the presentation of a petition for the winding up by the court of a co-ownership scheme as an unregistered company, the scheme is being wound up by virtue of a direction given by the Authority under section 261V(2)(b) or 261X(2) or (4)—

(a) section 129(2) of the 1986 Act does not apply; and

(b) any winding up of the scheme by the court is to be deemed to have commenced at the time at which the direction was given.

(6) If, before the presentation of a petition for the winding up by the court of a co-ownership scheme as an unregistered company, the court has appointed a person to wind up the scheme on the application of the Authority under section 261W(3)(b)—

(a) section 129(2) of the 1986 Act does not apply; and

(b) any winding up upon the petition concerned is to be deemed to have commenced on the date of the order making that appointment.

(7) In so far as the provisions of Part 4 of the 1986 Act apply to a co-ownership scheme which is wound up as an unregistered company, those provisions are to be read as if any reference to the directors or to a director or an officer of the company included a reference to the operator and the depositary of a co-ownership scheme.

(8) Where a sub-scheme of an umbrella scheme is wound up as an unregistered company under Part 5 of the 1986 Act, the provisions of that Act which are applicable to the sub-scheme by virtue of section 221 of that Act are to be read with the modifications in subsections (4), (5) and (7), except that—

(a) those subsections are to be read as if the words “a sub-scheme” were substituted for the words “a co-ownership scheme”; and

(b) subsection (5) is to be read as if the words “or 261X(2) or (4)” were omitted.

261Z5.—Winding up as an unregistered company under the Insolvency (Northern Ireland) Order 1989

(1) In this section—

“the 1989 Order” means the Insolvency (Northern Ireland) Order 1989; and

“umbrella scheme” and “sub-scheme” in relation to an umbrella scheme have the same meaning as in section 261Z4.

(2) Part 6 of the 1989 Order applies to—

(a) a co-ownership scheme which is not an umbrella scheme, and

(b) a sub-scheme of an umbrella scheme,

as if each were an unregistered company within the meaning given by Article 184 of that Order.

(3) Where a co-ownership scheme which is not an umbrella scheme is wound up as an unregistered company under Part 6 of the 1989 Order, the provisions of that Order which are applicable to the scheme by virtue of Article 185 of that Order are to be read with the following modifications.

(4) Part 6 of the 1989 Order has effect as if Article 187 were omitted.

(5) If, before the presentation of a petition for the winding up by the court of a co-ownership scheme as an unregistered company, the scheme is being wound up by virtue of a direction given by the Financial Services Authority under section 261V(2)(b) or 261X(2) or (4)—

(a) Article 109(2) of the 1989 Order does not apply; and

(b) any winding up of the scheme by the court is to be deemed to have commenced at the time at which the direction was given.

(6) If, before the presentation of a petition for the winding up by the court of a co-ownership scheme as an unregistered company, the court has appointed a person to wind up the scheme on the application of the Financial Services Authority under section 261W(3)(b)—

(a) Article 109(2) of the 1989 Order does not apply; and

(b) any winding up upon the petition concerned is to be deemed to have commenced on the date of the order making that appointment.

(7) In so far as the provisions of Part 5 of the 1989 Order apply to a co-ownership scheme which is wound up as an unregistered company, those provisions are to be read as if any reference to the directors or to a director or an officer of the company included a reference to the operator and the depositary of a co-ownership scheme.

(8) Where a sub-scheme of an umbrella scheme is wound up as an unregistered company under Part 6 of the 1989 Order, the provisions of that Order which are applicable to the sub-scheme by virtue of Article 185 of that Order are to be read with the modifications in subsections (4), (5) and (7), except that—

(a) those subsections are to be read as if the words “a sub-scheme” were substituted for the words “a co-ownership scheme”; and

(b) subsection (5) is to be read as if the words “or 261X(2) or (4)” were omitted.”.

(10) In section 272 (individually recognised overseas schemes), in subsection (6)—

(a) after paragraph (a) insert—

“(aa) authorised contractual schemes which are co-ownership schemes;

(ab) authorised contractual schemes which are partnership schemes”; and

(b) for paragraph (c) substitute—

“(c) all or any two of the kinds of collective investment scheme mentioned in paragraphs (a) to (b).”.

(11) In section 283A(**a**) (master-feeder structures), in sub-paragraph (ii) of subsection (5)(b), after “the trust deed” insert “, contractual scheme deed”.

(12) In section 347 (the record of authorised persons etc.)—

(a) in subsection (1), after paragraph (b) insert “(ba) authorised contractual scheme;”;

(**a**) Section 283A was inserted by S.I. 2011/1613.

(b) in subsection (2), after paragraph (b) insert—

"(ba) in the case of an authorised contractual scheme, the name and address of the operator and the depositary of the scheme;"; and

(c) in subsection (7), after ""Authorised unit trust scheme"," insert ""authorised contractual scheme",".

(13) In section 351A(**a**) (disclosure under the UCITS directive)—

(a) in subsection (2)—

(i) in paragraphs (a) and (c), after "authorised unit trust scheme" insert "or authorised contractual scheme";

(ii) after paragraph (b) insert—

"(bb) the depositary of an authorised contractual scheme that is a master UCITS;"

(iii) after paragraph (d) omit "or" and insert—

"(dd) the depositary of an authorised contractual scheme that is a feeder UCITS; or "; and

(iv) for paragraph (e) substitute—

"(e) a person acting on behalf of a person within paragraph (a), (b), (bb), (c), (d) or (dd) above"; and

(b) in subsection (4), after ""authorised unit trust scheme"," insert ""authorised contractual scheme",".

