

“Stakeholder” savings & investment products regulations

Government Response

November 2004



HM TREASURY



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products regulations**

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CONTENTS

		Page
Foreword	About the Consultation	3
Chapter 1	Aims & Objectives of Policy	5
Chapter 2	Summary of Consultation Questions	7
Chapter 3	Summary of Responses to Consultation	9
Chapter 4	Additional Points Arising from the Consultation	15
Annex A	The Financial Services And Markets Act 2000 (Regulated Activities Order)	17
Annex B	The Financial Services and Markets Act 2000 (Stakeholder Products)	21
Annex C	List of Respondents	29

ABOUT THE CONSULTATION

The consultation sought views on the regulations for creating the cash and medium term products of the stakeholder product suite, bringing to fruition one of the main recommendations of the Sandler Review of Medium and Long Term Savings in the UK.

The Government received responses principally from providers and consumer groups, but also from current investors in stakeholder pensions. It is extremely grateful to all who have spent time and effort in responding to this consultation, and to all those who have contributed to the development of this important policy. The Statutory Instruments implementing the stakeholder policy are attached at Annex A & B.

The list of those who responded formally to the consultation is set out in Annex C.

This document can be accessed via the Treasury's website (www.hm-treasury.gov.uk/stakeholder). Paper copies are available by contacting:

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Those who would like to receive copies of the non-confidential responses should contact Sarah Douch at sarah.douch@hm-treasury.x.gsi.gov.uk, making clear which of the responses they would like to receive.

AIMS & OBJECTIVES OF POLICY

Consultation Proposals

1.1 The Sandler Review¹ recommended that it should be possible for consumers to invest in a suite of simple, low-cost products without the need for full advice. The consultation sought views on proposed legislative measures for implementing the Government's policy to specify simple, low-cost and risk-controlled "stakeholder products".

1.2 The consultation referred to the deposit account and medium term products. Stakeholder products are intended to help drive competition in the industry and to improve access to financial services for those on lower incomes. The proposed legislative measures necessitate an amendment to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

Consultation Responses

1.3 Whilst some providers were sceptical about the need for price caps in the market, others believed they would be able to offer basic advice or even full advice under the new price cap, due to the efficiencies they have achieved.

1.4 Consumer and financial services employee groups generally commented that the Government had achieved a good balance between the needs of consumers and the industry in raising the cap from one per cent. However, current investors in stakeholder pensions expressed concern about the possibility of charges on their investments increasing, although the pension product was not consulted upon in this consultation.

1.5 Some respondents expressed concern about the quality of streamlined advice, whilst others expressed an interest in offering non-stakeholder products through the basic advice process. These are obviously matters for the Financial Services Authority to consider.

The Government Response

1.6 The Government welcomes the support for its decision to raise the price cap on stakeholder products.

(¹) Medium and Long-Term Retail Savings in the UK – A Review, July 2002, HM Treasury. A copy is available on-line at http://www.hm-treasury.gov.uk/Documents/Financial_Services/Savings/fin_sav_sand.cfm

2

SUMMARY OF CONSULTATION QUESTIONS

2.1 For reference, below are a copy of the original consultation questions that Government asked respondents to comment on:

1. Respondents are asked to comment on whether Article 3 adequately captures the core features of the FSA's basic advice process, and whether it could create problems or difficulties.
2. Respondents are asked to comment on the proposed streamlined approach to authorising firms to offer 'basic advice'.
3. Comments are invited on the change to the interest rate margin on the cash deposit product.
4. Feedback is invited on any operational difficulties envisaged in implementing the regulations for minimum contributions.
5. Respondents are asked to consider whether the timeframe over which firms will be expected to adjust to rising markets to ensure their funds do not over-expose investors to equity and property risk is workable and reasonable.
6. Respondents are invited to consider whether the proposed regulations provide sufficient clarity to achieve the policy intent.
7. Respondents are asked whether these information requirements for the smoothed investment fund are sufficient to enable consumers to understand the product they are buying.
8. The precise requirement of smoothing and of target ranges for payouts have not been specified in the regulations to allow providers to adopt their own policy and to explain it to consumers. We have decided not to impose a single smoothing model. Do respondents support this approach or should the parameters of smoothing be more tightly defined?
9. Respondents are asked whether they are content with limiting guarantees in this way.
10. Respondents are asked whether the structure of the smoothed investment fund provides sufficient reassurance for consumers, while still being practical for providers to deliver.
11. Respondents are invited to comment on the status of costs outside the charge cap.

3

SUMMARY OF RESPONSES TO CONSULTATION

QUESTION 1

Consultation Proposal:

3.1 Respondents were asked to comment on whether the activity as described in Article 3 of the Draft Order adequately captures the core features of the FSA's basic advice process, and whether it could create problems or difficulties.

Consultation Response:

3.2 Some respondents were concerned that the legislation does not allow other products to be distributed through the basic advice process. There were mixed views on the level of detail in legislation describing the basic advice process: some welcomed the high degree of flexibility, whilst others preferred a more detailed description.

Government Response:

3.3 The Financial Services Authority may use its general rule making power to modify its current standards of advice to parallel those applied to the basic advice regime, should it decide that this is appropriate. The Government believes a high degree of flexibility is needed in the description of the basic advice process to allow adviser firms the scope to work with their Financial Services Authority supervisor to design a process appropriate to their chosen distribution channels and the products they wish to distribute.

