

Financial Services and Markets Act two year review:

Changes to secondary legislation

Government response

November 2004



HM TREASURY



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INTRODUCTION

1.1 This feedback statement relates to a number of proposed changes to the boundary of financial services regulation, as set out in a consultation document issued by HM Treasury ('the Treasury') on 27 February 2004 titled "Financial Services and Markets Act Two Year Review: Changes to Secondary Legislation."

1.2 The consultation period closed on 28 May 2004. This feedback statement summarises key messages from the seventy written responses received and from further discussions with some respondents, and explains how the Treasury proposes to proceed. All written responses are being made available at http://www.hm-treasury.gov.uk/consultations_and_legislation/fsma_twoyrrev/consult_fsma2yrev_responses.cfm, except where respondents did not wish their views to be made public.

1.3 The consultation document contained an initial Regulatory Impact Assessment and drafts of some of the legislation which the Treasury was proposing to introduce. This feedback statement includes a final Regulatory Impact Assessment. The Treasury intends to publish revised drafts of all of the legislation early in 2005 prior to their adoption, except legislation relating to future work requiring further public consultation.

1.4 The proposals contained in the consultation document form part of the Two Year Review of the Financial Services and Markets Act 2000 ('FSMA'). There are three strands to this review. First, an assessment of the impact of FSMA on competition in financial services. Second, changes to aspects of the Financial Services Authority's practices and possible changes to the Financial Ombudsman Service. Third, changes to the boundary of legislation. This feedback statement and associated consultation relate to the third strand.

1.5 The Treasury consulted separately on other proposals relating to the third strand, notably in a consultation document published on 26 January 2004 titled "Informal Capital Raising and High Net Worth and Sophisticated Investors." A feedback statement relating to that consultation is being published alongside this statement.

1.6 More details on all aspects of the Two Year Review of FSMA were announced in a statement to Parliament by Ruth Kelly MP, the then Financial Secretary to the Treasury, on 4 November 2003. The outcome of the Two Year Review was announced in a statement to Parliament by Stephen Timms MP, Financial Secretary to the Treasury, on 25 November 2004. A copy of each statement can be found at http://www.hm-treasury.gov.uk/newsroom_and_speeches/speeches/statement/speech_statement_fst041103.cfm

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OVERVIEW

2.1 The Treasury plans to adopt a deregulatory package of reforms which should improve the functioning of the UK's financial regulation framework by reducing the scope of regulation in many areas. This package involves three main types of reform:

- ⚡ **Clarifying and simplifying particular regulatory requirements**, especially in relation to financial promotion, in order to make compliance more straightforward and less burdensome. Specific changes are being made in order to encourage an increased uptake of personal pensions and stakeholder pensions and in relation to managing personal debt more effectively.
- ⚡ **Redrawing the boundary of regulation in a range of places where appropriate**, thereby reducing the application of regulatory requirements and reducing the need to conduct business with or through persons who have been authorised by the Financial Services Authority (FSA). These deregulatory and cost-saving changes should have a positive impact on competition in a number of areas, including in relation to occupational pension fund management and open-ended investment companies.
- ⚡ **Enabling the FSA to operate more efficiently and more effectively** in certain specific areas, in relation to assessing authorisation applications, investigating compliance, and taking enforcement action.

2.2 The Treasury's reforms should deliver the following key outcomes by introducing the following specific improvements:

- ⚡ **Placing people in a stronger position to manage their personal debt more effectively** by making it easier for advice centres such as Citizens Advice Bureaux to provide them with assistance. Advice centres will be provided with an exemption from the FSMA financial promotion regime which will enable them to raise awareness and understanding of financial services issues, and enable them to provide advice and other debt-related support such as assistance with applications, without advice centres having to worry that they might be subject to the financial promotion restriction. This exemption from the FSMA financial promotion regime will apply in areas where advice centres have already developed experience and competence, and advice centres will be required to hold adequate levels of professional indemnity insurance or comparable guarantees. Advice centres will be able to refer their clients to FSA authorised persons, for example where more specialised support is needed, and advice centres will not be able to charge for their services. People with personal debt problems who currently find it difficult to access the regulated sector should find it easier to secure assistance from advice centres in future, and these advice centres are likely to provide a complementary service to that which is available from the regulated sector.

- ⚡# **Placing employees in a stronger position to make sound decisions about investing in their own pensions** by making it easier for their employers to provide them with a wider and more in-depth range of advice and information. Employers will be provided with an exemption from the FSMA financial promotion regime enabling them to make presentations and other promotions about their pensions to their employees, including providing written material. The intention is that employees' levels of awareness and understanding would rise, and as a result more employees may take up pensions, or those that have already done so may invest more in their own pensions. Employers should refer employees to FSA authorised persons where specific individual advice is sought, and when a pension is taken up an FSA authorised person would always be involved in the process somewhere. Employers would therefore be working in tandem with the regulated sector. Employees would be further safeguarded by the fact that employers would need to contribute financially to the pensions they promote, and would not receive a commission or other financial gains from making promotions. Employers would initially be able to promote their own pensions only, but in due course might be able to promote other work-related products such as health insurance.
- ⚡# **Boosting the performance of occupational pension funds** by enabling the trustees of these funds to make a wider range of investments without needing to be authorised by the FSA, in particular allowing them to invest in pooled investment vehicles and contracts of insurance. These have similar risk characteristics to the current instruments in which occupational pension fund trustees are allowed to invest, and this deregulatory reform should help encourage greater investment by occupational pension fund trustees in private equity and in pooled investments. Occupational pension fund trustees would also be able to take advice from a wider range of sources, in particular from professional firms such as legal and accounting firms operating under Part XX of FSMA, and would be able to challenge the advice they receive. These reforms should contribute to improving the quality of advice provided and improving investment decisions.
- ⚡# **Allowing open-ended investment companies (OEICs) to benefit from certain freedoms from regulation** which should reduce their operating costs, enable some of their business to be conducted more efficiently, and place them on a more even regulatory footing with authorised unit trusts, all without causing detriment to investors. OEICs will be able to dispense with annual general meetings, which are expensive to hold and generally poorly attended. Some of the business which was previously assigned to annual general meetings, such as employing auditors, would be conducted by the OEIC's authorised corporate director instead. Information which was previously made available at annual general meetings would be made available via other means. Annual general meetings are generally not used to question how well the OEIC's funds are being managed, and the other avenues currently used to do this will remain open. These deregulatory changes should enable OEICs to compete on a more even basis with authorised unit trusts, and any increase in competition is likely to benefit investors further.

- ⚡# **Facilitating the making of financial promotions** by narrowing the scope of the FSMA financial promotion regime and clarifying it in various places. The changes envisaged are essentially deregulatory in nature and should reduce costs by avoiding the need for financial promotions to be approved by an authorised person where this is not justified. These changes are predominantly technical in nature and reducing the scope of the FSMA financial promotions regime in this way should not have an adverse impact on consumers or investors.
- ⚡# **Reducing the number of activities requiring FSA authorisation** at the margin and providing continued regulatory certainty in the form of an exemption from financial services regulation for those engaged in electricity balancing and settlement activities, so that they do not need to be regulated by both the FSA and Ofgem.
- ⚡# **Enhancing the effectiveness and efficiency of the FSA's operations** in a number of specific areas relating to authorisation requirements, investigating compliance, and taking enforcement action. In particular the FSA will be able to obtain a wider range of information from Swiss insurance companies seeking to be authorised in the UK, independent actuaries appointed to assist with the FSA's regulatory functions will be permitted to disclose a wider range of information to the FSA, the issuance of notices to OEICs will be made less bureaucratic, the serving of notices by the FSA will be made more effective, and the FSA will no longer be required to publish certain notifications relating to OEICs.
- ⚡# **Pursuing further reforms in the future.** The FSMA controllers regime will be reviewed in the future together with further possible changes to the FSMA financial promotions regime. The Treasury's proposals on the regulation of takeovers activity are being placed on hold pending imminent public consultation by the Department of Trade and Industry on implementation of the EC Takeovers Directive in the UK.

2.3 A Regulatory Impact Assessment explains how the benefits of these measures outweigh the costs, how risks have been mitigated and will be managed, and how these deregulatory reforms will have a positive impact on competition. The changes required to FSMA secondary legislation to implement these reforms should be made by spring 2005.

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THE IMPACT OF FSMA ON ADVICE CENTRES

3.1 The Treasury consulted about whether the current boundary of regulation gives rise to any unnecessary obstacles (whether actual or perceived) to the services provided by bodies which provide free, confidential and independent financial advice to individuals. These bodies include Citizens Advice Bureaux and similar advice centres, such as the members of adviceUK. The Treasury consulted about how any such obstacles might be addressed. The following questions were posed in the consultation document:

Q1: Do you think that the current scope of the financial promotion restriction creates uncertainty or is unduly restrictive of the work of advice centres?

Q2: Do you think that there should be a specific financial promotion exemption for advice centres?

Q3: Is there a case for further legislation?

Q4: Do you think that there should be additional legislation to confirm that advice centres are not carrying on regulated activities?

Q5: Do you agree with the proposed conditions for exemptions relating to advice centres?

Q6: Do you think that there should be other conditions (e.g. minimum competence criteria and specific professional indemnity insurance (PII) thresholds)?

Q7: Do you agree with limiting the exemptions to mortgages, endowments, pension products and shares?

Q8: Do you think that an exemption limited only to members of certain established networks of advice centres provides a better alternative?

Q9: Do you think that exemptions for advice centres could have regulatory consequences for other bodies besides advice centres?

3.2 Almost all respondents believed that advice centres should be provided with greater certainty about whether their activities are subject to financial regulation by the FSA. The majority of respondents supported providing advice centres with an exemption from FSMA in particular areas. Some other respondents favoured clarifying how advice centres should operate outside the scope of FSMA.

3.3 Both sets of respondents largely shared the same underlying concerns, notably that those providing advice or engaging in other activities should be competent to do so, that the scope for any mis-selling should be minimised, and that the clients of advice centres should be able to pursue some form of redress if necessary. **The Treasury agrees with the majority of respondents that advice centres should be provided with an exemption from the FSMA financial promotion regime, and that the scope and nature of the exemption should aim to address the underlying concerns identified.**

- Free and independent advice** 3.4 Most respondents agreed that the provision of financial advice by advice centres should only be exempt from FSMA where this advice is free at the point of delivery and independent, i.e. not connected to any commission or equivalent payment. This should reduce the risk of the exemption being abused for commercial gain. A small minority of respondents were not opposed to charging, for example in circumstances where clients were able to pay, or where charges might help cover core advice centre costs. **The Treasury agrees that advice centres should be provided with an exemption from FSMA only where the advice provided is free and independent.**
- Debt advice the main activity** 3.5 Almost all respondents agreed that the exemption should apply only to advice centres which provide debt advice as their principal financial services activity. This would accord with the main financial services activity currently provided by most advice centres, i.e. helping less well-off clients manage debt problems, where advice from the private sector may be unavailable or may be difficult to secure at a reasonable price. **The Treasury agrees that only advice centres which provide debt advice as their principal financial services activity should be provided with an exemption from FSMA.**
- Professional indemnity insurance (PII)** 3.6 Almost all respondents agreed that advice centres should hold adequate professional indemnity insurance (PII) cover, or a comparable guarantee, or that they should be a service provided by a local authority. Many respondents believed that these conditions would provide clients with greater means of redress, would require advice centres to develop the necessary competences, and would require advice centres to establish effective management systems which reduce the risk of advisers going beyond their field of expertise. Two respondents suggested that advice centres should hold at least £250,000 of PII cover. **The Treasury agrees that advice centres should hold adequate levels of professional indemnity insurance (PII) cover, or a comparable guarantee, or advice centres should be a service provided by a local authority. The Treasury believes that the legislation should set out criteria relating to how the adequacy of cover might be determined, rather than imposing a less flexible specific financial limit.**
- Generic advice** 3.7 Many advice centres currently provide general information and generic advice to clients. This is generally uncontroversial and was supported by many respondents, some of whom believed that the provision of generic advice is a regulatory grey area and should be subject to an exemption from FSMA. **The Treasury agrees that generic financial advice provided by advice centres should not be subject to FSMA regulation.**
- Making referrals** 3.8 Many advice centres currently make referrals to authorised financial advisers. This is generally uncontroversial, especially as advice centres normally do not gain commercially or financially from doing so. A number of respondents believed that advice centres should aim to make referrals to authorised financial advisers where possible rather than straying into the provision of regulated activities themselves. **The Treasury agrees that advice centres should be provided with an exemption from FSMA when they refer and/or introduce clients to authorised financial advisers and product providers, provided advice centres receive no financial reward as a result.**
- Specific advice** 3.9 Most respondents were more concerned about the provision of product-specific advice by advice centres, in particular that such advice should be provided by people who hold an appropriate level of knowledge, competence and experience. The consultation document proposed that an exemption from FSMA might be limited to mortgages, endowments and pension products, as these are the investments on which advice centres traditionally advise.

