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INTRODUCTION

SUMMARY OF PROPOSALS

1.1 The Housing Act 2004 set a number of requirements for landlords/their agents in relation to taking deposits from tenants. Where landlords, or their agents, require tenancy deposits, those deposits will be safeguarded by Government sponsored Tenancy Deposit schemes.

1.2 ODPM proposes to introduce custodial and insurance-based Tenancy Deposit schemes. Both kinds of scheme potentially fall within the definition of a collective investment scheme in FSMA. This consultation document seeks views on allowing exemption from Financial Services Regulation for custodial and insurance-based Tenancy Deposit schemes. This would be done by amending the Schedule to the Financial Services Markets Act 2000 (Collective Investment Schemes) Order 2001 which sets out arrangements which are not to be regarded as collective investment schemes for the purposes of the Financial Services and Markets Act 2000.

1.3 The exemption would be introduced by means of secondary legislation.

1.4 Draft implementing legislation is attached together with a regulatory impact assessment.

2 RESPONDING TO THE CONSULTATION

CONSULTATION

2.1 The Government would welcome responses to the issues raised in this consultation document.

How to respond

2.2 The Government welcomes the views of all stakeholders on the issues raised in this document. The consultation period begins with the publication of this document, and will run for 12 weeks. Please ensure that your responses reach us by **24th August 2006.**

Responses to the consultation should be sent to:

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Financial Services Strategy Team
Room 4/18
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Tel: (+44) (0) 207 270 5312
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Email: john.sparrow@hm-treasury.x.gsi.gov.uk

This document can also be found on the HM Treasury website: **www.hm-treasury.gov.uk**

2.3 When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the view of members were assembled.

Confidentiality

2.4 All written responses will be made public on HM Treasury's website unless the author specifically requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. If you wish, part, but not all, of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and other confidential version for the Team managing the consultation.

2.5 Even where confidentiality is requested, if a request for disclosure of the consultation response is made in accordance with the freedom of information legislation, and the response is not covered by one of the exemptions in the legislation, the Government may have to disclose the response in whole or in part.

PARTIAL REGULATORY IMPACT ASSESSMENT

2.6 As highlighted above, the Partial Regulatory Impact Assessment (Partial RIA) is published with this document and should be read in conjunction with it. The Partial RIA lays out implementation options for the two areas highlighted above and considers qualitative, and where possible, quantitative costs and benefits for each option.

2.7 A copy of the Partial RIA can be found on HM Treasury's website: www.hm-treasury.gov.uk or requested through HM Treasury's correspondence and enquiry unit. Contact details can be found on http://www.hm-treasury.gov.uk/contact/contact_index.cfm.

THE CONSULTATION CRITERIA

2.8 The consultation is being conducted in line with the Code or Practice on Consultation. The criteria are listed below, a full version of the criteria can be found at http://www.cabinet-office.gov.uk/regulation/Consultation/Code.htm.

The Six Consultation Criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about who may be affected, what questions are being asked, and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

If you feel that this consultation does not fulfil these criteria please contact:

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Additional copies of this consultation document are available electronically at www.hm-treasury.gov.uk/consultations_and_legislation/consult_liveindex.cfm

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

BACKGROUND

Tenancy Deposits

3.1 Deposits are taken by landlords to secure a financial commitment from the tenant to prevent loss or damage arising from the tenants negligence or breach of the tenancy agreement. In the event of damage, unpaid rent at the end of a tenancy etc part or all of the deposit may be withheld. Where such losses do not arise, the deposit should be returned to the tenant promptly and in full. However, evidence suggests that deposits are being withheld by landlords and agents without justification, damaging the image of the private rented sector.

3.2 The Housing Act 2004 set a number of requirements for landlords/their agents in relation to taking deposits from tenants. Where landlords, or their agents, require tenancy deposits, those deposits will be safeguarded by Government sponsored schemes. The scheme operators will be under contract to the Office of the Deputy Prime Minister (ODPM) and subject to ODPM oversight.

3.3 This consultation seeks views on allowing exemption from Financial Services Regulation for insurance-based and custodial Tenancy Deposit schemes.

Custodial schemes

3.4 Under the custodial scheme the tenant pays his deposit to the landlord who in turn pays it into the scheme administrator's bank account. The scheme administrator controls this account and ensures that the deposit is returned to the tenant if appropriate. The scheme administrators will each manage a large number of deposits, part of the interest from which will cover their costs. Because of this collective account management, such an arrangement would currently qualify as a collective investment scheme under section 235 of the Financial Services & Markets Act 2000 (FSMA) and therefore would need to be authorised by the FSA.