(14) In section 392—

(a) in paragraph (a)—

(i) after "255(1)" insert "261T(1),"; and

(ii) after "249(1)" insert "or 261J(1)".

(b) in paragraph (b)—

(i) after "255(2)" insert "261T(2),"; and

(ii) after "249(1)" insert "or 261J(1)".

(15) In section 395(13), after paragraph (d) insert—

"(dd) 261Y(3), (8) or (9)(b);".

PART 3

AMENDMENTS TO OTHER PRIMARY LEGISLATION

Amendments to the Limited Partnerships Act 1907

3. After section 17 of the Limited Partnerships Act 1907(**b**) insert—

"**18.—Limited partnerships which are authorised contractual schemes**

(1) The provisions of this Act have effect with the following modifications in relation to a limited partnership which is a partnership scheme as defined by section 235A(5) of the Financial Services and Markets Act 2000.

(2) Section 4 is to be read as if—

(a) in subsection (2), the words ", and who shall not be liable for the debts or obligations of the firm beyond the amount so contributed" were omitted; and

(b) the following subsections were substituted for subsection (3)—

(**a**) Section 351A was inserted by S.I. 2011/1613.
(**b**) 1907 c.24.

"(3) But the depositary or proposed depositary of a partnership scheme shall not make any such contribution.

(3A) A limited partner who is a participant in a partnership scheme—

(a) shall not be liable for the debts of the scheme beyond the amount which, at the time when any debts fall to be discharged, is equal to the value at that time of the limited partner's units; and

(b) shall cease to have any liability for the debts of the scheme upon the redemption of the limited partner's units.

(3B) In this section—

"depositary" and "units" have the meaning given by section 237(2) of the Financial Services and Markets Act 2000;

"participant" has the meaning given by section 235(2) of that Act; and

"partnership scheme" has the meaning given by section 235A(5) of that Act".

(3) Section 6 is to be read as if—

(a) the following subsection were inserted after subsection (1)—

"(1A) For the purposes of subsection (1) the depositary of a partnership scheme does not take part in the management of the partnership business of the scheme by virtue of performing the powers and duties of the depositary.";

(b) in subsection (5)—

(i) the words "Subject to any agreement expressed or implied between the partners" were omitted; and

(ii) the following paragraph were substituted for paragraph (b)—

"(b) A limited partner in a partnership scheme may not assign the limited partner's share in the partnership, except where assignment is permitted by rules made under section 261H of the Financial Services and Markets Act 2000."; and

(c) the following subsection were inserted after subsection (5)—

"(6) In this section—

"depositary" has the meaning given by section 237(2) of the Financial Services and Markets Act 2000; and

"partnership scheme" has the meaning given by section 235A(5) of that Act.".

(4) Section 9 is to be read as if—

(a) in subsection (1),—

(i) the following paragraph were substituted for paragraph (d)—

"(d) the identity of the general partner or the depositary of a partnership scheme,"; and

(ii) paragraph (f) were omitted; and

(b) the following subsection were inserted after subsection (2)—

"(3) In this section—

"depositary" has the meaning given by section 237(2) of the Financial Services and Markets Act 2000; and

"partnership scheme" has the meaning given by section 235A(5) of that Act.".

(5) Section 10 does not apply.".

Amendments to the Corporation Tax Act 2010

4. In section 1121 of the Corporation Tax Act 2010(**a**) ("company"), in subsection (1), after "does not include a partnership," insert "a co-ownership scheme (as defined by section 235A(2) of the Financial Services and Markets Act 2000),".

PART 4

AMENDMENTS TO SECONDARY LEGISLATION

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

5.—(1) The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(**b**) is amended as follows.

(2) In article 51 (establishing etc. a collective investment scheme)—

(a) in paragraph (1), after sub-paragraph (b) insert—

"(bb) acting as the depositary of an authorised contractual scheme;"; and

(b) in paragraph (2), after ""authorised unit trust scheme"" insert ", "authorised contractual scheme"".

The Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001

6.—(1) The Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001(**c**) is amended as follows.

(2) In article 2 (interpretation: general), in paragraph (1)—

(a) before the definition of "authorised unit trust scheme" insert—

""authorised contractual scheme" has the meaning given by section 237 of the Act;"; and

(b) in the definition of "unregulated scheme", after "authorised unit trust scheme" insert "nor an authorised contractual scheme".

The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001

7.—(1) The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001(**d**) is amended as follows.

(2) In article 2 (interpretation)—

(a) before the definition of "authorised unit trust scheme" insert—

""authorised contractual scheme" has the meaning given by section 237(3) of the Act;";

(b) for the definition of "feeder fund" substitute—

""feeder fund" means an authorised unit trust scheme the sole object of which is investment in units of a single authorised unit trust scheme, in units of a single authorised contractual scheme or in shares in a single open-ended investment company;"; and

(c) in the Schedule (arrangements not amounting to a collective investment scheme), in paragraph 1 (individual investment management arrangements), in sub-paragraph (a)(ii), after "authorised unit trust schemes," insert "authorised contractual schemes,".