3.10 Some respondents suggested that an exemption for providing product-specific advice might apply to a wider range of products. Other respondents, including a number of advice centres, favoured a tighter exemption covering a narrower range of less risky areas which accords more precisely with their established areas of competence and experience, i.e. debt-related activities. A wider exemption might also have adverse implications for the cost of obtaining PII cover. **The Treasury agrees that advice centres should be provided with an exemption from FSMA when they provide specific financial advice to clients in a particular range of circumstances, i.e. when helping clients renegotiate the repayment of debt relating to an existing mortgage agreement. This would include providing specific financial advice relating to endowments when helping clients negotiate the repayment of debt.**

Promotional activities

3.11 Many advice centres engage in activities where it may be perceived that an element of inducement might be involved, such as providing or helping clients with applications. These promotional activities generally carry less risk to clients than the provision of specific investment advice. Accordingly the consultation document suggested that an exemption for financial promotions might apply to investments such as shares and gilts, in addition to mortgages, endowments and pension products. Many respondents did not agree that an exemption should cover gilts and shares, and some advice centres did not favour covering pension products. Conversely, one respondent suggested that there was no particular case for not covering a wider range of mass market products, such as children's bonds. **The Treasury agrees that advice centres should be provided with an exemption from FSMA when making financial promotions in relation to mortgages and insurance contracts. The Treasury considers that this exemption should cover Child Trust Funds as well, as these funds will also be held by some of the clients of advice centres.**

Which bodies to exempt

3.12 Some respondents believed that the exemption should apply to particular activities only and not (in addition) to certain types of body, for example according to their legal, funding or profit status. One respondent proposed that the ethical for-profit sector generally should benefit from the exemption. Other respondents suggested that the exemption might cover a broader range of not-for-profit bodies. They noted that exempting certain types of not-for-profit body only might discourage others from assisting clients with debt management issues, even though those bodies might be in a position to provide assistance without being caught by FSMA.

3.13 On the other hand some respondents were concerned that an exemption might be abused by authorised profit-making bodies, which might re-organise some of their operations to qualify for the exemption and use this to secure more referrals to their related commercial activities. A number of respondents favoured applying the exemption only to recognised advice centre networks, partly to prevent this from happening. These respondents noted that recognised advice centre networks might also be better-placed to ensure that advice and other support are provided by competent people, subject to sound management, compliance and audit frameworks. Other respondents opposed providing an exemption for recognised advice centre networks only.

3.14 The Treasury agrees that an exemption should be applied only to non-profit making advice centres, but the Treasury believes that there should be no formal requirement for such centres to be members of an established network. This requirement might create entry barriers and divisions within the sector, and might reduce the number of advice centres which benefit from the exemption. In practice, many advice centres may choose to join an established network in order to benefit from their training, accreditation and management systems, with positive implications for the cost of obtaining PII cover.

Competence and training criteria **3.15** Some respondents raised the issues of competency testing, accreditation systems and the need for formal training certificates. Some advice centre networks already provide training programmes. HMT believes that the requirement to secure adequate PII cover should lead to advice centres maintaining the necessary levels of competence and experience. In addition the proposed exemption from FSMA would be tailored to cover only those activities and investments where advice centres have already demonstrated their competence and experience. **In summary the Treasury does not support introducing formal minimum competence and training criteria.**

Which legislation to amend **3.16** Many respondents believed that the Financial Promotion Order¹ in particular places overly tight constraints on advice centres, and that this will become more acute as mortgage advisers and general insurance intermediaries become subject to FSA regulation. The exemption from FSMA outlined above would apply to the Financial Promotion Order. There was little support for amending any other FSMA legislation in addition to confirm that advice centres should not require authorisation from the FSA, e.g. amending the Regulated Activities Order² or the Business Order³. **In summary the Treasury agrees that exemptions should be made only in relation to the Financial Promotion Order.**

¹ Financial Services and Markets Act 2000 (Financial Promotion) Order 2001, SI 2001/1335 (as amended).

² Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/3544 (as amended).

³ Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001, SI 2001/1177 (as amended).

Summary of the Treasury's conclusions

- ⚡ Advice centres should be provided with an exemption from the FSMA financial promotion regime, and the scope and nature of the exemption should aim to address underlying concerns identified. In particular the following terms and conditions should apply:
 - ⚡ The advice provided should be free and independent.
 - ⚡ Advice centres' principal financial services activity should be debt advice.
 - ⚡ Advice centres should hold adequate levels of professional indemnity insurance (PII) cover, or a comparable guarantee, or advice centres should be a service provided by a local authority. The legislation should set out criteria relating to how the adequacy of cover might be determined, rather than imposing a less flexible specific financial limit.
 - ⚡ Advice centres should be able to provide generic financial advice.
 - ⚡ Advice centres should be able to refer and/or introduce clients to authorised financial advisers and product providers, provided advice centres receive no financial reward as a result.
 - ⚡ Advice centres should be able to provide specific financial advice to clients when renegotiating the repayment of debt relating to an existing mortgage agreement. This would include providing specific financial advice relating to endowments when helping clients negotiate the repayment of debt.
 - ⚡ Advice centres should be able to make financial promotions in relation to mortgages and insurance contracts, and this exemption should cover Child Trust Funds as well.
 - ⚡ The exemption should apply to non-profit making advice centres, and there should be no formal requirement for such centres to be members of an established network.
 - ⚡ There should be no formal minimum competence and training criteria.

4

THE IMPACT ON FSMA ON EMPLOYERS OFFERING PENSION PRODUCTS

4.1 Following concerns raised by some employers about their ability to provide advice to employees about pensions-related issues, HMT proposed that the current boundaries of FSMA regulation should be adjusted to enable employers to do more to promote the value of pensions and to provide better information about them. Employers can already promote their occupational pension schemes as these are not caught by FSMA's financial promotion regime (unless they are stakeholder pensions), and the same applies to employee share schemes. The following questions were posed in the consultation document:

Q10: Do you believe that there should be an exemption for both real time and non-real time promotions made by employers (option 1c)? If not, which of options 1 (a) or (b) do you prefer?

Q11: Do you agree that any exemption should be subject to conditions and not be unrestricted?

Q12: Do you agree with the conditions outlined above?

Q13: Do you think that there should be other conditions?

Q14: Do you think that the exemption should contain an additional condition restricting the ability of employers to provide individual advice to employees?

Q15: If so do you think that limiting the ability of employers to make promotions by a requirement that they do not provide pensions advice in relation to an employee's individual circumstances is an appropriate condition?

Q16: Do you think that limiting the ability of employers to make promotions by reference to the definition of the activity of advising in Article 53 of the FSMA Regulated Activities Order is an appropriate condition above?

Q17: Do you think that limiting the ability of employers to make promotions by prohibiting reference to unfavourable comparisons with other pensions is a viable alternative condition above?

Q18: Do you agree that there should be no restriction on which employer's representatives can promote the employer's pension schemes?

4.2 Almost all respondents supported the thrust of the Treasury's proposals, notably that employers should be supported in promoting the uptake of pensions in the workplace, subject to certain terms and conditions which aim to provide employees with protections and minimise the scope for possible mis-selling. Some respondents believed that these terms and conditions should be simple to understand, straightforward to apply and limited in number, otherwise employers might be dissuaded from promoting pensions in the workplace. Other respondents noted that advice in the workplace has involved mis-selling in the past, and the risks facing a captive audience of employees should be managed properly.

- Real time and non-real time promotions** **4.3** The consultation document proposed that an exemption from the FSMA financial promotion regime should be provided to employers when they make both oral and written communications (i.e. real time and non-real time promotions). A small number of respondents favoured providing an exemption for oral communications only, as this might reduce the scope for mis-selling. Other respondents favoured providing an exemption for written communications only, for the same reason. The majority of respondents favoured an exemption for both types of promotion. This media-neutral option would be the simplest and clearest for employers and would enable them to use the most appropriate mode of communication in a given circumstance. **The Treasury agrees that the exemption from FSMA should apply to both real time and non-real time promotions (option 1c).**
- Employers' financial contributions** **4.4** Many respondents agreed that requiring employers to make a financial contribution to the pension being promoted would act as a powerful safeguard against mis-selling. Some respondents favoured setting a minimum contribution rate or requiring employers to make matching contributions. Others suggested that employers should disclose the size and nature of their contribution. A number of respondents disagreed that employers should need to make financial contributions, however, in part because this might exclude some employers. One respondent suggested that the best response would be to encourage more employers to make contributions rather than to drop this condition. **The Treasury agrees that employers should be required to make a financial contribution to the pensions they are promoting, and that employers should disclose the size and nature of their contributions.** This would be a powerful safeguard against mis-selling. Not setting a minimum contribution rate would raise the number of employers which might benefit from the exemption, and requiring employers to disclose the size and nature of their contribution would help employees assess the financial attractiveness of the pensions being promoted.
- Exempt products** **4.5** The consultation document proposed that the exemption should apply to group personal pension schemes and to stakeholder pensions schemes only rather than to investments more generally. A number of respondents suggested that the exemption should apply to other investment and insurance products which are relevant to the workplace, such as employee share saver schemes, share incentive plans, health cover, income protection and death cover. **The Treasury agrees that it may be worth widening the exemption from FSMA to cover other work-related investment and insurance products in future, but that it would be sensible first to assess how well workplace promotions are operating in practice in relation to pensions.** A step-by-step approach might also be easier for employers to manage.
- Right to independent advice** **4.6** Respondents were content with the consultation document's proposal that written promotional material should inform employees of their right to seek independent advice from an authorised person. Some respondents believed that applying this condition to oral promotions as well might send confusing signals to employees and could be counter-productive, even though the consultation document had not suggested that this condition should also be applied to oral promotions. **The Treasury agrees that employees should be informed of their right to seek independent advice from authorised persons in written promotional material only.**

No direct commercial benefit **4.7** Many respondents agreed with the consultation document's proposal that employers should not receive a direct commercial benefit from making workplace promotions. This condition would reduce the scope for mis-selling, and would help prevent employers from possibly being swayed towards pensions providers which could offer more commission. Other respondents believed that this condition as framed is somewhat confusing and as a result might dissuade some employers from making workplace promotions. **The Treasury agrees that this type of condition should be retained and a narrower formula should be adopted – such as 'direct financial benefit' rather than 'direct commercial benefit'. The Treasury is also considering whether the legislation could contain a non-exhaustive list of the types of benefit envisaged so as to provide greater certainty.**

Specific advice to individuals **4.8** The Treasury consulted on whether employers should be able to provide specific advice tailored to the circumstances of individual employees, and if so whether this should be subject to additional restrictions. A number of respondents disagreed that employers should be able to provide such individual advice. One respondent noted that individuals might be reluctant to disclose pertinent information to their employer, such as details of their future career plans, and hence the employer might not be in a position to provide sound individual advice. Some respondents believed that employers should inform employees of the existence of authorised financial advisers when the need for individual advice arises, and suggested that employers should go no further than providing 'class advice', i.e. generic advice which relates to a number of different types of employee rather than to individuals per se.

4.9 Other respondents noted that employers might not promote the uptake of pensions if they were dissuaded by complicated legislation which seeks to distinguish between different types of advice. Applying these distinctions might create confusion and uncertainty, leaving employers in a similar position to where they are now. **The Treasury believes that employers should be encouraged not to provide individual advice, and that the best means of achieving this would be via non-statutory initiatives including guidance, rather than by creating a restriction in the legislation.** Even if an employer strays into providing specific advice to individuals, whenever an employee takes up a pension there should always be an FSA-authorized firm involved somewhere in the process. That firm will be subject to FSA conduct of business rules and the employee may also have access to the Financial Ombudsman Service and to the Financial Services Compensation Scheme.

4.10 Respondents generally did not support the additional restrictions on employers' ability to provide individual advice which were floated in the consultation document, i.e. that employers should be prohibited from making unfavourable comparisons with other pensions, and that individual advice should be subject to the restrictions imposed by Article 53 of the FSMA Regulated Activities Order. **The Treasury agrees that additional restrictions should not be placed on employers' abilities to provide individual advice.**

Employer representative 4.11 The majority of respondents agreed that there should be no restrictions on which employers' representative can make workplace promotions, as long as they possess the necessary competence and are aware of the boundaries of their advice. Some respondents suggested that only certain employer representatives may make workplace promotions, such as HR specialists or qualified pensions managers. Other respondents suggested that training and competence criteria or an accreditation process should apply to employer representatives. **The Treasury agrees that there should be no formal restrictions on employer representatives, but that guidance and other initiatives should encourage employers to ensure that their representatives are competent and knowledgeable.**

Summary of the Treasury's conclusions

- ⌘ An exemption for employers from the Financial Promotion Order should apply to real time and non-real time promotions which relate to group personal pension schemes and stakeholder pension schemes.
- ⌘ This exemption should apply only to employers which make a financial contribution to the pensions they are promoting, and employers should disclose the size and nature of their contributions.
- ⌘ It may be worth widening the scope of this exemption to cover other work-related investment and insurance products in future. But it would be sensible first to assess how well workplace promotions are operating in practice in relation to pensions.
- ⌘ Employees should be informed in written promotional material of their right to seek independent advice from authorised persons.
- ⌘ Employers should not make a direct financial benefit from making promotions. HMT is also considering whether the legislation could contain a non-exhaustive list of the types of benefit envisaged.
- ⌘ Employers should be encouraged not to provide individual advice. The best means of achieving this would be via non-statutory initiatives including guidance, rather than by creating a restriction in the legislation.
- ⌘ There should be no formal restrictions on employer representatives, but guidance and other initiatives should encourage employers to ensure that their representatives are competent and knowledgeable.

5

THE FINANCIAL PROMOTION ORDER

5.1 The consultation document proposed that the Financial Promotion Order should be amended in places to clarify the boundary of regulation and to enable firms to communicate more effectively with potential investors. These amendments would reduce the scope of regulation in almost all cases. The consultation document proposed that equivalent changes should be made to corresponding provisions in the Collective Investment Schemes Exemption Order¹. The following questions were posed:

Q19: Do you agree with the proposed changes to the Financial Promotion Order?