3.5 Tenants' deposits will be held in accounts at credit institutions which are already authorised by the FSA, and the scheme administrators controlling those accounts will be subject to ODPM oversight and contractual obligations. In these circumstances, securing FSA authorisation of the deposit scheme itself would have significant cost implications without any clear benefits to consumers.

3.6 The proposal is to allow exemption from Financial Services Regulation for custodial and insurance-based Tenancy Deposit schemes so that the schemes themselves would not need to be regulated by the FSA as collective investment schemes.

Insurance-based schemes

3.7 Under these schemes the landlord retains the tenant's deposit and only transfers it into a scheme if there is a dispute with the tenant over the amount to be repaid at the end of a tenancy. If the landlord unfairly refuses to return the deposit or part of it the scheme administrator would repay the tenant on behalf of the landlord. The scheme administrator is required to take out insurance to cover the possibility of a

landlord failing to transfer the deposit to the scheme following a dispute with the tenant in which event the scheme remains liable to repay the tenant.

3.8 Once a landlord pays the deposit or part thereof into the scheme following a dispute, it operates in the same way as the custodial scheme and would potentially fall within the definition of a collective investment scheme in FSMA.

3.9 The proposal is to also allow exemption from Financial Services Regulation for Insurance Tenancy Deposit schemes so that the schemes themselves would not need to be regulated by the FSA as collective investment schemes.

Question: Do you agree that there is no advantage in requiring custodial and insurance-based Tenancy Deposit schemes to be regulated by the FSA as collective investment schemes?

A Partial Regulatory Impact Assessment

TITLE OF THE PROPOSAL

The Financial Services and Markets Act 2000 (Collective Investment Schemes) (Amendment) Order 2006

PURPOSE AND INTENDED EFFECT

A.1 Evidence suggests that tenancy deposits are being withheld by landlords and agents without justification, damaging the image of the private rented sector.

A.2 The Housing Act 2004 set a number of requirements for landlords/their agents in relation to taking deposits from tenants. Where landlords, or their agents, require tenancy deposits, those deposits will be safeguarded by Government sponsored Tenancy Deposit schemes.

A.3 ODPM proposes to introduce custodial and insurance-based Tenancy Deposit schemes. Such schemes are intended to provide tenants with greater assurance that their deposits will be returned when they move out, and that any deductions for damage to rented property will be fair. Both kinds of scheme potentially fall within the definition of a collective investment scheme in FSMA. The proposed regulations introduce an exemption from Financial Services Regulation for such schemes.

RATIONALE FOR INTERVENTION

A.4 Securing FSA authorisation as a collective investment schemes in these circumstances would have significant cost implications with minimal benefits to consumers. These are set out in the section on costs and benefits.

CONSULTATION

A.5 This partial RIA lays out the implementation options for the changes to the Financial Collateral Arrangements (No. 2) Regulations 2003. Risks, unintended consequences, any compliance and enforcement issues, competition issues and the impact on small firms have also been considered.

A.6 When formally responding to the Partial RIA we are seeking comments on the analysis of costs and benefits, likely risks and unintended consequences of the proposed options, as well as supporting evidence where possible. If you feel that are alternative options, or indeed alternative combinations of existing options, please suggest these. The responses to the Partial RIA will provide valuable information which will feed into the final RIA which will be produced following this consultation. The consultation document and the Partial RIA should be read together.

OPTIONS

Do nothing

A.7 Without the proposed exemption from Financial Services Regulation for custodial and insurance-based Tenancy Deposit schemes, both types of scheme would potentially fall within the definition of a collective investment scheme in FSMA and

therefore would need to secure FSA authorisation which would have significant cost implications with minimal benefits to consumers.

Legislative option

A.8 The legislative option would be to amend the Schedule to the Financial Services Markets Act 2000 (Collective Investment Schemes) Order 2001 which sets out arrangements which are not to be regarded as collective investment schemes for the purposes of the Financial Services and Markets Act 2000.

COSTS AND BENEFITS

A.9 Securing FSA authorisation of the deposit scheme itself would have significant cost implications without any clear benefits to consumers. The costs, in the event that an exemption is not granted, are expected to be significant. The authorisation process involves application fees, ongoing supervisory fees, and, more importantly, internal and third party costs associated with compliance procedures. The total cost incurred over the three year contract period for a firm that may be FSA regulated for parts of its business, but is not authorised to run and manage a CIS would be in the range of approximately £280,000 to £550,000.

