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Financial Services Authority
Proposed amendments
to the regulations for
collective investment
schemes: tax related
amendments

November 1999



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This paper is published in accordance with paragraph 12 of Schedule 9 to the Financial Services Act 1986 (the FS Act), under which the Financial Services Authority (the FSA) is required to publish principles, rules and regulations which it proposes to make in such manner as appears to it to be best calculated to bring them to the attention of the public, together with a statement that representations in respect of the proposals can be made to the FSA within a specified period. The FSA is required to have regard, before making the instrument, to any representations duly made in accordance with that statement. Representations may include those concerning the cost to those to whom the proposed provisions will apply of complying with them.

Representations in respect of the proposals in this paper can be made to:

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Representations should reach the FSA by 25 November 1999

It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

Introduction

- 1 This consultation paper proposes amendments to the FSA's product regulations for unit trusts¹ and open-ended investment companies (oeics),² largely in order to reflect changes in stamp duty and tax legislation. It has three main purposes:
 - to facilitate the operation of the *Stamp Duty Reserve Tax* regime, to be introduced in February next year (Chapter 1);
 - to ensure that the FSA's regulations do not inhibit the investment funds industry's ability to benefit from the *stamp duty exemption* available in the case of the conversion of unit trusts to oeics (Chapter 2), and
 - to permit unit trust and oeic *charges to be made to capital* where this is in the interests of investors. Typically, this would result from changes in tax legislation (Chapter 3).
- 2 Each of these topics has been discussed in the Collective Investment Schemes Forum.³ The FSA is grateful for the input that Forum members have made.

¹ *The Financial Services (Regulated Schemes) Regulations 1991.*

² *The Financial Services (Open-Ended Investment Companies) Regulations 1997.*

³ The Collective Investment Schemes Forum (CIS Forum) is a group chaired by the FSA, comprising representatives of the Association of Unit Trusts and Investment Funds (AUTIF), Depositary and Trustee Association (DATA), Futures and Options Association (FOA) and consumer bodies.

1 Stamp Duty Reserve Tax

Background

- 1.1 The Finance Act 1999⁴ imposes, with effect from 6 February 2000, Stamp Duty Reserve Tax (SDRT) on certain dealings in units in unit trust schemes. This will replace the existing stamp duty regime. The Inland Revenue has indicated that a broadly equivalent regime will be introduced for oeics.
- 1.2 The FSA has held discussions with AUTIF, DATA and other representatives of the investment funds industry regarding the effect of the SDRT regime on authorised unit trusts and on oeics and to determine how the FSA's regulations should be amended to accommodate this new regime.
- 1.3 In order to assist the industry in its planning, the FSA issued, in September, a statement of its position and the outline of its proposed policy. This Chapter sets out the proposed policy in full.

FSA approach

- 1.4 In determining its policy on how FSA regulations should cater for SDRT, the FSA has taken into account a number of key factors. These are also relevant to cost benefit considerations:
 - **purpose:** the FSA's regulations should be amended so as to provide the trustee of a unit trust, who under the Finance Act 1999 will be accountable for payment of SDRT to the Inland Revenue, with a means to recoup that tax. Currently, the FSA's regulations do not provide for this;
 - **liability:** the Finance Act 1999 makes the trustee of a unit trust liable for SDRT, and we understand that the SDRT regime for oeics will make the oeic liable. So, to avoid competitive distortions between those vehicles, and to minimise the potential for investor confusion, the necessary

⁴ Section 122 and Schedule 19 of the *Finance Act 1999*.

changes to the FSA's regulations should ensure that a parallel regime applies, as far as possible, for both unit trusts and oeics;

- **incidence:** the amount of SDRT will depend on the pattern of dealing in units or shares. Thus, it cannot be determined at the time of an investor's purchase or redemption. Nor, under normal dealing conditions, can the amount of the ultimate SDRT charge be controlled by the manager⁵ or trustee;
- **flexibility and fairness:** given the above, the FSA considers that there should be a flexible regulatory regime enabling those operating a fund to choose the extent and the circumstances under which SDRT may be recoverable from investors;
- **transparency:** the new SDRT regime offers the prospect of improved transparency if amounts charged to investors as a provision against the SDRT bill are clearly stated. This contrasts with the current arrangements in dual priced unit trusts, where stamp duty is built into the bid-offer spread, and
- **materiality:** industry estimates, based on calculations of sales and redemptions over a 12 month period, suggest that in nearly all affected funds the annual SDRT bill would be less than 0.1% of the fund value. This may be offset by an amount a manager may recoup from investors in accordance with the proposed regulations. The FSA considers that the changes it is proposing to its regulations, as distinct from the changes in tax law, would not impose additional costs.

1.5 In light of the above, and after discussions in the CIS Forum and with AUTIF and DATA, the FSA is proposing a system which it believes to be both fair and transparent, and which would provide sufficient flexibility to recover all or some of the SDRT. The key components of this system would be to:

- permit SDRT to be charged to the property of a fund; and/or
- permit separate charges to be made to investors as a 'provision' against SDRT and to require those charges to be paid into the fund; and
- give investors adequate disclosure and notice.

1.6 The following paragraphs of this Chapter provide further comment on the FSA's proposals. Annex A, Part A contains draft amendments to the unit trust regulations.

⁵ In this Chapter, 'manager' means a manager of an authorised unit trust or an Authorised Corporate Director (ACD) of an oeic.

- 1.7 The Inland Revenue's regulations for oeics have not yet been published. However, in order to assist those operating and administering oeics to plan systems and procedures for the implementation of SDRT, Annex B, Part A contains draft amendments to the FSA's regulations for oeics. These follow the same approach as those for unit trusts. The FSA will need to review these proposed amendments when the Inland Revenue's regulations have been published.