Q20: Are there any further changes to the Financial Promotion Order which you think should be considered?

Q21: Do you agree that the current Article 69 of the Financial Promotion Order is too complex and should be simplified?

Q22: Do you agree with narrowing the scope of the exemption but widening the circumstances in which it can be used, and with applying fewer conditions to its use?

Q23: Do you agree with the proposed specific conditions for the exemption to apply?

'Issued by' **5.2** Almost all respondents supported the consultation's proposed changes. Respondents agreed with the proposals to widen the scope of the term 'issued by' to 'issued or to be issued by' throughout the Financial Promotion Order. **The Treasury agrees that this change should be implemented.**

Article 43 **5.3** Respondents agreed that references in Article 43 of the Financial Promotion Order to communications being 'made to' members and creditors of certain bodies corporate should be widened to communications being 'made to or directed at' those persons. Respondents agreed that the exemption in Article 43 should be widened to include communications made 'by or on behalf of' a body corporate. **The Treasury agrees that these changes should be implemented.**

Articles 11, 15, 18, 51, 55A **5.4** Respondents agreed that Article 11 should be relaxed to enable firms to combine existing exemptions in FSMA and in the Financial Promotion Order and so for example advertise deposit taking, investment services and insurance business in a single communication. Respondents agreed that the current exemption in Article 15 of the Financial Promotion Order should be extended to enable firms to make both oral and written introductions to authorised persons and appointed representatives. Respondents agreed that Article 18 of the Financial Promotion Order should be clarified to apply only to communications by mere conduits and not to persons who use mere conduits as a means of communicating their promotions. Respondents agreed that the exemption in Article 51 of the Financial Promotion Order should apply to communications to associations of high net worth or sophisticated investors as well as to individual members of those associations. Respondents agreed that Article 55A of the Financial Promotions Order should be amended so that a minor defect such as a typing error does not affect the validity of statements which accompany an exempt financial promotion made by a Part XX professional firm. **The Treasury agrees that all of these amendments should be implemented subject to some minor drafting refinements.**

¹ Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes)(Exemptions) Order 2001, SI 2001/1060 (as amended).

Article 69 5.5 Article 69 of the Financial Promotion Order specifies when promotions made by a company which already has securities admitted to a market are not subject to FSMA regulation. The consultation document proposed that this exemption should be simplified, applied to fewer investments, used in more circumstances and be subject to fewer conditions. Respondents supported these proposals. **The Treasury agrees that these amendments should be implemented.**

Other proposals 5.6 Some respondents suggested that the Financial Promotion Order should be further refined. Some of these proposals would involve further public consultation in future and are covered in Chapter 11 of this document, which deals with future work. **The Treasury agrees that some technical proposals should be implemented, including:**

- ⚡ Making it clearer and simpler to issue promotions to overseas investors and to UK high net worth companies at the same time.
- ⚡ Clarifying that employers promoting share options as part of employee share schemes remain outside the scope of FSMA (as they were under FSMA's predecessor legislation).
- ⚡ Clarifying that mere conduits for a communication (including, where appropriate, commercial websites) are outside the FSMA financial promotion regime.

Summary of the Treasury's conclusions:

- ⚡ **The proposed amendments to Articles 43, 11, 15, 18, 51, 55A, and 69 of the Financial Promotion Order should be adopted, subject to some minor drafting refinements.**
- ⚡ **Throughout the Financial Promotion Order the term 'issued by' should be replaced with the term 'issued or to be issued by'.**
- ⚡ **The Financial Promotion Order should be amended to:**
 - ⚡ **Make it clearer and simpler to issue promotions to overseas investors and to UK high net worth companies at the same time.**
 - ⚡ **Clarify that employers promoting share options as part of employee share schemes remain outside the scope of FSMA.**
 - ⚡ **Clarify that mere conduits for a communication (including, where appropriate, commercial websites) are outside the FSMA financial promotion regime.**

6

SALE OF A BODY CORPORATE

6.1 A range of activities connected with the sale of a body corporate, i.e. with takeovers, are currently subject to an exclusion from FSMA regulation, in particular from the Regulated Activities Order. This exclusion is wider than that which existed under FSMA's predecessor legislation¹, and by comparison provides relatively less investor protection and relatively less statutory underpinning for the City Code on Takeovers and Mergers ('The Takeover Code'). The consultation document proposed to narrow the scope of the current exemption and to make complementary changes to the Financial Promotion Order. The following questions were posed:

Q24: Do you agree that the exclusion in the Regulated Activities Order should be narrowed so that the 'may reasonably be regarded' test will apply only in relation to a party who is acquiring or disposing of the day to day control of that body corporate and hence not to advice given to a party whose object is not acquisition or disposal of day to day control?

Q25: Do you agree that the exclusion in the Regulated Activities Order should be narrowed so that the 'may reasonably be regarded' test will apply only in relation to takeovers of small companies?

Q26: Which option do you prefer as the definition of "small" company in respect of which the 'may reasonably be regarded' test should apply? Do you have any other suggestions?

Q27: Do you agree that the exemption for promotions in respect of takeovers should be subject to the same conditions as those which apply under the revised Regulated Activities Order?

Q28: Do you agree that it is desirable to have some form of regulation or conditions on unauthorised persons who are carrying out telephone campaigns?

Q29: Do you agree that broadly speaking we should regulate to the same extent as under previous legislation?

Q30: Which of the three options above do you prefer and why?

Q31: Do you agree that under the proposed regulatory framework the provisions in the Financial Promotion Order providing exemptions for takeovers of relevant unlisted companies (i.e. Articles 63-66) are no longer necessary?

6.2 Some respondents queried the justification for increasing the scope of FSMA regulation as proposed in the consultation document, given the absence of investor and consumer detriment from the current arrangements. Other respondents believed that the potential for detriment justified narrowing the current FSMA exclusion. All respondents focussed on how the current FSMA exclusion might be narrowed.

¹ Financial Services Act 1986, Schedule 1, paragraph 21.

Exempting only certain types of shareholder

6.3 The consultation document proposed that the “may reasonably be regarded” limb of the current exclusion from FSMA should be narrowed so that it applies only to financial advice which is given to persons holding shares for commercial purposes, rather than to persons holding shares for investment purposes. The formulation proposed in the consultation document was that the exemption should apply only in relation to parties which are acquiring or disposing of the day-to-day control of the body corporate in question.

6.4 Many respondents objected to this proposal on the grounds that it might not be possible to identify different types of shareholder in practice, and seeking to differentiate shareholders in this way could be expensive. Furthermore, if a financial promotion was made to a person who with hindsight turned out not to be excluded from FSMA the entire transaction could be unwound. Some respondents believed that one implication of this consequence might be that financial promotions would no longer be directed towards smaller or less well-known shareholders. **The Treasury agrees that the current FSMA exclusion should not be narrowed to apply to certain types of shareholder only.**

6.5 The consultation document proposed that the narrower exclusion should apply to a single person or to a ‘group of persons acting together’. Some respondents were unsure how this formulation would work in practice, and how it related to the ‘group of connected individuals’ formulation which currently exists. The revised formulation was designed to complement a narrower exclusion applying only to persons holding shares for commercial purposes. Given that the Treasury agrees that this narrower exclusion should not be pursued, **the Treasury believes that that the existing ‘group of connected individuals’ formulation should be retained** and not replaced with the proposed ‘group of persons acting together’ formulation.

Exempting only small companies

6.6 Most respondents agreed that the FSMA exclusion should apply to financial promotions made in relation to the takeover of small companies. A small number of respondents believed that the size of a company does not relate to the extent to which its shareholders should be protected. Some respondents believed that in a small company each shareholder is more likely to be kept well-informed and shareholders more often act in unison. The Takeover Code does not apply to small companies. **The Treasury agrees that small companies should remain subject to an exclusion from FSMA.**

6.7 Three possible definitions of a small company were floated in the consultation document. Many industry respondents favoured the broadest definition (Option 2), which would include companies owned by no more than 50 persons plus any unlisted company. Some respondents favoured a narrower definition (Option 3) which would include companies owned by no more than 50 persons plus only some unlisted companies. This would tie-in with the Takeover Panel’s definition of a small company. **The Treasury believes that the tightest definition of a small company would be preferable (Option 1), i.e. only companies owned by less than 50 persons.** This would be most consistent with the intention of limiting the exclusion to small companies only. Some unlisted companies can have large numbers of shareholders. This would also be consistent with the Treasury’s decision to allow the FSMA exclusion to apply to all types of shareholder, including those holding shares for investment purposes.

6.8 Many respondents commented upon whether the fifty persons test, which applies to the definition of a small company, should apply to legal owners or to beneficial owners. Some respondents believed that the number of legal owners does not necessarily reflect the size of the company, for example if nominees are holding shares on behalf of many beneficiaries. These arrangements can apply to investment companies and to some employee share ownership schemes, when shares are held in nominee accounts on behalf of beneficial owners. Other respondents believed that it may be difficult in practice to identify the number of beneficial owners. This ambiguity may open the possibility of financial promotions being made to persons who with hindsight are not subject to the FSMA exemption, and under FSMA the entire transaction might then be unwound as a result. **The Treasury agrees that the fifty persons test for small companies should apply to the number of legal owners.**

What legislation to amend **6.9** The consultation document proposed that exclusions should apply to the Regulated Activities Order and that analogous exemptions should be made to the Financial Promotion Order. Respondents broadly approved. **The Treasury agrees that both Orders should be amended.**

Telephone campaigns **6.10** Most respondents agreed that telephone campaigns by unauthorised persons should be subject broadly to the same regulatory position which applied under FSMA's predecessor legislation. Three possible regulatory options were floated in the consultation document. Many respondents did not support the option of not providing an exemption from the financial promotions regime for unsolicited real time communications and instead relying upon unauthorised persons speaking in accordance with a script which has been approved by an authorised person (Option 1). In practice the unauthorised person might deviate from the script, especially in response to questions. The financial promotion regime would then be breached, and under FSMA the entire transaction might then be unwound.

6.11 Some respondents agreed that an exemption for telephone campaigns should not mirror the current provisions in the Takeover Code (Option 3), as the Takeover Code would then form the boundary of criminal liability and it was not drafted with that intention. Many respondents favoured requiring unauthorised persons who engage in telephone campaigns to be supervised by authorised persons (broadly Option 2). This would replicate most closely the position which applied under FSMA's predecessor legislation. **The Treasury agrees that unauthorised persons should be provided with an exemption from the Financial Promotion Order when making takeover-related calls under the supervision of an authorised person.**

Hard-edged test **6.12** The consultation document suggested that the 'hard-edged' test should be broadened. This is a separate part of the current exclusion from the Regulated Activities Order for takeovers activity which would be retained. This exclusion applies to a 'group of connected individuals'. The consultation document proposed to expand the categories of person caught by this definition. Respondents were content with this proposal, but raised some issues concerning the proposed drafting of the revised exemption. **The Treasury agrees that the 'hard-edged' test should be expanded as proposed, and agrees that this test should be drafted more closely in line with the current structure.**

Articles 63 to 66 **6.13** The consultation document proposed that the exemptions contained in Articles 63 to 66 of the Financial Promotion Order should be revoked on the grounds that they are rarely used. Many respondents preferred retaining these exemptions. Some respondents suggested that more use might be made of these exemptions if they were simplified. **The Treasury agrees that the exemptions in Articles 63 to 66 of the Financial Promotion Order should be retained.**

EC Takeovers Directive **6.14** Following the launch of the consultation paper the text of the EC Takeovers Directive was finalised and this Directive was adopted. The Department for Trade and Industry (DTI) plans to issue a public consultation shortly on how this Directive might be implemented in the UK. The deadline for implementation is May 2006. **The Treasury considers that the conclusions outlined above should be revisited if necessary in light of the outcome of DTI's consultation exercise.**

Summary of the Treasury's conclusions

- ⚡ The current exclusion for takeovers activity in the Regulated Activities Order should not be narrowed to apply to certain types of shareholder only.
- ⚡ The existing 'group of connected individuals' formulation should not be replaced with the proposed 'group of persons acting together' formulation.
- ⚡ The current FSMA exclusion should be narrowed to cover small companies only. The tightest proposed definition of a small company would be preferable (option 1), i.e. companies owned by no more than fifty persons. The fifty persons test for small companies should apply to the number of legal owners.
- ⚡ The exclusions which exist in the Regulated Activities Order should be complemented by analogous exemptions in the Financial Promotion Order.
- ⚡ Unauthorised persons should be provided with an additional exemption from the Financial Promotion Order when making takeover-related calls under the supervision of an authorised person.
- ⚡ The 'hard-edged' test should be expanded to apply to a wider range of persons. This test should be drafted closely in line with the current structure.
- ⚡ The exemptions in Articles 63 to 66 of the Financial Promotion Order should be retained.
- ⚡ These conclusions should be revisited if necessary in light of DTI's consultation on how the EC Takeovers Directive should be implemented.

7

INVESTMENT BY OCCUPATIONAL PENSION SCHEME TRUSTEES

7.1 The consultation document proposed that occupational pension scheme trustees should be provided with more freedom to invest in various products, including private equity limited partnerships. The following questions were posed:

Q32: Do you agree that the expression 'routine or day to day decisions' should be replaced with 'day to day decisions' so as to increase the scope of decisions which unauthorised trustees are permitted to take?

