

Chapter 5

Investment and borrowing powers

5.1 Introduction

Application

5.1.1

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- (1) Subject to 1(A), ■ COLL 5.1 to ■ COLL 5.5 apply to the *authorised fund manager* and the *depository* of an *authorised fund*, and to an *ICVC*, which is or ever has been a *UCITS scheme*.
- (1A) The only sections of ■ COLL 5 that apply to the *authorised fund manager* and the *depository* of a *feeder UCITS*, and to an *ICVC* which is a *feeder UCITS*, are ■ COLL 5.3 and ■ COLL 5.8, although particular rules in ■ COLL 5.1, ■ COLL 5.2 and ■ COLL 5.5 are incorporated by reference.
- (2) Subject to 2(A), ■ COLL 5.1, ■ COLL 5.4 and ■ COLL 5.6 apply to the *authorised fund manager* and *depository* of an *authorised fund*, and to an *ICVC*, which is a *non-UCITS retail scheme*.
- (2A) ■ COLL 5.1, ■ COLL 5.4 and ■ COLL 5.7 apply to the *authorised fund manager* and the *depository* of an *authorised fund* and to an *ICVC* which is a *non-UCITS retail scheme* operating as a *fund of alternative investment funds*.
- (3) Paragraphs (2) and (2A) cease to apply if a *non-UCITS retail scheme* converts to be authorised as a *UCITS scheme*.
- (4) [deleted]

Purpose

5.1.2

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- (1) This chapter helps in achieving the *statutory objective* of protecting *consumers* by laying down minimum standards for the investments that may be held by an *authorised fund*. In particular:
 - (a) the proportion of *transferable securities* and *derivatives* that may be held by an *authorised fund* is restricted if those *transferable securities* and *derivatives* are not listed on an *eligible market*; the intention of this is to restrict investment in *transferable securities* or *derivatives* that cannot be accurately valued and readily disposed of; and
 - (b) *authorised funds* are required to comply with a number of *investment rules* that require the spreading of risk.

(2) Table 5.1.4G gives an overview of the permissible investments and maximum investment limits for *UCITS schemes* and *non-UCITS retail schemes*.

Treatment of obligations

5.1.3

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- (1) Where a *rule* in this chapter allows a transaction to be entered into or an investment to be retained only if possible obligations arising out of the transaction or out of the retention would not cause the breach of any limits in this chapter, it must be assumed that the maximum possible liability of the *authorised fund* under any other of those *rules* has also to be provided for.
- (2) Where a *rule* in this chapter permits a transaction to be entered into or an investment to be retained only if that transaction, or the retention, or other similar transactions, are covered:
 - (a) it must be assumed that in applying any of those *rules*, the *authorised fund* must also simultaneously satisfy any other obligation relating to cover; and
 - (b) no element of cover must be used more than once.

Indicative overview of investment and borrowing powers

5.1.4

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This table belongs to ■ COLL 5.1.2G (2).

Scheme investments and investment techniques	Limits for <i>UCITS schemes</i>		Limits for <i>non-UCITS retail schemes</i>	
	Permissible investment	Maximum limit	Permissible investment	Maximum limit
<i>Approved securities</i>	Yes	None	Yes	None
<i>Transferable securities that are not approved securities</i>	Yes	10%	Yes	20%
<i>Government and public securities</i>	Yes	None	Yes	None
<i>Regulated schemes other than qualified investor schemes and long-term asset funds</i>	Yes	None	Yes	None
<i>Unregulated schemes, qualified investor schemes, and long-term asset funds</i>	No	N/A	Yes	20% (C) (D)
<i>Warrants</i>	Yes	None	Yes	None
<i>Investment trusts</i>	Yes	None	Yes	None
<i>Deposits</i>	Yes	None	Yes	None
<i>Derivatives</i>	Yes	None	Yes	None
<i>Immovables (i.e real property)</i>	No	N/A	Yes	None
<i>Gold</i>	No	N/A	Yes	10%
<i>Hedging</i>	Yes	None	Yes	None
<i>Stock lending</i>	Yes	None	Yes	None
<i>Underwriting</i>	Yes	None	Yes	None
<i>Borrowing</i>	Yes	10% (T)	Yes	10%

Scheme investments and investment techniques	Limits for UCITS schemes		Limits for non-UCITS retail schemes	
	Yes	None	Yes	None
Cash and <i>near cash</i>				
Note:	Meaning of terms used:			
A percentage	an upper limit (though there may be limits of other kinds).			
"(T)"	temporary only- see COLL 5.5.4R(4)			
"N/A"	Not applicable			
"(C)"	In the case of a <i>non-UCITS retail scheme</i> operating as a <i>FAIF</i> there is no maximum limit - see COLL 5.7.7 R.			
"(D)"	The second <i>scheme</i> would also need to meet the applicable requirements specified in the <i>rules</i> .			



5.2 General investment powers and limits for UCITS schemes

Application

5.2.1

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- (1) This section applies to an *ICVC*, an *ACD*, an *authorised fund manager* of an *AUT* or *ACS* and a *depository* of an *ICVC*, *AUT* or *ACS* where such *ICVC*, *AUT* or *ACS* is a *UCITS scheme*, in accordance with ■ COLL 5.2.2 R (Table of application).
- (2) [deleted]

Table of application

5.2.2

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This table belongs to ■ COLL 5.2.1 R.

Rule	<i>ICVC</i>	<i>ACD</i>	<i>Au- thorised fund man- ager of an AUT or ACS</i>	<i>Depos- itary of an ICVC, AUT or ACS</i>	<i>Au- thorised fund manager of an AUT or ACS, or ACD of an ICVC, that is a regu- lated money market fund</i>
5.2.3R		x	x		x
5.2.4R		x	x		
5.2.4AG					x
5.2.5R to 5.2.9R		x	x		
5.2.9AR		x	x		
5.2.10R(1)		x	x		
5.2.10R(2)(a)& (b)		x	x		
5.2.10R(2)(c)				x	
5.2.10R(3)		x	x		
5.2.10AR to 5.2.10EG		x	x		
5.2.11R to 5.2.20R (excluding		x	x		

Rule	ICVC	ACD	Au- thorised fund man- ager of an AUT or ACS	Deposit- ary of an ICVC, AUT or ACS	Au- thorised fund manager of an AUT or ACS, or ACD of an ICVC, that is a regu- lated money market fund
5.2.17AR and 5.2.17BG)					
5.2.17AR and 5.2.17BG	x	x	x		
5.2.20AR		x	x		x
5.2.20BG		x	x		
5.2.21R		x	x		x
5.2.22R	x		x		x

Rule	ICVC	ACD	Authorised fund manager of an AUT or ACS	Depositary of an ICVC, AUT or ACS	Authorised fund manager of an AUT or ACS, or ACD of an ICVC, that is a regulated money market fund
5.2.22AG	x	x	x	x	x
5.2.23R(1)	x	x	x		x
5.2.23R(2) to (4)	x	x	x	x	
COLL 5.2.23-AG	x	x	x		x
5.2.23CR		x	x		
5.2.26R		x	x		
5.2.27R	x				
5.2.28R			x		
5.2.29R	x	x	x		
5.2.30R	x	x	x		x
5.2.31R to 5.2.33R	x	x	x		
5.2.34G		x	x		
Note: x means "applies"					

5.2.2A G In addition to the parts of *CESR's UCITS eligible assets guidelines* specifically referred to in this section, the *authorised fund manager* of a *UCITS scheme* should have regard to the other parts of those guidelines when applying the *rules* in this section. *CESR's UCITS eligible assets guidelines* are available at https://www.esma.europa.eu/sites/default/files/library/2015/11/07_044.pdf.

5.2.3 R **Prudent spread of risk**

(1) An *authorised fund manager* must ensure that, taking account of the investment objectives and policy of the *UCITS scheme* as stated in the most recently published *prospectus*, the *scheme property* of the *UCITS scheme* aims to provide a prudent spread of risk.

(2) The *rules* in this section relating to spread of investments do not apply until the expiry of a period of six *months* after the date of which the *authorisation order*, in respect of the *UCITS scheme*, takes effect or on which the *initial offer* commenced, if later, provided that (1) is complied with during such period.

Investment powers: general

5.2.4 **R** The *scheme property* of each *UCITS scheme* must be invested only in accordance with the relevant provisions in sections ■ COLL 5.2 to ■ COLL 5.5 that are applicable to that *UCITS scheme* and up to any maximum limit so stated, but, the *instrument constituting the fund* may further restrict:

- (1) the kind of property in which the *scheme property* may be invested;
- (2) the proportion of the *capital property* of the *UCITS scheme* that may be invested in assets of any description;
- (3) the descriptions of transactions permitted; and
- (4) the borrowing powers of the *UCITS scheme*.

5.2.4A **G** Investment powers and limits for *UCITS schemes* that are *regulated money market funds* are set out in the *Money Market Funds Regulation*. Subject to complying with that Regulation, the *instrument constituting the fund* may further restrict:

- the kind of money market instruments in which the *scheme property* may be invested;
- the proportion of the *capital property* of the *UCITS scheme* to be invested in money market instruments of any description;
- the descriptions of transactions permitted; and
- the borrowing powers of the *UCITS scheme*.

Valuation

5.2.5 **R** (1) In this chapter, the value of the *scheme property* of a *UCITS scheme* means the net value determined in accordance with ■ COLL 6.3 (Valuation and pricing), after deducting any outstanding borrowings, whether immediately due to be repaid or not.

- (2) When valuing the *scheme property* for the purposes of this chapter:
 - (a) the time as at which the valuation is being carried out ("the relevant time") is treated as if it were a *valuation point*, but the valuation and the relevant time do not count as a valuation or a *valuation point* for the purposes of ■ COLL 6.3 (Valuation and pricing);
 - (b) *initial outlay* is to be regarded as remaining part of the *scheme property*; and
 - (c) if the *authorised fund manager*, having taken reasonable care, determines that the *UCITS scheme* will become entitled to any unrealised profit which has been made on account of a transaction in *derivatives*, that prospective entitlement is to be regarded as part of the *scheme property*.

(3) When valuing the *scheme property* of a *dual-priced authorised fund*, the *cancellation* basis of valuation referred to in ■ COLL 6.3.3 R (2) (Valuation) is to be applied.

Valuation guidance

5.2.6 **G** It should be noted that for the purpose of ■ COLL 5.2.5 R, ■ COLL 6.3 may be affected by specific provisions in this chapter such as, for example, ■ COLL 5.4.6 R (Treatment of collateral).

UCITS schemes: permitted types of scheme property

5.2.6A **R** The *scheme property* of a *UCITS scheme* must, except where otherwise provided in the *rules* in this chapter, consist solely of any or all of:

- (1) *transferable securities*;
- (2) *approved money-market instruments*;
- (3) *units in collective investment schemes*;
- (4) *derivatives and forward transactions*;
- (5) *deposits*; and
- (6) (for an *ICVC*) *movable and immovable property that is essential for the direct pursuit of the ICVC's business*;

in accordance with the *rules* in this section.

[**Note:** articles 50(1) (in conjunction with other *rules* in this section) and 50(3) of the *UCITS Directive*]

Transferable securities

5.2.7 **R**

- (1) A *transferable security* is an *investment* which is any of the following:
 - (a) a *share*;
 - (b) a *debenture*;
 - (ba) an *alternative debenture*;
 - (c) a *government and public security*;
 - (d) a *warrant*; or
 - (e) a *certificate representing certain securities*.
- (2) An *investment* is not a *transferable security* if the title to it cannot be transferred, or can be transferred only with the consent of a third party.
- (3) In applying (2) to an *investment* which is issued by a *body corporate*, and which is a *share* or a *debenture*, the need for any consent on the part of the *body corporate* or any members or *debenture* holders of it may be ignored.
- (4) An *investment* is not a *transferable security* unless the liability of the holder of it to contribute to the debts of the issuer is limited to any amount for the time being unpaid by the holder of it in respect of the *investment*.

Investment in transferable securities

5.2.7A

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- (1) A *UCITS scheme* may invest in a *transferable security* only to the extent that the *transferable security* fulfils the following criteria:
- (a) the potential loss which the *UCITS scheme* may incur with respect to holding the *transferable security* is limited to the amount paid for it;
 - (b) its liquidity does not compromise the ability of the *authorised fund manager* to comply with its obligation to *redeem units* at the request of any qualifying *unitholder* (see ■ COLL 6.2.16 R (3));
 - (c) reliable valuation is available for it as follows:
 - (i) in the case of a *transferable security* admitted to or *dealt* in on an *eligible* market, where there are accurate, reliable and regular prices which are either market prices or prices made available by valuation systems independent from issuers;
 - (ii) in the case of a *transferable security* not admitted to or *dealt* in on an *eligible* market, where there is a valuation on a periodic basis which is derived from information from the issuer of the *transferable security* or from competent investment research;
 - (d) appropriate information is available for it as follows:
 - (i) in the case of a *transferable security* admitted to or *dealt* in on an *eligible* market, where there is regular, accurate and comprehensive information available to the market on the *transferable security* or, where relevant, on the portfolio of the *transferable security*;
 - (ii) in the case of a *transferable security* not admitted to or *dealt* in on an *eligible* market, where there is regular and accurate information available to the *authorised fund manager* on the *transferable security* or, where relevant, on the portfolio of the *transferable security*;
 - (e) it is negotiable; and
 - (f) its risks are adequately captured by the risk management process of the *authorised fund manager*.
- (2) Unless there is information available to the *authorised fund manager* that would lead to a different determination, a *transferable security* which is admitted to or *dealt* in on an *eligible* market shall be presumed:
- (a) not to compromise the ability of the *authorised fund manager* to comply with its obligation to *redeem units* at the request of any qualifying *unitholder*; and
 - (b) to be negotiable.

[Note: article 2(1) of the *UCITS eligible assets Directive*]

5.2.7B

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Where the *authorised fund manager* considers that the liquidity or negotiability of a *transferable security* might compromise the ability of the *authorised fund manager* to comply with its obligation to *redeem units* at the request of any qualifying *unitholder*, it should assess the liquidity risk in accordance with *CESR's UCITS eligible assets guidelines* with respect to article 2(1) of the *UCITS eligible assets Directive*.

Closed end funds constituting transferable securities

5.2.7C

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A unit in a closed end fund shall be taken to be a *transferable security* for the purposes of investment by a *UCITS scheme*, provided it fulfils the criteria for *transferable securities* set out in ■ COLL 5.2.7A R, and either:

- (1) where the closed end fund is constituted as an investment company or a unit trust:
 - (a) it is subject to corporate governance mechanisms applied to companies; and
 - (b) where another *person* carries out asset management activity on its behalf, that *person* is subject to national regulation for the purpose of investor protection; or
- (2) where the closed end fund is constituted under the law of contract:
 - (a) it is subject to corporate governance mechanisms equivalent to those applied to companies; and
 - (b) it is managed by a *person* who is subject to national regulation for the purpose of investor protection.

[Note: articles 2(2)(a) and (b) of the *UCITS eligible assets Directive*]

5.2.7D

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- (1) An *authorised fund manager* should not invest the *scheme property* of a *UCITS scheme* in units of a closed end fund for the purpose of circumventing the investment limits set down in this section.
- (2) When required to assess whether the corporate governance mechanisms of a closed end fund in contractual form are equivalent to those applied to companies, the *authorised fund manager* should consider whether the contract on which the closed end fund is based provides its investors with rights to:
 - (a) vote on the essential decisions of the closed end fund (including appointment and removal of asset management company, amendment to the contract which set up the closed end fund, modification of investment policy, merger, liquidation); and
 - (b) control the investment policy of the closed end fund through appropriate mechanisms.
- (3) The assets of the closed end fund in contractual form should be separate and distinct from those of the asset manager and the closed end fund should be subject to liquidation rules that adequately protect its investors.

[Note: *CESR's UCITS eligible assets guidelines* with respect to articles 2(2) and 2(2)(b)(ii) of the *UCITS eligible assets Directive*]

Transferable securities linked to other assets

5.2.7E

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- (1) A *UCITS scheme* may invest in any other *investment* which shall be taken to be a *transferable security* for the purposes of investment by a *UCITS scheme* provided the *investment*:
 - (a) fulfils the criteria for *transferable securities* set out in ■ COLL 5.2.7A R; and

(b) is backed by or linked to the performance of other assets, which may differ from those in which a *UCITS scheme* can invest.

- (2) Where an *investment* in (1) contains an embedded derivative component (see ■ COLL 5.2.19R (3A)), the requirements of this section with respect to *derivatives* and forwards will apply to that component.