(**a**) 2010 c.4.
(**b**) S.I. 2001/544, to which there are amendments not relevant to these Regulations.
(**c**) S.I. 2001/1060, to which there are amendments not relevant to these Regulations.
(**d**) S.I. 2001/1062, to which there are amendments not relevant to these Regulations.

The Financial Services and Markets Act 2000 (Stakeholder Products) Regulations 2004

8.—(1) The Financial Services and Markets Act 2000 (Stakeholder Products) Order 2004(**a**) is amended as follows.

(2) In regulation 2 (interpretation)—

(a) for the definition of "manager" substitute—

""manager" means the operator of a relevant collective investment scheme or the insurer of a relevant linked long-term contract as the case may be;"; and

(b) in the definition of "relevant collective investment scheme", after "authorised unit trust scheme," insert "an authorised contractual scheme,".

(3) In regulation 9 (permitted reductions in investor's rights and investment property), in paragraph (9)(e), after paragraph (i) omit "or" and insert—

"(ia) to arrange for the investor to receive a copy of the annual report and accounts issued to investors by a contractual scheme in which the investment scheme is invested directly or indirectly, or to receive any other information issued to investors by such a scheme; or".

The Undertakings for Collective Investment in Transferable Securities Regulations 2011

9.—(1) Part 4 of the Undertakings for Collective Investment in Transferable Securities Regulations 2011(**b**) (mergers) is amended as follows.

(2) In regulation 7 (interpretation)—

(a) in the definition of "depositary", after paragraph (a) insert—

"(aa) in relation to an authorised contractual scheme means the person entrusted with safekeeping of the scheme property;";

(b) in the definition of "managers", after paragraph (a) insert—

"(aa) in relation to an authorised contractual scheme means the operator of that scheme,";

(c) in the definition of "UCITS", after "open-ended investment company," insert "an authorised contractual scheme,";

(d) in the definition of "unit-holders", after paragraph (a) insert—

"(aa) in the case of an authorised contractual scheme, the unit-holders in that scheme; and"; and

(e) in the definition of "units", after paragraph (a) insert—

"(aa) in the case of an authorised contractual scheme, units in the scheme;".

(3) In regulation 8, in paragraph (1), after "new company" insert ", contractual scheme".

PART 5

REVIEW

Review

10.—(1) Before the end of each review period, the Treasury must—

(a) carry out a review of regulations 2 to 9,

(b) set out the conclusions of the review in a report, and

(c) lay the report before Parliament.

(**a**) S.I. 2004/2738, to which there are amendments not relevant to these Regulations.
(**b**) S.I. 2011/1613.

(2) In carrying out the review, the Treasury must, so far as is reasonable, have regard to how in relation to the constitution of UCITS in accordance with contract law (as common funds managed by management companies) the UCITS Directive is implemented in other Member States.

(3) The report must in particular—

(a) set out the objectives intended to be achieved by the regulatory system established or applied in relation to a contractual scheme by regulations 2 and 3,

(b) assess the extent to which those objectives are achieved, and

(c) assess whether those objectives remain appropriate and, if so, the extent to which they could be achieved with a system that imposes less regulation.

(4) If a report under this regulation is laid before Parliament before the last day of the review period to which it relates, the following review period is to begin with the day on which that report is laid.

(5) In this regulation—

(a) "contractual scheme" has the same meaning as it has by virtue of regulation 2(3)(a) in section 237 of the Financial Services and Markets Act 2000(**a**);

(b) "review period" means—

(i) the period of five years beginning with the day on which regulations 2 and 3 come into force, and

(ii) subject to paragraph (4), each successive period of five years;

(c) "the UCITS Directive" means the Directive of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (No 2009/65/EC)(**b**); and

(d) "UCITS" has the same meaning as in Article 1.2 of the UCITS Directive.

Name
Name
Date — Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations make provision for the formation of undertakings for collective investment constituted in accordance with contract law. Such undertakings are called contractual schemes and are a new class of collective investment scheme (as defined by section 235 of the Financial Services and Markets Act 2000 (c.8)). A contractual scheme may be either a co-ownership scheme, which has no legal personality distinct from the persons who take part as investors, or a partnership scheme, which is a limited partnership under the Limited Partnerships Act 1907 (c.24).

The Regulations also make provision for the authorisation and supervision of contractual schemes by the Financial Services Authority ("the Authority").

Provision for the formation of contractual schemes arises out of and is related to the right conferred by Article 1.3 of the Directive of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to

(**a**) 2000 c.8.
(**b**) OJ No. L 302, 17.11.2009, p.32. The Directive has been implemented by the Undertakings for Collective Investment in Transferable Securities Regulations 2011 (S.I. 2011/1613).

undertakings for collective investment in transferable securities ("the UCITS Directive"). Article 1.3 confers a right to constitute undertakings of this description ("UCITS") as common funds managed by management companies.