3.4 The Government does not propose to provide a more detailed description of the sales process.

QUESTION 2

Consultation Proposal:

3.5 Respondents were asked to comment on the proposed fast-track approach to authorising firms to offer 'basic advice'.

Consultation Response:

3.6 The majority of respondents were satisfied that the approach was sensible and proportionate.

Government Response:

3.7 The Government will implement the Draft Order as consulted upon.

QUESTION 3

Consultation Proposal:

3.8 Comments were invited on the change to the interest rate margin on the cash deposit product.

Consultation Response:

3.9 The proposed change was welcomed by consumer groups, who recognised that most firms charge within the proposed margin anyway. A few firms were concerned that the margin might be too narrow.

Government Response:

3.10 The Government will reduce the margin to one per cent as consulted upon. This is an important safeguard against consumer inertia.

QUESTION 4

Consultation Proposal:

3.11 Feedback was invited on any operational difficulties envisaged in implementing the regulations for minimum contributions.

Consultation Response:

3.12 Firms were concerned that they would not be able to profit from consumers making the minimum level of contributions of £20 with the payment methods allowed, particularly payments made by cheque. Respondents were also concerned that they would be compelled to accept payments from credit and debit cards.

Government Response:

3.13 The stakeholder policy seeks to address the current disenfranchisement of people on low and moderate incomes from the medium and long-term investment market. The Government believes consumers should be offered a high degree of flexibility as to when and how they make payments. It has therefore retained the requirement that cheques must be accepted as a means of payment, but has excluded payment by debit and credit cards for both the deposit and medium term products. In addition, firms will not be required to accept cash payments to the medium term product. This is in line with the stakeholder pension product regulations. The regulations for minimum contributions will be implemented as consulted upon.

QUESTION 5

Consultation Proposal:

3.14 Respondents were asked to consider whether the timeframe over which firms will be expected to adjust to rising markets to ensure their funds do not over-expose investors to equity and property risk is workable and reasonable.

Consultation Response:

3.15 There was widespread support for the three-month adjustment period. However, some respondents did not believe the proposed legislation implemented the policy of the three month adjustment period.

Government Response:

3.16 An additional sub-clause has been inserted in Regulation 7 (6) to make the three month maximum adjustment period explicit.

QUESTION 6

Consultation Proposal:

3.17 Respondents were invited to consider whether the proposed regulations on investment diversification provide sufficient clarity to achieve the policy intent.

Consultation Response:

3.18 Respondents generally welcomed the decision not to include a reference to the “cautious investor” in the regulations. Whilst some were supportive at the level of detail in the regulations, others were nervous that they might be accused of mis-selling at a later date, and sought greater clarity. One firm requested clarification over the position of collectives investing in other funds or collectives.

3.19 Several respondents commented that investments in the medium term product could fall in value, and consumers should be made aware that there are no capital guarantees. They were concerned that describing the medium term product as “risk-controlled” would be interpreted by consumers as meaning their capital was not at risk.

Government Response:

3.20 The consultation on stakeholder product specifications undertaken in 2003 found that most respondents preferred a general principles approach. The Government agreed with this, and the regulations therefore require the manager to have regard for the need for diversification of the investment property.

3.21 The 60% maximum investment in property and equity applies to the investment in its entirety. Some sub-funds may be invested entirely in equities, whilst other sub-funds could have a lower equity content. The sub-funds in aggregate must not exceed the 60% limit in property and equity.

3.22 The Government agrees that “risk control” does not imply there can never be loss of value, and the FSA would expect this point to be made clear during the advice process and in disclosure material. However, it does imply that risk is mitigated. For this reason it is appropriate to refer to the medium term product as “risk controlled”.

3.23 The regulation will be implemented as consulted upon.

QUESTION 7

Consultation Proposal:

3.24 Respondents were asked whether the information requirements for the smoothed investment fund are sufficient to enable consumers to understand the product they are buying.

Consultation Response:

3.25 As several respondents pointed out, the requirement to make the information requirements not narrower in scope or less detailed than that required for the PPFM would come into force before the Consumer Friendly PPFM is finalised by the Financial Services Authority. Use of the full length PPFM would not be the most effective way to get information across to most consumers. There will also be aspects of the PPFM that are specific to with-profits funds and which will therefore not automatically relate to the smoothed investment fund. Others have suggested that the Government should either define precisely how smoothing should operate or require the production of a Consumer Friendly PPFM.

Government Response:

3.26 We have sympathy with both these views. We want product providers to have a degree of flexibility with regard to smoothing, subject to the requirement to enable the consumer properly to understand the product. But we recognise the difficulties of using the full weight of PPFM regulation in a non-with profits product. We have therefore removed the reference to the Financial Services Authority's Conduct of Business Rules, but will review this decision in consultation with the Financial Services Authority once we know the outcome of their consultation on the Consumer Friendly PPFM. To counterbalance this removal, we will require the necessary information to be provided automatically to every investor and on request to anyone else.

QUESTION 8

Consultation Proposal:

3.27 The precise requirement of smoothing and of target ranges for payouts have not been specified in the regulations to allow providers to adopt their own policy and to explain it to consumers. We have decided not to impose a single smoothing model. Respondents were asked whether they supported this approach or whether the parameters of smoothing should be more tightly defined.

Consultation Response:

3.28 There was general agreement from with-profits providers that the approach was appropriate. Consumer groups, however, are concerned at the degree of freedom the proposed regulations allow for the providers of the smoothed investment fund.