[Note: articles 2(2)(c) and 2(3) of the *UCITS eligible assets Directive*]

Approved money-market instruments

5.2.7F

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An *approved money-market instrument* is a money-market instrument which is normally dealt in on the money market, is liquid and has a value which can be accurately determined at any time.

[Note: article 2(1)(o) of the *UCITS Directive*]

5.2.7G

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A money-market instrument shall be regarded as normally dealt in on the money market if it:

- (1) has a maturity at issuance of up to and including 397 days;
- (2) has a residual maturity of up to and including 397 days;
- (3) undergoes regular yield adjustments in line with money market conditions at least every 397 days; or
- (4) has a risk profile, including credit and interest rate risks, corresponding to that of an instrument which has a maturity as set out in (1) or (2) or is subject to yield adjustments as set out in (3).

[Note: article 3(2) of the *UCITS eligible assets Directive*]

5.2.7H

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- (1) A money-market instrument shall be regarded as liquid if it can be sold at limited cost in an adequately short time frame, taking into account the obligation of the *authorised fund manager* to *redeem units* at the request of any qualifying *unitholder* (see ■ COLL 6.2.16 R (3)).
- (2) A money-market instrument shall be regarded as having a value which can be accurately determined at any time if accurate and reliable valuations systems, which fulfil the following criteria, are available:
 - (a) enabling the *authorised fund manager* to calculate a net asset value in accordance with the value at which the instrument held in the portfolio could be exchanged between knowledgeable willing parties in an arm's length transaction; and
 - (b) based either on market data or on valuation models including systems based on amortised costs.
- (3) A money-market instrument that is normally *dealt* in on the money market and is admitted to or dealt in on an *eligible* market shall be presumed to be liquid and have a value which can be accurately determined at any time unless there is information available to the

authorised fund manager that would lead to a different determination.

[Note: article 4 of the *UCITS eligible assets Directive*]

Guidance on assessing liquidity and quality of money-market instruments

5.2.7I

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- (1) The *authorised fund manager* should assess the liquidity of a money-market instrument in accordance with *CESR's UCITS eligible assets guidelines* with respect to article 4(1) of the *UCITS eligible assets Directive*.
- (2) Where an *approved money-market instrument* forms part of the *scheme property* of a *qualifying money market fund*, the *authorised fund manager* should adequately monitor that the instrument continues to be of high quality, taking into account both its credit risk and its final maturity.

[Note: *CESR's UCITS eligible assets guidelines* with respect to article 4(2) of the *UCITS eligible assets Directive*.]

Transferable securities and money-market instruments generally to be admitted to or dealt in on an eligible market

5.2.8

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- (1) [deleted]
- (2) [deleted]
- (3) *Transferable securities* and *approved money-market instruments* held within a *UCITS scheme* must be:
 - (a) admitted to or *dealt in* on an *eligible* market within ■ COLL 5.2.10 R (1)(a) (Eligible markets: requirements); or
 - (b) *dealt in* on an *eligible* market within ■ COLL 5.2.10 R (1)(b); or
 - (c) admitted to or *dealt in* on an *eligible* market within ■ COLL 5.2.10 R (2); or
 - (d) for an *approved money-market instrument* not admitted to or *dealt in* on an *eligible* market, within ■ COLL 5.2.10AR (1); or
 - (e) recently issued *transferable securities*, provided that:
 - (i) the terms of issue include an undertaking that application will be made to be admitted to an *eligible* market; and
 - (ii) such admission is secured within a year of issue.
- (4) However, a *UCITS scheme* may invest no more than 10% of the *scheme property* in *transferable securities* and *approved money-market instruments* other than those referred to in (3).

[Note: article 50(1)(a)-(d) and (h) and (2)(a) of the *UCITS Directive* and article 3(1) of the *UCITS eligible assets Directive*]

Eligible markets regime: purpose

- 5.2.9 **G** (1) This section specifies criteria based on those in article 50 of the *UCITS Directive*, as to the nature of the markets in which the property of a *UCITS scheme* may be invested.
- (2) Where a market ceases to be *eligible*, *investments* on that market cease to be *approved securities*. The 10% restriction in **COLL 5.2.8 R (4)** applies, and exceeding this limit because a market ceases to be *eligible* will generally be regarded as a breach beyond the control of the *authorised fund manager*.

5.2.9A **R** The ability to hold up to 10% of the *scheme property* in ineligible assets under **COLL 5.2.8 R (4)** is subject to the following limitations:

- (1) for a *qualifying money market fund*, the 10% restriction is limited to high quality money market instruments with a maturity or residual maturity of not more than 397 *days*, or regular yield adjustments consistent with such a maturity, and with a weighted average maturity of no more than 60 *days*.
- (2) [deleted]

Eligible markets: requirements

- 5.2.10 **R** (1) A market is *eligible* for the purposes of the *rules* in this sourcebook if it is:
- (a) a *regulated market*;
 - (b) a market in the *United Kingdom* or an *EEA State* which is regulated, operates regularly and is open to the public; or
 - (c) any market within (2).
- (2) A market not falling within (1)(a) and (b) is *eligible* for the purposes of the *rules* in this sourcebook if:
- (a) the *authorised fund manager*, after consultation with and notification to the *depository* (and in the case of an *ICVC*, any other *directors*), decides that market is appropriate for investment of, or *dealing in*, the *scheme property*;
 - (b) the market is included in a list in the *prospectus*; and
 - (c) the *depository* has taken reasonable care to determine that:
 - (i) adequate custody arrangements can be provided for the *investment dealt in* on that market; and
 - (ii) all reasonable steps have been taken by the *authorised fund manager* in deciding whether that market is *eligible*.
- (3) In (2)(a), a market must not be considered appropriate unless it:
- (a) is regulated;
 - (b) operates regularly;
 - (c) is recognised as a market or exchange or as a self-regulating organisation by an *overseas regulator*;
 - (d) is open to the public;

- (e) is adequately liquid; and
- (f) has adequate arrangements for unimpeded transmission of income and capital to or to the order of investors.

Money-market instruments with a regulated issuer

5.2.10A

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(1) (In addition to instruments admitted to or *dealt* in on an *eligible* market) a *UCITS* scheme may invest in an *approved money-market instrument* provided it fulfils the following requirements:

- (a) the issue or the issuer is regulated for the purpose of protecting investors and savings; and
- (b) the instrument is issued or guaranteed in accordance with **COLL 5.2.10B R**.

[**Note:** article 50(1)(h)(i) to (iii) of the *UCITS Directive*]

(2) The issue or the issuer of a money-market instrument, other than one dealt in on an *eligible* market, shall be regarded as regulated for the purpose of protecting investors and savings if:

- (a) the instrument is an *approved money-market instrument*;
- (b) appropriate information is available for the instrument (including information which allows an appropriate assessment of the credit risks related to investment in it), in accordance with **COLL 5.2.10C R**; and
- (c) the instrument is freely transferable.

[**Note:** article 5(1) of the *UCITS eligible assets Directive*]

Issuers and guarantors of money-market instruments

5.2.10B

R

(1) A *UCITS* scheme may invest in an *approved money-market instrument* if it is:

- (a) issued or guaranteed by any one of the following:
 - (i) a central authority of the *United Kingdom* or an *EEA State* or, if the *EEA State* is a federal state, one of the members making up the federation;
 - (ii) a regional or local authority of the *United Kingdom* or an *EEA State*;
 - (iii) the Bank of England, the European Central Bank or a central bank of an *EEA State*;
 - (iv) the European Union or the European Investment Bank;
 - (v) a non-*EEA State* or, in the case of a federal state, one of the members making up the federation;
 - (vi) a public international body to which the *United Kingdom* or one or more *EEA States* belong; or
- (b) issued by a body, any *securities* of which are dealt in on an *eligible* market; or
- (c) issued or guaranteed by an establishment which is:
 - (i) subject to prudential supervision in accordance with criteria defined by *UK* or *EU* law; or

(ii) subject to and complies with prudential rules considered by the *FCA* to be at least as stringent as those laid down by *UK* or *EU* law.

(2) An establishment shall be considered to satisfy the requirement in (1)(c)(ii) if it is subject to and complies with prudential rules, and fulfils one or more of the following criteria:

- (a) it is located in the *European Economic Area*;
- (b) it is located in an *OECD* country belonging to the Group of Ten;
- (c) it has at least investment grade rating;
- (d) on the basis of an in-depth analysis of the issuer, it can be demonstrated that the prudential rules applicable to that issuer are at least as stringent as those laid down by *UK* or *EU* law.

[Note: article 6 of the *UCITS eligible assets Directive*]

Appropriate information for money-market instruments

5.2.10C

R

- (1) In the case of an *approved money-market instrument* within
 - COLL 5.2.10BR (1)(b) or issued by a body of the type referred to in
 - COLL 5.2.10E G; or which is issued by an authority within
 - COLL 5.2.10BR (1)(a)(ii) or a public international body within
 - COLL 5.2.10BR (1)(a)(vi) but is not guaranteed by a central authority within
 - COLL 5.2.10BR (1)(a)(i), the following information must be available:
 - (a) information on both the issue or the issuance programme, and the legal and financial situation of the issuer prior to the issue of the instrument, verified by appropriately qualified third parties not subject to instructions from the issuer;
 - (b) updates of that information on a regular basis and whenever a significant event occurs; and
 - (c) available and reliable statistics on the issue or the issuance programme.
- (2) In the case of an *approved money-market instrument* issued or guaranteed by an establishment within ■ COLL 5.2.10BR (1)(c), the following information must be available:
 - (a) information on the issue or the issuance programme or on the legal and financial situation of the issuer prior to the issue of the instrument;
 - (b) updates of that information on a regular basis and whenever a significant event occurs; and
 - (c) available and reliable statistics on the issue or the issuance programme, or other data enabling an appropriate assessment of the credit risks related to investment in those instruments.
- (3) In the case of an *approved money-market instrument*:
 - (a) within ■ COLL 5.2.10BR (1)(a)(i), ■ (iv) or ■ (v); or
 - (b) which is issued by an authority within ■ COLL 5.2.10BR (1)(a)(ii) or a public international body within ■ COLL 5.2.10BR (1)(a)(vi) and is guaranteed by a central authority within ■ COLL 5.2.10BR (1)(a)(i);

information must be available on the issue or the issuance programme, or on the legal and financial situation of the issuer prior to the issue of the instrument.

[Note: articles 5(2), (3) and (4) of the *UCITS eligible assets Directive*]

5.2.10D G

- (1) The appropriately qualified third parties referred to in ■ COLL 5.2.10CR (1)(a) should specialise in the verification of legal or financial documentation and be composed of persons meeting professional standards of integrity.
- (2) The regular updates of information referred to in ■ COLL 5.2.10CR (1)(b) and ■ (2)(b) should normally occur on at least an annual basis.

[Note: CESR's *UCITS eligible assets guidelines* with respect to articles 5(2)(b) and (c) of the *UCITS eligible assets Directive*]

Other money-market instruments with a regulated issuer

5.2.10E G

- (1) In addition to instruments admitted to or *dealt* in on an *eligible* market, a *UCITS scheme* may also with the express consent of the *FCA* (which takes the form of a *waiver* under sections 138A and 138B of the *Act* as applied by section 250 of the *Act* or regulation 7 of the *OEIC Regulations*) invest in an *approved money-market instrument* provided:
 - (a) the issue or issuer is itself regulated for the purpose of protecting investors and savings in accordance with ■ COLL 5.2.10AR (2);
 - (b) investment in that instrument is subject to investor protection equivalent to that provided by instruments which satisfy the requirements of ■ COLL 5.2.10BR (1)(a), ■ (b) or ■ COLL 5.2.10BR (1)(c); and
 - (c) the issuer is a company whose capital and reserves amount to at least EUR 10 million and which presents and publishes its annual accounts in accordance with the requirements of the Companies Act 2006 applicable to public companies limited by shares or by guarantee, or private companies limited by shares or by guarantee, or, for companies incorporated in the *EEA*, Directive 2013/34/EU, is an entity which, within a group of companies which includes one or several listed companies, is dedicated to the financing of the group or is an entity which is dedicated to the financing of securitisation vehicles which benefit from a banking liquidity line.
- (2) A securitisation vehicle is a structure, whether in corporate, trust or contractual form, set up for the purpose of securitisation operations.
- (3) A banking liquidity line is a banking facility secured by a financial institution which is an establishment subject to prudential supervision in accordance with criteria defined by *UK* or *EU* law or an establishment which is subject to and complies with prudential rules considered by the *FCA* (in accordance with ■ COLL 5.2.10BR (2)) to be at least as stringent as those laid down by *UK* or *EU* law.

[Note: article 50(1)(h)(iv) of the *UCITS Directive* and article 7 of the *UCITS eligible assets Directive*]

Spread: general

5.2.11

R

- (1) This *rule* does not apply in respect of a *transferable security* or an *approved money-market instrument* to which ■ COLL 5.2.12R (Spread: government and public securities) applies.
- (2) For the purposes of this *rule* companies included in the same group for the purposes of consolidated accounts as defined in accordance with section 399 of Companies Act 2006, Directive 2013/34/EU or, in the same group in accordance with international accounting standards, are regarded as a single body.
- (3) Not more than 20% in value of the *scheme property* is to consist of *deposits* with a single body.
- (4) Not more than 5% in value of the *scheme property* is to consist of *transferable securities* or *approved money-market instruments* issued by any single body.
- (5) The limit of 5% in (4) is raised to 10% in respect of up to 40% in value of the *scheme property*. *Covered bonds* need not be taken into account for the purpose of applying the limit of 40%.
- (5A) The limit of 5% in (4) is raised to 25% in value of the *scheme property* in respect of *covered bonds*, provided that when a *UCITS scheme* invests more than 5% in *covered bonds* issued by a single body, the total value of *covered bonds* held must not exceed 80% in value of the *scheme property*.
- (6) In applying (4) and (5), *certificates representing certain securities* are to be treated as equivalent to the underlying *security*.
- (7) The exposure to any one counterparty in an *OTC derivative* transaction must not exceed 5% in value of the *scheme property*; this limit being raised to 10% where the counterparty is an *approved bank*.
- (8) Not more than 20% in value of the *scheme property* is to consist of *transferable securities* and *approved money-market instruments* issued by the same group (as referred to in (2)).
- (9) Not more than 20% in value of the *scheme* is to consist of the *units* of any one *collective investment scheme*.
- (10) In applying the limits in (3),(4),(5), (6) and (7) in relation to a single body, and subject to (5A), not more than 20% in value of the *scheme property* is to consist of any combination of two or more of the following:
 - (a) *transferable securities* (including *covered bonds*) or *approved money-market instruments* issued by that body; or
 - (b) *deposits* made with that body; or
 - (c) exposures from *OTC derivatives* transactions made with that body.
- (11) [deleted]

(12) [deleted]

(13) [deleted]

(14) [deleted]

[Note: article 52 of the *UCITS Directive*]

Guidance on spread: general

5.2.11A

G

(1) [deleted]

(2) [deleted]

(3) In applying the spread limit of 20% in value of *scheme property* which may consist of *deposits* with a single body, all uninvested cash comprising *capital property* that the *depository* holds should be included in calculating the total sum of the *deposits* held by it and other companies in its group on behalf of the *scheme*.

Counterparty risk and issuer concentration

5.2.11B

R

(1) An *authorised fund manager* of a *UCITS scheme* must ensure that *counterparty risk* arising from an *OTC derivative* transaction is subject to the limits set out in ■ COLL 5.2.11R (7) and ■ COLL 5.2.11R (10).

(2) When calculating the exposure of a *UCITS scheme* to a counterparty in accordance with the limits in ■ COLL 5.2.11R (7), the *authorised fund manager* must use the positive mark-to-market value of the *OTC derivative* contract with that counterparty.

(3) An *authorised fund manager* may net the *OTC derivative* positions of a *UCITS scheme* with the same counterparty, provided:

(a) it is able legally to enforce netting agreements with the counterparty on behalf of the *UCITS scheme*; and

(b) the netting agreements in (a) do not apply to any other exposures the *UCITS scheme* may have with that same counterparty.

(4) An *authorised fund manager* of a *UCITS scheme* may reduce the exposure of the *scheme property* to a counterparty to an *OTC derivative* transaction through the receipt of collateral. Collateral received must be sufficiently liquid so that it can be sold quickly at a price that is close to its pre-sale valuation.