Charging

Ability to charge the amount of SDRT due to the fund property

- 1.8 The FSA proposes to amend unit trust regulation 8.04.1 to permit the amount of SDRT due to be paid out of the property of a unit trust. The power already exists under Government regulations for oeics⁶ to pay charges or expenses out of the oeic's scheme property.

Ability to make a separate charge to investors as a 'provision' against SDRT

- 1.9 The FSA recognises that there may be circumstances where, in the interests of equity and fairness to unitholders or shareholders, managers would want to have discretion to recover the cost of SDRT borne by the unit trust or oeic from unitholders or shareholders. The FSA also recognises that the actual amount of SDRT cannot be determined at the time of a deal in units or shares. Therefore, the draft unit trust and oeic regulations would permit (but not oblige) a manager to require a separate payment or deduction of a provision against SDRT when units or shares are sold or redeemed (or created⁷ or cancelled). Any such provision received must be paid to the trustee or depositary to become part of the property of the unit trust or oeic.

Duties of the trustee

- 1.10 The draft regulations in Annex A, Part A set out the trustee's duty in respect of a manager's decision whether or not to exercise its ability to charge a provision against SDRT. The trustee will need to be satisfied that the manager has considered whether or not to exercise the power to charge an SDRT provision and the amount or rate of any SDRT provision that is imposed, and, that the manager has, so far as the trustee is aware, taken account of all factors that are material and relevant to his decision. The FSA does not believe it is appropriate to introduce a similar requirement for depositaries of oeics.

⁶ *The Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations 1996, SI 1996 No 2827.*

⁷ In this Chapter, 'creation' by the trustee of a unit trust, in the case of an oeic, means issue by the company.

Disclosure

Notice to existing investors

- 1.11 The FSA considers it important that investors are advised that they may be subject to a separate charge as a provision against SDRT, and that they receive suitable information about the circumstances in which a manager may impose such a charge. Therefore, draft unit trust regulation 16.16 and draft oeic regulation 7.13 would require holders and plan investors to be given a notice containing an explanation of what is meant by an SDRT provision and how it may affect them. Such notice would need to be given on or before the date of publication of the annual or half-yearly report next following 6 February 2000, or before any SDRT provision is charged, whichever is the earlier. Notice given prior to the coming into effect of the regulations could satisfy this requirement.

Key Features

- 1.12 Disclosure in Key Features depends on which method is used to recover all or some of the SDRT. If a separate charge is made to investors, this needs to be disclosed. If SDRT is charged to the fund property, it may be treated as 'dealing costs' for the purposes of A3.2 Expense Disclosure of PIA's Guidance to accompany new Non-Life Disclosure Rules.

Scheme particulars and prospectus

- 1.13 The FSA also considers it important that relevant details about SDRT charges or provisions are included in the more detailed information that is available to investors. The draft regulations would therefore require the scheme particulars and prospectus to include information on what is meant by SDRT, by SDRT provision, and the manager's policy on imposing such a provision.

Meetings

- 1.14 The FSA does not consider that the introduction of provisions in scheme particulars or a prospectus or, insofar as may be necessary, in a trust deed or an instrument of incorporation, solely to implement the SDRT regime, will require unitholder or shareholder approval at a meeting of investors.

Valuation and pricing

- 1.15 The FSA is considering how the IMRO Guidances on Valuation and Pricing of unit trusts and oeics would be affected by the proposals in this consultation paper. The results of that consideration will be published shortly.

Charging to capital or to income

- 1.16 The existing regulations⁸ will apply in determining whether SDRT should be treated as a charge to be made to the income or to the capital account, but more flexibility will be provided when the proposals in Chapter 3 come into effect.

Transfer of units by act of parties

- 1.17 Under the draft unit trust regulations, trustees of unit trusts would be entitled (unless the transfer is of a type excluded from SDRT) not to register a transfer of units unless an amount agreed between trustee and manager and not exceeding the rate of SDRT applied to the value of units transferred, is paid to the trustee for the account of the fund.

Issues for consultation

- 1.18 *Should the FSA's regulations for SDRT ensure a broadly equivalent regime for unit trusts and oeics?*
- 1.19 *Do the FSA's proposals strike an appropriate balance between fairness, transparency and flexibility?*

⁸ Regulation 8.06 of the unit trust regulations and 7.12 of the oeic regulations.

2 Conversion of authorised unit trusts to oeics

Background

- 2.1 In June 1999 the FSA extended the time limit for the application of its special ‘conversion’ provisions⁹ until 30 June 2000. This enabled managers to benefit from the Government’s extension of relief from stamp duty on conversion of a unit trust to an oeic and to extend, for a further year, the ‘fast track’ mechanism for unit trusts converting to oeics.
- 2.2 The FSA is re-visiting this subject again now so that appropriate provisions are in place well before 30 June 2000, thus enabling the industry to plan on the basis of certainty.

FSA proposals

- 2.3 The proposed amendments at Annex A, Part B seek to provide managers with the ability to take advantage of the Government stamp duty relief beyond June 2000. The FSA does not consider that a further extension of the ‘fast-track’ mechanism for conversion is justified. Therefore that facility will fall away.

Considerations

- 2.4 The ‘fast track’ mechanism allows managers to convert unit trusts to oeics by providing holders with a ‘notice of the proposal’ rather than holding a unitholders’ meeting. This is at odds with other unit trust regulations that require a meeting to be held for major changes to a fund.
- 2.5 In CP 22¹⁰ the FSA indicated its intention of holding further discussions with interested parties on the rights of investors in unit trusts and oeics. This

9 Regulation 11.06A of the unit trust regulations.

10 *Conversion of authorised unit trusts to oeics: Proposed extension of the time limit for application of regulation 11.06A (conversion) of the Financial Services (Regulated Schemes) Regulations 1991*, published in April 1999, Consultation paper 22 (CP22).

process started recently in the CIS Forum where there was unanimous support for continuing with the current arrangements whereby major changes to unit trusts need to be approved by an extraordinary resolution of unitholders. Allowing the 'fast-track' mechanism to expire is consistent with that approach.