Government Response:

3.29 We recognise the concern expressed by some respondents that the parameters for smoothing should be clearly defined to reduce the potential complexity for consumers. However, we also wish to encourage innovation and competition among providers. We therefore do not believe that it is appropriate to set detailed requirements for smoothing and target ranges in the framework legislation. At the same time, providers should make clear to policyholders and potential policyholders what the features of their smoothed investment funds are. The Financial Services Authority is continuing to consult, among other topics, on the issue of target ranges in the context of with-profits funds in Consultation Paper 04/14: "Treating with-profits policyholders fairly". The outcomes of this consultation will also be relevant to the smoothed investment fund and we will continue to liaise on this issue with the Financial Services Authority.

QUESTION 9

Consultation Proposal:

3.30 Respondents were asked whether they were content with limiting guarantees on the smoothed investment fund to 101% of the total value of the units allocated under a contract in the event of the death of the insured.

Consultation Response:

3.31 Most respondents were of the view that there was little scope to provide additional guarantees within the charge cap, although some asked for the ability to do so.

Government Response:

3.32 We have considered whether any relaxation was possible, but given the discretion over smoothing that has been provided for and the need to keep these products simple and comparable between providers, we do not propose to move away from the existing position. Another suggestion was the provision of additional guarantees funded outside the charge cap. However, these would also add to the complexity of the product and would have to be considered in the context of the applicability of the basic advice process. The Government is therefore not minded at this stage to allow additional guarantees outside the price cap.

QUESTION 10

Consultation Proposal:

3.33 Respondents were asked whether the structure of the smoothed investment fund provides sufficient reassurance for consumers, while still being practical for providers to deliver.

Consultation Response:

3.34 Some respondents argued that a market value reduction (MVR) should be allowed in the smoothed investment product. Others felt that the range of charges to consumers for smoothing (between 0.1 per cent and 0.2 per cent of the value of the fund) suggested in the consultation document was insufficient to cover the cost of smoothing.

Government Response:

3.35 The stakeholder product policy was designed to provide consumers with products without a “sting in the tail”. MVRs are not appropriate for the smoothed investment fund, and the Government will not change its proposed legislation to allow them. Providers are reminded that smoothing policies can be changed in extremis, and this should be disclosed to potential investors. The ability to change the smoothing policy in extremis obviates the need for imposing MVRs. Smoothing policies should reflect the low cost nature of the stakeholder suite.

QUESTION 11

Consultation Proposal:

3.36 Respondents were invited to comment on the status of costs outside the charge cap.

Consultation Response:

3.37 Respondents welcomed the clarification on the status of costs. It was argued that all property management costs should be excluded from the scope of the cap, and that broader regulation is needed to include the costs associated with securing rental income. Some respondents also argued that custodian fees relating to transactions should lie outside of the price cap. Others were uncertain as to how Value Added Tax would be treated.

Government Response:

3.38 The Government consulted widely on the status of costs before drafting the legislation. The intention was that costs relating to service charges and collection of rent, or other sums due under the terms of a lease from occupiers of any land or building in which the investment property is invested should be excluded from the scope of the cap. Regulation 9 has been altered to reflect this.

3.39 The Government has not received sufficient evidence from providers to be persuaded that custodian costs should be allowed outside of the price cap. Regulation 9 (9) (a) has been changed to clarify these costs are tax related. Regulation 9 (9) (d) has been altered to clarify that these costs relate to charges or expenses incurred as a result of court orders or other legal processes. The Treasury will review stakeholder legislation in 2005, and the issue of custodian fees may be consulted upon again as part of that process.

3.40 It was intended that Value Added Tax would fall within the definition of Regulation 9 (9) (a), and it is now specifically mentioned to provide clarification.

3.41 The treatment of tax charges arising as reserves for such charges as are anticipated in respect of underlying investments as outside the charge cap has been made explicit.

4

ADDITIONAL POINTS ARISING FROM THE CONSULTATION

THE FSA'S BASIC ADVICE PROCESS AND THE SMOOTHED INVESTMENT FUND.

4.1 The FSA announced on the 21st October that it will implement the “basic advice” regime in support of the stakeholder product initiative. The FSA’s consultation and consumer testing highlighted some concerns regarding the Smoothed Investment Fund. The FSA proposes to test this product further before allowing it to be distributed through the basic advice process.

Government Response:

4.2 The Government is very grateful for the extensive work carried out by the FSA in support of this important initiative. The FSA board have agreed three out of four products should be available through basic advice.

4.3 The Government has decided that it will continue to implement all the stakeholder products through legislation, including the Smoothed Investment Fund. This will enable firms which wish to participate to distribute the Smoothed Investment Fund through full advice or through execution-only channels. This will also allow the FSA to conduct further research using real products developed by firms and if appropriate to review its assessment of the Smoothed Investment Fund’s suitability to be distributed through basic advice.

PROTECTION FOR CONSUMERS AFTER TEN YEARS

4.4 Ten years after an investor makes a first contribution, the charge cap applicable to the investment falls from 1.5 percent to one percent. Some respondents were concerned that firms might transfer consumers out of one stakeholder product into another stakeholder product after holding the investment for ten years, thus allowing firms to charge investors up to 1.5 per cent.