By reason of the treatment of contractual schemes for direct taxation, the Regulations will enable full advantage of the opportunities offered by the UCITS Directive to be taken in the United Kingdom in relation to marketing UCITS in other states of the European Economic Area and in relation to operating master and feeder UCITS. In the interests of maintaining existing parity of tax treatment for all collective investment schemes authorised under Part 17 of the Financial Services and Markets Act 2000 and maintaining uniform law and practice in the market for such schemes, the Regulations enable contractual schemes to be formed for authorised schemes not regulated by the UCITS Directive.

Part 2 of these Regulations makes provision for contractual schemes by amending the Financial Services and Markets Act 2000.

Paragraph (2) of regulation 2 provides that the powers of the Authority to make rules under section 140 in relation to the managers of certain collective investment schemes shall be exercisable for like purposes and subject to the same conditions in relation to the operators of authorised contractual schemes.

Paragraph (4) inserts new section 235A, which defines "contractual scheme" and "contractual scheme deed".

Paragraph (5)(a) amends section 237(1) to exclude contractual schemes from the definition of unit trust scheme.

Paragraph (5)(b) amends section 237(2) to specify who the operator is for a co-ownership scheme and a partnership scheme.

Paragraph (8) inserts a new chapter (Chapter 3A) into Part 17 of the Financial Services and Markets Act 2000. Chapter 3A consists of sections 261C to 261Z4.

Sections 261C to 261F make provision for the determination and refusal of applications for authorisation of contractual schemes.

Sections 261H and 261I extends to authorised contractual schemes the power which the Authority has under sections 247 and 248 to make rules in relation to authorised unit trust schemes. Rules may be modified or waived under section 261K.

Sections 261L to 261N make provision about the contracts and liabilities of the participants in an authorised contractual scheme which is a co-ownership scheme. Section 261N makes provision for co-ownership schemes constituted as umbrella schemes and for the segregation of the sub-schemes of an umbrella scheme.

Sections 261O to 261Q make provision for the alteration of authorised contractual schemes, including the replacement of the operator or the depositary and the conversion of a UCITS which is a feeder UCITS into a UCITS which is not a feeder UCITS.

Sections 261S to 261U make provision for the revocation of an authorisation order made for a contractual scheme.

Sections 261V to 261Z3 confer powers of intervention on the Authority and on the court on application by that authority, including powers exercisable where a master UCITS which has one or more feeder UCITS which are authorised contractual schemes is wound up, merges with another UCITS or is divided into two or more UCITS.

Sections 261Z4 and 261Z5 apply the Insolvency Act 1986 (c.45) and the Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2505 (N.I. 19)) with modifications to provide for the winding-up of co-ownership schemes by the court (winding up as an unregistered company).

Part 3 of these Regulations makes provision for contractual schemes by amending other primary legislation.

Regulation 3 amends and modifies the Limited Partnerships Act 1907 in relation to partnership schemes. The depositary, who is a limited partner, makes no contribution to the property of the partnership and is not taken to participate in the management of the partnership business by virtue of performing the powers and duties of the depositary. Modified provision is made for the limited liability of participants, the transfer of units and the registration of changes in the partnership.

Regulation 4 amends the Corporation Tax Act 2010 (c.4.) so that no charge to corporation tax arises in relation to a co-ownership scheme.

Part 4 of these Regulations makes provision for contractual schemes by amending relevant secondary legislation.

Regulation 10 requires the Treasury to review the operation and effect of these Regulations within five years after they come into force and within every five years after that. Following a review it will fall to the Treasury to consider whether the Regulations should remain as they are, or be revoked or be amended. A further instrument would be needed to revoke the Regulations or to amend them.

An Impact Assessment of the effect that these Regulations will have on the costs of business is available on HM Treasury's website (hm-treasury.gov.uk) and is annexed to the Explanatory Memorandum which is available alongside these Regulations on the legislation.gov.uk website.

C Impact assessment

C.1 The following pages contain the impact assessment for the proposals contained in this consultation document.

Title: Contractual Scheme Regulations **IA No:** **Lead department or agency:** HMT - Financial Regulation and Markets **Other departments or agencies:** HMRC / FSA	**Date:** 28/10/2011 **Stage:** Consultation **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries**: Victoria Gibbs; Cathy Lynch; Alex Fernandes

Summary: Intervention and Options

RPC: RPC Opinion Status

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£1,825m	£425m	£0m	Yes	Zero Net Cost

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

European legislation has allowed pan-EU asset pooling schemes for investors, via a right in the UCITS IV Directive allowing for 'master-feeder' structures. Under the current legislative framework in the UK there is not a suitable legally recognisable vehicle under which the master fund for such a pool of assets could be authorised. The vehicles presently available in the UK which are authorised unit trusts and open-ended investment companies are taxable. In other EU jurisdictions vehicles exist which are tax transparent – the individual investor contributing to the fund is taxed but the vehicle itself is not. Government intervention is therefore necessary to put UK investment managers on a level footing with overseas competitors.

What are the policy objectives and intended effects?

The policy objective is to ensure that the UK competes on a level playing-field with overseas competitors in the EU as a fund domicile. This will help to ensure competitiveness of the UK's fund management industry, the reputation of London as a financial centre of excellence and prevent outflows of funds domiciled in the UK and consequent reductions in business activity that could impose economic costs. Studies have shown that fund domiciles benefit proportionately to the quantum of funds based in the domicile in terms of ancilliary services being purchased in that territory. The UK is the European market leader in terms of investment management activity but fifth in terms of being domicile of choice.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The Government could: do nothing (option 0) or legislate to recognise the tax transparency of certain asset pooling vehicles (option 1).