- 2.6 The 'fast track' mechanism was introduced by the FSA as a temporary measure to help give a kick-start to oeics. By June 2000 this provision will have been in place for over three years. The FSA now views oeics as an established product. Thus, from the FSA's viewpoint the justification for a 'fast track' mechanism has ceased. Further, although the mechanism allowed managers to convert without holding a meeting, the vast majority of conversions have been made with a meeting.
- 2.7 The view has been expressed that managers are waiting for the second stage of oeics regulations to be enacted before converting their unit trusts to oeics and that the 'fast track' mechanism should therefore be continued in parallel with the relief from stamp duty which will run for a further 12 months from that date. Whilst the FSA recognises this argument, it sees no link between this argument and the original rationale for the 'fast-track' mechanism. However, the FSA welcomes comments from anyone who considers that there are other overriding reasons for extending the 'fast track' mechanism.
- 2.8 It is recognised that the requirement to hold a meeting will impose additional costs on managers. But the FSA considers these to be minimal, relating only to the costs of holding the meeting itself. This is not expected to be more than £1,000 per conversion. By comparison, where the 'fast-track' mechanism is used and unitholders request a meeting, the savings on a meeting will no longer be made and the FSA estimates that extra costs of approximately a pound per unitholder will be incurred. Given that the meeting route provides some additional benefits for investors, in that they have a better opportunity to question management on their proposed action, and given that it is the approach used for all other major changes to unit trusts, these costs do not appear unreasonable.

Issues for consultation

- 2.9 *Do the draft regulations at Annex A, Part B, achieve the desired effect of enabling advantage to be taken of the stamp duty exemption on converting unit trusts to oeics?*
- 2.10 *Are there any overriding reasons why the 'fast-track' mechanism for conversion should be extended?*

3 Charging to capital

Background

- 3.1 The FSA's regulations currently permit, for certain categories of unit trust and oeic, the manager's periodic charge to be charged to the capital of a fund rather than income. In September 1998 the FSA, in CP14,¹¹ proposed extending this facility to other charges. CP14 sought views on proposals to permit operators of unit trusts and oeics to charge expenses to income or capital in whatever proportion they felt appropriate for the benefit of investors.
- 3.2 The FSA proposed that this flexibility should be subject to: a) in most cases, unitholders' approval; and b) appropriate disclosure in certain scheme documents. The disclosure would include a warning to investors about any potentially negative effects on capital, which might be caused by the change in policy.

Response to CP14

- 3.3 The eleven responses to CP14 were overwhelmingly in favour of the proposal to allow managers to charge expenses to capital in whatever proportion they regarded as appropriate. Respondeees were also generally in favour of the disclosure proposals and the risk warning on capital growth. The main area of disagreement was on the need for a meeting of holders to give permission to the manager to change the way expenses are charged. A number of commentators felt that a 90-day notice period was sufficient for the change.
- 3.4 Where there was opposition to the proposals it was based on a view that the enhanced yields from charging to capital could not be reinvested to preserve capital without some cost. This is due to the fact that the amounts for

¹¹ *Collective Investment Schemes: Single Pricing and other amendments to the regulations*, published in September 1998, Consultation paper 14 (CP14).

reinvestment would be below the minimum normally accepted by most managers and the lack of accumulation units in some funds. Also funds which do offer reinvestment do not usually accept partial reinvestment.

- 3.5 Concerns were also expressed that investors may not be able to understand the significance of any risk warning on capital erosion and whether there would be adequate protection for holders, who, in spite of the need for unitholders' approval, were disadvantaged by a change of policy.
- 3.6 On the basis of the responses received, further discussions were held with industry and consumer representatives within the CIS Forum. These discussions focused on areas of contention within the original proposals and helped to shape the proposals in this consultation paper.

FSA proposals

- 3.7 Given the overwhelming support for the FSA's proposals in CP14 to permit further flexibility, the FSA is now putting forward detailed proposals for consideration. These are contained in Annex A, Part C and Annex B, Part B, and are summarised below.

Unitholders' meetings

- 3.8 Information from the industry has indicated that, under current tax legislation, most investors benefit from the fund charging expenses to capital. However, not all investors benefit and some investors only benefit to the extent that they save on capital gains tax. In particular, higher rate tax payers with no liability to capital gains tax would be worse off if expenses were charged to capital. This group of investors represents approximately 5% of the unit trust owning population.¹² Conversely, charging expenses to income would be disadvantageous to a number of types of investors including PEP and ISA holders. Changing the way expenses are charged will increase income at the expense of capital. Although the total return available to investors in general is increased, the manager does not necessarily know how individual investors are affected. It is therefore felt appropriate that investors in 'growth' funds should retain the right to vote on a manager's proposal to be given flexibility over how to charge expenses against the fund.
- 3.9 For income and balanced funds, managers already have the ability to charge the manager's expenses to capital after giving unitholders suitable notice. In the proposed regulations that provision would also apply to a situation where a manager intends to take advantage of the wider flexibility.

¹² Source: FSA calculation based on NOP Financial Research Survey, Inland Revenue Statistics and ONS population estimates.

Disclosure to investors

3.10 Consideration has been given to the information to be provided to holders. We would expect managers to provide sufficient information for holders to be able to reach an informed opinion on the manager's proposal. The points covered might include:

- the reason for introducing a variable charging policy;
- an explanation of a variable policy;
- an explanation of the existing arrangements for charging expenses;
- why flexibility is desirable and the extent to which the treatment of expenses can be variable;
- overall impact on the fund;
- impact of manager's charging policy on different types of investors;
- who decides that the charging policy should change;
- when the change will be implemented;
- information about the cost of reinvestment.