Government Response:

4.5 The Government has added an additional clause to Regulation 9 to prevent this practice. This states:

“Where an investment scheme is brought to an end by a manager and the investor takes up a transfer facility offered by the manager of that original investment scheme to another investment scheme, relevant percentage for the purposes of paragraphs (3) to (5) shall be the same as that which would have been allowed under or in respect of the original investment scheme as if the original scheme were continuing, notwithstanding any rules of the new investment scheme.”

SUITABILITY TESTING FOR THE DEPOSIT ACCOUNT

4.6 Several respondents were concerned that the inclusion of the deposit account brought cash products within the Financial Services Authority’s Conduct of Business regime, imposing suitability requirements.

Government Response

4.7 The proposed legislation is designed to give effect to stakeholder products. It is not the Government's intention to impose suitability testing on cash products through this legislation. The Financial Services Authority's basic advice rules will enable firms to market a range of deposit products, if basic advice results in a recommendation for a cash investment. All stakeholder products may be sold through full advice, direct offer or execution only channels.

ALIGNMENT WITH FSA DRAFT BASIC ADVICE RULES

4.8 One respondent commented that the Draft Order did not reflect the Financial Services Authority's draft basic advice rules, in that the Order allowed the person providing basic advice to rely 'solely on the information provided by the retail customer in response to or related to the questions'.

Government Response

4.9 The word 'solely' has been removed from the Draft Order.

CERTAINTY AROUND ENFORCEMENT

4.10 The ABI asked for certainty that the Government is relying on financial promotions rules to enforce the stakeholder product requirements.

Government Response

4.11 The Government agrees with the Association of British Insurers that costly and bureaucratic enforcement arrangements would not be welcome. It further agrees that the experience of voluntary CAT-standard Individual Savings Accounts suggests the risks of reputational damage and the Financial Services Authority's financial promotion rules will be sufficient to prevent breaches of stakeholder product regulations. The Government is, therefore, happy to confirm that the chosen approach to enforcement relies on the Financial Services Authority's financial promotions rules.



THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES ORDER)

Order made by the Treasury, laid before Parliament under paragraph 26 of Schedule 2 to the Financial Services and Markets Act 2000 for approval by resolution of each House of Parliament within twenty-eight days beginning with the day on which the Order was made, subject to extension for periods of dissolution, prorogation or adjournment for more than four days.

STATUTORY INSTRUMENTS

2004 No. 2737

FINANCIAL SERVICES AND MARKETS

Financial Services and Markets Act 2000 (Regulated Activities)(Amendment)(No.2) Order 2004

<i>Made</i> - - - -	<i>16 November 2004</i>
<i>Laid before Parliament</i>	<i>16 November 2004</i>
<i>Coming into force</i> - -	<i>6 April 2005</i>

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

The Treasury, in exercise of the powers conferred upon them by sections 22(1) and (5) and 428(3) of, and paragraph 25 of Schedule 2, to that Act hereby make the following Order:

Citation, commencement and interpretation

1.—(1) This Order may be cited as the Financial Services and Markets Act 2000 (Regulated Activities)(Amendment)(No.2) Order 2004, and comes into force on 6 April 2005.

(2) In this Order—

“the Act” means the Financial Services and Markets Act 2000;

“the principal Order” means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001^(b).

^(a) 2000 c. 8

^(b) S.I. 2001/544, as amended by S.I. 2001/3544, S.I. 2002/682, S.I. 2002/1310, S.I. 2002/1776, S.I. 2002/1777, S.I. 2003/1475, S.I. 1476, S.I. 2003/2822 and S.I. 2004/1610.

Amendment of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

2. The principal Order is amended as follows.

Providing basic advice on stakeholder products

3. After article 52A of the principal Order, insert—

“CHAPTER XIA
PROVIDING BASIC ADVICE ON STAKEHOLDER PRODUCTS
The activity”

Providing basic advice on stakeholder products

52B.—(1) Providing basic advice to a retail consumer on a stakeholder product is a specified kind of activity.

(2) For the purposes of paragraph (1), a person (“P”) provides basic advice when—

- (a) he asks a retail consumer questions to enable him to assess whether a stakeholder product is appropriate for that consumer; and
- (b) relying on the information provided by the retail consumer P assesses that a stakeholder product is appropriate for the retail consumer and—
 - (i) describes that product to that consumer;
 - (ii) gives a recommendation of that product to that consumer; and
- (c) the retail consumer has indicated to P that he has understood the description and the recommendation in sub-paragraph (b).

(3) In this article—

“retail consumer” means any person who is advised by P on the merits of opening or buying a stakeholder product in the course of a business carried on by P and who does not receive the advice in the course of a business carried on by him;

“stakeholder product” means—

- (a) an account which qualifies as a stakeholder child trust fund within the meaning given by the Child Trust Funds Regulations 2004^(a);
- (b) rights under a relevant stakeholder pension scheme, and for these purposes—
 - “relevant stakeholder pension scheme” means a stakeholder pension scheme within the meaning given by section 1 of the Welfare Reform and Pensions Act 1999^(b) and which is subject to lifestyling, and
 - “lifestyling” means the process, applied from a date at least five years before the member's retirement date, or, in the case of a member who joins the scheme less than five years before his retirement date, immediately after he becomes a member, and continuing until the member's retirement date, by which an investment strategy is adopted by the trustees or manager which aims progressively to minimise the variation or potential variation in the value of the member's rights caused by market conditions from time to time, and the words “member” and “scheme” have the same meaning as they have in the Welfare Reform and Pensions Act 1999;
- (c) an investment of a kind specified in regulations made by the Treasury.”

