EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES) (AMENDMENT) (NO.2) ORDER 2006

2006 No. 2383

1. This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 This Order amends the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) (RAO) to introduce new regulated activities relating to home reversion plans and home purchase plans from 6 April 2007. The amendments will come into force early (6 November 2006) for purposes of applications only. This is so firms may apply to the Financial Services Authority (FSA) for permissions and approvals and these permissions and approvals can be determined by the FSA, before the activities become regulated activities. The Order is subject to the affirmative resolution procedure.

3. Matters of Special Interest to the Joint Committee on Statutory Instruments

3.1 Article 22 of the Order amends article 72F of the RAO, which relates to the exemption for business angel-led capital funds. This amendment is made pursuant to the recommendation of the Joint Committee on Statutory Instruments in its Sixth Report of the 2005-6 Session (HL 55, HC 35-vi) when it reported SI 2005/1518 (which inserted article 72F) for defective drafting.

4. Legislative Background

4.1 Under the Financial Services and Markets Act 2000 (FMSA), only FSA authorised or exempt persons are allowed to carry on a regulated activity. In order for an activity to be regulated under FSMA, it must be carried on by way of business and specified in the RAO. The Regulation of Financial Services (Land Transactions) Act 2005 amended FSMA to add finance arrangements in connection with the acquisition or disposal of land to the list of matters with respect to which regulated activities may be specified.

4.2 The Order makes amendments to the RAO to introduce from 6 April 2007 new regulated activities of entering into, administering, advising on and arranging home reversion plans and home purchase plans.

4.3 Articles 3 to 24 contain amendments to the RAO. Articles 25 to 28 of the Order make the necessary consequential amendments to primary legislation. Articles 29 to 35 of the Order make the necessary amendments to secondary legislation.

4.4 In order to ease transition for business into the new regime, firms which already conduct these activities are given interim permission whilst their applications are pending. Articles 37 and 38 of the Order provide for interim permissions and interim approvals respectively to be granted. Articles 39, 40 and the Schedule to the Order enable FSA rules, guidance and codes of practice to be tailored to firms with interim permission or approval.

5. Extent

5.1 The Order applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Economic Secretary to the Treasury has made the following statement under section 19(1)(a) of the Human Rights Act 1998:

'In my view the provisions of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2006 are compatible with the Convention rights.'

7. Policy Background

7.1 The main policy focus is consumer protection by ensuring a level playing field for the regulation of equity release products and the regulation of Islamic home purchase products and a competitive market in those products. Policy has been informed by a series of consultations, most recently on the detail of the definitions.

7.2 The FSA does not currently regulate activities relating to certain forms of equity release products and Islamic law compliant home purchase plans.

7.3 Equity release schemes allow homeowners to release the value of their property in return for all or a share of their interest in the home. There are two types of equity release product:

- Lifetime mortgages – where the consumer takes out a mortgage, but makes no repayments, as interest is rolled up by the lender and the loan is paid off when the property is sold. These are regulated by the FSA.
- Home Reversion Plans (HRPs) – where the consumer sells all or part of their home but retains the right to live there. HRPs are currently not regulated by the FSA.

7.4 Interest-based home finance products do not comply with Islamic law, but Islamic law can accommodate contracts to facilitate house purchase. There are two main types of Islamic law compliant home purchase plan:

- Murabaha home purchase products – where an institution buys and re-sells the home to the consumer, accepting payment of the price over a lengthy period. These are regulated by the FSA.
- Ijara Home Purchase Plans (HPPs) – where the institution combines a sale with renting the un-owned share of the property to the consumer. HPPs are currently not FSA regulated.

7.4 The Order will make activities relating to HRPs and HPPs "regulated activities". Regulating HRPs will help people make informed choices, offer valuable consumer protection and ensure a level playing field in the equity release market. Regulating HPPs will afford Muslim consumers equivalent protections to those afforded by existing FSA mortgage regulation, and ensure a level playing field in the Islamic home purchase plan market. This is consistent with the Government's general desire to support the development of Islamic finance in the UK.

7.5 The general approach towards making RAO amendments has been to adopt the same approach as for mortgages. However there are two main policy differences between the approach taken for mortgages and the approach taken for home reversion plans. Both arise from the fact that, unlike the mortgage (and home purchase plan) market, a significant part of the home reversion market is make up of private investors acting as plan provider (ie the equivalent to mortgage lender).

7.6 First, mortgage intermediary activities (ie arranging or advising on a mortgage) are only regulated activities if provided to a mortgage borrower. However home reversion intermediary activities (ie arranging or advising on a home reversion plan) are regulated where provided to a reversion seller, and also to a plan provider (ie the equivalent of a mortgage lender) (see articles 25B and 53B of the RAO inserted by articles 4 and 13 of the Order). This is because of the significant number of private investors (ie consumers) who enter into home reversion plans as plan providers.

7.7 Secondly, administration of a mortgage is a regulated activity only where the mortgage was entered into by way of business before the commencement of regulation. However, administration of a home reversion plan is a regulated activity whether or not the plan was entered into by way of business before the commencement of regulation (see article 63B(2) of the RAO inserted by article 18 of the Order). This is because private investors (acting as plan providers) are unlikely to enter into home reversion plans by way of business. However as these plans are administered by professional administrators for the life of the plan (which can be a significant length of time), the policy intention is to catch continuing administration activities.

7.8 Both industry and consumer groups have been supportive of regulation.

8. Impact

8.1 A Regulatory Impact Assessment has been prepared and is available online at http://www.hm-treasury.gov.uk

8.2 The impact on the public sector is negligible.

9. Contact

9.1 Keith Davis at the HM Treasury Tel: 020 7270 5266 or e-mail: mailto:keith.davis@hm-treasury.x.gsi.gov.uk can answer any queries regarding the Order.