The Government's preferred option is option 1.

Option 1 protects and indeed boosts the competitiveness of the UK fund management industry. The benefits of legislating outweigh the costs and will protect and create jobs as well as providing UK savers with the ability to make tax efficient investments through fund managers that are authorised, regulated and supervised by the UK Financial Services Authority.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 07/2017

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** 0	**Non-traded:** 0	

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: M Hh Date: 2/11/11

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 290	**High:** 4,695	**Best Estimate:** 1,825

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	(180)	10	N/A	**(160)**
High	(90)		N/A	**(80)**
Best Estimate	(135)		N/A	**(120)**

Description and scale of key monetised costs by 'main affected groups'

There would be no mandatory costs to industry. Legislation will create the option for fund managers to set up tax transparent fund vehicles. They will incur incremental set up costs if they choose to do so, estimated at £120m on an NPV basis over 10 years. The FSA would incur transitional costs making changes to their rules which are estimated to be within their existing resource capacity.

Other key non-monetised costs by 'main affected groups'

None

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	10	53	**450**
High	0		575	**4,775**
Best Estimate	Nil		235	**1,945**

Description and scale of key monetised benefits by 'main affected groups'

Without the initiative, investment management will likely remain in the UK but the administration of TTFs (and the jobs that go with this) may be lost. Allowing for authorised TTFs will also provide industry with the opportunity to convert overseas domiciled funds to a UK domicile and increase market share incrementally. The estimated benefit given certain assumptions is £445m directly accruing to the investment management industry and £1,625m to wider UK industry.

Other key non-monetised benefits by 'main affected groups'

The UK retains a reputation for innovation and as an international financial centre of that is 'pro-business'

Certain classes of tax-exempt investor may reduce tax drag suffered on investments resulting in a transfer of tax from foreign jurisdictions to UK investors.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

0.2% funds under management represent GVA linked to the domicile of the fund (IMA/KPMG report)
Over the coming 10 years:
50% of UCITS domiciled in UK would go elsewhere
25% of UCITS managed in the UK with an overseas domicile could be converted to UK domicile
UK can attract inflows (in domicile terms) of a further £290bn of the EU market of which 10% become FUM
£500 billion non-UCITS domiciled in the UK would go elsewhere out of desire for corporate simplification

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 120	**Benefits:** 545	**Net:** 425	Yes	Zero net cost

Evidence Base (for summary sheets)

Problem under consideration:

Under the current legislative framework in the UK there is not a suitable vehicle (that would be capable of authorisation by the FSA) under which a competitive 'master fund' could be established, as permitted by the EU Undertaking for Collective Investment in Transferable Securities (UCITS) IV Directive (UCITS IV).

A 'master fund' is capable of pooling the investments collected in multiple 'feeder funds' allowing the funds under management to benefit from increased scale and therefore higher returns for the investors. The UCITS IV Directive has been fully implemented in the UK, the requisite changes in legislation and FSA rules came into force on 1 July 2011. In order to be competitive master funds need to be tax transparent. EU jurisdictions including Ireland, Luxembourg and the Netherlands have already recognised such vehicles in their national legislation to increase their attractiveness as a fund domicile.

Rationale for intervention and policy objective:

Presently, vehicles that can be set up for authorised collective investment in the UK are: Authorised Unit Trusts (AUTs) and Open-Ended Investment Companies (OEICs). However, these are unsuitable within a 'master-feeder' structure because they do not benefit from tax transparency. Tax authorities 'look through' Tax Transparent Funds (TTFs) when considering tax liability. They look directly to the investor within the TTF who is then assessed on any income or gains associated with their contribution to the fund. This allows the investor to benefit from any double taxation agreements between their domicile and the jurisdiction in which the collective funds have been invested rather than seeing the fund taxed on income and gains and then being taxed themselves on distributions.

Asset pooling arrangements such as a master-feeder structure are not tax efficient if the master vehicle is opaque for tax purposes as investors effectively suffer double taxation (the master fund is taxed and then the feeder fund is taxed).

The lack of a suitable TTF vehicle for authorised collective investment schemes in the UK discourages fund managers from establishing cross-border master UCITS funds in the UK. Instead such funds are typically established and administered in domiciles that recognise tax transparent vehicles.

UCITS are a type of authorised scheme that can take the form of an AUT or OEIC in the UK. They are the only type of collective investment scheme that can be promoted cross-border to retail investors throughout the EU and EEA as they are governed by criteria and requirements laid down in the UCITS IV directive. The European UCITS market is estimated at €6 trillion by the Investment Management Association (75% of all European Collective Investments market). Presently the UK investment managers manage €1.4 trillion of this market but more than half (51.5%) of that is domiciled outside of the UK.

As is described in greater detail below, it has been shown that fund domiciles benefit proportionate to the value of funds domiciled in their jurisdiction; a benefit that is incremental to the value added by the actual management activity occurring there.

The policy objective for the Government is therefore to improve the UK's competitiveness as a domicile of choice for funds.