Q33: Do you agree that the scope of products in which unauthorised trustees are permitted to invest should include pooled investment vehicles and contracts of insurance?

Q34: Do you agree that the conditions under which unauthorised trustees can invest in certain products should be relaxed so that they only have to obtain and consider independent advice rather than act in accordance with it?

Q35: Do you agree that the condition under which unauthorised trustees can invest in certain products should be relaxed so that advice can also be given by professional firms operating under Part XX of FSMA?

Q36: Do you agree with the rationale for our proposals for deregulating trustees' investment activities?

Q37: Do you agree that the scope of exempt products should be limited to pooled investment vehicles or contracts of insurance and not include individual quoted securities and derivatives?

'Routine or day to day' decisions

7.2 Almost all respondents were supportive of the consultation paper's proposals, and with the rationale behind these proposals. All respondents agreed that the scope of decisions which unauthorised trustees are permitted to take should be increased by replacing the expression 'routine or day to day decisions' with 'day to day decisions' in the Business Order. **The Treasury agrees that this amendment should be implemented.**

Scope of products

7.3 Many respondents agreed that unauthorised trustees should be permitted to take decisions to invest in a wider range of products, in particular pooled investment vehicles in general and contracts of insurance. These products generally involve similar or lower risks than investment in private equity limited partnerships, in which unauthorised trustees are already permitted to invest. A small number of respondents proposed that unauthorised trustees should be permitted to invest in a wider range of more risky products. **The Treasury agrees with the majority of respondents that unauthorised trustees should be permitted to invest in pooled investment vehicles and contracts of insurance.** Guidance could provide more clarity on which products are covered.

Expert advice condition 7.4 Most respondents supported the consultation document's proposal that unauthorised trustees should only have to obtain and consider independent advice rather than act in accordance with it. A small number of respondents were concerned about the risks of unauthorised trustees not following expert advice. Trustees are subject to a general duty of care, however, and are unlikely to ignore expert advice without good reason. One respondent believed that trustees may have been too dependent on their advisers in the past. **The Treasury agrees that unauthorised trustees should only have to obtain and consider independent advice rather than act in accordance with it**, especially if unauthorised trustees are only allowed to invest in products which are no more risky than those in which they currently invest (as proposed above).

Part XX firms 7.5 The majority of respondents agreed with the consultation document's proposals to add professional firms which operate under Part XX of FSMA to the list of persons on whose advice unauthorised trustees can take investment decisions. Some respondents were concerned that Part XX firms might not be qualified to give investment advice to pension trustees. Part XX firms are professionally qualified and subject to the discipline of designated professional bodies. Enabling Part XX firms to provide financial advice would also diversify the sources of advice available to trustees. **The Treasury agrees that unauthorised trustees should be able to take advice from professional firms which operate under Part XX of FSMA.**

7.6 One respondent suggested that unauthorised trustees should also be permitted to take investment advice from in-house experts (who are not authorised by the FSA and who do not operate under Part XX), on the grounds that the Pensions Act 1995 allows advice to be provided by in-house experts and unauthorised trustees should be subject to a consistent set of legislative requirements. Allowing Part XX firms to provide advice, as proposed above, would go part-way towards achieving greater consistency between FSMA and the Pensions Act 1995. **The Treasury believes that allowing in-house experts to provide advice to unauthorised trustees might not provide investors with sufficient safeguards.** Nevertheless the Treasury agrees that this issue should be kept under review.

Summary of the Treasury's conclusions

- ⚡ **The expression 'routine or day to day decisions' should be replaced with 'day to day decisions' in the Business Order.**
- ⚡ **Unauthorised trustees should be permitted to invest in pooled investment vehicles and contracts of insurance in addition to the products in which they are already permitted to invest.**
- ⚡ **Unauthorised trustees should only have to obtain and consider independent advice rather than to act in accordance with it**
- ⚡ **Unauthorised trustees should be able to take advice from professional firms which operate under Part XX of FSMA.**
- ⚡ **The possibility of allowing in-house experts (who are not authorised by the FSA and who do not operate under Part XX of FSMA) to provide advice to unauthorised trustees should be kept under review.**

8

CHANGES TO THE REGULATED ACTIVITIES ORDER

8.1 The consultation document proposed that three particular provisions in the Regulated Activities Order could usefully be amended in addition to the other amendments to this Order proposed elsewhere. The following question was posed:

Q38: What are your views on the three changes proposed to the Regulated Activities Order? We seek, in particular, views on the question of theatrical debentures.

Absence of holding out

8.2 The activity of dealing in investments as principal requires authorisation by the FSA. Article 15 of the Regulated Activities Order currently provides an exclusion from this requirement. The consultation document proposed that a relatively minor amendment should be made to broaden this exclusion. In particular, that where a shareholder with more than 20 per cent of voting shares in a company solicits others with a view to acquiring more shares in that company, whether or not they are voting shares, it is not carrying on the regulated activity of dealing in principal. This proposal was supported. **The Treasury agrees that the exclusion provided in Article 15 of the Regulated Activities Order should be broadened.**

Trustees' use of custodians

8.3 The consultation document proposed that a new exclusion should be provided in Article 40 of the Regulated Activities Order which would enable trustees to arrange for assets to be held by custodians (without the trustees themselves needing to be authorised in addition). The responses received to this proposal were all supportive. Some respondents proposed in addition that overseas assets could be held by the custodian's sub-custodian network, and that trustees should be able to deal directly with both custodians and sub-custodians. **The Treasury agrees that a new exclusion should be provided in Article 40 of the Regulated Activities Order to allow trustees to arrange for assets to be held where appropriate by custodians and sub-custodians.**

Theatrical debentures

8.4 The consultation document proposed that Article 77 of the Regulated Activities Order should be amended to provide more legal certainty that the instruments used to finance theatrical productions are not subject to FSMA regulation. A number of respondents were concerned that the particular changes proposed in the consultation document might unintentionally lead to a range of other financial instruments being brought within the scope of FSMA, and might lead to other financial instruments being reclassified under FSMA with adverse regulatory consequences. There has been no evidence of investor detriment from the existing arrangements and **the Treasury agrees that Article 77 of the Regulated Activities Order should not be amended.**

Qualifying contracts of insurance

8.5 One respondent proposed that the Regulated Activities Order should be amended in relation to the treatment of qualifying contracts of insurance. Two alternative sets of FSA rules apply in some instances to seemingly similar types of consumer. The nature and extent of consumer detriment resulting from this is unclear. **The Treasury believes that it might be worth considering this issue once the FSA's regulation of general insurance and pure protection policies is in place and more is known about how it is operating in practice.**

Summary of the Treasury's conclusions

- ⊘ The exclusion provided in Article 15 of the Regulated Activities Order should be broadened.
- ⊘ A new exclusion should be provided in Article 40 of the Regulated Activities Order to allow trustees to arrange for assets to be held where appropriate by custodians and sub-custodians.
- ⊘ Article 77 of the Regulated Activities Order should not be amended for the sake of providing more legal certainty in relation to the way theatrical productions tend to be financed.
- ⊘ It might be worth considering the regulation of qualifying contracts of insurance once the FSA's regulation of general insurance and pure protection policies is in place and more is known about how it is operating in practice.

OTHER SECONDARY LEGISLATION

9.1 The Treasury consulted on five further changes to pieces of secondary legislation under FSMA, as outlined below together with the questions posed.

SERVICE OF NOTICES

Q39: We welcome views on this proposed change to the Service of Notice Regulations¹.

9.2 The consultation document proposed introducing a minor amendment to the circumstances when an FSA notice relating to a variation of a firm's permission (under Part IV of FSMA) should take effect. In particular, that where it is essential for the FSA to take immediate action against a firm using its power of own-initiative variation of permission, any such notice should take effect when it is received. This proposal was largely supported by respondents. One respondent proposed that this amendment should be applied to other areas where it is essential that immediate action is taken. **The Treasury agrees with this.**

Summary of the Treasury's conclusions:

Where it is essential to take immediate action, FSA notices should take effect when they are received. This should apply to sections 53(2), 77, 78, 257 and 259 of FSMA and to regulations 25 and 27 of the FSMA Open-Ended Investment Company Regulations².

TRUSTEES IN BANKRUPTCY

Q40: Do you agree that there should be provisions in FSMA applying to trustees similar to those of the Financial Services Act³?

Q41: We welcome views on the appropriate means of legislating for trustees in bankruptcy.

9.3 The consultation document proposed that trustees in bankruptcy should be subject to similar regulatory provisions as those which existed under FSMA's predecessor legislation⁴. This proposal would increase the scope of FSMA regulation and was opposed by a number of respondents, who were concerned that there is no body of evidence suggesting that current arrangements are causing detriment, yet the consultation document's proposals would require insolvency practitioners who wish to accept appointments as trustees in bankruptcy to secure FSA authorisation and comply with FSA rules, with implications for costs. This might discourage insolvency practitioners from accepting appointments as trustees in bankruptcy (the consultation document did not propose that other forms of insolvency practitioner appointment should be subject to FSMA regulation).

¹ Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001, SI 2001/1420.

² Financial Services and Markets Act 2000 (Open-Ended Investment Companies) Regulations 2001, SI 2001/1228.

³ Financial Services Act 1986, section 45(2) in particular.

⁴ Financial Services Act 1986, section 45(2) in particular.

However, the purpose of the consultation document's proposals was not to require trustees in bankruptcy to seek FSA authorisation. Rather it was to require trustees in bankruptcy to comply with FSA rules when carrying on regulated activities on behalf of the bankrupt's estate, a requirement to which other insolvency practitioners are in practice already subject. Respondents noted that most insolvency practitioners are members of designated professional bodies, all are licensed by the Insolvency Service, and in practice insolvency practitioners tend to use authorised persons to conduct financial services activities rather than conducting those activities themselves. **The Treasury agrees that, in the absence of evidence of detriment, the regulatory treatment of trustees in bankruptcy should not be changed, but that this should be kept under review.**

Summary of the Treasury's conclusions:

⚡ **The regulatory treatment of trustees in bankruptcy should not be changed, but this should be kept under review.**

DISCLOSURE OF INFORMATION BY ACTUARIES

Q42: We welcome views on this proposed change to the Disclosure Regulations⁵. Do you think that independent actuaries should be able to disclose information to others in either of the situations outlined in (a) or (b) above, or both, or not at all?

9.4 The consultation paper proposed that where the court has appointed an independent actuary to report on the need to reduce policyholder benefits, that actuary should be able to pass confidential information which they come across to the FSA where it is not specifically dealt with in their report. These disclosure provisions already apply to other independent persons who have been appointed to assist the FSA. These provisions would apply only where disclosure would help the FSA discharge its responsibilities, or help the independent actuary discharge their functions under FSMA.

9.5 Actuaries would be left to judge whether to make disclosures, subject to professional guidance. These proposals would apply where disclosure would not otherwise be permitted. On these grounds these proposals were supported by respondents. One respondent proposed that actuaries appointed by the firm or the FSA to report on a scheme transfer should be permitted to disclose information in the same circumstances, where there is not necessarily such a high level of prior FSA suspicion that problems might exist. **The Treasury agrees that actuaries should be permitted to disclose information to the FSA in the ways proposed in the consultation document, and that any further disclosure provisions should be considered in light of the Morris review⁶.**

⁵ Financial Services and Markets Act 2000 (Disclosure of Information by Prescribed Persons) Regulations 2001, SI 2001/1857 (as amended).

⁶ On 8 March 2004 the Financial Secretary to the Treasury announced an independent review into the actuarial profession. The review is being conducted by Sir Derek Morris. It commenced on 1 May 2004 and is due to report by spring 2005. A public consultation document was issued on 20 June 2004 and the consultation period closed on 1 October 2004. More details are available at www.hm-treasury.gov.uk

Summary of the Treasury's conclusions:

- # Independent actuaries appointed to assist with the FSA's regulatory functions should be permitted at their discretion to disclose confidential information to the FSA which they come across outside their remit, where disclosure would help the FSA or the actuary to discharge their responsibilities.
- # Wider disclosure provisions relating to actuaries should be considered in light of the Morris review.

SWISS INSURERS

Q43: In relation to the proposals above should the existing exemptions be removed or limited? If so to what degree? Please provide reasons for your responses.

9.6 Swiss insurance companies conducting business in the UK are regulated in accordance with a 1989 Agreement⁷ formed between Switzerland and the EU. Areas not covered by this 1989 Agreement fall to host states (i.e. the UK) to regulate. The consultation document proposed introducing new provisions relating to authorisation applications from Swiss insurers. These would restore some of the FSA's powers which existed under FSMA's predecessor legislation⁸ and would enable the 1989 Agreement to be implemented more effectively. The issue of 'close links' between an authorisation applicant and other bodies is not covered by the 1989 Agreement but is pertinent to authorisation requirements, and the consultation document proposed to apply the existing UK threshold conditions on 'close links' to Swiss insurers. The consultation document also proposed to modify the treatment of capital requirements in line with the 1989 Agreement. Following further clarification these proposals were supported by respondents. **The Treasury agrees that these proposals should be implemented.**

Summary of the Treasury's conclusions:

- # The FSA should be provided with improved powers to implement the 1989 Swiss-EU Agreement in relation to authorisation requirements.
- # Swiss insurers should be subject to existing UK provisions on 'close links'.
- # The treatment of regulatory capital held by Swiss insurers should be modified in accordance with the 1989 Swiss-EU Agreement.