The cost of reinvestment

3.11 The FSA recognises the concern that where charges are made to capital there can be a cost of reinvestment of income. From a regulatory point of view the FSA thinks it important that investors are alerted to this possibility as suggested above.

3.12 Some 'growth' trusts only have accumulation units. In these instances consideration of whether expenses are paid from income or capital is less important. However a number of 'growth' funds only have distribution units which will make the preservation of capital a more complex issue. We would welcome views from commentators on how costs of reinvestment might be contained.

Cost benefit considerations

3.13 As previously mentioned in this paper, the change in the tax regime means that a greater number of types of investors are worse off by charging expenses to income than from charging expenses to capital. The requirement to hold a meeting for 'growth' funds already exists under unit trust regulation 11.04.3. Therefore, continuing the requirement does not represent an increase in costs to the industry.

- 3.14 The FSA is not aware of any cost increases for managers which would arise from the implementation of the proposals. We would be pleased to hear from any commentator who believes that there will be a cost associated with the implementation of these regulations.

Issues for consultation

- 3.15 *Should a manager /ACD be allowed the flexibility to charge expenses to capital in whatever proportion they feel appropriate?*
- 3.16 *Should granting of this flexibility require a meeting for 'growth' funds and only 90 days notice for those funds with a greater preference for income generation, or equal emphasis on income and capital growth?*
- 3.17 *Comments are invited on how reinvestment costs can be contained. For instance, should all growth funds be required to offer accumulation units?*

The Financial Services (Regulated Schemes) (Amendment No 3) Regulations 1999 (in draft)

The Financial Services Authority, in exercise of the powers contained in sections 81 and 85 of the Financial Services Act 1986, and now exercisable by the Authority, hereby makes the following regulations:

1.01 Citation and commencement

These regulations, 'the Financial Services (Regulated Schemes) (Amendment No 3) Regulations 1999', are made on [• 1999] and shall come into operation in respect of the amendments to the principal regulations stated in each Part of the Schedule hereto on the respective date shown below opposite that Part:

Part	Date of operation
A	6 February 2000
B	30 June 2000
C	[• 2000]
D	[• 2000]

1.02 Purpose

The purpose of this instrument is to amend the Financial Services (Regulated Schemes) Regulations 1991.

1.03 Interpretation

In these regulations, 'the principal regulations' means the Financial Services (Regulated Schemes) Regulations 1991, and a reference in the Schedule hereto to a regulation or other provision is a reference to that regulation or provision in the principal regulations.

1.04 Amendments

The principal regulations shall be amended in the manner provided in the Schedule hereto.

SCHEDULE

PART A STAMP DUTY RESERVE TAX

1. To the end of regulation 4.17 add the following new paragraph –

‘6 Nothing in this regulation affects the power of the manager to require the payment of an SDRT provision permitted under regulation 4.21C.’.
2. In regulation 4.19, immediately after paragraph 1, insert the following new paragraph –

‘1A There may be deducted from the proceeds of redemption to be paid under paragraph 1 any SDRT provision permitted under regulation 4.21C.’.
3. Immediately after regulation 4.21B insert the following regulation –

‘4.21C SDRT provision

 - 1 The manager shall have the power to require either or both of –
 - a. the payment of an SDRT provision in respect of the creation, or the sale by the trustee under regulation 4.22, or the issue, of units, and
 - b. the deduction of an SDRT provision in respect of the redemption, or the purchase by the trustee under regulation 4.22, of units, or the cancellation of units, other than a cancellation of units under regulation 4.28 resulting in a transfer of property that is such part of each description of asset in the property of the scheme as is proportionate to, or as nearly as practicable proportionate to, the holder’s share in the property of the scheme.
 - 2 Any such payment or deduction shall become due at the same time as payment or transfer of property becomes due in respect of the creation, sale, issue, redemption, purchase or cancellation.
 - 3 An SDRT provision may be imposed only in a manner that is, so far as practicable, fair to all holders and potential holders, but the imposition of an SDRT provision (or a higher SDRT provision) in respect of large deals in a manner described in the scheme particulars current at the time of the deal shall not be considered unfair.
 - 4 If the manager receives an SDRT provision in respect of any unit issued or to be issued by it (or sold or to be sold for the trustee), it shall forthwith upon receipt of that SDRT provision pay it to the trustee to become part of the property of the scheme.

- 5 If the manager deducts an SDRT provision from the proceeds of redemption of a unit redeemed by it (or bought for the trustee), it shall forthwith pay it to the trustee to become part of the property of the scheme.’.
4. To the end of regulation 4.22 add the following new paragraph –
 - ‘9 Where the manager sells units for the trustee, the manager may require the payment of any SDRT provision payable under regulation 4.21C and, where the manager buys units for the trustee, the manager may deduct from the proceeds payable to the holder any SDRT provision deductible under regulation 4.21C.’.
5. To the end of regulation 4.23 add the following new paragraph –
 - ‘4 As soon as practicable after each notification under paragraph 1, the manager shall notify the trustee of the transactions, or the types of transaction, in respect of which an SDRT provision applied and the amounts or rates of those SDRT provisions.’.
6. To the end of regulation 4.28 add the following new paragraph –
 - ‘9 Nothing in this regulation shall prevent property which would otherwise be transferred to the participant being sold in order to enable payment of any manager’s charge on redemption due under regulation 4.21 or any SDRT provision due under regulation 4.21C.’.
7. In Section 4 of Table 4.2 –
 - a. in paragraph 19, at the end of paragraph b. substitute a semi-colon for the comma, at the end of paragraph c. substitute ‘, and’ for the full stop and immediately after paragraph c. add the following new paragraph –
 - ‘d. including stamp duty reserve tax and any other fiscal charge not otherwise covered under this Section.’, and
 - b. in paragraph 22, at the end of paragraph a. substitute a semi-colon for ‘, and’, at the end of paragraph b. substitute ‘, and’ for the full stop and immediately after paragraph b. add the following new paragraph –
 - ‘c. any SDRT provision anticipated to be received.’.
8. In regulation 4A.11.3 at the end of paragraph a. substitute a semi-colon for ‘, and’, at the end of paragraph b. substitute ‘, and’ for the full stop and immediately after paragraph b. add the following new paragraph –
 - ‘c. any SDRT provision permitted under regulation 4A.19.’.
9. In regulation 4A.14 for paragraph c. substitute –