(5) An *authorised fund manager* of a *UCITS scheme* must take collateral into account in calculating exposure to *counterparty risk* in accordance with the limits in ■ COLL 5.2.11BR (7) when it passes collateral to the counterparty to an *OTC derivative* transaction on behalf of the *UCITS scheme*.

(6) Collateral passed in accordance with (5) may be taken into account on a net basis only if the *authorised fund manager* is able legally to enforce netting arrangements with this counterparty on behalf of the *UCITS scheme*.

5.2.12

R

- (7) An *authorised fund manager* of a *UCITS scheme* must calculate the issuer concentration limits referred to in ■ COLL 5.2.11 R on the basis of the underlying exposure created through the use of *OTC derivatives* in accordance with the commitment approach.
- (8) In relation to exposures arising from *OTC derivative* transactions, as referred to in ■ COLL 5.2.11R (10), the *authorised fund manager* must include in the calculation any *counterparty risk* relating to the *OTC derivative* transactions.

[Note: article 43 of the *UCITS implementing Directive*]

Spread: government and public securities

- (1) This *rule* applies in respect of a *transferable security* or an *approved money-market instrument* ("such securities") that is issued by:
 - (a) the *United Kingdom* or an *EEA State*;
 - (b) a local authority of the *United Kingdom* or an *EEA State*;
 - (c) a non-*EEA State*; or
 - (d) a public international body to which the *UK* or one or more *EEA States* belong.
- (2) Where no more than 35% in value of the *scheme property* is invested in such *securities* issued by any one body, there is no limit on the amount which may be invested in such *securities* or in any one issue.
- (3) An *authorised fund* may invest more than 35% in value of the *scheme property* in such *securities* issued by any one body provided that:
 - (a) the *authorised fund manager* has before any such investment is made consulted with the *depository* and as a result considers that the issuer of such *securities* is one which is appropriate in accordance with the investment objectives of the *authorised fund*;
 - (b) no more than 30% in value of the *scheme property* consists of such *securities* of any one issue;
 - (c) the *scheme property* includes such *securities* issued by that or another issuer, of at least six different issues; and
 - (d) the disclosures in ■ COLL 3.2.6R(8) (Table: contents of the instrument constituting the fund) and ■ COLL 4.2.5R(3)(i) (Table: contents of the prospectus) have been made.
- (4) [deleted]
- (5) In this *rule* in relation to such *securities*:
 - (a) issue, issued and issuer include guarantee, guaranteed and guarantor; and
 - (b) an issue differs from another if there is a difference as to repayment date, rate of interest, guarantor or other material terms of the issue.

- (6) Notwithstanding ■ COLL 5.2.11R (1) and subject to ■ (2) and ■ (3), in applying the 20% limit in ■ COLL 5.2.11R (10) with respect to a single body, such *securities* issued by that body shall be taken into account.

Investment in collective investment schemes

5.2.13

R

A *UCITS scheme* must not invest in *units* in a *collective investment scheme* ("second *scheme*") unless the second *scheme* satisfies all of the following conditions, and provided that no more than 30% of the value of the *UCITS scheme* is invested in second *schemes* within (1)(b) to (e):

- (1) the second *scheme* must:
 - (a) be a *UCITS scheme* or satisfy the conditions necessary for it to enjoy the rights conferred by the *UCITS Directive* as implemented in the *EEA*; or
 - (b) be a *recognised scheme* that is authorised by the *supervisory authorities* of Guernsey, Jersey or the Isle of Man (provided the requirements of ■ COLL 5.2.13AR are met); or
 - (c) be authorised as a *non-UCITS retail scheme* (provided the requirements of ■ COLL 5.2.13AR(1), (3) and (4) are met); or
 - (d) be authorised in an *EEA State* (provided the requirements of ■ COLL 5.2.13AR are met); or
 - (e) be authorised by the competent authority of an *OECD* member country (other than an *EEA State*) which has:
 - (i) signed the IOSCO Multilateral Memorandum of Understanding; and
 - (ii) approved the *scheme's* management company, rules and *depository/custody* arrangements;

(provided the requirements of ■ COLL 5.2.13AR are met);
- (2) the second *scheme* must comply, where relevant, with ■ COLL 5.2.15 R (Investment in associated collective investment schemes) and ■ COLL 5.2.16 R (Investment in other group schemes);
- (3) the second *scheme* must have terms which prohibit more than 10% in value of the *scheme property* consisting of *units* in *collective investment schemes*; and
- (4) where the second *scheme* is an *umbrella*, the provisions in (2) and (3) and ■ COLL 5.2.11 R (Spread: general) apply to each *sub-fund* as if it were a separate *scheme*.

5.2.13A

R

The requirements referred to in ■ COLL 5.2.13R(1) are that:

- (1) the second *scheme* is an undertaking:
 - (a) with the sole object of collective investment in *transferable securities* or in other liquid financial assets, as referred to in this chapter, of capital raised from the public and which operate on the principle of risk-spreading; and
 - (b) with *units* which are, at the request of holders, repurchased or *redeemed*, directly or indirectly, out of those undertakings' assets

(action taken by a *scheme* to ensure that the price of its *units* on an investment exchange does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or *redemption*);

- (2) the second *scheme* is authorised under laws which provide that they are subject to supervision considered by the *FCA* to be equivalent to that laid down in the law of the *United Kingdom*, and that cooperation between the *FCA* and the *supervisory authorities* of the second *scheme* is sufficiently ensured;
- (3) the level of protection for *unitholders* in the second *scheme* is equivalent to that provided for *unitholders* in a *UCITS scheme*, and in particular that the rules on asset segregation, borrowing, lending, and uncovered sales of *transferable securities* and *approved money market instruments* are equivalent to the requirements of this chapter; and
- (4) the business of the second *scheme* is reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period.

Qualifying non-UCITS collective investment schemes

5.2.14

G

- (1) ■ COLL 9.3 gives further detail as to the recognition of a *scheme* under section 272 of the *Act*.
- (2) A *scheme* which has the power to invest in gold or immovables would not meet the criteria set out in ■ COLL 5.2.13R (1).
- (3) In determining whether a *scheme* (other than a *UCITS*) meets the requirements of ■ COLL 5.2.13AR for the purposes of ■ COLL 5.2.13R (1), the *authorised fund manager* should consider the following factors before deciding that the *scheme* provides a level of protection for *unitholders* which is equivalent to that provided to *unitholders* in a *UCITS scheme*:
 - (a) the rules guaranteeing the autonomy of the *scheme* and management in the exclusive interest of the *unitholders*;
 - (b) the existence of an independent *depository/custodian* with similar duties and responsibilities in relation to both safekeeping and supervision; where an independent *depository/custodian* is not a requirement of local law as regards *collective investment schemes*, robust governance structures may provide a suitable alternative;
 - (c) the availability of pricing information and reporting requirements;
 - (d) redemption facilities and frequency;
 - (e) restrictions in relation to dealings by related parties;
 - (f) the extent of asset segregation; and
 - (g) the local requirements for borrowing, lending and uncovered sales of *transferable securities* and money market instruments regarding the portfolio of the *scheme*.

[Note: article 26 of *CESR's UCITS eligible assets guidelines* with respect to article 50(1)(e) of the *UCITS Directive*]

- (4) The requirement for supervisory equivalence, as described in ■ COLL 5.2.13AR(2), also applies to *schemes* (that are not *EEA UCITS schemes*) established in *EEA States*. In considering whether the second scheme satisfies this requirement, the *authorised fund manager* should have regard to the first section of article 26 of *CESR's UCITS eligible assets guidelines*.

Investment in associated collective investment schemes

5.2.15

R

- (1) A *UCITS scheme* must not invest in or dispose of *units* in another *collective investment scheme* (the *second scheme*) if the *second scheme* is managed or operated by (or, for an *ICVC*, whose *ACD* is) the *authorised fund manager* of the investing *UCITS scheme* or an *associate* of that *authorised fund manager*, unless:
 - (a) the *prospectus* of the investing *UCITS scheme* clearly states that the property of that investing *scheme* may include such *units*; and
 - (b) ■ COLL 5.2.16 R (Investment in other group schemes) is complied with.
- (2) Where a *sub-fund* of a *UCITS scheme* which is an *umbrella* invests in or disposes of *units* in another *sub-fund* of the same *umbrella* (the *second sub-fund*), the requirement in:
 - (a) ■ COLL 5.2.15R (1)(a) is modified as follows - the *prospectus* of the *umbrella* must clearly state that the *scheme property* attributable to the investing or disposing *sub-fund* may include units in another *sub-fund* of the same *umbrella*; and
 - (b) ■ COLL 5.2.15R (1)(b) is modified as follows - ■ COLL 5.2.16 R (Investment in other group schemes) must be complied with, modified such that references to the "*UCITS scheme*" are taken to be references to the investing or disposing *sub-fund* and references to the "*second scheme*" are taken to be references to the *second sub-fund*.

5

Investment in other group schemes

5.2.16

R

- (1) Where:
 - (a) an investment or disposal is made under ■ COLL 5.2.15 R; and
 - (b) there is a charge in respect of such investment or disposal;
 the *authorised fund manager* of the *UCITS scheme* making the investment or disposal must pay the *UCITS scheme* the amounts referred to in (2) or (3) within four *business days* following the date of the agreement to invest or dispose.
- (2) When an investment is made, the amount referred to in (1) is either:
 - (a) any amount by which the consideration paid by the *UCITS scheme* for the *units* in the *second scheme* exceeds the price that would have been paid for the benefit of the *second scheme* had the *units* been newly issued or sold by it; or

- (b) if such price cannot be ascertained by the *authorised fund manager* of the *authorised fund*, the maximum amount of any charge permitted to be made by the seller of *units* in the second *scheme*.
- (3) When a disposal is made, the amount referred to in (1) is any charge made for the account of the *authorised fund manager* or *operator* of the second *scheme* or an *associate* of any of them in respect of the disposal.
- (4) In this *rule*:
 - (a) any addition to or deduction from the consideration paid on the acquisition or disposal of *units* in the second *scheme*, which is applied for the benefit of the second *scheme* and is, or is like, a *dilution levy* made in accordance with ■ COLL 6.3.8 R (Dilution) is to be treated as part of the *price* of the *units* and not as part of any charge; and
 - (b) any charge made in respect of an exchange of *units* in one *sub-fund* or separate part of the second *scheme* for *units* in another *sub-fund* or separate part of that *scheme* is to be included as part of the consideration paid for the *units*.

Investment in nil and partly paid securities

- 5.2.17 **R** (1) [deleted]
- (2) A *transferable security* or an *approved money-market instrument* on which any sum is unpaid falls within a power of investment only if it is reasonably foreseeable that the amount of any existing and potential call for any sum unpaid could be paid by the *UCITS scheme*, at the time when payment is required, without contravening the *rules* in this chapter.

Investment in securitisation positions

- 5.2.17A **R** Where an *authorised fund manager* is exposed to a securitisation that does not meet the requirements provided for in *SECN* and, where applicable, the Securitisation Part of the *PRA Rulebook*, it must, in the best interests of the investors in the relevant *UCITS scheme*, act and take corrective action, if appropriate.
[Note: Article 50a of the *UCITS Directive*]

- 5.2.17B **G** ■ *SECN* 4 (Due diligence requirements) applies to *authorised fund managers* in combination with ■ COLL 5.2.17AR.

- 5.2.18 **R** [deleted]

Derivatives: general

- 5.2.19 **R** (1) A transaction in *derivatives* or a forward transaction must not be effected for a *UCITS scheme* unless:

- (a) the transaction is of a kind specified in ■ COLL 5.2.20 R (Permitted transactions (derivatives and forwards)); and
 - (b) the transaction is covered, as required by ■ COLL 5.3.3A R (Cover for investment in derivatives and forward transactions).
- (2) Where a *UCITS scheme* invests in *derivatives*, the exposure to the underlying assets must not exceed the limits in ■ COLL 5.2.11 R (Spread: general) and ■ COLL 5.2.12 R (Spread: government and public securities) save as provided in (4).
- (3) Where a *transferable security* or *approved money-market instrument* embeds a *derivative*, this must be taken into account for the purposes of complying with this section.
- (3A) (a) A *transferable security* or an *approved money-market instrument* will embed a *derivative* if it contains a component which fulfils the following criteria:
- (i) by virtue of that component some or all of the cash flows that otherwise would be required by the *transferable security* or *approved money-market instrument* which functions as host contract can be modified according to a specified interest rate, financial instrument price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, and therefore vary in a way similar to a stand-alone *derivative*;
 - (ii) its economic characteristics and risks are not closely related to the economic characteristics and risks of the host contract; and
 - (iii) it has a significant impact on the risk profile and pricing of the *transferable security* or *approved money-market instrument*.
- (b) A *transferable security* or an *approved money-market instrument* does not embed a *derivative* where it contains a component which is contractually transferable independently of the *transferable security* or the *approved money-market instrument*. That component shall be deemed to be a separate instrument.
- [Note: article 10 of the *UCITS eligible assets Directive*]
- (4) Where a *scheme* invests in an index based *derivative*, provided the relevant index falls within ■ COLL 5.2.20AR (Financial indices underlying derivatives) the underlying constituents of the index do not have to be taken into account for the purposes of ■ COLL 5.2.11 R and ■ COLL 5.2.12 R.
- (5) The relaxation in (4) is subject to the *authorised fund manager* taking account of ■ COLL 5.2.3 R (Prudent spread of risk).

Guidance on transferable securities and money-market instruments embedding derivatives

5.2.19A G

- (1) Collateralised debt obligations (CDOs) or asset-backed securities using *derivatives*, with or without an active management, will generally not be considered as embedding a *derivative* except if:

- (a) they are leveraged, i.e. the CDOs or asset-backed securities are not limited recourse vehicles and the investors' loss can be higher than their initial investment; or
 - (b) they are not sufficiently diversified.
- (2) Where a *transferable security* or *approved money-market instrument* embedding a *derivative* is structured as an alternative to an *OTC derivative*, the requirements set out in ■ COLL 5.2.23 R with respect to transactions in *OTC derivatives* will apply. This will be the case for tailor-made hybrid instruments, such as a single tranche CDO structured to meet the specific need of a *scheme*, which should be considered as embedding a *derivative*. Such a product offers an alternative to the use of an *OTC derivative*, for the same purpose of achieving a diversified exposure with a pre-set credit risk level to a portfolio of entities.
- (3) The following list of *transferable securities* and *approved money-market instruments*, which is illustrative and non-exhaustive, could be assumed to embed a *derivative*:
- (a) credit linked notes;
 - (b) *transferable securities* or *approved money-market instruments* whose performance is linked to the performance of a bond index;
 - (c) *transferable securities* or *approved money-market instruments* whose performance is linked to the performance of a basket of shares, with or without active management;
 - (d) *transferable securities* or *approved money-market instruments* with a fully guaranteed nominal value whose performance is linked to the performance of a basket of shares, with or without active management;
 - (e) convertible bonds; and
 - (f) exchangeable bonds.
- (4) *Schemes* cannot use *transferable securities* or *approved money-market instruments* which embed a *derivative* to circumvent the rules in this section.
- (5) *Transferable securities* and *approved money-market instruments* which embed a *derivative* are subject to the rules applicable to *derivatives* as required by this section. It is the *authorised fund manager's* responsibility to check that these requirements are complied with. The nature, frequency and scope of checks performed will depend on the characteristics of the embedded *derivatives* and on their impact on the *scheme*, taking into account its stated investment objective and risk profile.