Options considered:

The objective would be achieved, through the introduction of an authorised vehicle for contractual schemes (a type of TTF). These would form a new class of collective investment scheme within the meaning of section 235, Financial Services and Markets Act 2000 (FSMA) and exercise a right, established within UCITS IV, to set up a scheme for collective investment under contract law. Legislative changes would be required to introduce this vehicle.

Further, it is proposed to amend the legislation concerning limited partnerships (the Limited Partnership Act 1907) to enable the FSA to authorise Limited Partnerships as partnership schemes (one form of contractual scheme vehicle).

Legislation would enter into force by summer 2012 subject to appropriate parliamentary procedure.

This legislative proposal constitutes 'Option 1' for the Government. The Government has also considered the implications of not introducing a TTF vehicle through legislation (i.e. a 'do-nothing' scenario) which is described as 'Option 0' throughout the rest of this impact assessment.

The costs and benefits to stakeholders are set out for both options below on the basis of available information. It is the Government's intention to consult on the proposed legislation to gather further data from stakeholders and validate a number of the assumptions made in this analysis. The level of analysis supplied below which relies on historic available public data as well as estimates from stakeholders is considered proportionate at this stage. The public consultation will allow the views of wider interested parties to be assessed as well as encouraging challenge to the estimates provided in this impact assessment.

When reading the cost:benefit assessment that follows it is important to do so with the understanding that the proposed legislation confers no obligations on business, rather it will provide businesses with an opportunity. Should businesses choose to take advantage of this opportunity they will do so on the basis that doing so has a positive net present value for them.

Given the use of estimates and assumptions within the calculations rounding has been applied throughout to avoid the impression of spurious accuracy.

Estimated industry benefits:

Policy Option 0

There are no benefits to the industry from doing nothing.

Policy Option 1

There are a number of benefits to the wider UK business community that will accrue from the availability of a TTF in the UK. Quantifying the marginal benefit of increased UK competitiveness from launching a TTF vehicle is challenging particularly for a specific and technical piece of legislation that will depend on voluntary industry uptake to achieve its potential benefits. However, informal consultation with industry suggests that there is a strong desire from participants to have access to such a UK vehicle.

The benefits predominantly arise from the marginal benefit of avoiding the flight of funds with a UK domicile and creating the opportunity to capture more than the UK's current 11% market share of the wider European UCITS market. The avoidance of such a flight will translate into retained UK corporate profits, retained UK jobs as well as other intangible benefits to the UK's reputation as an international financial centre of excellence.

Should the UK fail to launch a TTF it is highly probable that this would result in a shift in domicile for those existing funds with a UK domicile to EU jurisdictions that offer a recognised TTF vehicle. Such jurisdictions will likely also capture the domicile for asset pooling vehicles set up in future.

The benefit of fund domicile has been discussed at length in a joint IMA / KPMG report released in November 2007. This report concluded that the gross value added (GVA) by investment management activity could be analysed into variant and invariant categories relative to fund domicile. The major part of GVA by investment management is invariant and therefore independent of domicile. However the analysis showed that 16% of the total expense ratio (TER) levied by a fund manager was linked to fund domicile. This represents necessary administrative spending on services such as fund accounting, legal advice and audit. This spending is generally in the form of payments to local service providers (e.g. law firms) or wages to employees. Therefore there is a clear link to employment and also to corporate profits (i.e. those of the service provider). It is important to note that for the investment manager this spending is not incremental – only the jurisdiction in which the spending occurs changes. The report notes that the UK has a lower average TER than other comparative EU jurisdictions (at the time of the report) so this might imply that some savings could accrue to businesses. However, this is caveated in terms of the different requirements of funds typically domiciled in those two territories so we have not sought to attribute this potential benefit in this impact assessment.

The report demonstrates that 16% of the average TER in the UK can be approximated to 20 basis points of the funds under management. Of this GVA the report asserts that approximately 26% converts to operating surplus (i.e. corporate profit) within service providers. For the purpose of this impact assessment to reflect a prudent approach we have assumed that this is only 10% in our best estimate case. This revised assumption is based on the fact that the split of 74:26 between operating surplus and salaries and wages is an assumption within the report itself. It has not been possible at this stage to validate that assumption however given that it reflects pre-2008 operating conditions it is reasonable to assume that cost inflation and dampened overall revenues are likely to have reduced average net profitability.

The UCITS market in Europe is estimated to at approximately £5.1 trillion for which the UK is fund domicile to £579 billion. Funds managed in the UK with an overseas domicile stand at £617 billion.

On this basis if it were assumed that 50% of current UK domiciled activity would migrate to other EU jurisdictions over the next ten years there would be a net cost to UK business of approximately £260 million.

Equally, it is reasonable to assume that some investors that have assets managed in the UK would chose a UK domicile, it is likely to be the investment manager that makes this choice but there is an element of 'stickiness' once domiciles are designated, if they could achieve equivalent tax efficiency. The benefit to UK industry of 25% of foreign domiciled UK managed funds transferring to the UK would be approximately £140 million.

Finally, if the UK were able to increase its market share of the EU UCITS market to 20% that would equate to further 'domicile inflows' of approximately £290 billion and a benefit to UK industry of £260 million.