- ‘c. any SDRT provision permitted under regulation 4A.19.’.
10. In regulation 4A.15.5 –
- a. at the end of sub-paragraph a.(i) substitute a semi-colon for ‘, and’, at the end of sub-paragraph a.(ii) substitute ‘, and’ for the semi-colon and immediately after sub-paragraph a. (ii) add the following new sub-paragraph –

‘(iii) for the account of the scheme, any SDRT provision permitted under regulation 4A.19.’, and
 - b. substitute for sub-paragraph b. (iii) –

‘(iii) for the account of the scheme, any SDRT provision permitted under regulation 4A.19.’.
11. To the end of regulation 4A.16 add the following new paragraph –
- ‘3 As soon as practicable after each notification under paragraph 1, the manager shall notify the trustee of the transactions or the types of transaction, in respect of which an SDRT provision applied and the amounts or rates of those SDRT provisions.’.
12. In regulation 4A.18.1, in paragraph d. for ‘stamp duty or stamp duty reserve tax’ substitute ‘redemption charge under regulation 4B.04 or any SDRT provision under regulation 4A.19’.
13. In Section D of Part 4A –
- a. for the heading substitute ‘**Section D Dilution Levy and Stamp Duty Reserve Tax**’, and
 - b. to the end of the Explanation add the following new paragraph –

‘A manager is also permitted to require the payment of an SDRT provision, as an addition to the price of units on their creation or sale by the trustee or issue by the manager, and as a deduction on their cancellation (other than a particular type of in specie cancellation) or purchase by the trustee or redemption by the manager. It should be noted that regulation 6.12.2 deals with circumstances when a payment related to the rate of stamp duty reserve tax can be required.’.
14. For regulation 4A.19 substitute –
- ‘4A.19 Dilution Levy and SDRT provision**
- 1 The manager shall have the power to require any one or more of –
 - a. the payment of a dilution levy in respect of the creation, or the sale by the trustee under regulation 4A.15, or the issue, of units;

- b. the deduction of a dilution levy in respect of the redemption, or the cancellation, or the purchase by the trustee under regulation 4A.15, of units;
 - c. the payment of an SDRT provision in respect of the creation, or the sale by the trustee under regulation 4A.15, or the issue, of units, and
 - d. the deduction of an SDRT provision in respect of the redemption, or the purchase by the trustee under regulation 4A.15, of units, or the cancellation of units, other than a cancellation of units under regulation 4A.18 resulting in a transfer of property that is such part of each description of asset in the property of the scheme as is proportionate to, or as nearly as practicable proportionate to, the holder's shares in the property of the scheme.
- 2 Any such payment or deduction shall become due at the same time as payment or transfer of property becomes due in respect of the creation, sale, issue, redemption, purchase or cancellation.
 - 3 A dilution levy or SDRT provision may be imposed only in a manner that is, so far as practicable, fair to all holders and potential holders, but the imposition of a dilution levy (or a higher dilution levy) or SDRT provision (or a higher SDRT provision) in respect of large deals in a manner described in the scheme particulars current at the time of the deal shall not be considered unfair.
 - 4 If the manager receives a dilution levy or SDRT provision in respect of any unit issued or to be issued by it, it shall forthwith upon receipt of that dilution levy or SDRT provision, pay it to the trustee to become part of the property of the scheme, except to the extent in the case of a dilution levy that it has already been, or will be, paid by the manager to the trustee on the creation of that unit.
 - 5 If the manager deducts a dilution levy or SDRT provision from the proceeds of redemption of a unit redeemed by it, it shall forthwith pay it to the trustee to become part of the property of the scheme, except to the extent in the case of a dilution levy that it has already been, or will be, deducted from the payment by the trustee to the manager on the cancellation of that unit.'
15. In regulation 4B.04.1 after 'upon a redemption of units' insert 'or in specie cancellation of units under regulation 4A.18'.
 16. Delete regulation 4B.07.
 17. In Table 4C.1 –
 - a. in the adaptation of regulation 7.09 –

- (i) in the first paragraph for ‘and subject to paragraph 4’ substitute ‘and subject to paragraphs 4 and 5’;
 - (ii) at the beginning of the third paragraph –
for ‘After paragraph 3’ substitute ‘After paragraph 4’;
 - (iii) re-number the new paragraph 4 as paragraph 5, and
 - (iv) in sub-paragraph b. of that paragraph 5 for ‘this paragraph 4’ substitute ‘this paragraph 5’;
- b. in the adaptation of Schedule 2, in paragraph 10d. for ‘and by large deal’ substitute ‘and, for the purposes of paragraph e., by large deal’, and
 - c. in the adaptation of Schedule 4 delete the substitution for the definition of ‘large deal’.
18. In regulation 6.12.2 at the end of paragraph c. substitute a semi-colon for the comma, at the end of paragraph d. substitute ‘, or’ for the full stop and immediately after paragraph d., add the following new paragraph –
- ‘e. unless the transfer is excluded by Schedule 19 of the Finance Act 1999 (or any statutory modification or re-enactment thereof) from a charge to stamp duty reserve tax or there has been paid to the trustee, for the account of the scheme, an amount agreed between the trustee and the manager not exceeding the amount that would be derived by applying the rate of stamp duty reserve tax to the market value of the units being transferred.’.
19. In regulation 7.09 –
- a. in sub-paragraph 1a. after ‘except in relation to Part 5,’ insert ‘and subject to paragraph 4,’ and
 - b. after paragraph 3 add the following new paragraph –
 - ‘4 a. The trustee shall take reasonable care to ensure that-
 - (i) the manager considers whether or not to exercise the power provided by regulation 4.21C.1 and the amount or rate of any SDRT provision that is imposed, and
 - (ii) in that consideration the manager has, so far as the trustee is aware, taken account of all factors that are material and relevant to the manager’s decision, and