^(a) S.I. 2004/1450 as amended by S.I. 2004/2676

^(b) 1999 c.30

Transitional provisions

4.—(1) Part 4 of the Act shall apply in the case of persons who have permission at the date this Order comes into force to carry out the activity specified in article 53 of the principal Order and who wish to carry out the activity specified in article 52B of that Order as follows.

(2) Where P is a person to whom paragraph (1) applies—

- (a) the procedures established under sections 44 and 45 in respect of application for permission shall not apply in respect of permission to carry out the article 52B activity,
- (b) P shall be deemed to have such a permission if he has notified the Authority in writing of his wish to undertake the activity and the Authority has acknowledged receipt of P's notification in writing from the date of the acknowledgement.

Supplemental amendments of secondary legislation

5.—(1) The Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001^(a) are amended as follows.

(2) In regulation 2(1) (descriptions of business for which appointed representatives are exempt) after subparagraph (b) insert—

“(ba) an activity of the kind specified by article 52B of that Order (providing basic advice on stakeholder products);”.

(3) The Financial Services and Markets Act 2000 (Professions) (Non-Exempt Activities) Order 2001^(b) is amended as follows.

(4) In article 4 after paragraph (e) insert—

“(ea) article 52B (providing basic advice on stakeholder products);”.

Signatory text

Date

Names
Two of the Lords Commissioners of Her Majesty's Treasury

^(a) S.I. 2001/1217 as amended by S.I. 2001/2508 and S.I. 2004/453.

^(b) S.I. 2001/1227, S.I. 2001/3650, S.I. 2002/682, S.I. 2002/1777, S.I. 2003/1475 and S.I. 2003/1476.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) by inserting a new article 52B into the Order.

This provides that providing basic advice to a retail consumer on a stakeholder product is a regulated activity where the consumer is asked questions to assess the suitability of a stakeholder product for him and, if a stakeholder product is assessed to be appropriate for him, a description of that product is discussed with him, a recommendation is given to him and he certifies that he has understood the description and recommendation.

Transitional provision is made for existing Part 4 permissions in respect of the article 53 activity to have effect as from the date the order comes into force as permission also for the article 52B activity.

Supplemental provision is made to include the Article 52B activity in the list of activities for which appointed representatives do not need Part 4 permission and in the list of activities for which certain professions are not exempt from requiring permission.

Regulations will be made defining other stakeholder products in addition to the stakeholder child trust fund account and rights in a stakeholder pension scheme which are defined in the Child Trust Fund Act 2004 (c.6) and the Welfare Reform and Pensions Act 1999 (c.90) respectively.



THE FINANCIAL SERVICES AND MARKETS ACT 2000 (STAKEHOLDER PRODUCTS)

STATUTORY INSTRUMENTS

2004 No. 2738

FINANCIAL SERVICES AND MARKETS

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

<i>Made</i> - - - -	<i>16 November 2004</i>
<i>Laid before Parliament</i>	<i>16 November 2004</i>
<i>Coming into force</i> - -	<i>April 2005</i>

The Treasury, in exercise of the powers conferred upon them by section 428 of the Financial Services and Markets Act 2000^(a) and article 52B(3)^(b) of the Financial Services and Markets Act 2000 (Regulated Activities) Order^(c) hereby make the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Financial Services and Markets 2000 (Stakeholder Products) Regulations 2004 and come into force on 6th April 2005.

Interpretation

2.—(1) In these Regulations—

“the 2000 Act” means the Financial Services and Markets Act 2000;

“account-holder” means the holder of a deposit account;

“Bank of England base rate” means the rate announced from time to time by the Monetary Policy Committee of the Bank of England as the official dealing rate, being the rate at which the Bank of England is willing to enter into transactions for providing short-term liquidity in the money markets;

“the Conduct of Business Rules” means the Conduct of Business Rules made by the Financial Services Authority under section 153 of the 2000 Act;

“relevant contract of insurance” means a contract of insurance—

- (a) which, or any part of which, is one or more of the following kinds—
- (i) life and annuity,
 - (ii) linked long-term, and

^(a) 2000 c.8.

^(b) Article 52B was inserted by S.I. 2004/2737 and confers a power on the Treasury (by reason of paragraph 25(1)(c) of Schedule 2 to the 2000 Act) to specify by regulations investments which qualify as stakeholder products.

^(c) S.I. 2001/544, as amended by S.I. 2001/3544, S.I. 2002/682, S.I. 2002/1310, S.I. 2002/1776, S.I. 2002/1777, S.I. 2003/1475, S.I. 2003/1476, S.I. 2003/2822 and S.I. 2004/1610.