This is demonstrably feasible given that Luxembourg is the market leader in terms of fund domicile in the EU but is not in the top 6 jurisdictions in Europe in terms of funds under management. This demonstrates that an attractive regime for domiciliation can open a jurisdiction to business even where the underlying investment management activity does not move across. Therefore it is reasonable that the UK should expect to increase funds domiciled by more than simply 25% of overseas funds already under management in the UK.

These flows are set out in the table below and do not take into account potential growth in the period of funds under management. For simplicity the flows have been assumed to occur in a linear fashion although in reality they could occur far more quickly.

Year	UK domicile outflows (£bn)	UK domicile inflows from UK managed assets (£bn)	incremental UK domicile inflows from non-UK managed assets (£bn)	GVA variant to domicile	GVA impact (£m)	Impact on UK business profits (£m)	Discount Factor (3.5%)	Annual NPV (£m)	Cumulative NPV (£m)
0	28.95	15.43	28.68	0.20%	146	15	1.00	15	15
1	57.90	30.85	57.35	0.20%	292	29	1.04	28	43
2	86.85	46.28	86.03	0.20%	438	44	1.07	41	84
3	115.80	61.70	114.70	0.20%	584	58	1.11	53	136
4	144.75	77.13	143.38	0.20%	731	73	1.15	64	200
5	173.70	92.55	172.05	0.20%	877	88	1.19	74	274
6	202.65	107.98	200.73	0.20%	1,023	102	1.23	83	357
7	231.60	123.40	229.40	0.20%	1,169	117	1.27	92	449
8	260.55	138.83	258.08	0.20%	1,315	131	1.32	100	549
9	289.50	154.25	286.75	0.20%	1,461	146	1.36	107	**656**

Therefore the cumulative benefit of these flows to UK industry over the period presented is approximately £655 million.

Not incidentally an inflow in terms of domicile would likely be associated with an inflow of funds under management given the UK's predominance in this area and the availability of talented fund managers. Any such inflow would see a direct benefit to industry that could be approximated to 42 basis points of net inflows (from a 1.24% average industry TER and a 34% industry operating profit margin). In the scenario above we assumed incremental inflows over the ten year period of £290 billion in terms of domicile over and above conversion of UK managed funds to UK domicile. If this was accompanied by just 10% of these inflows also moving fund management to the UK this would equate to a direct benefit to the UK fund management industry of approximately £545 million over the period.

Additionally assets managed by the major life insurance groups in the UK are presently estimated to be c. £1 trillion. These groups (many of which have grown through merger and acquisition activity) are likely to benefit operationally from asset pooling and therefore make use of a master fund structure. In order to manage their funds in a tax efficient manner for their investors they will need to ensure that any such pooling is performed through a TTF so that the tax implications do not outweigh the operational benefits.

If, conservatively, there was potential for 50% of funds to be pooled within a TTF this gives a figure of £500 billion that would, presently, need to be off-shored from a domicile perspective (for life insurance companies only).

These companies are likely to be able to move their funds over a much faster period given that they are concentrated in large well resourced businesses. To reflect the reality that asset flight on this scale is not anticipated to be an overnight phenomenon, we have spread this over a three year period: £100bn in the first year followed by £200bn in the following two years. This shows a potential cost to wider UK industry of £742 million over the period as shown in the table below.

Year	Outflows averted for UK managed assets able to transfer domicile (£bn)	GVA variant to domicile	GVA foregone (£m)	Impact on UK business profits (£m)	Discount Factor (3.5%)	Annual NPV (£m)	Cumulative NPV (£m)
0	100.00	0.20%	200.00	20.00	1.00	20	20
1	300.00	0.20%	600.00	60.00	1.04	58	78
2	500.00	0.20%	1,000.00	100.00	1.07	93	171
3	500.00	0.20%	1,000.00	100.00	1.11	90	262
4	500.00	0.20%	1,000.00	100.00	1.15	87	349
5	500.00	0.20%	1,000.00	100.00	1.19	84	433
6	500.00	0.20%	1,000.00	100.00	1.23	81	514
7	500.00	0.20%	1,000.00	100.00	1.27	79	593
8	500.00	0.20%	1,000.00	100.00	1.32	76	669
9	500.00	0.20%	1,000.00	100.00	1.36	73	**742**

Additionally UK investors whose pension funds currently put assets to work by investing these in an opaque fund structure suffer a 'tax drag' on their investments. This is because even though the pension fund into which savers have invested are tax exempt the fund their pension fund invests in may not be. It will therefore suffer withholding tax on foreign equity investments as well as potentially tax on income and gains before it can distribute proceeds back to the tax exempt pension fund. This could equally apply to other tax exempt investors (e.g. charities). Whilst many tax exempt investors can eliminate this tax drag through direct investment strategies there is some reason to think that some may currently choose not to do so (for example because they wish to benefit from economies of scale arising from asset pooling, desire exposure to a particular fund or can off-set the loss with securities stock lending income. Informal consultation with industry has suggested that the potential tax drag may be between 20 and 30 basis points for such investors. An article in Finance Week suggested that on a compound annual basis over ten years this could potentially equate to 5.75% on the initial investment in gains foregone (cumulatively over the ten year period). A UK TTF would provide this type of investor with a fund structure that can provide the pooling benefits whilst preserving the appropriate tax exempt treatment. As it is not possible, at this stage, to reliably estimate the number of tax exempt investors that may be suffering from this tax drag we have not assigned a monetised benefit to these potential increased returns. We do expect that this would be a further driver of take up by industry affording non-trivial gains for end investors.