- b. subject to a. of this paragraph 4, the trustee shall not have any duty in respect of the manager's exercise or omission to exercise the power provided by regulation 4.21C.1.'.
20. In regulation 8.04.1 in paragraph c. after 'the issue of units', insert 'and any stamp duty reserve tax charged in accordance with Schedule 19 of the Finance Act 1999 (or any statutory modification or re-enactment thereof)'.
21. After regulation 16.15 insert the following new regulation –
- '16.16 Transitional : SDRT provision**
- 1 A notice in writing containing an explanation of what is meant by SDRT provision and how it may affect unitholders and potential unitholders shall be given to holders and plan investors.
- 2 The notice in paragraph 1 shall be given on or before the date of publication of the manager's annual or half-yearly report (which ever is the earlier) next following 6 February 2000.
- 3 Regulation 4.21.C and, insofar as it relates to SDRT provision, regulation 4A.19 shall not take effect in relation to any units of a scheme until notice in paragraph 1 has been given and scheme particulars have been changed to reflect the contents of the notice.
- 4 The requirements of paragraphs 1, 2 and 3 relating to the giving of notice may be satisfied by a notice to holders and plan investors given prior to the provisions of these regulations relating to SDRT provision coming into operation provided that the contents of the notice remain accurate and not misleading immediately after those provisions come into operation.'.
22. In Schedule 2, after paragraph 10, insert the following new paragraph –
- '10A SDRT provision**
- State –
- a. what is meant by stamp duty reserve tax, SDRT provision and, for the purposes of paragraph b., by large deal, and
- b. the manager's policy on imposing an SDRT provision including its policy on large deals.'.
23. In Schedule 4 –
- a. in the definition of 'large deal' –
- (i) delete 'as principal', and

- (ii) after 'total value of £15,000 (or' insert ', for all or any specified purposes,' , and
- b. after the definition of 'scheme particulars' insert the following new definition –

“**SDRT provision**’ means a charge of such amount or at such rate as is determined by the manager of an authorised unit trust scheme to be made as a provision for stamp duty reserve tax for which the trustee may become liable under Schedule 19 of the Finance Act 1999 (or any statutory modification or re-enactment of it) in respect of a surrender of units to the manager within the meaning of that Schedule;’.

PART B CONVERSIONS

- 24. In regulation 4A.05.1b. for '11.06 (reconstruction) or 11.06A (conversion)' substitute '11.06 (reconstruction or conversion)'.
- 25. Delete regulation 6.02A.16.
- 26. In regulation 11.05.1 –
 - a. in paragraph 1, immediately after 'scheme of arrangement' insert 'which is not a conversion' and immediately before 'notified' insert 'and which is', and
 - b. delete paragraph 1A.
- 27. In regulation 11.05.3A delete '(subject to regulation 11.06A)'.
- 28. In regulation 11.06 –
 - a. add to the heading '**or conversion**';
 - b. in paragraph 1, immediately after 'scheme of arrangement' insert 'which is not a conversion' and immediately before 'notified' insert 'and which is';
 - c. for paragraph 1A substitute –

‘1A A conversion of an authorised unit trust scheme is a scheme of arrangement (notified to the FSA under section 82 of the Act) by which –

 - a. the whole or part of the property of an authorised unit trust scheme becomes the whole or part of the property of an authorised company or of a sub-fund of an authorised company, or

- b. the whole or part of the property of an authorised unit trust scheme becomes the whole or part of the property of more than one authorised company, or of sub-funds of one or more authorised companies, and

by which holders in the unit trust scheme being converted receive shares in the authorised company or companies in exchange for the property received into that company or these companies.’;

- d. in paragraph 2, after ‘reconstruction’ add ‘or conversion’ and after ‘reconstructed’ add ‘or converted’, and
 - e. in the first line of paragraph 3 for ‘the scheme’ substitute ‘a scheme’.
29. Delete regulation 11.06A.
30. In Schedule 4 –
- a. in the definition of ‘amalgamation’ delete ‘and 11.05.1A’, and
 - b. in the definition of ‘conversion’ for ‘a scheme of arrangement to which regulation 11.06A applies’ substitute ‘a scheme of arrangement of the type described in regulation 11.06.1A’.