(b) which is carried out by an insurer who has permission, as the case may be, under—

(i) Part 4 of the 2000 Act, or

(ii) paragraph 15 of Schedule 3 to the 2000 Act,

to effect or carry out contracts of insurance of that kind, and

(c) is not a with-profits policy and does not include rights in a with-profits fund;

“deposit account” means a deposit account with a deposit-taker and includes a share account with a building society within the meaning of the Building Societies Act 1986^(a);

“deposit-taker” means—

(a) a person who has permission under Part 4 of the 2000 Act to accept deposits, or

(b) an EEA firm of the kind mentioned in paragraph 5(b) of Schedule 3 to the 2000 Act which has permission under paragraph 15 of that Schedule (as a result of qualifying for authorisation under paragraph 12 of that Schedule) to accept deposits;

“dilution levy” has the meaning given by the handbook made by the Financial Services Authority under section 153 of the 2000 Act;

“insurer” means—

(a) a person who has permission under Part 4 of the 2000 Act to effect or carry out contracts of insurance, or

(b) an EEA firm of the kind mentioned in paragraph 5(d) of Schedule 3 to that Act, which has permission under paragraph 15 of that Schedule (as a result of qualifying for authorisation under paragraph 12 of that Schedule) to effect or carry out contracts of insurance;

“investor” means a member of a collective investment scheme which complies with regulation 5 or an underlying fund which complies with regulation 6 as the case may be;

“investment property” means the scheme property of a collective investment scheme which complies with regulation 5 or an underlying fund which complies with regulation 6 as the case may be;

“investment scheme” means a collective investment scheme which complies with regulation 5 or a linked long-term contract which complies with regulation 6 as the case may be;

“land and buildings” means interests in any land or buildings which satisfy the conditions in rule 5A.8.5R of the Collective Investment Schemes Sourcebook made by the Financial Services Authority under section 153 of the 2000 Act;

“linked long-term contract” means a contract of long-term insurance as specified in paragraph 3 of Part 2 of Schedule 1 to the principal Order;

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

“the principal Order” means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001;

“relevant collective investment scheme” means an authorised unit trust scheme, an authorised open-ended investment company or a recognised scheme, as the case may be, as defined in section 237(3) of the 2000 Act;

“relevant investments” means—

(a) shares issued by a company wherever incorporated and officially listed on a recognised stock exchange;

(b) units in a relevant collective investment scheme where a substantial proportion of the scheme property is invested, directly or indirectly, in shares, as defined in paragraph (a) or land and buildings; and

(c) rights under a contract of insurance where a substantial proportion of the assets of the funds held in respect of that contract are invested, directly or indirectly, in shares as set out in sub-paragraph (a) or land and buildings;

“relevant linked long-term contract” means a linked long-term contract which meets the conditions and characteristics specified in regulation 6(1);

(a) 1986 c.53 as amended by the Building Societies Act 1997 (c.32) and S.I. 2001/3649.

“units” means the rights or interests (however described) of the members of a relevant collective investment scheme.

(2) The definitions of “deposit-taker” and “insurer” in paragraph (1) must be read with—

- (a) section 22 of the 2000 Act,
- (b) any relevant order under that section, and
- (c) Schedule 2 to that Act.

Meaning of stakeholder product

3. These Regulations specify kinds of investment for the purposes of sub-paragraph (c) of the definition of “stakeholder product” in article 52B(3) of the principal Order and accordingly an investment of one of these kinds is a stakeholder product for the purposes of article 52B of that Order.

Certain deposit accounts

4. A deposit account (“the account”) is a stakeholder product if the following conditions are fulfilled—

- (a) the minimum amount which an account-holder may deposit on a single occasion is £10, except where the deposit-taker permits a smaller payment;
- (b) the deposit-taker permits as a means of payment to the account payment by—
 - (i) cash;
 - (ii) cheque;
 - (iii) direct debit;
 - (iv) standing order;
 - (v) direct credit (other than standing order),

excluding payments by credit card or debit card or any combination including a payment by credit card or debit card;

- (c) interest accrues on the account on a daily basis at a rate that is not less than the Bank of England base rate minus 1 per cent. per annum (“the interest rate”);
- (d) when the Bank of England base rate increases, the interest rate must be raised within one month of the date of that increase;
- (e) on the instructions of the account holder, any cash and interest held in the account is transferred or paid to the account holder within a period which may not exceed seven days (“withdrawal instructions”); and
- (f) there is no limitation on the frequency with which an account holder may issue withdrawal instructions.

Units in certain collective investment schemes

5. Units in a relevant collective investment scheme are a stakeholder product where that scheme has the characteristics, and complies with the conditions, set out in regulation 7.

Rights under certain linked long-term contracts

6.—(1) Rights under a linked long-term contract are a stakeholder product where the insurer ensures that the fund held in respect of that contract (“the underlying fund”)—

- (a) has the characteristics and complies with the conditions set out in regulation 7; and
- (b) where the investment returns are smoothed, complies with the conditions set out in regulation 8.

(2) For the purposes of this regulation and regulations 8 and 9, investment returns are smoothed when the insurer offers the product on the basis that the amount in respect of the investment returns earned from time to time by the underlying funds to be attributed under the contract to the policyholder will be managed and attributed with a view to reducing the volatility of such returns over given periods, and “smoothing”, “smoothed” and “unsmoothed” are to be construed accordingly.