⁷ The Agreement between the European Economic Community and the Swiss Confederation concerning direct insurance other than life assurance, 10 October 1989 (see Council Decision 91/370/EEC and Council Directive 91/371/EEC).

⁸ The Insurance Companies (Switzerland) Regulations 1993, SI 1993/3127, which amended the Insurance Companies Act 1982, the Insurance Companies Regulations 1981 (SI 1981/1654, replaced by SI 1994/1516) and the Insurance Companies (Accounts and Statements) Regulations 1983 (SI 1983/1811, revoked by SI 1996/943) in order to comply with the 1989 Agreement.

NEW ELECTRICITY TRADING ARRANGEMENTS ADVICE EXEMPTION

Q44: Do you agree that there has been no evidence of investor detriment from unregulated advice being given to investors (a) in the electricity forward markets or (b) in the course of either the Balancing and Settlement Arrangements or the provision of balancing services to the NGC?

Q45: Do you agree that only those investors who have knowledge of the electricity markets, i.e. professionals are likely to consider investing in the electricity forward markets?

Q46: Do you feel that there is a need for the Electricity Industry advice exemption?

Q47: Are there any BSC Parties who currently take advantage or might take advantage of this exemption?

Q48: Could a BSC Party take advantage of the exemption to provide investment advice (e.g. advice about financial engineering in the electricity markets) that should properly be regulated by the FSA?

Q49: Do you agree that the Electricity Industry advice exemption should be retained? Please explain your views.

9.7 The balancing and settlement activities of the New Electricity Trading Arrangements (NETA) are provided with an exemption from FSMA⁹ which covers certain investment activities including the provision of investment advice. This exemption provides legal comfort that FSMA does not apply to what are essentially commercial activities, and ensures that those involved in electricity balancing and settlement activities do not need to be regulated by both the FSA and by Ofgem. The Treasury consulted about whether the NETA advice exemption in particular should be retained. The consultation document noted that the NETA exemption might be affected by the EC Markets in Financial Instruments Directive, which the UK is due to implement in 2006. Retention of the NETA exemption might not be consistent with this Directive. The consultation document also noted that NETA is expected to be superseded by the British Electricity Trading and Transmission Arrangements (BETTA) on 1 April 2005. BETTA will, inter alia, extend trading arrangements in England and Wales to Scotland.

9.8 The consultation exercise revealed that most if not all balancing and settlement activities probably do not constitute investment activities, i.e. they would be covered by the other exclusions from FSMA regulation (principally in the Regulated Activities Order) which already apply to commercial activities. This would imply that the NETA exemption might be unnecessary here. Nevertheless some uncertainties appear to exist in one or two areas. The consultation exercise revealed that few if any parties are relying upon the NETA exemption to provide unauthorised investment advice, again implying that the NETA exemption might be unnecessary. Some uncertainties remain about whether some types of body might be relying upon the advice exemption, however.

⁹ Financial Services and Markets Act 2000 (Exemption) Order 2001, SI 2001/1201 (as amended), Schedule Part IV, paragraph 49.

9.9 Both types of uncertainty might be resolved if industry operations were adjusted in places. Industry participants relayed a firm preference for reviewing and adjusting their operations once the requirements of the EC Markets in Financial Instruments Directive have become certain. Otherwise there is a danger that operations might be reviewed and adjusted twice, for example if the Directive's final requirements differ from current expectations. There is no evidence of investor detriment from current arrangements. **The Treasury agrees that the scope of the NETA exemption should be reviewed more thoroughly once the full scope of the EC Markets in Financial Instruments Directive has been finalised. In the interim the Treasury believes that the NETA exemption should be amended to accommodate the introduction of BETTA.**

Summary of the Treasury's conclusions:

- # The NETA exemption should be updated and amended to accommodate BETTA.**
- # The future of the BETTA exemption, and consequent implications for adjustments to the electricity industry's operations, should be reviewed when the requirements of the EC Markets in Financial Instruments Directive are finalised. This review could build upon the analysis undertaken by the electricity industry to date in the context of the FSMA two-year review.**

10

OPEN-ENDED INVESTMENT COMPANIES

10.1 The consultation document proposed removing some of the regulatory requirements placed on open-ended investment companies (OEICs) by the OEIC Regulations¹, and in the process bringing the regulatory treatment of OEICs closer to that of authorised unit trusts. Both are similar vehicles operating in similar markets. The following questions were posed:

Q50: Do you agree that such a change to Regulation 22(5) should be made?

Q51: Do you agree that the costs of requiring OEICs to have an AGM outweigh the benefits?

Q52: Do you agree that OEICs should be able to elect to dispense with the holding of AGMs?

Q53: Do you agree that there will be adequate safeguards to protect shareholders if the requirement for OEICs to have an AGM is changed to an elective requirement?

Q54: Is the requirement that all shareholders agree to an elective resolution too onerous for OEICs to meet? Should the threshold be lower, e.g. 95 per cent of shareholders?

Q55: Should an ordinary resolution be sufficient to revoke the elective resolution?

Q56: Regarding the proposed amendments to regulation 34 outlined in paragraph 10.18, do you agree that appointments should not have effect for longer than twelve months starting on the date of the appointment?

Q57: Do you have any comments on our proposed amendment for regulation 36 outlined in paragraph 10.19?

Q58: If it is possible to do so, should any amendments be made to the requirement in regulation 78 regarding the information that is made public?

Q59: If it is possible to do so, should any amendments be made to the requirement in regulation 78 regarding the manner in which information is made public? Is publication in the London or Edinburgh Gazettes appropriate or would publication elsewhere be more useful?

FSA approval of changes

10.2 The consultation document proposed that where the FSA decides to approve a proposal after having previously issued a warning notice, the FSA should only provide a 'written notice' of its decision rather than a 'decision notice'. Fewer requirements apply to written notices and the additional requirements associated with decision notices do not appear to be appropriate in these circumstances. This proposal was supported by respondents. **The Treasury agrees that OEIC regulation 22(5) should be amended accordingly.**

¹ Financial Services and Markets Act 2000 (Open-Ended Investment Companies) Regulations 2001, SI 2001/1228.

Publishing notifications in Gazettes 10.3 All respondents agreed that the FSA should not be required to publish in the London or Edinburgh Gazettes notifications that the FSA has issued or received certain OEIC documents. The documents in question are already made available to OEIC shareholders. OEICs are authorised by the FSA and as a result are already required to disclose a wider range of information to the public. **The Treasury agrees that publication in the Gazettes of these notifications serves little if any purpose and that OEIC regulation 78 should be amended to remove this requirement.**

Dispensing with AGMs 10.4 All respondents agreed that OEICs should be able to dispense with AGMs, which are costly to organise and tend to be poorly attended. Respondents noted that some of the business which might be conducted by AGMs is not undertaken in practice, such as electing, re-electing and removing directors. Other AGM business can be transacted in more cost-effective ways without harming investor protection. For example, OEIC accounts are laid before the AGM, but these are already issued separately to each OEIC shareholder. Some respondents noted that in general, the business of AGMs is not for shareholders to question how the OEIC's authorised corporate director is managing the fund.

10.5 All respondents believed that enabling AGMs to be dispensed with if 95 per cent of shareholders approved this via an elective resolution is too high a barrier which would probably not be achievable in practice. Some respondents proposed that OEICs should be treated similarly to unit trusts, whereby 'significant' changes (as opposed to 'fundamental' changes) can be made once 60 days' notice has been given. **The Treasury agrees that dispensing with AGMs would constitute a 'significant change', and that the authorised corporate director of an OEIC should be able to make this change after giving 60 days notice. The Treasury agrees that new OEICs do not need to provide for AGMs.**

Reinstating AGMs 10.6 The consultation document suggested that AGMs might be reinstated if one shareholder requested this. Respondents believed that this condition might be too easily met and could be subject to abuse. Some respondents suggested that AGMs should only be reinstated once 5 or 10 per cent of shareholders successfully call for either an ordinary resolution or an extraordinary resolution to approve this. These respondents also suggested that it might be simplest if AGMs could not be reinstated. If general meetings were subsequently required to conduct OEIC business then Extraordinary General meetings (EGMs) could be used. EGMs may be called by 10 per cent of shareholders by value, may be held more frequently than annually and those calling the EGM may have more scope to set the agenda. **The Treasury agrees that once AGMs have been dispensed with they should not be reinstated, but EGMs should be used instead where appropriate.**

Appointing and removing OEIC directors 10.7 The consultation document proposed that where AGMs have been dispensed with, OEIC directors should be appointed for 12 months only. A number of respondents believed that this might be too inflexible. **The Treasury agrees with respondents that an OEIC's authorised corporate director should appoint other OEIC directors where appropriate and determine their length of appointment. Other OEIC directors would essentially be co-opted to provide the authorised corporate director with assistance. In practice OEICs invariably do not have other directors. The Treasury agrees with respondents that other OEIC directors should be removable if 10 per cent of shareholders by value successfully call for an EGM which approves an ordinary resolution to that effect.**

Appointing and removing auditors 10.8 Some respondents suggested that where AGMs have been dispensed with, the OEIC's auditors should be appointed, re-appointed and removed by the OEIC's authorised corporate director. This would bring OEIC requirements closer in line with those of unit trusts. **The Treasury agrees that the OEIC's authorised corporate director should be responsible for employing the OEIC's auditors.**

OEIC directors contracts 10.9 The consultation document proposed that, where AGMs have been dispensed with, directors' contracts or terms of employment should be sent to all shareholders. This material is currently made available at AGMs. **The Treasury agrees with almost all respondents that this requirement would create unnecessary expense and that it would be more appropriate for this material to be made available to OEIC shareholders upon request at any time.**

Summary of the Treasury's conclusions:

- # OEIC regulation 22(5) should be amended to enable the FSA to issue written notices rather than decision notices in certain circumstances.
- # OEIC regulation 78 should be amended to remove a requirement for the FSA to publish certain notifications in the London or Edinburgh Gazettes.
- # The authorised corporate director of an OEIC should be able to dispense with AGMs after giving 60 days notice. New OEICs do not need to provide for AGMs.
- # Once AGMs have been dispensed with they should not be reinstated, but EGMs should be used instead where appropriate.
- # Once AGMs have been dispensed with the OEIC's authorised corporate director should appoint other OEIC directors and determine their length of appointment. Such directors should be removable if 10 per cent of shareholders by value successfully call for an EGM which approves an ordinary resolution to that effect.
- # Once AGMs have been dispensed with the OEIC's authorised corporate director should be responsible for employing the OEIC's auditors.
- # Once AGMs have been dispensed with OEIC directors' contracts or terms of employment should be made available to shareholders upon request at any time.

11

FUTURE WORK

11.1 The Treasury consulted about whether other possible changes to FSMA's secondary legislation might be considered in future. The following questions were posed:

Q: What is your view of the issues which we might consider in due course? Are there any other issues?

Q: What do you think of the two possible ways in which the financial promotions framework could be restructured? Are there any others?

Controllers 11.2 A number of respondents supported reviewing the FSMA provisions on controllers, and suggested that a more proportionate regime might be introduced which is more closely aligned with the requirements of EC Directives. **The Treasury agrees that the FSMA controllers regime should be reviewed in the future**, especially given the EC Transparency Directive, which it is currently expected will have to be implemented in the UK towards the end of 2006.

Financial promotion 11.3 A number of respondents favoured addressing elements of the FSMA financial promotion framework, including in relation to when unauthorised persons instruct an authorised person to make a promotion on their behalf. The Treasury will keep the possibility of restructuring the FSMA financial promotion framework under review. In the meantime **the Treasury agrees that some technical amendments should be pursued now** (see Chapter 5 of this document for more details), and that the additional issue mentioned above should be considered alongside the review of the FSMA controllers regime.

Summary of the Treasury's conclusions:

- # The FSMA controllers regime should be reviewed in the future.
- # The treatment of unauthorised persons who instruct an authorised person to make a promotion on their behalf should be considered alongside the review of controllers.

A

REGULATORY IMPACT ASSESSMENT

PROPOSED CHANGES TO SECONDARY LEGISLATION UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000

PURPOSE AND INTENDED EFFECT

1 The objective of the changes is:

- ⌘ **Item 1. To facilitate the provision of investment advice and other debt-related support by Citizens Advice Bureaux and similar advice centres.** In particular to enable non-profit making advice centres whose principal financial services activity is debt advice (a) to provide generic financial advice, (b) to refer and/or introduce clients to financial advisers which have been authorised by the Financial Services Authority (FSA), (c) to provide specific financial advice to clients in particular circumstances, and (d) to make financial promotions to clients in particular circumstances, in all cases without the advice centres being subject to the financial promotion regime, as long as the advice and other support they provide is independent and clients are not charged.
- ⌘ **Item 2. To facilitate the promotion by employers of improved pensions uptake by employees.** In particular to enable employers to make real time and non-real time promotions to employees which relate to group personal pension schemes and to stakeholder pension schemes, without the employers being subject to the financial promotion regime, in circumstances where (a) employers make a financial contribution to the pensions they are promoting and disclose the size and nature of this contribution, (b) written promotional material informs employees of their right to seek independent advice from FSA-authorised persons, and (c) employers do not make a direct financial gain from making promotions.
- ⌘ **Item 3. To clarify and narrow the scope of which particular activities are considered to be financial promotions and hence need to be undertaken or approved by persons authorised by the FSA.** In particular to reduce the scope of the financial promotion regime at the margin, including (a) to ease the regulation of communications between bodies corporate and their members and creditors, (b) to ease the regulation of promotions covering more than one activity, (c) to ease the regulation of introductions to FSA authorised persons and appointed representatives, (d) to ease the regulation of promotions by companies whose securities are admitted to a market which is not subject to regulation under the Financial Services and Markets Act 2000 ('FSMA'), (e) to ease the regulation of promotions made to overseas investors and UK high net worth companies at the same time, (f) to clarify that employers promoting share options as part of employee share schemes remain outside the scope of financial services regulation, and (g) to clarify that only mere conduits for a communication and not other persons are outside the scope of financial services regulation.