[Note: CESR's UCITS eligible assets guidelines with respect to article 10 of the UCITS eligible assets Directive]

Permitted transactions (derivatives and forwards)

5.2.20

R

- (1) A transaction in a *derivative* must:
 - (a) be in an *approved derivative*; or

- (b) be one which complies with ■ COLL 5.2.23 R (OTC transactions in derivatives).
- (2) The underlying of a transaction in a *derivative* must consist of any one or more of the following to which the *scheme* is *dedicated*:
- (a) *transferable securities* permitted under ■ COLL 5.2.8 R (3)(a) to ■ (c) and ■ COLL 5.2.8 R (3)(e);
 - (b) *approved money-market instruments* permitted under ■ COLL 5.2.8 R (3)(a) to ■ COLL 5.2.8 R (3)(d);
 - (c) *deposits* permitted under ■ COLL 5.2.26 R (Investment in deposits);
 - (d) *derivatives* permitted under this *rule*;
 - (e) *collective investment scheme* units permitted under ■ COLL 5.2.13 R (Investment in collective investment schemes);
 - (f) financial indices which satisfy the criteria set out in ■ COLL 5.2.20A R;
 - (g) interest rates;
 - (h) foreign exchange rates; and
 - (i) currencies.
- [**Note:** article 8(1)(a) of the *UCITS eligible assets Directive*]
- (3) A transaction in an *approved derivative* must be effected on or under the rules of an *eligible derivatives* market.
- (4) A transaction in a *derivative* must not cause a *scheme* to diverge from its investment objectives as stated in the *instrument constituting the fund* and the most recently published *prospectus*.
- (5) A transaction in a *derivative* must not be entered into if the intended effect is to create the potential for an uncovered sale of one or more *transferable securities, approved money-market instruments, units in collective investment schemes or derivatives* provided that a sale is not to be considered as uncovered if the conditions in ■ COLL 5.2.22R (1) (Requirement to cover sales), as read in accordance with the guidance at ■ COLL 5.2.22A G, are satisfied.
- (6) Any forward transaction must be made with an *eligible institution* or an *approved bank*.
- (7) A *derivative* includes an instrument which fulfils the following criteria:
- (a) it allows the transfer of the credit risk of the underlying independently from the other risks associated with that underlying;
 - (b) it does not result in the delivery or the transfer of assets other than those referred to in ■ COLL 5.2.6A R (UCITS schemes: permitted types of scheme property) including cash;
 - (c) in the case of an *OTC derivative*, it complies with the requirements in ■ COLL 5.2.23 R (OTC transactions in derivatives);
 - (d) its risks are adequately captured by the risk management process of the *authorised fund manager*, and by its internal control mechanisms in the case of risks of asymmetry of information

between the *authorised fund manager* and the counterparty to the *derivative*, resulting from potential access of the counterparty to non-public information on *persons* whose assets are used as the underlying by that *derivative*.

[Note: article 8(2) of the *UCITS eligible assets Directive*]

(8) A *UCITS scheme* may not undertake transactions in *derivatives* on *commodities*.

[Note: article 8(5) of the *UCITS eligible assets Directive*]

Financial indices underlying derivatives

(1) The financial indices referred to in ■ COLL 5.2.20R (2)(f) are those which satisfy the following criteria:

- (a) the index is sufficiently diversified;
- (b) the index represents an adequate benchmark for the market to which it refers; and
- (c) the index is published in an appropriate manner.

(2) A financial index is sufficiently diversified if:

- (a) it is composed in such a way that price movements or trading activities regarding one component do not unduly influence the performance of the whole index;
- (b) where it is composed of assets in which a *UCITS scheme* is permitted to invest, its composition is at least diversified in accordance with the requirements with respect to spread and concentration set out in this section; and
- (c) where it is composed of assets in which a *UCITS scheme* cannot invest, it is diversified in a way which is equivalent to the diversification achieved by the requirements with respect to spread and concentration set out in this section.

(3) A financial index represents an adequate benchmark for the market to which it refers if:

- (a) it measures the performance of a representative group of underlyings in a relevant and appropriate way;
- (b) it is revised or rebalanced periodically to ensure that it continues to reflect the markets to which it refers, following criteria which are publicly available; and
- (c) the underlyings are sufficiently liquid, allowing users to replicate it if necessary.

(4) A financial index is published in an appropriate manner if:

- (a) its publication process relies on sound procedures to collect prices, and calculate and subsequently publish the index value, including pricing procedures for components where a market price is not available; and
- (b) material information on matters such as index calculation, rebalancing methodologies, index changes or any operational difficulties in providing timely or accurate information is provided on a wide and timely basis.

- (5) Where the composition of underlyings of a transaction in a *derivative* does not satisfy the requirements for a financial index, the underlyings for that transaction shall where they satisfy the requirements with respect to other underlyings pursuant to ■ COLL 5.2.20R (2), be regarded as a combination of those underlyings.

[Note: article 9 of the *UCITS eligible assets Directive*]

Guidance on financial indices underlying derivatives

5.2.20B

G

- (1) An index based on *derivatives* on *commodities* or an index on property may be regarded as a financial index of the type referred to in ■ COLL 5.2.20R (2)(f) provided it satisfies the criteria for financial indices set out in ■ COLL 5.2.20A R.
- (2) If the composition of an index is not sufficiently diversified in order to avoid undue concentration, its underlying assets should be combined with the other assets of the *UCITS scheme* when assessing compliance with the requirements on cover for transactions in *derivatives* and forward transactions set out in ■ COLL 5.3.3A R and spread set out in ■ COLL 5.2.11 R.
- (3) (a) In order to avoid undue concentration, where *derivatives* on an index composed of assets in which a *UCITS scheme* cannot invest are used to track or gain high exposure to the index, the index should be at least diversified in a way which is equivalent to the diversification achieved by the requirements with respect to spread and concentration set out in this section.
- (b) If *derivatives* on that index are used for risk-diversification purposes, provided that the exposure of the *UCITS scheme* to that index complies with the 5%, 10% and 40% ratios required by ■ COLL 5.2.11R (4) and ■ (5), there is no need to look at the underlying components of that index to ensure that it is sufficiently diversified.

[Note: UCITS eligible assets guidelines with respect to article 9 of the *UCITS eligible assets Directive*]

- (3A) *Authorised fund managers* of *UCITS schemes* are advised that *UCITS schemes* should not be invested in commodity indices that do not consist of different commodities, as provided by paragraph 50 of *ESMA's* guidelines on ETFs and other UCITS issues (ESMA 2012/832)

https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-832en_guidelines_on_etfs_and_other_ucits_issues.pdf.

- (4) [deleted]

Transactions for the purchase of property

5.2.21

R

A *derivative* or forward transaction which will or could lead to the delivery of property for the account of the *UCITS scheme* may be entered into only if:

- (1) that property can be held for the account of the *UCITS scheme*; and

- (2) the *authorised fund manager* having taken reasonable care determines that delivery of the property under the transaction will not occur or will not lead to a breach of the *rules* in this sourcebook.

Requirement to cover sales

5.2.22

R

- (1) No agreement by or on behalf of a *UCITS scheme* to dispose of property or rights may be made unless:
 - (a) the obligation to make the disposal and any other similar obligation could immediately be honoured by the *UCITS scheme* by delivery of property or the assignment (or, in Scotland, assignation) of rights; and
 - (b) the property and rights at (a) are owned by the *UCITS scheme* at the time of the agreement.
- (2) Paragraph (1) does not apply to a *deposit*.
- (3) [deleted]
- (4) [deleted]

Guidance on requirement to cover sales

5.2.22A

G

- [deleted]
- (1) In the *FCA's* view the requirement in ■ COLL 5.2.22R (1)(a) can be met where:
 - (a) the risks of the underlying financial instrument of a *derivative* can be appropriately represented by another financial instrument and the underlying financial instrument is highly liquid; or
 - (b) the *authorised fund manager* or the *depository* has the right to settle the *derivative* in cash, and cover exists within the *scheme property* which falls within one of the following asset classes:
 - (i) cash;
 - (ii) liquid debt instruments (e.g. government bonds of first credit rating) with appropriate safeguards (in particular, haircuts); or
 - (iii) other highly liquid assets having regard to their correlation with the underlying of the financial *derivative* instruments, subject to appropriate safeguards (e.g. haircuts where relevant).
- (2) In the asset classes referred to in (1), an asset may be considered as liquid where the instrument can be converted into cash in no more than seven *business days* at a price closely corresponding to the current valuation of the financial instrument on its own market.

OTC transactions in derivatives

5.2.23

R

A transaction in an *OTC derivative* under ■ COLL 5.2.20 R (1) (b) or, for the purposes of (1) only, executed by or on behalf of a *regulated money market fund*, must be:

- (1) with an approved counterparty; a counterparty to a transaction in *derivatives* is approved only if the counterparty is:
 - (a) an *eligible institution* or an *approved bank*;
 - (b) a *person* whose *permission* (including any *requirements* or *limitations*), as published in the *Financial Services Register*, permits it to enter into the transaction as *principal off-exchange*;
 - (c) a *CCP* that is authorised in that capacity for the purposes of *EMIR*;
 - (d) a *CCP* that is recognised in that capacity in accordance with the process set out in article 25 of *EMIR*; or
 - (e) to the extent not already covered above, a *CCP* supervised in a jurisdiction that:
 - (i) has implemented the relevant G20 reforms on over-the-counter derivatives to at least the same extent as the *United Kingdom*; and
 - (ii) is identified as having done so by the Financial Stability Board in its summary report on progress in implementation of G20 financial regulatory reforms dated 25 June 2019;

- (2) on approved terms; the terms of the transaction in *derivatives* are approved only if the *authorised fund manager*:
 - (a) carries out, at least daily , a reliable and verifiable valuation in respect of that transaction corresponding to its fair value and which does not rely only on market quotations by the counterparty; and
 - (b) can enter into one or more further transactions to *sell*, liquidate or *close out* that transactions at any time, at its fair value ;

- (3) capable of reliable valuation; a transaction in *derivatives* is capable of reliable valuation only if the *authorised fund manager* having taken reasonable care determines that, throughout the life of the *derivative* (if the transaction is entered into), it will be able to value the *investment* concerned with reasonable accuracy:
 - (a) on the basis of an up-to-date market value which the *authorised fund manager* and the *depository* have agreed is reliable; or
 - (b) if the value referred to in (a) is not available, on the basis of a pricing model which the *authorised fund manager* and the *depository* have agreed uses an adequate recognised methodology; and

- (4) subject to verifiable valuation; a transaction in *derivatives* is subject to verifiable valuation only if, throughout the life of the *derivative* (if the transaction is entered into) verification of the valuation is carried out by:
 - (a) an appropriate third party which is independent from the counterparty of the *derivative*, at an adequate frequency and in such a way that the *authorised fund manager* is able to check it; or
 - (b) a department within the *authorised fund manager* which is independent from the department in charge of managing the *scheme property* and which is adequately equipped for such a purpose.

[**Note:** articles 8(1)(b), 8(3) and 8(4) of the *UCITS eligible assets Directive*.

In relation to ■ COLL 5.2.23R(1)(e), see the table on page 3 of the Financial Stability Board’s report of 25 June 2019 which is available here: <https://www.fsb.org/wp-content/uploads/P250619-2.pdf>

5.2.23-A **G** The jurisdictions that fall within ■ COLL 5.2.23R(1)(e) are Australia, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, Spain, Switzerland, and the United States of America.

5.2.23A **R** For the purposes of ■ COLL 5.2.23 R (2), “fair value” is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

5.2.23B **R** In respect of its obligations under ■ COLL 6.6.4 R (1) (a) , the *depository* must take reasonable care to ensure that the *authorised fund manager* has systems and controls that are adequate to ensure compliance with ■ COLL 5.2.23 R (1) to ■ (4).

Valuation of OTC derivatives

5.2.23C **R**

(1) For the purposes of ■ COLL 5.2.23 R (2), an *authorised fund manager* of a *UCITS scheme* must:

- (a) establish, implement and maintain arrangements and procedures which ensure appropriate, transparent and fair valuation of the exposures of a *UCITS scheme* to *OTC derivatives*; and
- (b) ensure that the fair value of *OTC derivatives* is subject to adequate, accurate and independent assessment.

(2) Where the arrangements and procedures referred to in (1) involve the performance of certain activities by third parties, the *authorised fund manager* must comply with the requirements in ■ SYSC 8.1.13 R (Additional requirements for a management company) and ■ COLL 6.6A.4 R (5) and ■ (6) (Due diligence requirements of AFMs of UCITS schemes).

(3) The arrangements and procedures referred to in this *rule* must be:

- (a) adequate and proportionate to the nature and complexity of the *OTC derivative* concerned; and
- (b) adequately documented.

[**Note:** article 51(1) second paragraph of the *UCITS Directive* and articles 44(2) and 44(4) of the *UCITS implementing Directive*]

5.2.24 **R**

- (1) [deleted]
- (2) [deleted]
- (3) [deleted]

- 5.2.25 **G**
- (1) [deleted]
 - (2) [deleted]
 - (3) [deleted]
 - (4) [deleted]
 - (5) [deleted]
 - (6) [deleted]
 - (7) [deleted]
 - (8) [deleted]

Investment in deposits

5.2.26 **R** A UCITS scheme may invest in deposits only if it:

- (1) is with an *approved bank*;
- (2) is:
 - (a) repayable on demand; or
 - (b) has the right to be withdrawn; and
- (3) matures in no more than 12 months.

Significant influence for ICVCs

- 5.2.27 **R**
- (1) An ICVC must not acquire *transferable securities* issued by a *body corporate* and carrying rights to vote (whether or not on substantially all matters) at a general meeting of that *body corporate* if:
 - (a) immediately before the acquisition, the aggregate of any such *securities* held by the ICVC gives the ICVC power to influence significantly the conduct of business of that *body corporate*; or
 - (b) the acquisition gives the ICVC that power.
 - (2) For the purpose of (1), an ICVC is to be taken to have power significantly to influence the conduct of business of a *body corporate* if it can, because of the *transferable securities* held by it, exercise or control the exercise of 20% or more of the voting rights in that *body corporate* (disregarding for this purpose any temporary suspension of voting rights in respect of the *transferable securities* of that *body corporate*).

Significant influence for authorised fund managers of AUTs or ACSs

- 5.2.28 **R**
- (1) An *authorised fund manager* must not acquire, or cause to be acquired for an AUT or ACS of which it is the *authorised fund manager*, *transferable securities* issued by a *body corporate* and carrying rights to vote (whether or not on substantially all matters) at a general meeting of the *body corporate* if:

- (a) immediately before the acquisition, the aggregate of any such *securities* held for that *AUT* or *ACS*, taken together with any such *securities* already held for other *AUTs* or *ACs* of which it is also the *authorised fund manager*, gives the *authorised fund manager* power significantly to influence the conduct of business of that *body corporate*; or
 - (b) the acquisition gives the *authorised fund manager* that power.
- (2) For the purpose of (1), an *authorised fund manager* is to be taken to have power significantly to influence the conduct of business of a *body corporate* if it can, because of the *transferable securities* held for all the *AUTs* or *ACs*, of which it is the *authorised fund manager*, exercise or control the exercise of 20% or more of the voting rights in that *body corporate* (disregarding for this purpose any temporary suspension of voting rights in respect of the *transferable securities* of that *body corporate*).

Concentration

5.2.29

R

A *UCITS scheme*:

- (1) must not acquire *transferable securities* (other than *debt securities*) which:
 - (a) do not carry a right to vote on any matter at a general meeting of the *body corporate* that issued them; and
 - (b) represent more than 10% of those *securities* issued by that *body corporate*;
- (2) must not acquire more than 10% of the *debt securities* issued by any single body;
- (3) must not acquire more than 25% of the *units* in a *collective investment scheme*;
- (4) must not acquire more than 10% of the *approved money-market instruments* issued by any single body; and
- (5) need not comply with the limits in (2), (3) and (4) if, at the time of acquisition, the net amount in issue of the relevant *investment* cannot be calculated.

UCITS schemes that are umbrellas

5.2.30

R

- (1) In relation to a *UCITS scheme* which is an *umbrella*, the provisions in ■ COLL 5.2 to ■ COLL 5.5 apply to each *sub-fund* as they would for an *authorised fund*, except the following *rules* which apply at the level of the *umbrella* only:
 - (a) ■ COLL 5.2.27 R (Significant influence for ICVCs);
 - (b) ■ COLL 5.2.28 R (Significant influence for authorised fund managers of *AUTs* or *ACs*); and
 - (c) ■ COLL 5.2.29 R (Concentration).

- (2) A *sub-fund* may invest in or dispose of *units* of another *sub-fund* of the same *umbrella* (the second *sub-fund*) only if the following conditions are satisfied:
 - (a) the second *sub-fund* does not hold *units* in any other *sub-fund* of the same *umbrella*;
 - (b) the conditions in ■ COLL 5.2.15 R (Investment in associated collective investment schemes) and ■ COLL 5.2.16 R (Investment in other group schemes) are complied with (for the purposes of this rule, ■ COLL 5.2.15 R and ■ COLL 5.2.16 R are to be read as modified by ■ COLL 5.2.15 R (2)); and
 - (c) the investing or disposing *sub-fund* must not be a *feeder UCITS* to the second *sub-fund*.