Characteristics and conditions applicable to certain stakeholder products

- 7.—(1) The characteristics in relation to an investment scheme are—
- (a) no more than 60 per cent. in value of the investment property, calculated in accordance with paragraph (3), consists of relevant investments;
 - (b) the investment property should be selected and managed having regard to the need to achieve a balance between—
 - (i) the opportunity for the investor to benefit from growth in the value of investments generally; and
 - (ii) control of the risk of loss of value in the investment; and
 - (c) the manager has regard to—
 - (i) the need for diversification of the investment property, in so far as appropriate to the circumstances of the investment scheme; and
 - (ii) the suitability for the purposes of the scheme of any investment option proposed.
- (2) The conditions with which the investment scheme must comply are—
- (a) the minimum amount which an investor may contribute to the investment scheme on a single occasion is £20, except where the manager permits a smaller amount;
 - (b) the manager must permit as a means of payment to the investment scheme payment by—
 - (i) cheque;
 - (ii) direct debit;
 - (iii) standing order;
 - (iv) direct credit (other than standing order),and excluding payments by cash, credit card or debit card or any combination including a payment by cash, credit card or debit card;
 - (c) the value of an investor's rights in the investment scheme and the value of the investment property may be reduced in the circumstances and to the extent set out in regulation 9; and
 - (d) where the stakeholder product consists of—
 - (i) units in a relevant collective investment scheme, it must be a requirement of that scheme that the purchase and sale price of those units shall, at any given time, not differ from each other and that price must be made available to the public on a daily basis;
 - (ii) rights under a relevant linked long-term contract which are expressed as shares in funds, it must be a requirement of that contract that the purchase and sale price of those shares shall, at any given time, not differ from each other and that price must be made available to the public on a daily basis.
- (3) For the purposes of the calculation set out in paragraph (1)(a), the following provisions apply—
- (a) where any of the investment property is invested in units in a relevant collective investment scheme, only such of the assets of that scheme as are invested, directly or indirectly, in relevant investments shall be taken into account; and
 - (b) the calculation shall be taken as an average over a period of 3 months.
- (4) When calculating the average over a period of 3 months for the purposes of paragraph (3)(b) (“the average”), where the manager has specified under paragraph (5) that the calculation is to be carried out weekly or monthly—
- (a) where the average is to be calculated weekly, it is to be carried out on such day of the week (“the specified day”) as has been so specified by the manager (except that, where that day is not a working day, the average is to be calculated on the next working day), and the average on each subsequent day prior to the next specified day is to be taken to be the average on the previous specified day; and
 - (b) where the average is to be calculated monthly, it is to be so calculated on such day in each month (“the specified day”) as has been so specified by the manager (except that, where that date is not a working day, the average is to be calculated on the next working day), and the average on each subsequent day prior to the next specified date is to be taken to be the average on the previous specified date.

(5) For the purposes of paragraph (4)—

- (a) the frequency, which must be daily, weekly or monthly, with which the average is to be calculated; and
- (b) where the average is to be calculated using weekly or monthly figures, that day of the week or, as the case may be, the date in the month on which it is to take place,

must be specified in writing by the manager; and the specification may not be amended during the period of 12 months after the date on which it is made.

(6) Where, following the calculation under paragraph (4), the average value of the investment property comprises more than 60 per cent. of relevant investments, the manager must take steps to bring that average value within the limit prescribed in regulation 7(1)(a) as soon as reasonably practicable and in any event within 3 months.

Additional conditions applicable to smoothed linked long-term contracts

8. The conditions under this paragraph are—

- (a) the manager must make available, to each investor who is also a policyholder or to anyone else requesting it, the information necessary to enable a person making such a request properly to understand the essential elements of the insurer's commitment under the terms of the policy;
- (b) the manager must make available, to each investor and anyone else requesting it, information on its policy on and charges for smoothing;
- (c) no payment may be made or property attributed from the underlying fund to any person other than an investor, except for permitted reductions in the investor's rights and investment property in accordance with regulation 9;
- (d) the manager must manage the underlying fund with the aim of attributing to each investor on the maturity or surrender of his rights under the linked long-term contract a value that falls within a target range which is notified to each investor before he enters into the linked long-term contract;
- (e) except as provided for in paragraph (f), there is no guarantee of the value of an investor's rights under the linked long-term contract;
- (f) the manager may guarantee that, on the death of an investor, the value of an investor's rights under the linked long-term contract are no more than 101 per cent of the total of the value of the units allocated to that contract.

Permitted reductions in investor's rights and investment property

9.—(1) The value of an investor's rights in an investment scheme may be reduced in the circumstances, and to the extent, set out in paragraphs (3) to (5).

(2) The value of the investment property may be reduced in the circumstances, and to the extent, set out in paragraph (9).

(3) To the extent that an investor's rights in an investment scheme are represented by a fund allocated to him to the exclusion of other investors, the value of those rights may be reduced by the making of deductions from that fund no greater than, at the choice of the manager—

- (a) the relevant percentage of its value for each day on which it is held; or
- (b) the proportion attributable to the investor's fund of the relevant percentage of the value of the investment property for each day on which the investor's fund is held for the purposes of the scheme.

(4) To the extent that an investor's rights in an investment scheme are represented by a share of funds held for the purposes of the scheme, the amount of that share not being determined by reference to a discretion exercisable by any person, the value of those rights may be reduced by the making of deductions from that share no greater than, at the choice of the manager—

- (a) the relevant percentage of its value for each day on which it is held; or
- (b) the proportion attributable to the investor's share of the relevant percentage of the value of the investment property for each day on which the investor's share is held for the purposes of the scheme.

(5) To the extent that an investor's rights are represented by rights under a linked long-term contract to which regulations 6(1)(b) and 8 apply, the value of those rights may be reduced by the making of deductions from those rights no greater than, at the choice of the manager—

- (a) the relevant percentage of the value of the investor's rights under the contract; or
- (b) the proportion attributable to the investor's rights of the relevant percentage of the value of the underlying fund for each day on which the investor has rights under the contract.