PART C CHARGING EXPENSES TO CAPITAL

31. In regulation 6.02A.9 for ‘11.04.3b.’ substitute ‘11.04.3a.’.
32. For regulation 8.06.3A substitute –
- ‘3A The manager and the trustee may agree that all or any part so agreed of –
- (i) any charge permitted by regulation 8.02 (Manager’s periodic charge), and
 - (ii) any payments permitted to be made out of the property of the scheme by regulations 8.03 or 8.04
- may be treated as a capital expense and, if met from the income account in the first instance, a transfer of the relevant debit made from the income account to the capital account.’.
33. For regulation 11.04.3 substitute –
- ‘3 Except where approved by an extraordinary resolution at a meeting of holders called for the purpose, a change to the scheme particulars may not be made if it relates to a proposal to treat as a capital expense all or any part of any charge permitted by regulation 8.02 (Manager’s periodic

charge) and of any payments permitted to be made out of the property of the scheme by regulations 8.03 or 8.04, but this prohibition does not apply where –

- a. the scheme concerned already has clear investment objectives indicating –
 - (i) a greater preference for the generation of income than for capital growth, or
 - (ii) equal emphasis on the generation of income and on capital growth, and

90 days have elapsed since the unitholders were notified in writing by the manager of the change to the scheme particulars and of the date when it is to come into effect, or

- b. the change is only to reflect a reduction in the types or amounts of the payments which may be treated as a capital expense.’.

34. In Schedule 2 –

- a. in paragraph 9, for the last paragraph substitute –

‘In particular, where, in accordance with regulation 8.06.3A, the manager and the trustee have agreed that all or part of the manager’s periodic charge and any payments permitted to be made out of the property of the scheme by regulations 8.03 or 8.04 is to be treated as a capital expense, state that this may constrain capital growth.’, and

- b. in paragraph 13, at the end of sub-paragraph c., substitute a semi-colon for the comma, at the end of sub-paragraph d. substitute ‘, and’ for the full stop, and immediately after sub-paragraph d. add the following sub-paragraph –

‘e. if in accordance with regulation 8.06.3A, the manager and the trustee have agreed that all or part of any payment permitted to be paid out of the property of the scheme by regulation 8.03 or 8.04 is to be treated as a capital expense –

- (i) that fact, and
- (ii) an estimate of the amount of the payments which may be so treated.’.

PART D MISCELLANEOUS AMENDMENTS

35. In Section 5 of Table 4.2 –

- a. in sub-paragraph 23c.(i) after ‘unit trust scheme’ insert –

- ‘to which Part 4 (dual pricing) applies’;
- b. in sub-paragraph 23c.(iA) after ‘an authorised company’ insert –
‘or units of an authorised unit trust scheme to which Parts 4A, 4B, 4C and 4D (single pricing) apply’, and
 - c. for Note 2A substitute –
‘2A Dealing costs under Note 2 include any dilution levy or SDRT provision which would be added in the event of a purchase by the scheme of the units in question but, if the manager of the scheme being valued or an associate of the manager is also the manager of the authorised unit trust scheme or the ACD of the authorised company whose units are held by the scheme, shall not include a preliminary charge which would be payable in the event of a purchase by the scheme of those units.’.
36. In Section 6 of Table 4.2 –
- a. in sub-paragraph 24c.(i) after ‘unit trust scheme’ insert –
‘to which Part 4 (dual pricing) applies’;
 - b. in sub-paragraph 24c.(iA) after ‘an authorised company’ insert –
‘or units of an authorised unit trust scheme to which Parts 4A, 4B, 4C and 4D (single pricing) apply’, and
 - c. for Note 2A substitute –
‘2A Dealing costs under Note 2 include any dilution levy or SDRT provision which would be deducted in the event of a sale by the scheme of the units in question and, except when the manager of the scheme being valued or an associate of the manager is also the manager of the authorised unit trust scheme or the ACD of the authorised company whose units are held by the scheme, include any charge payable on the redemption of those units (taking account of any expected discount).’.
37. For regulation 12.06.7 substitute –
- ‘7 Any valuation by the standing independent valuer (except a review under paragraph 4a.) shall be on the basis of an ‘Open Market Value’ as defined in Practice Statement 4 in the RICS Appraisal and Valuation Manual (first edition published September 1995, with subsequent amendments).’.

The Financial Services (Open-Ended Investment Companies) (Amendment No 2) Regulations 1999 (in draft)

The Financial Services Authority, in exercise of the powers contained in regulation 6 of the Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations 1996, hereby makes the following regulations:

1.01 Citation and commencement

These regulations, 'the Financial Services (Open-Ended Investment Companies) (Amendment No 2) Regulations 1999', are made on [• 1999] and shall come into operation on 6 February 2000, except for the amendments to the principal regulations in Part B, which shall come into operation on [• 2000].

1.02 Purpose

The purpose of this instrument is to amend the Financial Services (Open-Ended Investment Companies) Regulations 1997.

1.03 Interpretation

In these regulations, 'the principal regulations' means the Financial Services (Open-Ended Investment Companies) Regulations 1997, and a reference in the Schedule hereto to a regulation or other provision is a reference to that regulation or provision in the principal regulations.

1.04 Amendments

The principal regulations shall be amended in the manner provided by the Schedule hereto.

SCHEDULE

PART A STAMP DUTY RESERVE TAX

1. In regulation 4.11.3 at the end of paragraph a. substitute a semi-colon for ‘, and’, at the end of paragraph b. substitute ‘, and’ for the full stop and immediately after paragraph b. add the following new paragraph –
‘c. any SDRT provision permitted under regulation 4.19.’.
2. In regulation 4.14 for paragraph c. substitute –
‘c. any SDRT provision permitted under regulation 4.19.’.
3. In regulation 4.15.3 –
 - a. at the end of sub-paragraph a.(i) substitute a semi-colon for ‘, and’, at the end of sub-paragraph a.(ii) substitute ‘, and’ for the semi-colon and immediately after sub-paragraph a.(ii) add the following new sub-paragraph –
‘(iii) for the account of the company, any SDRT provision permitted under regulation 4.19.’, and
 - b. substitute for sub-paragraph b. (iii) –
‘(iii) for the account of the company, any SDRT provision permitted under regulation 4.19’.
4. In regulation 4.18.1, in paragraph d. for ‘stamp duty or stamp duty reserve tax’ substitute ‘redemption charge under regulation 7.04 or any SDRT provision under regulation 4.19’.
5. In Part 4 –
 - a. for the heading to Section D substitute ‘**Section D Dilution Levy and Stamp Duty Reserve Tax**’, and
 - b. to the end of the Explanation to Section D add the following new paragraph –
‘An ACD is also permitted to require the payment of an SDRT provision, as an addition to the price of shares on their sale by the ACD or issue by the company, and as a deduction on their redemption by the ACD or cancellation (other than certain in specie cancellations) by the company.’.
6. For the heading to regulation 4.19 substitute ‘**Dilution Levy and SDRT provision**’.