Schemes replicating an index

5.2.31

R

(1) Notwithstanding ■ COLL 5.2.11 R (Spread: general), a *UCITS scheme* may invest up to 20% in value of the *scheme property* in *shares* and *debentures* which are issued by the same body where the investment policy of that *scheme* as stated in the most recently published *prospectus* is to replicate the composition of a relevant index which satisfies the criteria specified in ■ COLL 5.2.33 R (Relevant indices).

(1A) Replication of the composition of a relevant index shall be understood to be a reference to replication of the composition of the underlying assets of that index, including the use of techniques and instruments permitted for the purpose of *efficient portfolio management*.

[Note: article 12(1) of the *UCITS eligible assets Directive*]

(2) The limit in (1) can be raised for a particular *UCITS scheme* up to 35% in value of the *scheme property*, but only in respect of one body and where justified by exceptional market conditions.

Index replication

5.2.32

G

(1) [deleted]

(2) In the case of a *UCITS scheme* replicating an index under ■ COLL 5.2.31 R (Schemes replicating an index) the *scheme property* need not consist of the exact composition and weighting of the underlying in the relevant index in cases where the *scheme's* investment objective is to achieve a result consistent with the replication of an index rather than an exact replication.

Relevant indices

5.2.33

R

- (1) The indices referred to in ■ COLL 5.2.31 R are those which satisfy the following criteria:
 - (a) the composition is sufficiently diversified;
 - (b) the index represents an adequate benchmark for the market to which it refers; and
 - (c) the index is published in an appropriate manner.

- (2) The composition of an index is sufficiently diversified if its components adhere to the spread and concentration requirements in this section.
- (3) An index represents an adequate benchmark if its provider uses a recognised methodology which generally does not result in the exclusion of a major issuer of the market to which it refers.
- (4) An index is published in an appropriate manner if:
 - (a) it is accessible to the public;
 - (b) the index provider is independent from the index-replicating *UCITS scheme*; this does not preclude index providers and the *UCITS scheme* from forming part of the same *group*, provided that effective arrangements for the management of conflicts of interest are in place.

[Note: articles 12(2),(3) and (4) of the *UCITS eligible assets Directive*]

Disclosure requirements in relation to UCITS schemes that employ particular investment strategies

5.2.34

G

- (1) *Authorised fund managers* of *UCITS schemes* should bear in mind that where a *UCITS scheme* employs particular investment strategies such as those in (2), ■ COBS 4.13.2R (Marketing communications relating to UCITS schemes) and ■ COBS 4.13.3R (Marketing communications relating to a feeder UCITS) contain additional disclosure requirements in relation to marketing communications that concern those investment strategies.
- (2) Examples of investment strategies that require these additional disclosures include a *scheme*:
 - (a) investing more than 35% in value of its *scheme property* in *transferable securities* or *approved money-market instruments* specified in ■ COLL 5.2.12R (Spread: government and public securities); or
 - (b) investing principally in *units* in *collective investment schemes*, *deposits* or *derivatives*; or
 - (c) replicating an index.

Guidance on syndicated loans

5.2.35

G

- (1) A syndicated loan for the purposes of this *guidance* means a form of loan where a group or syndicate of parties lend *money* to a third party and, in return, receive interest payments during the life of the debt and a return of principal either at the end of the loan period or amortised over the life of the loan. Such loans are usually arranged through agent banks which may, among other things, maintain a record of the lenders' interest in the loan and arrange or act as a conduit for the interest payments. Whether an interest in a syndicated loan constitutes a *transferable security* or otherwise will depend on the terms of the relevant instrument. Where an *authorised fund manager* plans to invest *scheme property* in interests in such syndicated loans, it may wish to consider seeking professional advice as to their eligibility.

- (2) To determine whether an interest in a syndicated loan would be an eligible investment for a *UCITS scheme* in accordance with ■ COLL 5.2, an *authorised fund manager* should first consider whether it constitutes a *transferable security* within the meaning of ■ COLL 5.2.7 R (Transferable securities) and ■ COLL 5.2.7AR (which implemented the additional eligibility criteria arising out of the *UCITS eligible assets Directive* that relate to liquidity, valuations and negotiability).
- (3) A *UCITS scheme* cannot lend money from its *scheme property*. Accordingly, it is unable to partake in the initial funding of a syndicated loan either as an original lender or as a person who becomes a lender as part of the primary syndication of the loan. However, we recognise that a *UCITS scheme* may be acknowledged as the lender of record as a consequence of the legal form of transfer used to purchase a loan in the secondary market, such as novation.
- (4) An instrument will not be a *transferable security* if it falls within one or more of the exclusions set out in article 77(2) of the *Regulated Activities Order*. An instrument acknowledging or creating indebtedness for, or for money borrowed to defray, the consideration payable under a contract for the supply of goods or services would be an example of an exclusion.
- (5) In the *FCA's* opinion, for an instrument to be classed as a *debenture* for the purposes of constituting a *transferable security* (see ■ COLL 5.2.7 R (1)(b)), there must be an instrument creating or evidencing indebtedness. A facilities agreement and a drawdown request which does not create or evidence indebtedness will not be a *debenture* for these purposes.
- (6) In the *FCA's* view, the simple fact that a debt obligation is legally transferable (whether by way of creation, assignment or otherwise) does not necessarily make it negotiable for the purposes of ■ COLL 5.2.7AR (1)(e) (Investment in transferable securities), so as to make it a permissible investment for a *UCITS scheme*. When *securities* are capable of being traded on a capital market, whether *on-exchange* or *off-exchange*, as a class and are fungible within their class, this would tend to indicate (unless the *AFM* was aware of specific evidence to the contrary) that they are negotiable.
- (7) The *FCA's* understanding is that leveraged loans are a non-investment grade sub-set of syndicated loans and, where this is the case, *AFMs* should use similar analysis to determine whether or not interests in such loans are eligible investments for *UCITS schemes*.
- (8) Where a loan falls within the *Glossary* definition of a *transferable security*, investment in such a loan in the case of a *UCITS scheme* is subject to the spread requirements in ■ COLL 5.2.11 R (Spread: general). *AFMs* also need to bear in mind that where such a *transferable security* does not meet the requirements of ■ COLL 5.2.8 R (3) (Transferable securities and money-market instruments generally to be admitted to or dealt in on an eligible market), the *scheme's* overall exposure to such loans will count towards the limit in ■ COLL 5.2.8 R (4).

ESMA guidelines

5.2.36

G

Authorised fund managers of UCITS schemes are advised that ESMA has issued guidelines which, in accordance with the UCITS implementing Directive, authorised fund managers should comply with in applying the rules in this section in relation to UCITS schemes:

Guidelines concerning eligible assets for investment by UCITS: The classification of hedge fund indices as financial indices (CESR/07-434)

https://www.esma.europa.eu/sites/default/files/library/2015/11/07_434.pdf

Guidelines to competent authorities and UCITS management companies on ETFs and other UCITS issues (ESMA 2012/832)

https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-832en_guidelines_on_etfs_and_other_ucits_issues.pdf

Revision of the provisions on diversification of collateral in ESMA's Guidelines on ETFs and other UCITS issues (ESMA 2014/294).

https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-294_final_report_revision_of_guidelines_etfs_and_other_ucits_issues.pdf



5.3 Derivative exposure

Application

5.3.1 **R** This section applies to an *authorised fund manager* of a *UCITS scheme* and to an *ICVC* which is a *UCITS scheme*.

Introduction

5.3.2 **G** (1) A *scheme* may invest in *derivatives* and forward transactions as long as the exposure to which the *scheme* is committed by that transaction itself is suitably covered from within its *scheme property*. Exposure will include any *initial outlay* in respect of that transaction.

(2) Cover ensures that a *scheme* is not exposed to the risk of loss of property, including *money*, to an extent greater than the net value of the *scheme property*. Therefore, a *scheme* is required to hold *scheme property* sufficient in value or amount to match the exposure arising from a *derivative* obligation to which the *scheme* is committed. This section sets out detailed requirements for cover of a *scheme*.

(3) In accordance with **COLL 5.1.3 R (2)(b)** (Treatment of obligations), cover used in respect of one transaction in *derivatives* or forward transaction should not be used for cover in respect of another transaction in *derivatives* or a forward transaction.

5.3.3 **R** (1) [deleted]
 (2) [deleted]
 (3) [deleted]
 (4) [deleted]
 (5) [deleted]

Cover for investment in derivatives and forward transactions

5.3.3A **R** The *authorised fund manager* of a *UCITS scheme* must ensure that its global exposure relating to *derivatives* and forward transactions held in the *UCITS scheme* does not exceed the net value of the *scheme property*.

[Note: article 51(3) first paragraph of the *UCITS Directive*]

Daily calculation of global exposure

5.3.3B **R** An *authorised fund manager* of a *UCITS scheme* must calculate its global exposure on at least a daily basis.

[Note: article 41(2) of the *UCITS implementing Directive*]

5.3.3C **R** For the purposes of this section, exposure must be calculated taking into account the current value of the underlying assets, the *counterparty risk*, future market movements and the time available to liquidate the positions.

[Note: article 51(3) second paragraph of the *UCITS Directive*]

Guidance on cover

5.3.4 **G** (1) An *authorised fund manager* should note that the scope of **COLL 5.3.3C R** is extended in relation to underwriting commitments by **COLL 5.5.8 R (4)** (General power to accept or underwrite placings).

(2) Property the subject of a transaction under **COLL 5.4** (Stock lending) should not be considered as available for cover unless the *authorised fund manager* has taken reasonable care to determine that it is obtainable (by return or re-acquisition) in time to meet the obligation for which cover is required.

Borrowing

5.3.5 **R** (1) Cash obtained from borrowing, and borrowing which the *authorised fund manager* reasonably regards an *eligible institution* or an *approved bank* to be committed to provide, is not available for cover under **COLL 5.3.3A R** (Cover for investment in derivatives and forward transactions), except if (2) applies.

(2) Where, for the purposes of this section, the *ICVC* or the *depository* for the account of the *AUT* or *ACS* on the instructions of the *authorised fund manager*:

(a) borrows an amount of currency from an *eligible institution* or an *approved bank*; and

(b) keeps an amount in another currency, at least equal to the borrowing for the time being in (a), on *deposit* with the lender (or his agent or nominee);

then this section applies as if the borrowed currency, and not the deposited currency, were part of the *scheme property*.

5.3.6 **R** (1) [deleted]

(2) [deleted]

Calculation of global exposure

5.3.7 **R** An *authorised fund manager* must calculate the global exposure of any *UCITS scheme* it manages either as:

- (1) the incremental exposure and leverage generated through the use of *derivatives* and forward transactions (including embedded *derivatives* as referred to in ■ COLL 5.2.19R (3A) (Derivatives: general)), which may not exceed 100% of the net value of the *scheme property*; or
- (2) the *market risk* of the *scheme property*.

[Note: article 41(1) of the *UCITS implementing Directive*]

5.3.8

R

- (1) An *authorised fund manager* must calculate the global exposure of a *UCITS scheme* by using:
 - (a) the commitment approach; or
 - (b) the value at risk approach.
- (2) An *authorised fund manager* must ensure that the method selected in (1) is appropriate, taking into account:
 - (a) the investment strategy pursued by the *UCITS scheme*;
 - (b) the types and complexities of the *derivatives* and forward transactions used; and
 - (c) the proportion of the *scheme property* comprising *derivatives* and forward transactions.
- (3) Where a *UCITS scheme* employs techniques and instruments including *repo* contracts or *stock lending* transactions in accordance with ■ COLL 5.4 (Stock lending) in order to generate additional leverage or exposure to *market risk*, the *authorised fund manager* must take those transactions into consideration when calculating global exposure.
- (4) For the purposes of (1), value at risk means a measure of the maximum expected loss at a given confidence level over the specific time period.

[Note: articles 41(3) and 41(4) of the *UCITS implementing Directive*]

Commitment approach

5.3.9

R

Where an *authorised fund manager* of a *UCITS scheme* uses the commitment approach for the calculation of global exposure, it must:

- (1) ensure that it applies this approach to all *derivative* and forward transactions (including embedded *derivatives* as referred to in ■ COLL 5.2.19R (3A) (Derivatives: general)), whether used as part of the *scheme's* general investment policy, for the purposes of risk reduction or for the purposes of *efficient portfolio management* in accordance with the *rules* of this chapter; and
- (2) convert each *derivative* or forward transaction into the market value of an equivalent position in the underlying asset of that *derivative* or forward (standard commitment approach).

[Note: articles 42(1) and 42(2) first paragraph of the *UCITS implementing Directive*]

5.3.10

R

- (1) An *authorised fund manager* of a *UCITS scheme* may apply other calculation methods which are equivalent to the standard commitment approach.
- (2) An *authorised fund manager* may take account of netting and hedging arrangements when calculating global exposure of a *UCITS scheme*, where those arrangements do not disregard obvious and material risks and result in a clear reduction in risk exposure.
- (3) Where the use of *derivatives* or forward transactions does not generate incremental exposure for the *UCITS scheme*, the underlying exposure need not be included in the commitment calculation.
- (4) Where the commitment approach is used, temporary borrowing arrangements entered into on behalf of the *UCITS scheme* in accordance with **COLL 5.5.4 R** (General power to borrow) need not form part of the global exposure calculation.

[**Note:** articles 42(2) final paragraph, 42(3), 42(4) and 42(5) of the *UCITS implementing Directive*]

ESMA guidelines

5.3.11

G

Authorised fund managers of *UCITS schemes* are advised that *ESMA* has issued guidelines which, in accordance with the *UCITS implementing Directive*, *authorised fund managers* should comply with in applying the rules in this section in relation to *UCITS schemes*:

Guidelines: Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR/10-788)

https://www.esma.europa.eu/sites/default/files/library/2015/11/10_788.pdf

Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS (ESMA 2012/197)

<https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-197.pdf>

Guidelines to competent authorities and UCITS management companies on ETFs and other UCITS issues (ESMA 2012/832)

https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-832en_guidelines_on_etfs_and_other_ucits_issues.pdf



5.4 Stock lending

Application

- 5.4.1 **R** (1) Subject to (2), this section applies to an *ICVC*, the *depository* of an *authorised fund* and an *authorised fund manager* in any case where the *authorised fund* is a *UCITS scheme* or a *non-UCITS retail scheme*.
- (2) This section does not apply in any case where a *UCITS scheme* or a *non-UCITS retail scheme* is a *regulated money market fund*. The *Money Market Funds Regulation* sets out restrictions in relation to *stock lending* and *repo* contracts that apply in relation to *regulated money market funds*.

- 5.4.1A **G** ■ COLL 6.6B sets out additional *FCA rules* applicable to a *depository* of a *UCITS scheme* in relation to the re-use of *UCITS custodial assets*.

Permitted stock lending

- 5.4.2 **G** (1) This section covers techniques relating to *transferable securities* and *approved money-market instruments* which are used for the purpose of *efficient portfolio management*. It permits the generation of additional income for the benefit of the *authorised fund*, and hence for its investors, by entry into *stock lending* transactions for the account of the *authorised fund*.
- (2) The specific method of *stock lending* permitted in this section is in fact not a transaction which is a loan in the normal sense. Rather it is an arrangement of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992, under which the lender transfers *securities* to the borrower otherwise than by way of *sale* and the borrower is to transfer those *securities*, or *securities* of the same type and amount, back to the lender at a later date. In accordance with good market practice, a separate transaction by way of transfer of assets is also involved for the purpose of providing *collateral* to the "lender" to cover him against the risk that the future transfer back of the *securities* may not be satisfactorily completed.

Stock lending: general

- 5.4.3 **R** (1) An *authorised fund* may only enter into a *stock lending* arrangement or *repo* contract in accordance with the *rules* in this section if the arrangement or contract is:
- (a) for the account of and for the benefit of the *scheme*; and

5.4.4

R

(b) in the interests of its *unitholders*.

(2) An arrangement or contract in (1) is not in the interests of *unitholders* unless it reasonably appears to the *ICVC* or *authorised fund manager* of an *authorised fund* to be appropriate with a view to generating additional income for the *authorised fund* with an acceptable degree of risk.