(6) When calculating the value of the rights of an investor for the purposes of paragraphs (3) to (5) above, where the manager has specified under paragraph (7) that such rights are to be valued weekly or monthly—

- (a) where such rights are to be valued weekly, they are to be valued on such day of the week ("the specified day") as has been so specified by the manager (except that, where that day is not a working day, the rights are to be valued on the next working day), and the value of the rights on each subsequent day prior to the next specified day is to be taken to be the value of the rights on the previous specified day; and
- (b) where the rights are to be valued monthly, they are to be valued on such date in each month ("the specified date") as has been so specified by the manager (except that, where that date is not a working day, the rights are to be valued on the next working day), and the value of the rights on each subsequent day prior to the next specified date is to be taken to be the value of the rights on the previous specified date.

(7) For the purposes of paragraph (6)—

- (a) the frequency, which must be daily, weekly or monthly, with which rights are to be valued; and
- (b) where valuation is to take place weekly or monthly, the day of the week or, as the case may be, the date in the month on which it is to take place,

must be specified in writing by the manager; and the specification may not be amended during the period of 12 months after the date on which it is made.

(8) For the purposes of paragraphs (3) to (5), "the relevant percentage" means—

- (a) during the period of 10 years beginning with the day on which the first contribution is made by the investor to the investment scheme or linked long-term contract (as the case may be), $\frac{3}{730}$ per cent.;
- (b) otherwise $\frac{1}{365}$ per cent.

(9) The value of the investment property may be reduced—

- (a) where any stamp duty, stamp duty reserve tax, value added tax or other charge (including any dilution levy) are incurred by the manager directly or indirectly in or consequent upon the sale or purchase of investments held for the purposes of the investment scheme, by the amount of those charges;
- (b) where any amount of tax is paid or anticipated to be payable in respect of income received or capital gains realised by the manager in respect of investments held for the purposes of the investment scheme, by the amount so deducted or anticipated;
- (c) where any charges or expenses are incurred by the manager directly or indirectly in maintaining or repairing any land or building in which the investment property is invested or in connection with the collection of rent, service charge or other sum due under the terms of a lease from occupiers of any land or building in which the investment property is invested, by the amount of those charges or expenses;
- (d) where any charges or expenses are incurred by the manager directly or indirectly in complying with an order of the court or any similar requirements imposed by law, by the amount of those charges or expenses;
- (e) to the extent that the manager incurs any expenses in complying with a requirement—
 - (i) to arrange for the investor to receive a copy of the annual report and accounts issued to investors by any company, unit trust, open-ended investment company or other entity in which the investment scheme is invested directly or indirectly ("the relevant entities"), or
 - (ii) to arrange for the investor to attend, vote or receive any other information issued to investors by the relevant entities,

by the amount of such of those expenses; and

- (f) in respect of a linked long-term contract referred to in regulation 6 which is subject to smoothing, by the amount of the charges or expenses incurred by the manager in providing funds to smooth investment returns but only when the provision of such funds is in accordance with the manager's stated policy on smoothing.

(10) Where the value of the investment property is reduced by reference to an amount of charges or expenses referred to in paragraph (9), then, for the purposes of calculating any reduction in the investor's rights under paragraphs (3), (4) or (5), the value of those rights is to be calculated after the deductions of any such amount.

(11) Where an investment scheme is brought to an end by a manager and the investor takes up a transfer facility to another investment scheme, the relevant percentage for the purposes of paragraphs (3) to (5) shall be the same as that which would have been applied under or in respect of the original investment scheme as if the original investment scheme were continuing, notwithstanding any rules of the new investment scheme.

Signatory text

Names

Two of the Lords Commissioners of Her Majesty's Treasury

Date

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations define the term “stakeholder product” for the purposes of article 52B of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544, as inserted by S.I. 2004/2737).

Regulation 4 provides that a deposit account will be a stakeholder product provided that it complies with certain requirements as to the minimum deposit, the time allowed for withdrawals, the interest payable, the frequency of withdrawals and the methods of making deposits.

Regulation 5 provides that units in a collective investment scheme will be a stakeholder product provided that the scheme complies with certain requirements set out in regulation 7.

Regulation 6 provides that rights in linked long-term contracts will be a stakeholder product provided that the fund held in respect of the contract complies with certain requirements set out in regulation 7 and, where the investment returns are smoothed, regulation 8.

Regulation 7 sets out the requirements applicable to units in collective investment schemes and rights in a linked long-term fund.

Regulation 8 sets out the additional requirements to be satisfied where the returns under a linked long-term contract are smoothed.

Regulation 9 sets out the detailed requirements for the charge cap applicable to stakeholder collective investment schemes and linked long-term funds.



LIST OF RESPONDENTS

The Government is very grateful to the following organisations and individuals for their responses to the consultation on “stakeholder” savings and investment products regulations published in June 2004.

- Aegon UK
- Alliance For Finance
- Association of British Insurers
- Association of Investment Trust Companies
- Association of Pension Lawyers
- Association of Private Client Investment Managers & Stockbrokers
- Barclays Group*
- Consumers Association
- Financial Services Consumer Panel
- Friends Provident
- Halifax Bank of Scotland
- Investment & Life Assurance Group
- Legal & General Group
- Nationwide Building Society
- Norwich Union
- PEP & ISA Managers’ Association
- Prudential Assurance Company Limited
- Standard Life Assurance Company
- The Association of Friendly Societies
- The Building Societies Association
- UK Social Investment Forum
- Zurich Financial Services

Responses marked with a () are confidential.*

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