- ⚡ **Item 4. To increase the range of investments which can be made by occupational pension fund trustees without involvement of an FSA authorised person, and to ease restrictions on the provision of advice to occupational pension fund trustees.** In particular (a) to enable unauthorised occupational pension fund trustees to invest in pooled investment vehicles and contracts of insurance in addition to the products in which they are already permitted to invest without the involvement of an FSA authorised person, (b) to require unauthorised occupational pension fund trustees to obtain and consider independent advice rather than requiring them to act in accordance with it, and (c) to enable such advice to be provided by professional firms which operate under Part XX of FSMA.
- ⚡ **Item 5. To clarify and withdraw the boundary of which particular activities are considered to be regulated activities and hence need to be undertaken by persons authorised by the FSA.** In particular (a) to broaden at the margin the exclusion from financial services regulation which currently applies to dealing in investments as principal, and (b) to enable unauthorised trustees to arrange for assets to be held by custodians and sub-custodians without themselves needing to be authorised by the FSA.
- ⚡ **Item 6. To provide continued certainty to those engaging in electricity balancing and settlement activities that they are not subject to financial services regulation.** In particular to extend the existing exemption from financial services regulation applying to certain investment activities including investment advice associated with the balancing and settlement activities of the New Electricity Trading Arrangements (NETA), which applies in England and Wales, so that this exemption also applies in Scotland when NETA is superseded by the British Electricity Trading and Transmission Arrangements (BETTA).
- ⚡ **Item 7. To enable the FSA to undertake certain regulatory functions more effectively.** In particular (a) to enable FSA notices to take effect when they are received, where it is essential to take immediate action, (b) to enable independent actuaries appointed to assist with the FSA's regulatory functions to be permitted at their discretion to disclose confidential information to the FSA which they come across outside their remit, where disclosure would help the FSA or actuary to discharge their responsibilities, and (c) to upgrade the authorisation requirements applying to Swiss insurance companies, including in relation to 'close links', and to improve the FSA's application of capital requirements to Swiss insurance companies.
- ⚡ **Item 8. To ease the regulation of open-ended investment companies (OEICs).** In particular (a) to enable the FSA to issue written notices to OEICs rather than decision notices in certain circumstances, (b) to remove a requirement for the FSA to publish certain notifications in the London and Edinburgh Gazettes, (c) to enable the authorised corporate director of an OEIC to dispense with annual general meetings (AGMs) after giving 60 days' notice, (d) to enable new OEICs not to provide for AGMs, and (e) to enable the authorised corporate director of an OEIC to appoint other directors and to employ auditors where AGMs have been dispensed with, such directors being removable by ordinary resolution in an Extraordinary General Meeting (EGM).

2 These proposals are being considered in one regulatory impact assessment because all will be implemented by changes to secondary legislation relating to the boundary of financial services regulation. Guidance provided by the FSA and/or by the Government may supplement these legislative changes in some places. Moreover, all the proposals were consulted upon in one consultation document.

3 These objectives will be achieved by:

- ⚡ **Item 1. Providing non-profit making advice centres with an exemption from the Financial Promotion Order¹**, subject to the conditions outlined above. This will enable advice centres to provide debt-related advice and other assistance, for example with form-filling and referrals to FSA-authorized persons, whilst remaining outside the scope of the financial promotion regime.
- ⚡ **Item 2. Providing employers with an exemption from the Financial Promotion Order**, subject to the conditions outlined above. This could be supplemented by guidance. This would make it easier for employers to promote the uptake of pensions to their employees, whilst remaining outside the scope of the financial promotion regime.
- ⚡ **Item 3. Making a range of amendments to the Financial Promotion Order.** These changes would enable firms to engage in a wider range of promotional activities without needing to secure the approval of an FSA-authorized person for a promotion.
- ⚡ **Item 4. Amending the Business Order²** to increase the range of investments which can be made by occupational pension fund trustees without the involvement of an FSA authorized person, and to ease restrictions on the provision of advice to occupational pension fund trustees. These changes would enable occupational pension fund trustees to invest in a wider range of instruments, to take advice from a wider range of sources and to question that advice where appropriate.
- ⚡ **Item 5. Making a small number of amendments to the Regulated Activities Order³.** These changes would enable certain dealing in investments as principal to take place without requiring FSA authorisation, and would enable trustees to arrange for assets to be held by custodians and sub-custodians without trustees themselves needing to secure authorisation by the FSA.
- ⚡ **Item 6. Amending the Exemption Order⁴** to replace the existing exemption relating to NETA with an exemption relating to BETTA which covers the same activities in the same circumstances and applies to the same types of party. This should enable the current electricity trading arrangements to continue to operate smoothly when NETA is superseded by BETTA.

¹ Financial Services and Markets Act 2000 (Financial Promotion) Order 2001, SI 2001/1335 (as amended).

² Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001, SI 2001/1177 (as amended).

³ Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/3544 (as amended).

⁴ Financial Services and Markets Act 2000 (Exemption) Order 2001, SI 2001/1201 (as amended).

- ⚡ **Item 7. Amending the Service of Notices Regulations⁵** to enable FSA notices to take effect when received when it is essential to take immediate action, **amending the Disclosure of Information Regulations⁶** to enable independent actuaries to pass information to the FSA as outlined above, and **amending the Variation of Threshold Conditions Order⁷** to modify the regulation of Swiss insurance companies as outlined above. These changes should enable the FSA to operate more effectively in relation to authorisation requirements, when investigating and assessing compliance with regulatory requirements, and when taking enforcement action.
- ⚡ **Item 8. Amending the OEIC Regulations⁸.** This would enable OEICs to dispense with AGMs and to conduct the business which used to be undertaken via AGMs by more efficient means instead, and would enable the FSA to regulate OEICs more efficiently by easing the requirements placed upon the FSA.

4 Those mainly affected by the changes are:

- ⚡ **Item 1. Non profit-making advice centres and their clients.** There are currently some 2,800 Citizens Advice Bureau outlets in the UK and adviceUK has a membership of around 1,000 independent information and advice centres. Non profit-making advice centres will benefit from greater legislative certainty and as a result might engage more in providing advice and related assistance on debt management to their clients, and the number of clients seeking this form of assistance might rise as a result. Persons currently authorised by the FSA are unlikely to be affected directly by these changes as the proposed exemption from financial services regulation would not apply to them, and the clients of non profit-making advice centres in many circumstances currently do not access advice from persons authorised by the FSA, i.e. the proposals should not result in business transferring from persons authorised by the FSA to non-profit making advice centres. Persons currently authorised by the FSA may be affected indirectly if they receive more referrals from non-profit making advice centres in future, and might benefit indirectly if the clients of non profit-making advice centres are able to manage their debts more effectively in future. 7 per cent of households have four or more credit commitments or are in arrears on household bill payments⁹, and 6.9 million families report some difficulties in meeting their debt repayments¹⁰.
- ⚡ **Item 2. Employers who provide advice about group personal pension schemes and stakeholder pension schemes, and their employees.** Employers are more likely to promote the uptake of pensions more actively to their employees, and the number of employees seeking advice on pensions-related issues might rise as a result. Persons authorised by the FSA might be affected indirectly as the increased promotion of pensions in the workplace might lead to employers making more referrals to FSA authorised persons where employees seek individual advice. Persons authorised by the

⁵ Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001, SI 2001/1420.

⁶ Financial Services and Markets Act 2000 (Disclosure of Information by Prescribed Persons) Regulations 2001, SI 2001/1857.

⁷ Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001, SI 2001/2507.

⁸ Financial Services and Markets Act 2000 (Open-Ended Investment Companies) Regulations 2001, SI 2001/1228.

⁹ "Over-indebtedness in Britain", a report for the DTI by Elaine Kempson, September 2002.

¹⁰ ONS Omnibus Survey, September 2003.

FSA would also be affected indirectly if the uptake of pensions by employees rose, as whenever an employee takes up a pension there will always be an FSA authorised person involved somewhere in the sale process. 76 per cent of private sector employers with 20 or more staff offer stakeholder pension schemes, and 41 per cent offer group private pension schemes¹¹.

- ⚡ **Item 3. Persons making financial promotions.** The FSMA financial promotion regime will be clarified at the margin and the scope of this regime will be reduced at the margin. This should place a number of financial promotions outside the scope of financial services regulation. This may in turn lead to an increase in the scale of such promotional activity at the margin, and might indirectly affect the recipients of promotions as well as the providers.
- ⚡ **Item 4. Occupational pension fund trustees and professional firms operating under Part XX of FSMA.** Occupational pension fund trustees will be able to invest in a wider range of instruments, in particular pooled investment vehicles and contracts of insurance without the involvement of an FSA authorised person. Indirectly this should benefit the providers of those instruments and should have positive implications for occupational pension fund performance. Occupational pension fund trustees will be able to obtain advice from Part XX firms, which may result in more advice being obtained from this source and more competition in the provision of advice. Occupational pension fund trustees will be able to question advice where appropriate and this might possibly raise the quality of advice provided and the quality of decision-making at the margin. The Occupational Pensions Regulatory Authority has indicated that there are currently around 94,000 occupational pension fund trustees. The FSA has indicated that about 17,000 professional firms currently operate under Part XX of FSMA.
- ⚡ **Item 5. Shareholders dealing in investments as principal in certain circumstances, trustees, custodians and sub-custodians.** In particular circumstances shareholders will be able to solicit others with a view to acquiring more shares without being regarded as carrying on the regulated activity of dealing as principal. This is likely to apply in a limited range of circumstances. As a result the extent of this activity might rise in future at the margin, although any changes are likely to be small. Those engaging in this activity might benefit from avoiding the costs and implications of securing authorisation from the FSA. Trustees will be able to arrange for assets to be held by custodians and sub-custodians without needing to secure FSA authorisation themselves. This might lead to trustees making greater use of custodians and sub-custodians, which may indirectly enable trustees to manage assets more efficiently, and indirectly affect beneficiaries and other parties to the trusts in question, including by having a positive impact on the security of assets. The FSA has indicated that there are currently just over 2,300 authorised custodians and sub-custodians.

¹¹ "Key Facts Compendium", Department for Work and Pensions, October 2004.

- ⚡ **Item 6. The Balancing and Settlement Code (BSC) parties of NETA and BETTA.** The NETA exemption supports the smooth functioning of electricity balancing and settlement activities and avoids the need for dual regulation by Ofgem and by the FSA. This geographical scope of NETA is due to be extended to cover Scotland with the introduction of BETTA, and the NETA exemption from FSMA will be extended accordingly. As a result all BSC parties engaging in balancing and settlement activities should continue to benefit from the same exemptions as now, and their activities should be unaffected. Parties based in Scotland which currently do not participate in NETA should gain by being able to participate in BETTA on the same terms and conditions as other BSC parties. This should support the smooth running of BETTA. Ofgem has indicated that 164 BSC parties are currently registered under NETA and have also been registered under BETTA. Ofgem has explained that at least 3 more parties (from Scotland) are currently registered under BETTA and that up to 5 more parties (from Northern Ireland) are expected to register under BETTA.
- ⚡ **Item 7. The FSA, independent actuaries, Swiss insurance companies, and those engaging in regulated financial services activities generally.** Some notices served by the FSA will take effect immediately, improving the effectiveness of enforcement action. This would affect all those subject to such notices plus investors, consumers and other regulated parties who might be connected to the recipient of such notices. Around 15 FSA notices are served per year in relation to the FSA's own-initiative variation of permission power which need to take effect immediately. Actuaries will be able to disclose more information to the FSA when assisting with the FSA's regulatory activities, and this should improve the effectiveness of FSA investigations at the margin. This would have indirect implications for those who might be subject to an FSA investigation plus any connected consumers and investors. Independent actuaries would be permitted to make disclosures to the FSA in circumstances where such disclosures would not otherwise be permitted, and making these disclosures might help the actuary discharge their functions under FSMA. The FSA does not make widespread use of actuaries to assist with its regulatory activities. Swiss insurance companies applying to be authorised by the FSA would need to provide marginally more information than is currently the case, especially in relation to 'close links'. Swiss insurance companies should not be subject to additional capital requirements.
- ⚡ **Item 8. OEICs and the FSA.** OEICs will be able to dispense with AGMs and to conduct the business previously undertaken at AGMs via other more efficient means. This should improve the operational efficiency of OEICs and would indirectly affect OEIC shareholders. The FSA would be able to regulate OEICs more efficiently. Authorised unit trusts might be affected indirectly as OEICs would be regulated more similarly to authorised unit trusts, facilitating competition between these investment vehicles. The FSA has indicated that there are currently 305 OEICs and 987 authorised unit trusts.

- ⚡# In all cases, those who advise others on the boundary of financial services regulation, such as law firms. The changes outlined above will affect the boundary of financial services regulation, and those providing advice on where the boundary of financial services legislation lies and on how persons might act accordingly would need to gain a firm understanding of the changes made.