Stock lending: requirements

(1) An *ICVC*, or the *depository* of an *authorised fund* acting in accordance with the instructions of the *authorised fund manager*, may enter into a *repo* contract, or a *stock lending* arrangement of the kind described in section 263B of the Taxation of Chargeable Gains Act 1992 (without extension by section 263C), but only if:

(a) all the terms of the agreement under which *securities* are to be reacquired by the *depository* for the account of the *ICVC*, *AUT* or *ACS* are in a form which is acceptable to the *depository* and are in accordance with good market practice;

(b) the counterparty is:

(i) an *authorised person*; or

(ii) a *person* authorised by a *Home State regulator*; or

(iii) a *person* registered as a broker-dealer with the Securities and Exchange Commission of the United States of America; or

(iv) a bank, or a branch of a bank, supervised and authorised to deal in investments as principal, with respect to *OTC derivatives* by at least one of the following federal banking supervisory authorities of the United States of America:

(A) the Office of the Comptroller of the Currency;

(B) the Federal Deposit Insurance Corporation; and

(C) the Board of Governors of the Federal Reserve System; and

(D) [deleted]

(c) high quality and liquid *collateral* is obtained to secure the obligation of the counterparty under the terms referred to in (a) and the *collateral* is:

(i) acceptable to the *depository*;

(ii) adequate; and

(iii) sufficiently immediate.

(2) The counterparty for the purpose of (1) is the *person* who is obliged under the agreement referred to in (1)(a) to transfer to the *depository* the *securities* transferred by the *depository* under the *stock lending* arrangement or *securities* of the same kind.

(3) (1)(c) does not apply to a *stock lending* transaction made through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme.

Stock lending: treatment of collateral

5.4.5

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Where a *stock lending* arrangement is entered into, the *scheme property* remains unchanged in terms of value. The *securities* transferred cease to be part of the *scheme property*, but there is obtained in return an obligation on the part of the counterparty to transfer back equivalent *securities*. The *depository* will also receive *collateral* to set against the risk of default in transfer, and that *collateral* is equally irrelevant to the valuation of the *scheme property* (because it is transferred against an obligation of equivalent value by way of re-transfer). ■ COLL 5.4.6 R accordingly makes provision for the treatment of the *collateral* in that context.

Treatment of collateral

5.4.6

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- (1) *Collateral* is adequate for the purposes of this section only if it is:
- (a) transferred to the *depository* or its agent;
 - (aa) for a *UCITS scheme*, received under a title transfer arrangement;
 - (ab) for a *UCITS scheme*, at all times equal in value to the market value of the *securities* transferred by the *depository* plus a premium;
 - (b) for a *non-UCITS retail scheme*, at all times at least equal in value to the value of the *securities* transferred by the *depository*; and
 - (c) for a *non-UCITS retail scheme*, in the form of one or more of:
 - (i) cash; or
 - (ii) [deleted]
 - (iii) a certificate of *deposit*; or
 - (iv) a letter of *credit*; or
 - (v) a *readily realisable security*; or
 - (vi) commercial paper with no embedded *derivative* content; or
 - (vii) a *qualifying money market fund*.

(1A) Where the *collateral* is invested in *units* in a *qualifying money market fund* managed or operated by (or, for an *ICVC*, whose *ACD* is) the *authorised fund manager* of the investing *scheme* or an *associate* of that *authorised fund manager*, the conditions in ■ COLL 5.2.16 R (Investment in other group schemes) must be complied with whether or not the investing *scheme* is a *UCITS scheme* or a *non-UCITS retail scheme*.

- (2) *Collateral* is sufficiently immediate for the purposes of this section if:
- (a) it is transferred before or at the time of the transfer of the *securities* by the *depository*; or
 - (b) the *depository* takes reasonable care to determine at the time referred to in (a) that it will be transferred at the latest by the close of business on the *day* of the transfer.
- (3) The *depository* must ensure that the value of the *collateral* at all times meets the requirement of either (1)(ab) or (1)(b), as appropriate.

- (4) The duty in (3) may be regarded as satisfied in respect of *collateral* the validity of which is about to expire or has expired where the *depository* takes reasonable care to determine that sufficient *collateral* will again be transferred at the latest by the close of business on the *day* of expiry.
- (5) Any agreement for transfer at a future date of *securities* or of *collateral* (or of the equivalent of either) under this section may be regarded, for the purposes of valuation under ■ COLL 6.3 (Valuation and pricing) or this chapter, as an unconditional agreement for the *sale* or transfer of property, whether or not the property is part of the property of the *authorised fund*.
- (6) *Collateral* transferred to the *depository* is part of the *scheme property* for the purposes of the *rules* in this sourcebook, except in the following respects:
 - (a) it does not fall to be included in any valuation for the purposes of ■ COLL 6.3 or this chapter, because it is offset under (5) by an obligation to transfer; and
 - (b) it does not count as *scheme property* for any purpose of this chapter other than this section.
- (7) Paragraph (5) and (6)(a) do not apply to any valuation of *collateral* itself for the purposes of this section.

5.4.6A

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As regards the *collateral* adequacy of a *UCITS scheme* and restrictions on *collateral* that take the form of cash for a *UCITS scheme*, *authorised fund managers* are referred to paragraph 43 of the *ESMA Guidelines* to competent authorities and *UCITS* management companies on *ETFs* and other *UCITS* issues (ESMA 2012/832)

https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-832en_guidelines_on_etfs_and_other_ucits_issues.pdf

Revision of the provisions on diversification of *collateral* in *ESMA's Guidelines* on *ETFs* and other *UCITS* issues (ESMA 2014/294)

https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-294_final_report_revision_of_guidelines_etfs_and_other_ucits_issues.pdf

Limitation by value

5.4.7

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There is no limit on the value of the *scheme property* which may be the subject of *repo* contracts or *stock lending* transactions within this section.

Guidance relating to the use of cash collateral

5.4.8

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- (1) The use of *stock lending* or the reinvestment of cash collateral should not result in a change of the *scheme's* declared investment objectives or add substantial supplementary risks to the *scheme's* risk profile.
- (2) Collateral taking the form of cash may only be invested in:
 - (a) one of the investments coming within ■ COLL 5.4.6 R (1) (c) (iii) to ■ (vii) (Treatment of collateral); or
 - (b) *deposits*, provided they:

- (i) are capable of being withdrawn within five *business days*, or such shorter time as may be dictated by the *stock lending* agreement; and
- (ii) satisfy the requirements of ■ COLL 5.2.26 R (1) (Investment in deposits).

5.4.9

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Where a *scheme* generates leverage through the reinvestment of collateral, this should be taken into account in the calculation of the *scheme's* global exposure.

[**Note:** CESR's *UCITS eligible assets guidelines* with respect to article 11 of the *UCITS eligible assets Directive* (part)]

5.4.10

G

Authorised fund managers of UCITS schemes are advised that ESMA has issued guidelines which, in accordance with the *UCITS implementing Directive*, *authorised fund managers* should comply with in applying the rules in this section in relation to *UCITS schemes*:

Guidelines to competent authorities and UCITS management companies on ETFs and other UCITS issues (ESMA 2012/832)

https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-832en_guidelines_on_etfs_and_other_ucits_issues.pdf

Revision of the provisions on diversification of collateral in ESMA's Guidelines on ETFs and other UCITS issues (ESMA 2014/294)

https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-294_final_report_revision_of_guidelines_etfs_and_other_ucits_issues.pdf

5.5 Cash, borrowing, lending and other provisions

Application

- 5.5.1** **R** (1) Subject to (2), this section applies to an *ICVC*, an *ACD*, an *authorised fund manager* of an *AUT* or *ACS*, and a *depository* of an *ICVC*, *AUT* or *ACS*, where such *ICVC*, *AUT* or *ACS* is a *UCITS scheme* as set out in **COLL 5.5.2R** (Table of application).
- (2) Other than **COLL 5.5.3R** and **COLL 5.5.9R**, this section does not apply to an *ICVC*, an *ACD*, an *authorised fund manager* of an *AUT* or *ACS*, or a *depository* of an *ICVC*, *AUT* or *ACS*, where such *ICVC*, *AUT* or *ACS* is a *regulated money market fund*.

Table of application

5.5.2 **R** This table belongs to **COLL 5.5.1 R**.

Rule	<i>ICVC</i>	<i>ACD</i>	<i>Au- thorised fund manager of an AUT or ACS</i>	<i>Depository of an ICVC</i>	<i>Depository of an AUT or ACS</i>
5.5.3R		x	x		
5.5.4R(1) to (3)	x				x
5.5.4R(4)&(5)		x	x		
5.5.4R(6)				x	x
5.5.4R(7)	x	x	x	x	x
5.5.4R(8)	x				
5.5.5R(1) to (3)		x	x		
5.5.6R(1)&(2)	x		x		x
5.5.6R(3)	x				
5.5.7R(1)-(3)	x		x		x
5.5.7R(4)	x			x	x
5.5.8R	x	x	x		
5.5.9R	x			x	x
5.5.10G	x	x	x	x	x

Note: x means "applies"

Cash and near cash

5.5.3

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- (1) Cash and *near cash* must not be retained in the *scheme property* except to the extent that this may reasonably be regarded as necessary in order to enable:
 - (a) the pursuit of the *scheme's* investment objectives; or
 - (b) *redemption* of *units*; or
 - (c) efficient management of the *authorised fund* in accordance with its investment objectives; or
 - (d) other purposes which may reasonably be regarded as ancillary to the investment objectives of the *authorised fund*.
- (2) During the period of the *initial offer* the *scheme property* may consist of cash and *near cash* without limitation.

General power to borrow

5.5.4

R

- (1) The *ICVC* or *depository* of an *AUT* or *ACS* (on the instructions of the *authorised fund manager*) may, in accordance with this *rule* and ■ COLL 5.5.5 R (Borrowing limits), borrow *money* for the use of the *authorised fund* on terms that the borrowing is to be repayable out of the *scheme property*.
- (2) Paragraph (1) is subject to the obligation of the *authorised fund* to comply with any restriction in the *instrument constituting the fund*.
- (3) The *ICVC* or *depository* of an *AUT* or *ACS* may borrow under (1) only from an *eligible institution* or an *approved bank*.
- (4) The *authorised fund manager* must ensure that any borrowing is on a temporary basis and that borrowings are not persistent, and for this purpose the *authorised fund manager* must have regard in particular to:
 - (a) the duration of any period of borrowing; and
 - (b) the number of occasions on which resort is had to borrowing in any period.
- (5) In addition to complying with (4), the *authorised fund manager* must ensure that no period of borrowing exceeds three *months*, whether in respect of any specific sum or at all, without the prior consent of the *depository*.
- (6) The *depository* may only give its consent as required under (5) on such conditions as appear to the *depository* appropriate to ensure that the borrowing does not cease to be on a temporary basis only.
- (7) This *rule* does not apply to "back to back" borrowing under ■ COLL 5.3.5 R (2) (Borrowing).
- (8) An *ICVC* must not issue any *debenture* unless it acknowledges or creates a borrowing that complies with (1) to (6)

Borrowing limits

- 5.5.5 **R**
- (1) The *authorised fund manager* must ensure that the *authorised fund's* borrowing does not, on any *day*, exceed 10% of the value of the *scheme property*.
 - (2) This *rule* does not apply to "back to back" borrowing under ■ COLL 5.3.5 R (2)(Borrowing).
 - (3) In this *rule*, borrowing includes, as well as borrowing in a conventional manner, any other arrangement (including a combination of *derivatives*) designed to achieve a temporary injection of *money* into the *scheme property* in the expectation that the sum will be repaid.
 - (4) [deleted]

- 5.5.5A **G**
- An *authorised fund manager* should ensure when calculating the *authorised fund's* borrowing for ■ COLL 5.5.5R(1) that:
- (1) the figure calculated is the total of all borrowing in all currencies by the *authorised fund*; and
 - (2) long and short positions in different currencies are not netted off against each other.

Restrictions on lending of money

- 5.5.6 **R**
- (1) None of the *money* in the *scheme property* of an *authorised fund* may be lent and, for the purposes of this prohibition, *money* is lent by an *authorised fund* if it is paid to a *person* ("the payee") on the basis that it should be repaid, whether or not by the payee.
 - (2) Acquiring a *debenture* is not lending for the purposes of (1); nor is the placing of *money* on deposit or in a current account.
 - (3) Paragraph (1) does not prevent an *ICVC* from providing an *officer* of the *ICVC* with funds to meet expenditure to be incurred by him for the purposes of the *ICVC* (or for the purposes of enabling him properly to perform his duties as an *officer* of the *ICVC*) or from doing anything to enable an *officer* to avoid incurring such expenditure.

Restrictions on lending of property other than money

- 5.5.7 **R**
- (1) The *scheme property* of an *authorised fund* other than *money* must not be lent by way of deposit or otherwise.
 - (2) Transactions permitted by ■ COLL 5.4 (Stock lending) are not to be regarded as lending for the purposes of (1).
 - (3) The *scheme property* must not be mortgaged.
 - (4) Where transactions in *derivatives* or forward transactions are used for the account of the *authorised fund* in accordance with any of the *rules* in this chapter, nothing in this *rule* prevents the *ICVC* or the

depository at the request of the *ICVC*, or the *depository* of an *AUT* or *ACS* at the request of the *authorised fund manager*, from:

- (a) lending, depositing, pledging or charging *scheme property* for *margin* requirements; or
- (b) transferring *scheme property* under the terms of an agreement in relation to *margin* requirements, provided that the *authorised fund manager* reasonably considers that both the agreement and the *margin* arrangements made under it (including in relation to the level of *margin*) provide appropriate protection to *unitholders*.

5.5.7A

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An agreement providing appropriate protection to *unitholders* for the purposes of ■ COLL 5.5.7 R (4)(b) includes one made in accordance with the 1995 International Swaps and Derivatives Association Credit Support Annex (English Law) to the International Swaps and Derivatives Association Master Agreement.

General power to accept or underwrite placings

5.5.8

R

- (1) Any power in this chapter to invest in *transferable securities* may be used for the purpose of entering into transactions to which this *rule* applies, subject to compliance with any restriction in the *instrument constituting the fund*.
- (2) This *rule* applies to any agreement or understanding which:
 - (a) is an underwriting or sub-underwriting agreement; or
 - (b) contemplates that *securities* will or may be issued or subscribed for or acquired for the account of the *authorised fund*.
- (3) Paragraph (2) does not apply to:
 - (a) an *option*; or
 - (b) a purchase of a *transferable security* which confers a right to:
 - (i) subscribe for or acquire a *transferable security*; or
 - (ii) convert one *transferable security* into another.
- (4) The exposure of an *authorised fund* to agreements and understandings within (2) must, on any *day*, be:
 - (a) covered under ■ COLL 5.3.3A R (Cover for investment in derivatives and forward transactions); and
 - (b) such that, if all possible obligations arising under them had immediately to be met in full, there would be no breach of any limit in this chapter.

Guarantees and indemnities

5.5.9

R

- (1) An *ICVC* or a *depository* for the account of an *authorised fund* must not provide any guarantee or indemnity in respect of the obligation of any *person*.

- (2) None of the *scheme property* of an *authorised fund* may be used to discharge any obligation arising under a guarantee or indemnity with respect to the obligation of any *person*.
- (3) Paragraphs (1) and (2) do not apply to:
 - (a) any indemnity or guarantee given for *margin* requirements where the *derivatives* or forward transactions are being used in accordance with the *rules* in this chapter; and
 - (b) for an *ICVC*:
 - (i) an indemnity falling within the provisions of regulation 62(3) of the *OEIC Regulations* (Exemptions from liability to be void);
 - (ii) an indemnity (other than any provision in it which is void under regulation 62 of the *OEIC Regulations*) given to the *depository* against any liability incurred by it as a consequence of the safekeeping of any of the *scheme property* by it or by anyone retained by it to assist it to perform its function of the safekeeping of the *scheme property*; and
 - (iii) an indemnity given to a *person* winding up a *scheme* if the indemnity is given for the purposes of arrangements by which the whole or part of the property of that *scheme* becomes the first property of the *ICVC* and the *holders* of *units* in that *scheme* become the first *unitholders* in the *ICVC*; and
 - (c) for an *AUT* or *ACS*, an indemnity given to a *person* winding up a body corporate or other *scheme* in circumstances where those assets are becoming part of the *scheme property* by way of a *unitisation*.

Guidance on restricting payments

5.5.10

G

■ COLL 6.7.15 R (Payment of liabilities on transfer of assets) and ■ COLL 6.7.4 R (Payments out of scheme property) contain provisions restricting payments out of *scheme property*.