Estimated industry costs:

Costs of Option 0:

Option zero involves no direct costs for industry. However, there are negative financial and non-financial impacts arising from the pursuit of Option 0 which have been captured as marginal benefits within option 1 as described above.

Costs of Option 1:

Costs for Option 1 have been split according to whether these are one-off transitional costs or will be recurring. It is important to note that the legislation proposed under Option 1 will simply confer an option on industry to launch TTFs **without obliging them to make any involuntary changes to their businesses**. Therefore these costs are not imposed by the legislation but may be voluntarily incurred by businesses. Further, our working assumption is that if this option is not available to fund managers in the UK they are likely to domicile funds in jurisdictions that recognise TTFs and therefore would incur the majority of these 'costs' in any case but without the UK seeing the benefit of the funds remaining UK domiciled as outlined above.

Legislation will create the option for fund managers to set up tax transparent fund vehicles. They will incur one-off set up costs if they choose to do so. These costs have been estimated to be in the range of £50-100k per fund established based on informal discussion with professional advisors and the fact that billing rates may range between c. £100 and >£1,000 per hour based on the seniority of resource applied by such firms to provision of advice. We have assumed that approximately £1.5 trillion of assets would make use of a UK TTF vehicle over the ten year period. We estimate that these would be spread across approximately 1,800 funds. This is based on the mean fund value estimate in the IMA Annual Survey of £280m (and the assumption that a TTF would comprise approximately 300% of the current mean, i.e. it would pool three feeder funds); given that our analysis, at this stage, is predominantly based on the largest fund managers it is conceivable that their mean fund size would be larger than the industry average therefore the 1,800 figure may represent an overestimate (relative to the £1.5 trillion of converted funds). The creation of 1,800 funds would confer a cost to industry in a range of £80-160 million using the assumed range above. On this basis we have assigned a best estimate of £120 million as a one-off, optional, transitional cost to industry. This is despite the fact that, as many of these funds would be established within the same corporate group, it seems likely that some cost synergy would be achieved. We have spread this transitional cost over the period years in the same proportion as for the assumed flows.

We estimate that transitional costs to the FSA of making relevant changes to their rules could be achieved within existing resource, although this will mean that other work is deprioritised, therefore there is no monetised transitional cost for the FSA. However, firms will have to have their TTFs authorised by the FSA. The cost of applying for authorisation is included in the set up costs above.

Annual recurring costs:

Funds that are set up will require administration which will confer costs on fund managers. These costs will only be incurred on a voluntary basis. The costs should be seen as the natural costs that any increase in volume or business activity necessarily entails. They would be more than off-set by the fees generated from managing the assets within the tax transparent funds. The costs are inherently included in the calculation methodology to establish the benefit as this incorporates firms' operating profit margin to get to a net operating profit figure.

The government has assumed that supervision of the UK domiciled funds by the FSA would entail some incremental costs in relation to resourcing. It has not been possible, at this time, to reliably estimate these costs. The FSA applies a risk-based approach to allocation of its resources. However, it is the case that the costs associated with additional supervision by the FSA will not be material to the overall NPV assessment of these proposals.

Impact on micro-businesses:

The proposal confers no mandatory costs on micro-businesses and therefore there is no compliance cost. The intention of the proposal is to provide an opportunity to industry on a voluntary basis to benefit from the availability of a TTF vehicle that can be authorised by the FSA. Applying an exemption from the force of the regulations to micro-businesses would be prejudicial to their interests as it would prevent these businesses from making use of the opportunity. Micro-businesses that choose to take advantage of the opportunity will inherently have considered any associated costs as being outweighed by the benefits. In addition we have consulted with the industry association and believe that the number of micro-businesses potentially affected is four. We will seek views on the potential transitional cost to micro-businesses within our consultation document to understand whether any micro-businesses would want to be exempt from the proposed measures.

Risks and assumptions:

Assumptions have been highlighted throughout the cost:benefit calculations presented above.

The launch of a TTF vehicle also has associated risks although these are considered improbable. A major risk is that the TTF fails to gain the take-up of industry. This could occur if another jurisdiction was able to make their TTF demonstrably more attractive than that of the UK. The draft legislation has been drafted (in consultation with HMRC) so as to ensure that the vehicle would be commercially viable.

Summary:

In summary HMG believes that the benefits of launching a recognised TTF in the UK significantly outweigh the associated costs. The proposal will be implemented through secondary legislation in H2 2012 following review of responses to the public consultation.

		Direct benefit to fund industry	Direct cost to fund industry	Total direct industry benefit	Indirect benefit to wider UK industry	Total UK industry benefit
(A)	GVA not forgone through retention of UK domiciled existing funds				1,000	
(B)	GVA gained from conversion of UK managed funds to UK domicile				140	
(C)	GVA gained from attracting non UK managed funds to UK domicile				260	
(D)	Increase in fund management profits from conversion of 20% of (C) to UK management	545			1,400	
(E)	Transitional cost of setting up UK TTFs		(120)			
				425		
	Total					**1,825**

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This document can be found in full on our website: http://www.hm-treasury.gov.uk

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ISBN 978-1-84532-932-7