BACKGROUND

5 These changes are related to two features of the financial services regulation framework.

- ⚡# Firstly, unauthorised firms or individuals carrying on regulated activities or making financial promotions risk civil or criminal sanctions where they act in breach of FSMA requirements. In the case of marketing financial products, the costs to an unauthorised person of obtaining approval for a communication made by someone who is authorised by the FSA might not be insignificant.
- ⚡# Secondly, the definition of what constitutes the boundary of regulation in some cases might appear to be complicated and/or unclear.

6 These features have the effect that a cautious attitude may be taken by those who are unauthorised towards carrying on activities which are at or near the boundary of regulation. For example:

- ⚡# A number of advice centres seem to have been reluctant to assist clients on financial services issues because of uncertainties about the scope of FSMA regulation.
- ⚡# Many employers have been reluctant to promote the uptake of pensions because of uncertainties about whether they are subject to the financial promotion regime.
- ⚡# Occupational pension fund trustees have been inclined to delegate asset allocation decisions to authorised fund managers. This may increase the likelihood of pension funds concentrating on certain types of investments such as quoted equities and gilts, and investing less than optimal amounts in other asset classes.
- ⚡# Unauthorised firms may wish to consult professional advisers more frequently about the boundary of regulation.

7 The legislation governing the regulation of financial services in the UK is the Financial Services and Markets Act 2000 (FSMA). The changes will amend the statutory instruments under FSMA which define the boundary of regulation. Details of these statutory instruments are provided above.

RISK ASSESSMENT

8 These changes aim to address the following risks:

- ⚡ **Item 1. Consumers and investors with debt management problems often find it difficult to access advice and other support** from persons authorised by the FSA, or find it difficult to access such advice and support easily and/or at reasonable cost to themselves given their circumstances. Advice centres have sometimes been reluctant to provide advice and support to these people because of the uncertainties about whether advice centres need to be authorised by the FSA. As a result consumers and investors are often not provided with debt management assistance. There is a risk that this would continue if the above-mentioned changes were not adopted.
- ⚡ **Item 2: Many people are currently under-saving for retirement.** Employers have been reluctant to provide information about pensions to their employees because of the risks that if they make unlawful promotions they might be committing a criminal offence. Where employers have been willing to provide some information, in many cases they have been cautious about providing supplementary information for example in response to staff questions. If these issues were not addressed there is a risk that many people would continue to under-save for retirement.
- ⚡ **Item 3: A number of financial promotions are not being made at present, or are being made subject to the expense of securing the approval of an FSA authorised person.** Investment opportunities might not be promoted to potential investors and consumers as a result, or might not be promoted as efficiently as might otherwise be the case, or the returns to investment might be lower as a result of the increased costs of promotion. There is a risk that these downsides might be perpetuated if the above-mentioned changes were not adopted.
- ⚡ **Item 4: Occupational pension fund performance is subject to regulatory restrictions** as a result of which trustees might be investing in too narrow a range of instruments, might be taking advice from too narrow a range of sources, and might not be questioning that advice sufficiently. There is a risk that an opportunity to support improved occupation pension fund performance might be missed if the above-mentioned changes were not adopted.
- ⚡ **Item 5: Trustees are restricted in how they hold the assets under their control.** As a result of trustees not being able to use custodians and sub-custodians (without trustees themselves needing to be authorised by the FSA), trustees might not be managing their assets as efficiently as might otherwise be the case, and those assets might not be held as securely as might otherwise be the case. These issues would not be addressed if the above-mentioned proposals were not adopted.

- ⚡ **Item 6: Electricity Balancing and Settlement Code (BSC) parties are uncertain that, without a specific exemption, they do not need to secure FSA authorisation.** If BSC parties which are not authorised by the FSA engage in regulatory activities which are caught by FSMA then any related contracts might be unenforceable. In order to avoid this, authorisation from the FSA might be sought in addition to existing regulation by Ofgem, or BSC parties might not engage in certain balancing and settlement activities. This might have adverse implications for costs and for balancing the electricity grid. There is a risk that these adverse implications might surface unless the NETA exemption is updated to reflect the introduction of BETTA.
- ⚡ **Item 7: The FSA's abilities to assess certain authorisation applications, to be kept informed of facts which are relevant to the FSA's functions, and to take certain enforcement actions are curtailed in some areas.** In particular the FSA has relatively limited powers to secure information from Swiss insurance companies which wish to be authorised, independent actuaries appointed to assist with the FSA's regulatory functions are restricted in what information they may disclose to the FSA, and FSA notices do not come into effect when they are received in instances where immediate action is needed. There is a risk that the FSA's effectiveness will continue to be impaired at the margin if the above-mentioned changes were not adopted.
- ⚡ **Item 8: OEICs are subject to regulatory requirements which are costly but which provide limited if any investor protection, and which might have an adverse impact on competition in the collective investment scheme sector.** In particular the requirement for OEICs to hold AGMs is costly and the business reserved for AGMs could be conducted more efficiently via other means. Certain requirements placed on the FSA in relation to publishing OEIC notifications and serving OEIC notices serve a limited purpose and/or their purpose could be achieved more effectively via other means. There is a risk that these burdens would not be relieved if the above-mentioned changes were not adopted.

9 The following risks apply to the changes being made:

- ⚡ **Item 1. There are potential risks that consumers or investors might receive inadequate, poor-quality or self-interested advice from advice centres.** In order to mitigate these risks a number of conditions have been attached to the exemption provided to advice centres: (a) advice centres should not be profit-making and should not benefit financially from assisting clients; (b) advice centres' principal financial services activity should be debt management advice; (c) the advice they provide should be free and independent; (d) the scope of the exemption from financial services regulation should relate closely to advice centres' areas of competence and experience. This exemption should be restricted in relation to financial promotions made by advice centres, and restricted further in relation to the provision of specific financial advice to clients; (e) advice centres should hold adequate levels of professional indemnity insurance cover, or a comparable guarantee, or advice centres should be a service provided by a local authority.

- ⚡ **Item 2. There are potential risks that employees might receive inadequate, poor-quality or self-interested advice from their employers.** In order to mitigate these risks a number of conditions have been attached to the exemption from financial services regulation provided to employers: (a) the exemption should apply in relation to group personal pension schemes and stakeholder pension schemes; (b) employers should make a financial contribution to the pensions they are promoting and should disclose the size and nature of their contributions; (c) employees should be informed of their ability to seek independent advice from persons authorised by the FSA when they receive written promotional materials; (d) employers should not make a direct financial benefit from making promotions; (e) employers should be encouraged by guidance not to provide specific advice to individuals; (f) employers should be encouraged by guidance to ensure that their representatives are competent and knowledgeable.

- ⚡ **Item 3. There are potential risks that reducing the scope of the FSMA financial promotion regime at the margin might lead to financial promotions being made which ought to have been approved by a person authorised by the FSA for the sake of avoiding possible consumer or investor detriment.** To mitigate these risks changes to the FSMA financial promotion regime have been limited to largely technical areas where the scope for possible detriment is reduced.

- ⚡ **Item 4. There are potential risks that unauthorised occupational pension fund trustees might ignore the advice they receive and make inappropriate investment decisions, or that they might act in accordance with advice provided by Part XX firms which is of an inadequate quality, or that they might invest in more risky instruments to the detriment of their funds.** Occupational pension fund trustees are subject to a general duty of care, however, and are unlikely to ignore expert advice without good reason. Enabling them to challenge expert advice might lead to higher-quality advice being provided in future. Part XX firms are professionally qualified, subject to the discipline of designated professional bodies. The risks that they will provide poor-quality advice are small. The wider range of instruments in which occupational pension fund trustees will be permitted to invest without the involvement of an FSA authorised person are generally no more risky than the current range of instruments in which they are permitted to invest.

- ⚡ **Item 5. Minimal risks** are associated with allowing trustees to arrange for assets to be held by custodians and sub-custodians, where appropriate, and with allowing some shareholders not to be regarded as dealing in principal when engaging in a narrow range of dealing activities.

- ⚡ **Item 6. There are potential risks of investor and consumer detriment from the provision of unregulated advice in relation to the balancing and settlement activities of NETA.** There has been no evidence of such detriment to date, nor any evidence suggesting that this exemption is subject to much, if any, use. Extending the NETA exemption to cover BETTA is unlikely to generate such risks. There are risks that if a balancing and settlement activity turns out to be an activity which ought to be regulated by the FSA, then the absence of an exemption from FSMA might render any associated contracts unenforceable. These risks are small, and would be eliminated by extending the NETA exemption to cover BETTA.

⚡ **Item 7. Minimal risks** are associated with improvements to the service of notices by the FSA, with increasing independent actuaries' ability to disclose information where actuaries decide that this is appropriate, and with improving the FSA's regulatory treatment of Swiss insurance companies.

⚡ **Item 8. There are potential risks that by dispensing with AGMs, OEIC shareholders will be in a weaker position to hold OEIC performance to account.** Any such risks would be mitigated by the fact that shareholders will be able to convene EGMs to address specific concerns as and when they arise. AGMs are generally not used to hold OEIC performance to account.

In general, there are potential risks that these changes might be inconsistent with other government and/or regulatory initiatives, for example those relating to the increased uptake of private pensions, and relating to improvements in financial capability. These changes are designed to complement all other related initiatives, however, and should not have any adverse implications for other initiatives.

OPTIONS

Not to legislate

10 Without legislative change, the various situations outlined would remain as they are. In particular the features of the financial services regulation framework outlined in paragraph 12.5 would continue to have the effects outlined in paragraph 12.6 and the consequent risks of possible detriment outlined in paragraph 12.7 would materialise.

Non-legislative options

11 These are available to some extent. In particular, FSA guidance could interpret the boundary of regulation. On the other hand, guidance cannot define the law. Moreover, if the legislation which is interpreted by guidance specifies the boundary in a confusing way, guidance will not be able to mitigate that. The problems described above have arisen despite the existence and use of FSA guidance.

Legislation

12 Paragraph 12.3 explains which legislative instruments would be used to address which of the objectives set out in this regulatory impact assessment.

COSTS AND BENEFITS

13 The costs and benefits below are of the changes to legislation compared with the option of not legislating.

14 The sectors affected will be:

- # Non-profit making advice centres.
- # Employers which provide workplace pensions.
- # Firms which are not authorised by the FSA but are carrying on an activity at or near the boundary of regulation.
- # Firms which are authorised by the FSA.
- # Occupational pension fund trustees and trustees making use of custodians and sub-custodians.
- # Professional firms operating under Part XX of FSMA, other legal and financial advisers, actuaries.
- # Custodians and sub-custodians.
- # Electricity Balancing and Settlement Code (BSC) parties.
- # OEICs.

Benefits

15 The following benefits are anticipated (these are not readily quantifiable):

- # Advice centres will be able to provide financial advice and debt-related assistance to their clients with greater legislative certainty, to the benefit of the advice centres themselves and their clients alike. This may help the clients of advice centres manage their debts better. Advice centres would also be able to provide this advice and assistance without needing to be authorised by the FSA. If advice centres were to seek authorisation from the FSA and were treated similarly to independent financial advisers they would incur an initial £1,500 authorisation fee and annual fees which vary according to the number of advisers. If an advice centre used two advisers to provide financial advice this annual fee would be almost £2,500. If this initial authorisation fee was applied only to the members of adviceUK and to Citizens Advice Bureaux, total fees of £5.7m would be levied. If each of these advice centres used two advisers to provide financial advice total fees of £9.5m would be levied per annum from advice centres which are members of these two networks. Additional fees are associated with the Financial Ombudsman Service and Financial Services Compensation Scheme. In addition to fees advice centres would incur regulatory compliance costs which might also be sizeable. A rule of thumb is that the cost of compliance is four times the direct cost of FSA fees. A recent study¹² estimated that the median incremental compliance costs facing a firm are 1.6 per cent of that firm's non-regulatory operating costs. Additional one-off compliance costs might be incurred at the outset by advice centres as they determine what the

¹² Costs of Compliance: A Report by Europe Economics, June 2003.

implications of FSA rules are for the way they operate, and how their operations might need to be modified as a result.

- ⚡ Employees are likely to receive more information about pensions from their employers. This should help employees make more informed choices about pension provision. Employers would also be able to provide this advice and assistance without needing to be authorised by the FSA. As with advice centres, if employers were to seek authorisation from the FSA and were treated similarly to independent financial advisers they would incur an initial £1,500 authorisation fee and annual fees which vary according to the number of advisers. If an employer used one representative to provide financial advice this annual fee would be just over £1,500. Additional fees are associated with the Financial Ombudsman Service and with the Financial Services Compensation Scheme. In addition to fees, employers would incur regulatory compliance costs which might also be sizeable, as outlined above. Additional one-off compliance costs might be incurred at the outset by employees as they determine what the implications of FSA rules are for the way they operate, and how their operations might need to be modified as a result.
- ⚡ At the margin it will be possible to make more flexible financial promotions, and it will be possible to make some promotions without needing to be authorised by the FSA or without needing to secure approval for the promotion from an FSA authorised person. The market for approval of financial promotions does not appear to be particularly liquid. In some cases approval is part of an investment bank's service for the particular transaction in question, and a separate discrete fee might not be charged. Some smaller corporate finance boutiques are understood to charge a flat fee of £25,000 for approval of a financial promotion.
- ⚡ Occupational pension fund trustees will not be deterred from investing in certain asset classes by the need to secure FSA authorisation. This may lead to trustees investing in a broader portfolio of investments, with positive implications for occupational pension fund performance. Occupational pension fund trustees will be able to secure advice from a wider range of sources and to challenge that advice where appropriate. This increased competition in the supply of advice from a wider range of sources, some of which might have a lower cost base, may reduce the cost of securing advice and raise the quality of advice provided;
- ⚡ Trustees will be able to arrange for assets to be held by custodians and sub-custodians without themselves needing to be authorised by the FSA. Those dealing in shares as principal in particular circumstances will be able to do so without needing to be authorised by the FSA.
- ⚡ Those engaging in electricity balancing and settlement activities will be provided with continuing certainty that they will not need to secure authorisation from the FSA. If balancing and settlement parties wished to secure FSA authorisation to obtain legal certainty that contracts would always be enforceable then industry members have indicated that annual FSA fees of around £15,000 would be required, and annual compliance costs of between £50,000 and £150,000 would be incurred. Additional costs would be incurred at the outset understanding the implications of FSA rules on business operations, and it has been suggested that these costs might approach £90,000. Applying these figures to all electricity balancing and

settlement code parties implies that initial costs of £18m might affect the industry followed by annual costs of up to £28m.