5.6 Investment powers and borrowing limits for non-UCITS retail schemes

Application

5.6.1

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- (1) Subject to (3), this section applies to the *authorised fund manager* and the *depository* of a *non-UCITS retail scheme* and to an *ICVC* which is a *non-UCITS retail scheme*.
- (2) Where this section contains a reference to a *rule* in any of ■ COLL 5.1 to ■ COLL 5.5, these *rules* and any *rules* to which they refer or any relevant *guidance* should be read as if any reference to a *UCITS scheme* is to a *non-UCITS retail scheme*.
- (3) Other than ■ COLL 5.6.3R(1), ■ 5.6.4AG, ■ 5.6.14R, ■ 5.6.15R, ■ 5.6.22R(2), ■ 5.6.22R(3), ■ 5.6.22R(9) and ■ 5.6.24R, this section does not apply where the *non-UCITS retail scheme* in question is a *regulated money market fund*.

Explanation of ■ COLL 5.6

5.6.2

G

- (1) This section contains *rules* on the types of permitted investments and any relevant limits with which *non-UCITS retail schemes* must comply. These *rules* allow for the relaxation of certain investment and borrowing powers from the requirements applicable to *UCITS schemes*.
- (2) Some examples of the different investment and borrowing powers under the *rules* in this section for *non-UCITS retail schemes* are the power to:
 - (a) invest not more than 10% of the value of *scheme property* in *transferable securities* or money-market instruments issued by any single body;
 - (b) invest in up to 20% in aggregate of the value of the *scheme property* in *transferable securities* which are not *approved securities* and *unregulated schemes*;
 - (c) invest in a wider range of *alternative investment funds*;
 - (d) include gold in the *scheme property* (up to a limit of 10% of the value of the *scheme property*);
 - (e) include immovables in the *scheme property*; and
 - (f) borrow on a non-temporary basis without any specific time limit as to repayment of the borrowing.

Prudent spread of risk

5.6.3

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- (1) An *authorised fund manager* must ensure that, taking account of the investment objectives and policy of the *non-UCITS retail scheme* as stated in its most recently published *prospectus*, the *scheme property* of the *non-UCITS retail scheme* aims to provide a prudent spread of risk
- (1A) For a *feeder NURS*, (1) applies only to the extent that the *feeder NURS* invests in assets other than *units* of its *qualifying master scheme*.
- (2) Subject to (3) and (4), the *rules* in this section relating to spread of investments, including immovables, do not apply until 12 *months* after the later of:
 - (a) the date when the *authorisation order* in respect of the *non-UCITS retail scheme* takes effect; and
 - (b) the date the *initial offer* commenced;

provided that (1) is complied with during such period.
- (3) Subject to (4), the limits in ■ COLL 5.6.19 R do not apply until 24 *months* after the later of:
 - (a) the date when the *authorisation order* in respect of the *non-UCITS retail scheme* takes effect; and
 - (b) the date the *initial offer* commenced;

provided that (1) is complied with during such period.
- (4) The limit in ■ COLL 5.6.19 R (7) relating to immovables which are unoccupied and non-income producing or are in the course of substantial development, redevelopment or refurbishment applies from the later of the date when the *authorisation order* in respect of the *non-UCITS retail scheme* takes effect and the date the *initial offer* period commenced.

Investment powers: general

5.6.4

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- (1) The *scheme property* of a *non-UCITS retail scheme* may, subject to the *rules* in this section, comprise any assets or *investments* to which it is *dedicated*.
- (2) For an *ICVC*, the *scheme property* may also include movable or immovable property that is necessary for the direct pursuit of the *ICVC's* business of investing in those assets or investments.
- (3) The *scheme property* must be invested only in accordance with the relevant provisions in this section that are applicable to that *non-UCITS retail scheme* and within any upper limit specified in this section.

- (4) The *instrument constituting the fund* may restrict the investment powers of a *scheme* further than the relevant restrictions in this section.
- (5) The *scheme property* may only, except where otherwise provided in the *rules* in this section, consist of any one or more of:
 - (a) *transferable securities*;
 - (b) money-market instruments;
 - (c) *units* in *collective investment schemes* permitted under ■ COLL 5.6.10 R (Investment in collective investment schemes);
 - (d) *derivatives* and forward transactions permitted under ■ COLL 5.6.13 R (Permitted transactions (derivatives and forwards));
 - (e) *deposits* permitted under ■ COLL 5.2.26 R (Investment in deposits);
 - (f) immovables permitted under ■ COLL 5.6.18 R (Investment in property) to ■ COLL 5.6.19 R (Investment limits for immovables); and
 - (g) gold up to a limit of 10% in value of the *scheme property*.

5.6.4A

G Investment powers and limits for *non-UCITS retail schemes* that are *regulated money market funds* are set out in the *Money Market Funds Regulation*. Subject to complying with that Regulation, the *instrument constituting the fund* may further restrict:

- (1) the kind of money market instruments in which the *scheme property* may be invested;
- (2) the proportion of the *capital property* of the *non-UCITS retail scheme* to be invested in money market instruments of any description;
- (3) the descriptions of transactions permitted; and
- (4) the borrowing powers of the *non-UCITS retail scheme*.

Eligibility of transferable securities and money-market instruments for investment by a non-UCITS retail scheme.....

5.6.5

R *Transferable securities* and money-market instruments held within a *non-UCITS retail scheme* must:

- (1)
 - (a) be admitted to or *dealt* in on an *eligible* market within ■ COLL 5.2.10 R (Eligible markets: requirements); or
 - (b) be recently issued *transferable securities* which satisfy the requirements for investment by a *UCITS scheme* set out in ■ COLL 5.2.8 R (3)(e); or
 - (c) be *approved money-market instruments* not admitted to or dealt in on an *eligible* market which satisfy the requirements for investment by a *UCITS scheme* set out in ■ COLL 5.2.10A R to ■ COLL 5.2.10C R; or
- (2) subject to a limit of 20% in value of the *scheme property* be:
 - (a) *transferable securities* which are not within (1); or

(b) money-market instruments which are liquid and have a value which can be determined accurately at any time.

5.6.5A **R** *Transferable securities* held within a *non-UCITS retail scheme* must also satisfy the criteria in **COLL 5.2.7A R**, **COLL 5.2.7C R** and **COLL 5.2.7E R** for the purposes of investment by a *UCITS scheme*.

5.6.5B **G** **COLL 5.2.7A R** to **COLL 5.2.7E R** contain *rules* and *guidance* relating to the criteria that need to be satisfied for the purposes of investment in *transferable securities*.

5.6.5C **R** [deleted]

5.6.5D **R** [deleted]

Funds investing in inherently illiquid assets (FIIA)

5.6.5E **G** (1) The *Glossary* definition of a *fund investing in inherently illiquid assets* (or *FIIA*) includes conditions relating to, amongst other things, the investment objectives of such *non-UCITS retail schemes* and the proportion of *scheme property* which is invested in *inherently illiquid assets*.

(2) Examples of such assets include:

- (a) property and real estate;
- (b) *shares* in a *special purpose vehicle* investing in infrastructure projects;
- (c) *shares* issued by a company that are not listed or admitted to trading; and
- (d) *units* in a *property authorised investment fund*.

Valuation

5.6.6 **R** In this section the value of the *scheme property* means the value of the *scheme property* determined in accordance with **COLL 5.2.5 R** (Valuation).

Spread: general

5.6.7 **R** (1) This *rule* does not apply in respect of a *transferable security* or an *approved money-market instrument* to which **COLL 5.6.8R** (Spread: government and public securities) applies.

(2) Not more than 20% in value of the *scheme property* is to consist of *deposits* with a single body.

(3) Not more than 10% in value of the *scheme property* is to consist of *transferable securities* or money-market instruments issued by any single body subject to **COLL 5.6.23 R** (Schemes replicating an index).

- (3A) The limit of 10% in (3) is raised to 25% in value of the *scheme property* in respect of *covered bonds*.
- (4) In applying (3) *certificates representing certain securities* are to be treated as equivalent to the underlying *security*.
- (5) The exposure to any one counterparty in an *OTC derivative* transaction must not exceed 10% in value of the *scheme*.
- (6) Except for a *feeder NURS* or a *scheme dedicated to units* in a single *property authorised investment fund*, not more than 35% in value of the *scheme* is to consist of the *units* of any one *scheme*.
- (6A) *Schemes* which (in respect of investment in *units* in *collective investment schemes*) are *dedicated to units* in a single *property authorised investment fund* or *qualifying master scheme* must, in addition to the investment in the *property authorised investment fund* or *qualifying master scheme*, only hold cash or near cash to maintain sufficient liquidity to enable the *scheme* to meet its commitments, such as *redemptions*. *Schemes* may also use techniques and instruments for the purpose of *efficient portfolio management*, where appropriate, such as forward foreign exchange transactions entered into for the purpose of reducing the effect of fluctuations in the rate of exchange between relevant currencies.
- (7) For the purpose of calculating the limit in (5), the exposure in respect of an *OTC derivative* may be reduced to the extent that collateral is held in respect of it if the collateral meets each of the conditions specified in (8).
- (8) The conditions referred to in (7) are that the collateral:
 - (a) is marked-to-market on a daily basis and exceeds the value of the amount at risk;
 - (b) is exposed only to negligible risks (e.g. government bonds of first credit rating or cash) and is liquid;
 - (c) is held by a third party custodian not related to the provider or is legally secured from the consequences of a failure of a related party; and
 - (d) can be fully enforced by the *non-UCITS retail scheme* at any time.
- (9) For the purpose of calculating the limit in (5), *OTC derivative* positions with the same counterparty may be netted provided that the netting procedures:
 - (a) comply with the conditions set out in Part Three, Title II, Chapter 6, Section 7(Contractual netting (Contracts for novation and other netting agreements)) of the *UK CRR* and
 - (b) are based on legally binding agreements.
- (10) In applying this rule, all *derivatives* transactions are deemed to be free of counterparty risk if they are performed on an exchange where the clearing house meets each of the following conditions:
 - (a) it is backed by an appropriate performance guarantee; and
 - (b) it is characterised by a daily mark-to-market valuation of the *derivative* positions and an at least daily margining.

- (11) For the purposes of this *rule* a single body is:
- (a) in relation to *transferable securities* and money market instruments, the *person* by whom they are issued; and
 - (b) in relation to *deposits*, the *person* with whom they are placed.

Guidance on spread: general

5.6.7A

G

- (1) ■ COLL 5.6.7 R (7) to ■ (10) replicate the provisions of Article 5 of the Commission Recommendation 2004/383/EC of 27 April 2004 on the use of financial derivative instruments for undertakings for collective investment in transferable securities, so as to enable *non-UCITS retail schemes* to benefit from the same flexibility.
- (2) The attention of *authorised fund managers* is specifically drawn to condition (d) in ■ COLL 5.6.7 R (8) under which the collateral has to be legally enforceable at any time. It is the FCA's view that it is advisable for an *authorised fund manager* to undertake a legal due diligence exercise before entering into any financial collateral arrangement. This is particularly important where the collateral arrangements in question have a cross-border dimension. The *depository* will also need to exercise reasonable care to review the collateral arrangements in accordance with its duties under ■ COLL 6.6.4 R (General duties of the depository).
- (3) In applying the spread limit of 20% in value of *scheme property* which may consist of *deposits* with a single body, all uninvested cash comprising *capital property* that the *depository* holds should be included in calculating the total sum of the *deposits* held by it on behalf of the *scheme*.

Spread: government and public securities

5.6.8

R

- (1) This *rule* applies in respect of a *transferable security* or an *approved money-market instrument* ("such securities") that is issued or guaranteed by:
 - (a) the UK or an EEA State; or
 - (b) a local authority of the UK or an EEA State; or
 - (c) a non-EEA State; or
 - (d) a public international body to which the UK or one or more EEA States belong.
- (2) The requirements in ■ COLL 5.2.12 R (Spread: government and public securities) apply to investment in such *securities* by a *non-UCITS retail scheme*, except for ■ COLL 5.2.12R(3)(d), which applies to such a *scheme* only to the extent that it concerns the most recently published *prospectus* of the *scheme*.

Investment in nil and partly paid securities

5.6.9

R

A *non-UCITS retail scheme* must not invest in nil and partly paid *securities* unless the investment complies with the conditions in ■ COLL 5.2.17 R (Investment in nil and partly paid securities).

Investment in collective investment schemes

5.6.10

R

A *non-UCITS retail scheme*, except for a *feeder NURS* (which must instead comply with ■ COLL 5.6.26 R), must not invest in *units* in a *collective investment scheme* (second *scheme*) unless the second *scheme* meets each of the requirements at (1) to (5):

- (1) the second *scheme*:
 - (a) is a *UCITS scheme* or satisfies the conditions necessary for it to enjoy the rights conferred by the *UCITS Directive* as implemented in the *EEA*; or
 - (b) is a *non-UCITS retail scheme*; or
 - (c) is a *recognised scheme*; or
 - (d) is constituted outside the *United Kingdom* and the investment and borrowing powers of which are the same or more restrictive than those of a *non-UCITS retail scheme*; or
 - (e) is a *scheme* not falling within (a) to (d) and in respect of which no more than 20% in value of the *scheme property* (including any *transferable securities* which are not *approved securities*) is invested;
- (2) the second *scheme* operates on the principle of the prudent spread of risk;
- (3) the second *scheme* is prohibited from having more than 15% in value of the property of that *scheme* consisting of *units* in *collective investment schemes* (unless ■ COLL 5.6.10AR applies);
- (4) the *participants* in the second *scheme* must be entitled to have their *units* redeemed in accordance with the *scheme* at a *price*:
 - (a) related to the net value of the property to which the *units* relate; and
 - (b) determined in accordance with the *scheme*; and
- (5) where the second *scheme* is an *umbrella*, the provisions in (2) to (4) and ■ COLL 5.6.7 R (Spread: general) apply to each *sub-fund* as if it were a separate *scheme*.

Investment in feeder schemes

5.6.10A

R

- (1) A *non-UCITS retail scheme* that is not a *feeder NURS* may, if the conditions in (2) to (5) are met, invest in *units* of:
 - (a) a *feeder UCITS*; or
 - (b) a *feeder NURS*; or
 - (c) a *scheme dedicated to units* in a single *property authorised investment fund*; or
 - (d) a *scheme dedicated to units* in a *recognised scheme*.
- (2) (a) The relevant *master UCITS* must comply with ■ COLL 5.2.13R(2), (3) and (4) as if it were the second *scheme* for the purpose of that *rule*.

- (b) The relevant *qualifying master scheme, property authorised investment fund or recognised scheme* must comply with ■ COLL 5.6.10R(2) to (5) as if it were the second *scheme* for the purpose of that *rule*.
- (3) Not more than 35% in value of the *scheme property* of the *non-UCITS retail scheme* may consist of *units* of one or more *schemes* permitted under (1)(a) to (d).
- (4) The *non-UCITS retail scheme* must not invest directly in *units* of the relevant *master UCITS, qualifying master scheme, property authorised investment fund or recognised scheme*.
- (5) The *authorised fund manager* of the *non-UCITS retail scheme* must be able to show on reasonable grounds that an investment in one or more *schemes* permitted under (1)(a) to (d) is:
 - (a) in the interests of investors; and
 - (b) no less advantageous than if the *non-UCITS retail scheme* had held *units* directly in the relevant:
 - (i) *master UCITS*; or
 - (ii) *qualifying master scheme*; or
 - (iii) *property authorised investment fund*; or
 - (iv) *recognised scheme*.

5.6.10B G When determining whether an investment is no less advantageous for ■ COLL 5.6.10AR(5)(b), an *authorised fund manager* should have regard in particular to:

- (1) the risk profile of the *non-UCITS retail scheme*;
- (2) the total costs borne by the *non-UCITS retail scheme*; and
- (3) the benefits to investors of investing in *units* of one or more *schemes* permitted under ■ COLL 5.6.10AR (1)(a) to (d).

5.6.10C G A *non-UCITS retail scheme* that is a *feeder NURS* is required to comply with ■ COLL 5.6.26R instead of ■ COLL 5.6.10AR.

Investment in associated collective investment schemes

- 5.6.11** R (1) *Units* in a *scheme* do not fall within ■ COLL 5.6.10 R if that *scheme* is managed or operated by (or, if it is an *ICVC*, has as its *ACD*) the *authorised fund manager* of the investing *non-UCITS retail scheme* or by an *associate* of that *authorised fund manager*, unless:
- (a) the *prospectus* of the investing *authorised fund* clearly states that the property of that investing fund may include such *units*; and
 - (b) the conditions in ■ COLL 5.2.16 R (Investment in other group schemes) are complied with.

