The City of London Law Society
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Tom Springbett
Savings & Investment Team
HM Treasury
1 House Guards Road
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12 September 2007

Dear Mr Springbett,

HM Treasury Second Consultation on amendments to the CIS border for property transactions (August 2007)

These comments are made on behalf of the Regulatory Committee of the City of London Law Society. The City of London Law Society is the local Law Society of the City of London and represents City solicitors, who make up 15% of the profession in England and Wales. Members of the Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisors, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure provides such as the operators of trading, clearing and settlement systems.

Introduction

This response is further to the response made by the Regulatory Committee of the City of London Law Society to HM Treasury's first consultation on amendments to the CIS border for property transactions on 4 April 2007. We continue to support the principle of reforming paragraph 9 to improve the certainty of the application of the notoriously uncertain definition of a "collective investment scheme" in relation to property and other joint ventures. We appreciate the way in which the revised proposals meet substantially all the specific issues we raised in relation to the original proposals. We do have a couple of points of substance and a few further technical and drafting comments to make but generally we welcome the revised proposals.

In relation to the specific questions raised in the second consultation paper:

1. Do you agree that the status quo for pre-existing arrangements should be preserved as proposed?

2. Do you agree that provision should be made to opt in and out of the exemption as proposed? Do you agree that opting in and out should be by irrevocable agreement in writing by all the participants as proposed?

For the reasons given in our response to the first consultation we do agree that it is important that pre-existing arrangements should be able to maintain their status quo. This is particularly important for

existing arrangements which have been deliberately structured as collective investment schemes and therefore need to opt out of the exclusion.

We also agree that the mechanism for opting in or out of the exclusion (the consultation draft only offers an "opt in" to the exclusion) should not require action from any participant where the status quo for the pre-existing arrangements is appropriate and desired by participants. Schemes which have been structured as and wish to continue as collective investment schemes should not be required to take further action. It is however important to have an "opt in" provision for arrangements where the original arrangements were, either completely inadvertently or by reason of a different interpretation of uncertain law, arguably or clearly in breach of the old paragraph 9 but would qualify for the new exclusion. We welcome the fact that no time limit is given for exercise of this "opt in" since it is of the nature of arrangements of this kind that they may have been entered into inadvertently and it may be only years later that the participants discover the potential breach. This does give rise to one potential difficulty in relation to the proposed requirement that the participants who are to enter into the irrevocable agreement must be those who were participants at the time the new Order comes into force. While we see the convenience of choosing a certain date on which participants are to be identified we foresee considerable practical problems for arrangements where the potential breach is only discovered later, particularly if the participants have subsequently changed and one or more of those who participated at the date the Order came into force cannot be found or, even if found, is not interested in taking any action because they are no longer affected.

We note that entering into such an opt in agreement might be argued to amount to an admission that the arrangements were previously in breach. It would be undesirable if people were discouraged from entering into a clarifying agreement for fear of such an admission. Presumably an agreement might be entered into "for the avoidance of doubt" or without making an admission but it could be of assistance if paragraph 9(1)(b) said "which amounted or might have amounted".

As to whether the agreement should be "irrevocable" or, putting it another way, whether it should be possible for a scheme which qualifies for the exclusion subsequently to "opt out" and become a collective investment scheme we can envisage situations where it would be desirable. For example it might be proposed that passive investors, who wished to have full scale investor protections, were to be brought into the arrangements at a later date or an offer was to be made to such investors. It might be desirable in such circumstances for the arrangements to opt to become a collective investment scheme before the first participant who is not a "permitted participant" actually joins the scheme.

As a general point we are not entirely convinced that the requirement, both in relation to pre-existing arrangements and in relation to new arrangements, that participants should "at all times ... have been" permitted participants is necessarily appropriate. We deal with this further below.

3. Do you agree that the proposed list of permitted SPV forms is appropriate and sufficient?

It is difficult to be definitive on this point in view of the risk that foreign entities will subsequently be identified which do not qualify under this list and are difficult to classify under English law. Examples might be a Continental European "fonds commun de placement" (which is essentially a contractual management arrangement) or a governmental or quasi governmental body which was not clearly identifiable as a body corporate but did not have an element of "association". However the extended list is a significant improvement on the original limitation to bodies corporate.

We think there is a potential problem with the wording of paragraph (3)(b)(i). It does not seem to us that there is any reason why the same SPV should not be used for more than one set of arrangements. If it did so we do not think that should make the first set of arrangements (or indeed any subsequent set) into a collective investment scheme. We suggest that paragraph (3)(b)(i) should read: "does not at the time of entering into the arrangements carry on any business other than participating in the arrangements and in any other arrangements which fall within this paragraph 9".