SMALL FIRMS IMPACT TEST

A.10 The changes introduced by these regulations apply only to the companies operating the custodial scheme and the insurance-based scheme.

COMPETITION ASSESSMENT

A.11 The changes introduced by these regulations apply only to the companies operating the custodial scheme and the insurance-based scheme.

ENFORCEMENT, SANCTIONS AND MONITORING

A.12 Compliance with the requirements of financial services regulation, including policing the regulatory perimeter will continue to be monitored and enforced by the FSA.

IMPLEMENTATION AND DELIVERY PLAN

A.13 These deregulatory changes will be implemented via the adoption of new secondary legislation amending the Schedule to the Financial Services and Markets Act 2000 (Collective Investment schemes) Order 2001 Post Implementation Review.

A.14 The impact of these changes will be kept under close review, including consideration of whether these changes have any unintended consequences, and whether they are having the desired effect.

SUMMARY AND RECOMMENDATIONS

A.15 Both the custodial scheme and the insurance-based scheme where the landlord pays the deposit or part thereof into the scheme following a dispute, potentially fall within the definition of a collective investment scheme in FSMA.

A.16 Under both types of scheme, tenants' deposits would be held in accounts at credit institutions which were already authorised by the FSA. In addition Scheme administrators controlling those accounts would be subject to ODPM oversight and contractual obligations.

A.17 Securing FSA authorisation as a collective investment schemes in these circumstances would have significant cost implications with minimal benefits to consumers.

A.18 The proposed amendment introduces an exemption from Financial Services Regulation for insurance-based and custodial Tenancy Deposit schemes.

B Cabinet Office Consultation Criteria

Cabinet Office guidelines require Departments, when issuing proposals, to;

1. consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy;
2. be clear about what the proposals are, who may be affected, what questions are being asked and the timescale for responses;
3. ensure that the consultation is clear, concise and widely accessible;
4. give feedback regarding the responses received and how the consultation process influenced the policy;
5. monitor their departmental effectiveness at consultation, including through the use of a designated consultation co-ordinator;
6. ensure the consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

STATUTORY INSTRUMENTS

2006 No.

FINANCIAL SERVICES AND MARKETS

The Financial Services and Markets Act 2000 (Collective Investment Schemes) (Amendment) Order 2006

Made - - - - *2006*

Laid before Parliament *2006*

Coming into force in accordance with article 1

The Treasury make the following Order in exercise of the powers conferred by section 235(5) of the Financial Services and Markets Act 2000([1]):

Citation and commencement

This Order may be cited as the Financial Services and Markets Act 2000 (Collective Investment Schemes) (Amendment) Order 2006 and comes into force the day on which section 212 of, and Schedule 10 to, the Housing Act 2004([2]) come into force.

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

—(1) The Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001([3]) (arrangements not amounting to a collective investment scheme) is amended as follows.

For paragraph 7([4]) (certain funds relating to leasehold property), substitute—

"**Certain funds relating to leasehold property**

7. Arrangements do not amount to a collective investment scheme if the rights or interests of the participants are rights or interests—

(a) in a fund which is a trust fund within the meaning of section 42(1) of the Landlord and Tenant Act 1987([5]) or which would be such a trust fund if the landlord were not an exempt landlord within the meaning of section 58(1) of that Act; or

(b) in money held in a designated account by the scheme administrator under a tenancy deposit scheme within the meaning of section 212(2) of the Housing Act 2004.".

([1]) 2000 c. 8.

([2]) 2004 c. 34

([3]) S.I. 2001/1062

([4]) Paragraph 7 was amended by S.I. 2005/57

([5]) 1987 c. 31

Two of the Lords Commissioners of Her Majesty's Treasury

2006

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends the Schedule to the Financial Services Markets Act 2000 (Collective Investment Schemes) Order 2001 (S.I. 2001/1062) which sets out arrangements which are not to be regarded as collective investment schemes for the purposes of the Financial Services and Markets Act 2000 (c. 8). Paragraph 7 of that Schedule excludes certain funds relating to leasehold property. The amendment made by article 2(1) of this Order extends this exclusion to arrangements where the participants have rights or interests in money held under a tenancy deposit scheme as provided for by Chapter 4 of Part 6 of the Housing Act 2004 (c. 34).