7. In regulation 4.19.1 –
 - a. for ‘either or both’ in the first line substitute ‘any one or more’, and
 - b. at the end of sub-paragraph a. substitute a semi-colon for ‘, and’ and at the end of paragraph b. substitute a semi-colon for the full stop and immediately after paragraph b. insert the following new paragraphs –
 - ‘c. the payment of an SDRT provision in respect of the issue or sale of shares or any class of shares, and
 - d. the deduction of an SDRT provision in respect of the redemption or cancellation of shares or any class of shares, other than a cancellation of shares under regulation 4.18 resulting in a transfer of property that is such part of each description of asset in the scheme property as is proportionate to, or as nearly as practicable proportionate to, the shareholder’s share in the company.’
8. In regulation 4.19.3 after the first reference to ‘dilution levy’ insert ‘or SDRT provision’ and after ‘(or a higher dilution levy)’ insert ‘or SDRT provision (or a higher SDRT provision)’.
9. For regulation 4.19.4 substitute –
 - ‘4 If the ACD receives a dilution levy or SDRT provision in respect of any share sold or to be sold by it, it shall forthwith upon receipt of that dilution levy or SDRT provision, pay it to the depository to become part of the scheme property, except to the extent in the case of a dilution levy that it has already been, or will be, paid by the ACD to the depository on the issue of that share.’
10. For regulation 4.19.5 substitute –
 - ‘5 If the ACD deducts a dilution levy or SDRT provision from the proceeds of redemption of a share redeemed by it, it shall forthwith pay it to the depository to become part of the scheme property, except to the extent in the case of a dilution levy that it has already been, or will be, deducted from the payment by the depository to the ACD on the cancellation of that share.’
11. In regulation 5.42.2a. after ‘dilution levy’ insert ‘or SDRT provision’.
12. In regulation 6.05.1a. (sub-paragraph 2) after ‘the dilution levy’ insert ‘or SDRT provision’.

13. For regulation 7.13 substitute –

‘7.13 Notice of SDRT provision

- 1 A notice in writing containing an explanation of what is meant by SDRT provision and how it may affect shareholders and potential shareholders shall be given to shareholders and plan investors.
- 2 The notice in paragraph 1 shall be given on or before the date of publication of the company’s annual or half-yearly report (which ever is the earlier) next following 6 February 2000.
- 3 Regulation 4.19, insofar as it relates to SDRT provision, shall not have effect in relation to any shares of a company until notice in paragraph 1 has been given and the prospectus has been changed to reflect the contents of the notice.
- 4 The requirements of paragraphs 1, 2 and 3 relating to the giving of notice may be satisfied by a notice to shareholders and plan investors given prior to the provisions of these regulations relating to SDRT provision coming into operation provided that the contents of the notice remain accurate and not misleading immediately after those provisions come into operation.’.

14. In Schedule 1 –

- a. in sub-paragraph 18a., after ‘by dilution levy and’ insert ‘, for the purposes of paragraph b.’, and
- b. after paragraph 18 insert the following new paragraph –

‘18A SDRT provision

State –

- a. what is meant by stamp duty reserve tax, SDRT provision and, for the purposes of paragraph b., by large deal, and
- b. the ACD’s policy on imposing an SDRT provision including its policy on large deals.’.

15. In Schedule 3 –

- a. for the definition of ‘large deal’ substitute –

‘large deal’ means a transaction (or a series of transactions in one dealing period) by any person to buy, sell, or exchange shares at a total value of £15,000 (or, for all or any specified purposes, such greater sum as may be specified in the prospectus);’, and

- b. after the definition of ‘scheme property’ insert the following new definition –
- “**SDRT provision**’ means a charge of such amount or at such rate as is determined by the ACD of a company to be made as a provision for stamp duty reserve tax for which [the company may become liable under the Stamp Duty and Stamp Duty Reserve Tax (Open-Ended Investment Companies) (Amendment No.2) Regulations 1999 (or any statutory modification or re-enactment of it) in respect of a surrender of shares to the ACD for the purposes of those Regulations];’.

PART B CHARGING EXPENSES TO CAPITAL

16. In regulation 3.05 –
- a. in paragraph 2 –
- (i) after the third indent insert –
- 12d. (ACD’s remuneration to be treated as a capital charge),
and
- (ii) for ‘to comply with paragraphs 3 or 12a.’ substitute ‘to comply with paragraphs 3, 12a., 12d. or 13e.’, and
- b. in paragraph 3 at the end of paragraph c. substitute a semi-colon for ‘, or’, at the end of paragraph d. substitute ‘, or’ for the full stop, and immediately after sub-paragraph d. add the following new paragraph –
- ‘e. in order to comply with paragraphs 12d. or 13e. of Schedule 1 if –
- (i) the company already has clear investment objectives indicating –
- (1) a greater preference for the generation of income than for capital growth, or
 - (2) equal emphasis on the generation of income and on capital growth, and
- 90 days have elapsed since the shareholders were notified in writing by the ACD of the change to the prospectus and of the date when it is to come into effect, or
- (ii) the change is only to reflect a reduction in the types or amounts of the payments which may be treated as a capital expense.’.
17. In regulation 7.12 –
- a. for paragraph 4 substitute –