- ⚡ The FSA will be able to serve certain notices more effectively, actuaries will be able to disclose certain information to the FSA in particular circumstances, and the FSA will have improved powers to assess authorisation applications from Swiss insurance companies.
- ⚡ OEICs will be able to dispense with AGMs and to conduct the business which would have been undertaken at an AGM via more efficient other means. The costs of holding an AGM usually range from £5,000 to £10,000, amounting to total costs of £3m for all OEICs.

Costs

16 These changes are almost entirely deregulatory and would not generate new or additional regulatory costs, because the purpose of the changes is to:

- ⚡ Clarify and simplify particular regulatory requirements, especially in relation to financial promotion, thereby reducing the need for certain promotions to be approved by FSA authorised persons.
- ⚡ Provide greater regulatory certainty that a range of activities may be undertaken without the need to secure authorisation from the FSA. These activities would include those associated with electricity balancing and settlement.
- ⚡ Redefine the boundary of regulation in a number of places, thereby reducing the application of regulatory requirements, including by allowing occupational pension fund trustees to invest in a wider range of instruments and to take advice from a wider range of sources, easing the regulation of OEICs, reducing the scope of the FSMA financial promotion regime in a number of areas, enabling trustees to arrange for assets to be held by custodians and sub-custodians, and enabling certain dealing as principal not to be regulated.
- ⚡ Enable the FSA to operate more effectively, by improving the service of FSA notices, enabling actuaries to disclose information to the FSA in certain circumstances, not requiring the FSA to publish certain OEIC notifications, enabling the FSA in certain circumstances to issue written notices to OEICs rather than warning notices, and enabling the FSA to consider authorisation applications from Swiss insurance more effectively.

17 It is possible that some costs might be generated in the following areas:

- ⚡ If non-profit making advice centres choose to provide more advice and debt-related support to clients there might be resource implications for those advice centres, including perhaps in relation to the cost of professional indemnity insurance cover (although the exemption from financial services legislation provided to advice centres is designed to accord with their current areas of experience and competence, and this should have positive implications for the cost of professional indemnity insurance cover). Other advice centre services might be re-prioritised in order to accommodate any resource implications from providing more advice. Alternatively, advice centres might seek additional funding from their sources, or might seek to attract additional (voluntary) human resources,

perhaps from persons associated with the financial services industry. In summary it is difficult to predict and quantify the cost implications for advice centres. Any increase in costs experienced by advice centres would not be imposed by the exemption from financial services regulation which advice centres will be given, instead costs would arise from advice centres making use of the proposed regulatory freedoms. They are likely to do so only if the benefits of using these freedoms outweigh the costs.

- ⚡# If employers promote the uptake of pensions more to their employees there might be resource implications for both employers and employees, for example in terms of staff time and resources taken to present and consider the information, in terms of the costs of producing any promotional material, written and oral, and in terms of ensuring that employer representatives are knowledgeable and competent. It is difficult to quantify these costs up front as they would depend upon the extent to which employers make use of their exemption from financial services regulation. As with advice centres, any rise in costs would not be imposed by the exemption provided from financial services but would arise from employers making use of their new regulatory freedoms. Employers are likely to do so where the benefits of using these freedoms outweigh the costs. The proposed exemption from financial services regulation has been kept clear in order to help minimise any costs of understanding the new measures.
- ⚡# Some occupational pension fund trustees may incur costs if they need to improve their levels of financial knowledge and understanding in order to be in a position to challenge within reason the advice which they receive. These continual professional development costs are difficult to quantify.
- ⚡# There may be costs to those who provide legal and other advice about the boundary of financial regulation and how persons might act accordingly. Persons authorised by the FSA might also incur costs in understanding the changes which will be made. The simplifications, clarifications and other changes being made will need to be understood and reflected in advice which is provided and decisions which are made. These costs are difficult to quantify.
- ⚡# There may be costs to Swiss insurance companies which wish to make authorisation applications to the FSA as a result of more information being provided to the FSA, especially in relation to 'close links'. These costs would depend upon the circumstances applying to each individual Swiss insurance company, and might be negligible. The number of Swiss insurance companies seeking to apply for FSA authorisation in the future is likely to be small.

18 In summary the unavoidable costs associated with this package of changes to FSMA secondary legislation relate largely to the costs of understanding the revised legislation and its implications. Legislative changes have been kept as straightforward as possible in order to help minimise these costs. The other categories of costs which might be incurred are largely associated with advice centres, employers and occupational pension fund trustees making use of the new exemptions or other reductions in regulatory requirements which will apply to them. These freedoms are only likely to be used if the benefits of doing so to these bodies outweigh the costs. In conclusion, to the extent that costs will be generated by the proposed changes to FSMA secondary legislation, these costs should be outweighed by the benefits of these deregulatory reforms, especially when wider factors are taken into consideration such as the benefits of people managing their personal debt situation better, the benefits of employees making sounder decisions about investing in their pensions, and the benefits of improved occupational pension fund performance.

EQUITY AND FAIRNESS

19 The Government supports steps to increase access for all consumers to financial advice and planning. The intended impact of these changes is that more people will have access to financial advice, in particular those for whom advice would otherwise be unavailable.

20 In terms of equity, clients of advice centres tend to be poorer than average. For example, adviceUK estimates that 60 per cent of its members' clients belong to socio-economic categories D and E. Moreover, the assumption is that they would be unlikely to receive advice elsewhere about financial services, for example from a financial adviser, given that they will not generally be looking for advice on where to make new investments but for advice about problems with debt and with existing financial products.

21 In respect of employers, a DWP survey¹³ of those of working age found that 26 per cent would seek information and advice about pensions from their employer, the second most likely route by which information and advice would be obtained.

SMALL FIRMS' IMPACT TEST

22 The changes to the regulation of occupational pension fund trustees will reduce the extent of regulation when investing in private equity which is the corporate form of many smaller firms. None of the other changes are likely to impact more materially on small firms. Indeed, to the extent that the boundary of regulation is clarified, small firms, which are less likely to have compliance specialists, should benefit to a greater extent.

COMPETITION ASSESSMENT

23 No impact is foreseen on the position of individual firms, in the sense that the changes apply to all those doing particular activities and are not specific to particular individual firms.

¹³ Pensions 2002: Public Attitude to Pensions and Saving for Retirement, Research Report 193 by Victoria Mayhew.

24 Positive impacts on competition could potentially arise from the removal of requirements to secure authorisation from the FSA, or from the reduction of regulatory requirements.

- ⚡ **Item 1: Enabling non-profit making advice centres to provide financial advice and other debt-related support might in theory mean that their clients seek less advice from other sources, in particular from financial advisers regulated by the FSA.** The particular changes proposed are designed to provide greater legal certainty to the existing position, however, rather than to generate a shift in client behaviour. Many of these clients are unable to access advice from persons authorised by the FSA, or are unable to do so simply and cheaply, i.e. there is a limited degree of potential overlap between the clients of advice centres and those seeking advice from FSA authorised persons. The exemption from financial services legislation provided to advice centres should apply in areas where advice centres have already developed experience and competence, and the conditions attached to this exemption should mean that advice centres do not compete on unfair grounds with persons authorised by the FSA. It is expected that advice centres will continue to refer their clients to persons authorised by the FSA in appropriate circumstances.
- ⚡ **Item 2: Enabling employers to make financial promotions to employees about pensions might in theory mean that employees seek less advice from other sources, in particular from financial advisers regulated by the FSA.** In practice it is expected that employers will provide generic advice to employees on taking-up pensions, and will refer employees to FSA authorised persons when they are seeking specific financial advice relating to individual circumstances. The conditions attached to employers' exemption from financial services regulation are designed to ensure that employers' promotions complement the activities of FSA authorised persons rather than compete on unfair grounds against them. For example employers' written promotional material will explain that employees have a right to seek independent advice from FSA authorised persons. If employers succeed in promoting the increased uptake of pensions then more business would be undertaken by FSA authorised persons, as whenever a pension is taken up an FSA authorised person will always be involved somewhere in the process.
- ⚡ **Item 3: Significant direct effects on competition are unlikely to stem from clarifying and withdrawing at the margin the boundary of which particular activities are considered to be financial promotions.**
- ⚡ **Item 4: Competition amongst advisers and in other areas should be enhanced.** By enabling occupational pension fund trustees to invest in a wider range of instruments without the involvement of an FSA authorised person more competition might be generated amongst the providers of all instruments in which occupational pension fund trustees can invest. By enabling occupational pension fund trustees to seek advice from professional firms operating under Part XX of FSMA more competition might be generated amongst those who are in a position to advise occupational pension fund trustees.

- ⚡ **Item 5: Significant direct effects on competition are unlikely** to stem from clarifying and withdrawing at the margin the boundary of which particular activities are considered to be regulated activities.
- ⚡ **Item 6: Significant direct effects on competition are unlikely** to stem from providing continued certainty to those engaging in balancing and settlement activities that they are not subject to financial services regulation.
- ⚡ **Item 7: Significant direct effects on competition are unlikely** to stem from enabling FSA notices to come into effect when they are received where it is essential to take immediate action. Although the disclosure provisions relating to independent actuaries appointed to assist with the FSA's regulatory functions would place actuaries in more of a similar position as other independent persons who have been appointed to assist the FSA, this is unlikely to have a significant effect on competition. Providing the FSA with improved powers to assess authorisation applications from Swiss insurance companies, especially in relation to 'close links', would bring the regulatory treatment of Swiss insurance companies in this regard closer to that of insurance companies from other companies. **The revised regulatory treatment of Swiss insurance companies would lead to more fair competition at the margin in the insurance sector.**
- ⚡ **Item 8: OEICs should be able to compete on a fairer basis with authorised unit trusts.** Enabling OEICs to dispense with AGMs would enable OEICs to compete on more similar grounds with authorised unit trusts, which do not hold AGMs. Enabling the OEIC authorised corporate director to appoint other directors and to employ auditors would also bring the regulatory treatment of OEICs closer to that of authorised unit trusts.

ENFORCEMENT AND SANCTIONS

25 Enforcement of the changes will primarily be by the FSA. The FSA has a large range of sanctions at its disposal, including powers to levy fines or withdraw authorisation from regulated firms. The UK's law enforcement authorities and the courts would also have responsibilities for enforcement and the application of sanctions where breaches of legislation have occurred, especially more serious breaches.

CONSULTATION

26 There were 70 responses from interested parties on the 'Financial Services and Markets Act: two year review: Changes to secondary legislation' consultation document. The consultation period closed on 28 May 2004. The Government took due account of consultation responses in developing legislation set out in this document and held a number of additional discussions with some consultation respondents. Overall, the responses provided a sound basis to proceed with the changes. Consultation took place with the FSA and with the Takeovers Panel. Within the Government HM Treasury consulted with the Department for Trade and Industry and with the Department for Work and Pensions, including the Employer Task Force.

MONITORING AND REVIEW

27 The proposals for the changes set out in this regulatory impact assessment arose from a review of FSMA two years after it came into force. HM Treasury updates FSMA secondary legislation when it is appropriate to do so.

SUMMARY AND RECOMMENDATION

28 A number of changes will be made to the boundary of financial services regulation in order to:

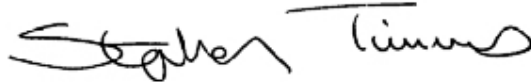
- ⌘ Facilitate the provision of investment advice and other debt-related support by Citizens Advice Bureaux and similar advice centres.
- ⌘ Facilitate the promotion by employers of improved pensions uptake by employees.
- ⌘ Clarify and withdraw the boundary of which particular activities are considered to be financial promotions and hence need to be undertaken or approved by persons authorised by the FSA.
- ⌘ Increase the range of investments which can be made by occupational pension fund trustees without the involvement of an FSA authorised person, and ease restrictions on the provision of advice to occupational pension fund trustees.
- ⌘ Clarify and withdraw the boundary of which particular activities are considered to be regulated activities and hence need to be undertaken by persons authorised by the FSA.
- ⌘ Provide continued certainty to those engaging in electricity balancing and settlement activities that they are not subject to financial services regulation.
- ⌘ Enable the FSA to undertake certain regulatory functions more effectively.
- ⌘ Ease the regulation of open-ended investment companies (OEICs).

29 These changes will be implemented via secondary legislation under the Financial Services and Markets Act 2000.

MINISTERIAL DECLARATION

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister, Stephen Timms MP, Financial Secretary to the Treasury.



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