We think it would also be necessary to make it clear that it is in its capacity as trustee of the relevant trust, not in any other capacity, that a trustee should not carry on any other business.

4 Do you agree that SPVs should only be permitted participants where their members etc are permitted participants?

In our response to the first consultation paper we did suggest that if a decision was taken to apply a form of statutory "look through" test of the kind now proposed it would be important that the "look through" test applied, as does the "commercial purposes of business" test, at the time the arrangements were entered into by the relevant entity.

We are concerned that the proposed formulation relating to an SPV only being a permitted participant if it "only ever has" other permitted participants as its members could create considerable new complexity and uncertainty and requirements for extensive analysis and legal advice which could reinstate the level of costs for those involved which the new proposals aim to remove. At a very basic level it would arguably make it impossible to buy a shelf company to act as an SPV since such companies have company agents as their initial members. It would also risk arrangements being turned into collective investment schemes ex post facto merely because of a change of members etc (which might be a very minor change) in an entity many layers up in a structure. Such a change might not even be known at the lower levels (and therefore by those who are at risk of committing the criminal offence of operating a collective investment scheme without authorisation). Look through provisions always involve a significant degree of uncertainty, complexity of analysis and danger of inadvertent disqualification. Those dangers are greatly increased, to a potentially unmanageable level, the longer the period over which they must be applied.

Might we suggest that consideration is again given to applying the test, if a look through test is to be used, at the time the arrangements are entered into by the SPV as the fairest and most certain approach, coupled, if the Treasury things it necessary with a provision that the actual and proposed members etc of the SPV at that time should themselves be SPVs. (This would pick up on the reference to the words "persons who are to participate" in the only definition there is of "participant").

5 Other matters

Although we note the Treasury's concern about arrangements opting in and out of the exemption it is a feature of paragraph 9 that arrangements do sometimes benefit from the exclusion, then lose it, then regain it, depending on the basis on which the participants from time to time joined the arrangements. We welcome the ability to "opt out" of the exclusion for new sets of arrangements and agree that generally the appropriate persons to do so should be those who first enter into the arrangements. However in view of the imprecision of the term "arrangements" there can be extensive arguments and uncertainty over when a "new" set of arrangements is entered into - which would,

under the proposed formulation require a new election to opt out.

As noted we have some concerns about the requirement that all participants not only are but "have been" permitted participants "at all times". It might even mean that not only is it possible for the nature of the arrangements to change if the "wrong" type of participant joins, which is the position at present, but also that that change in some way taints the previous status of the arrangements and cannot subsequently be rectified for the future by, for instance, ejecting the participant who is discovered not to qualify. In such circumstances it is preferable to remain with the existing possibility that arrangements may move in and out of the collective investment scheme category (which also applies to some other exemptions and indeed to the primary definition in s235 in relation to matters such as "day to day control") rather than force them to be collective investment schemes for ever.

In relation to the primary type of permitted participant it should not be necessary to refer to participants having been permitted at all times since the test applies at the moment they enter the arrangements. In relation to SPVs we have already mentioned the great uncertainty and difficulties which could be caused in relation to subsequent changes to the ultimate membership of layered SPVs but we also note that the requirement that they should qualify at all times from the date of the Order is inappropriate both for entities which did not exist at that date and for entities which have in the past carried on other business but have ceased to do so (e.g. where a corporate group wishes to use an existing dormant company rather than set up a new one).

We are also not entirely convinced that it is necessary for an "opt out" to be irrevocable or, more generally, for the participants always to have been confined to permitted participants. We can envisage situations where, for instance, it was hoped that there would be investor interest in a piece of land, or even that there was such interest at one stage, but subsequently only property development and investment companies were willing to invest and take it forward and they therefore acquire the interests of earlier investors. it does not seem reasonable to impose an obligation on these commercial ventures to continue to have an authorised operator and the full requirements of FSA regulation continuing to apply in relation to arrangements which have ceased to have any need for that investor protection. It seems to us it is perfectly feasible for an "opt out" of the exclusion to be effected by the agreement of those who are participants at the time the arrangements are first entered into and to be effective until such time, if ever, that all the then current participants qualify as permitted participants and opt in.

We hope that you find the above comments helpful, and we would welcome the opportunity to discuss the matters raised further with you. Please do not hesitate to contact us in the meantime if you would like further elaboration or information. Please contact the chair of the Regulatory Law Committee in the first instance: Margaret Chamberlain, Travers Smith, 10 Snow Hill, London, EC1A 2AL. Tel. 020 7295 3233. E-mail: Margaret.Chamberlain@traverssmith.com.

Yours sincerely

Margaret Chamberlain