- (2) Where a *sub-fund* of a *non-UCITS retail scheme* which is an *umbrella* invests in or disposes of *units* in another *sub-fund* of the same *umbrella* (the second *sub-fund*), the requirement in:
 - (a) ■ COLL 5.6.11 R (1)(a) is modified as follows - the *prospectus* of the *umbrella* must clearly state that the *scheme property* attributable to the investing or disposing *sub-fund* may include *units* in another *sub-fund* of the same *umbrella*; and
 - (b) ■ COLL 5.6.11 R (1)(b) is modified as follows - ■ COLL 5.2.16 R (Investment in other group schemes) must be complied with, modified such that references to the "*UCITS scheme*" are taken to be references to the investing or disposing *sub-fund* and references to the "*second scheme*" are taken to be references to the second *sub-fund*.

Derivatives: general

5.6.12

R

- (1) A transaction in *derivatives* or a forward transaction must not be effected for a *non-UCITS retail scheme* unless the transaction is:
 - (a) of a kind specified in ■ COLL 5.6.13 R (Permitted transactions (derivatives and forwards)); and
 - (b) covered, as required by ■ COLL 5.3.3A R (Cover for investment in derivatives and forward transactions).
- (2) Where a *scheme* invests in *derivatives*, the exposure to the underlying assets must not exceed the limits in ■ COLL 5.6.7 R (Spread: general) and ■ COLL 5.6.8 R (Spread: government and public securities) except as provided in (4).
- (3) Where a *transferable security* or money-market instrument embeds a *derivative*, this must be taken into account for the purposes of calculating any limit in this section.
- (4) Where a *scheme* invests in an index-based *derivative*, provided the relevant index falls within ■ COLL 5.6.23 R (Schemes replicating an index) the underlying constituents of the index do not have to be taken into account for the purposes of ■ COLL 5.6.7 R and ■ COLL 5.6.8 R.
- (5) The relaxation in (4) is subject to the *authorised fund manager* taking account of ■ COLL 5.6.3 R (Prudent spread of risk).

Permitted transactions (derivatives and forwards)

5.6.13

R

- (1) A transaction in a *derivative* must be within ■ COLL 5.2.20 R (1) (Permitted transactions (derivatives and forwards)) and:
 - (a) the underlying must be within ■ COLL 5.6.4 R (5) (Investment powers: general) or ■ COLL 5.2.20R (2)(f) to ■ (i); and
 - (b) the exposure to the underlying must not exceed the limits in ■ COLL 5.6.7 R (Spread: general), ■ COLL 5.6.8 R (Spread: government and public securities) and ■ COLL 5.6.5 R (2).
- (2) A transaction in an *approved derivative* must be effected on or under the rules of an *eligible derivatives* market.

- (3) A transaction in a *derivative* must not cause a *scheme* to diverge from its investment objectives as stated in the *instrument constituting the fund* and the most recently published *prospectus*.
- (4) transaction in a *derivative* must not be effected if the intended effect is to create the potential for an uncovered sale of:
 - (a) *transferable securities*;
 - (b) money-market instruments;
 - (c) *units in collective investment schemes*; or
 - (d) *derivatives*.
- (5) Any forward transaction must be made with an *eligible institution* or an *approved bank*.
- (6) The *authorised fund manager* must ensure compliance with ■ COLL 5.3.3A R (Cover for investment in derivatives and forward transactions), ■ COLL 5.3.3B R and ■ COLL 5.3.3C R (Daily calculation of global exposure).

Transactions for the purchase or disposal of property

5.6.14 **R** The requirements of ■ COLL 5.2.21 R (Transactions for the purchase of property) and ■ COLL 5.2.22 R (Requirement to cover sales) apply to *non-UCITS retail schemes* in the same manner as to *UCITS schemes*.

OTC transactions in derivatives

5.6.15 **R** Any transaction in an *OTC derivative* under ■ COLL 5.6.13 R (Permitted transactions (derivatives and forwards)) must comply with the requirements of ■ COLL 5.2.23 R (OTC transactions in derivatives).

Risk management

5.6.16 **R** An *authorised fund manager* must use a risk management process enabling it to monitor and measure as frequently as appropriate the risk associated with a *non-UCITS retail scheme's* positions and their contribution to the overall risk profile of the *scheme*.

Risk management process

- 5.6.17 **G**
- (1) The risk management process should take account of the investment objectives and policy of the *non-UCITS retail scheme* as stated in its most recent *prospectus*.
 - (2) The *depository* should take reasonable care to review the appropriateness of the risk management process in line with its duties under ■ COLL 6.6.4 R (General duties of the depository) and ■ COLL 6.6.14 R (Duties of the depository and authorised fund manager: investment and borrowing powers), as appropriate.
 - (3) An *authorised fund manager* is expected to demonstrate more sophistication in its risk management process for a *non-UCITS retail scheme* with a complex risk profile than for one with a simple risk profile. In particular, the risk management process should take

account of any characteristic of non-linear dependence in the value of a position to its underlying.

- (4) An *authorised fund manager* should take reasonable care to establish and maintain such systems and controls as are appropriate to its business as required by ■ SYSC 4.1 (General requirements).
- (5) The risk management process should enable the analysis required by ■ COLL 5.6.16 R (Risk management) to be undertaken at least daily or at each *valuation point* whichever is the more frequent.

Investment in property

5.6.18

R

- (1) Any investment in land or a building held within the *scheme property* of a *non-UCITS retail scheme* must be an immovable within (2) to (5).
- (2) An immovable must:
 - (a) be situated in a country or territory identified in the *prospectus* for the purpose of this *rule*; and
 - (b) if situated in:
 - (i) England and Wales or Northern Ireland, be a freehold or leasehold interest; or
 - (ii) Scotland, be any interest or estate in or over land or heritable right including a long lease; or
 - (c) if not situated in the jurisdictions referred to in (b)(i) or (ii), be equivalent to any of the interests in (b)(i) or (ii) or, if no such equivalent interest is available in the jurisdiction, be an interest that grants beneficial ownership of the immovable to the *scheme* and provides as good a title as any of the interests in (b)(i) or (ii).
- (3) The *authorised fund manager* must have taken reasonable care to determine that the title to the immovable is a good marketable title.
- (4) The *authorised fund manager* of an *AUT* or *ACS* or the *ICVC* must:
 - (a) have received a report from an *appropriate valuer* which:
 - (i) contains a valuation of the immovable (with and without any relevant subsisting mortgage); and
 - (ii) states that in the *appropriate valuer's* opinion the immovable would, if acquired by the *scheme*, be capable of being disposed of reasonably quickly at that valuation; or
 - (b) have received a report from an *appropriate valuer* as required by (4)(a)(i) and stating that:
 - (i) the immovable is adjacent to or in the vicinity of another immovable included in the *scheme property* or is another legal interest as defined in (2)(b) or (c) in an immovable which is already included in the *scheme property*; and
 - (ii) in the opinion of the *appropriate valuer*, the total value of both immovables would at least equal the sum of the price payable for the immovable and the existing value of the other immovable.
- (5) An immovable must:

- (a) be bought or be agreed by enforceable contract to be bought within six *months* after receipt of the report of the *appropriate valuer* under (4);
 - (b) not be bought, if it is apparent to the *authorised fund manager* that the report in (a) could no longer reasonably be relied upon; and
 - (c) not be bought at more than 105% of the valuation for the relevant immovable in the report in (4).
- (6) Any furniture, fittings or other contents of any building may be regarded as part of the relevant immovable.
- (7) An *appropriate valuer* must be a *person* who:
- (a) has knowledge of and experience in the valuation of immovables of the relevant kind in the relevant area;
 - (b) is qualified to be a *standing independent valuer* of a *non-UCITS retail scheme* or is considered by the *scheme's standing independent valuer* to hold an equivalent qualification;
 - (c) is independent of the *ICVC*, the *depository* and each of the *directors* of the *ICVC* or of the *authorised fund manager* and *depository* of the *AUT* or *ACS*; and
 - (d) has not engaged himself or any of his *associates* in relation to the finding of the immovable for the *scheme* or the finding of the *scheme* for the immovable.

Investment in overseas property through an intermediate holding vehicle

5.6.18A

R

- (1) An overseas immovable may be held by a *scheme* through an *intermediate holding vehicle* whose purpose is to enable the holding of immovables by the *scheme* or a series of such *intermediate holding vehicles*, provided that the interests of *unitholders* are adequately protected. Any investment in an *intermediate holding vehicle* for the purpose of holding an overseas immovable shall be treated for the purposes of this chapter as if it were a direct investment in that immovable.
- (2) An *intermediate holding vehicle* must be wholly owned by the *scheme* or another *intermediate holding vehicle* or series of *intermediate holding vehicles* wholly owned by the *scheme*, unless and to the extent that local legislation or regulation relating to the *intermediate holding vehicle* holding the immovable requires a proportion of local ownership.

5.6.18B

G

- (1) The *authorised fund manager* may transfer capital and income between an *intermediate holding vehicle* and the *scheme* by the use of inter-company debt if the purpose of this is for investment in immovables and repatriation of income generated by such investment. In using inter-company debt, the *authorised fund manager* should ensure the following:
 - (a) a record of inter-company debt is kept in order to provide an accurate audit trail; and

- (b) interest paid out on the debt instruments is equivalent to the net rental income earned from the immovables after deduction of the *intermediate holding vehicle's* reasonable running costs (including tax).
- (2) An *intermediate holding vehicle* should undertake the purchase, sale and management of immovables on behalf the *scheme* in accordance with the *scheme's* investment objectives and policy.
- (3) Wherever reasonably practicable, an *intermediate holding vehicle* should have the same auditor and accounting reference date as the *scheme*.
- (4) The accounts of any *intermediate holding vehicle* should be consolidated into the annual and interim reports of the *scheme*.
- (5) The *authorised fund manager* should provide sufficient information to enable the *depository* to fulfil its duties under *COLL* in relation to the immovables held through an *intermediate holding vehicle*.

Investment limits for immovables

5.6.19

R

The following limits apply in respect of immovables held as part of *scheme property of a scheme*:

- (1) not more than 15% in value of the *scheme property* is to consist of any one immovable;
- (2) in (1), immovables within ■ COLL 5.6.18 R (4) (b) (Investment in property) must be regarded as one immovable;
- (3) the figure of 15% in (1) may be increased to 25% once the immovable has been included in the *scheme property* in compliance with (1);
- (4) the income receivable from any one *group* in any accounting period must not be attributable to immovables comprising:
 - (a) more than 25%; or
 - (b) in the case of a government or public body more than 35% of the value of the *scheme property*;
- (5) not more than 20% in value of the *scheme property* is to consist of immovables that are subject to a mortgage and any mortgage must not secure more than 100% of the value in ■ COLL 5.6.18 R (4) (on the assumption the immovable is not mortgaged);
- (6) the aggregate value of:
 - (a) mortgages secured on immovables under (5);
 - (b) borrowing of the *scheme* under ■ COLL 5.6.22 R (5); and
 - (c) any *transferable securities* that are not *approved securities*;
 must not at any time exceed 20% of the value of the *scheme property*;

- (7) not more than 50% in value of the *scheme property* is to consist of immovables which are unoccupied and non-income producing or in the course of substantial development, redevelopment or refurbishment; and
- (8) no option may be granted to a third party to buy any immovable comprised in the *scheme property* unless the value of the relevant immovable does not exceed 20% of the value of the *scheme property* together with, where appropriate, the value of investments in:
 - (a) *unregulated collective investment schemes*; and
 - (b) any *transferable securities* which are not *approved securities*.

Standing independent valuer and valuation

5.6.20

R

- (1) The following requirements apply in relation to the appointment of a valuer:
 - (a) the *authorised fund manager* must ensure that any immovables in the *scheme property* are valued by an *appropriate valuer (standing independent valuer)* appointed by the *authorised fund manager*; and
 - (b) the appointment must be made with the approval of the *depository* at the outset and upon any vacancy.
- (2) The standing independent valuer in (1) must be:
 - (a) for an *AUT* or *ACS*, independent of the *authorised fund manager* and *depository*; and
 - (b) for an *ICVC*, independent of the *ICVC*, the *directors* and the *depository*.
- (3) The following requirements apply in relation to the functions of the *standing independent valuer*:
 - (a) the *authorised fund manager* must ensure that the *standing independent valuer* values all the immovables held within the *scheme property*, on the basis of a full valuation with physical inspection (including, where the immovable is or includes a building, internal inspection), at least once a year;
 - (b) for the purposes of (a) any inspection in relation to adjacent properties of a similar nature may be limited to that of only one such representative property;
 - (c) the *authorised fund manager* must ensure that the *standing independent valuer* values the immovables, on the basis of a review of the last full valuation, at least once a *month*;
 - (d) if either the *authorised fund manager* or the *depository* becomes aware of any matters that appear likely to:
 - (i) affect the outcome of a valuation of an immovable; or
 - (ii) cause the valuer to decide to value under (a) instead of under (c);
 it must immediately inform the *standing independent valuer* of that matter;

- (e) the *authorised fund manager* must use its best endeavours to ensure that any other *affected person* reports to the *standing independent valuer* immediately upon that *person* becoming aware of any matter within (d); and
- (f) any valuation by the *standing independent valuer* must be undertaken in accordance with UKVPS 3 and 2.3 of UKVPGA of the RICS Valuation – Global Standards 2017, UK national supplement 2018 (the RICS Red Book) or, in the case of overseas immovables, on an appropriate basis but subject to ■ COLL 6.3 (Valuation and pricing).

(4) In relation to an immovable:

- (a) any valuation under ■ COLL 6.3 (Valuation and pricing) has effect, until the next valuation under that *rule*, for the purposes of the value of immovables; and
- (b) an agreement to transfer an immovable or an interest in an immovable is to be disregarded for the purpose of the valuation of the *scheme property* unless it reasonably appears to the *authorised fund manager* to be legally enforceable.

5.6.20A **G** In considering whether a valuation of overseas immovables by the *standing independent valuer* is made on an appropriate basis for the purpose of ■ COLL 5.6.20 R (3) (f), the *authorised fund manager* should consider whether that valuation was made in accordance with internationally accepted valuation principles, procedures and definitions as set out in the International Valuation Standards published by the International Valuation Standards Committee.

Stock lending

5.6.21 **R** A *non-UCITS retail scheme* may undertake *stock lending* in accordance with ■ COLL 5.4 (Stock lending).

Cash, borrowing, lending and other provisions

5.6.22 **R** The following *rules* in Chapter 5 apply to a *non-UCITS retail scheme*:

- (1) ■ COLL 5.2.7 R (Transferable securities);
- (2) ■ COLL 5.5.1 R (Application) and ■ COLL 5.5.2 R (Table of application);
- (3) ■ COLL 5.5.3 R (Cash and near cash);
- (4) ■ COLL 5.5.4 R (1), ■ COLL 5.5.4 R (2), ■ COLL 5.5.4 R (3) and ■ COLL 5.5.4 R (8) (General power to borrow);
- (5) ■ COLL 5.5.5 R (1) and ■ COLL 5.5.5 R (2) (Borrowing limits);
- (6) ■ COLL 5.5.6 R (Restrictions on lending of money) ;
- (7) ■ COLL 5.5.7 R (1), ■ (2) and ■ (4) (Restrictions on lending of property other than money);

- (8) ■ COLL 5.5.8 R (General power to accept or underwrite placings); and
- (9) ■ COLL 5.5.9 R (Guarantees and indemnities).

Schemes replicating an index

5.6.23

R

- (1) A *non-UCITS retail scheme* may invest up to 20% in value of the *scheme property* in *shares* and *debentures* which are issued by the same body where the aim of the investment policy of that *scheme* as stated in its most recently published *prospectus* is to replicate the performance or composition of an index within (2).
- (2) The index must:
 - (a) have a sufficiently diversified composition;
 - (b) be a representative benchmark for the market to which it refers; and
 - (c) be published in an appropriate manner.
- (3) The limit in (1) may be raised for a particular *scheme* up to 35% in value of the *scheme property*, but only in respect of one body and where justified by exceptional market conditions.

5.6.23A

G

- (1) Replication of the composition of an index shall be understood to be a reference to replication of the composition of the underlying assets of that index, including the use of techniques and instruments for the purpose of *efficient portfolio management*.
- (2) The composition of an index is sufficiently diversified if its components adhere to the spread requirements in this section.
- (3) An index is a representative benchmark if its provider uses a recognised methodology which generally does not result in the exclusion of a major issuer of the market to which it refers.
- (4) An index is published in an appropriate manner if:
 - (a) it is accessible to the public;
 - (b) the index provider is independent from the index-replicating *scheme*; this does not preclude index providers and the *scheme* from forming part of the same *group*, provided that effective arrangements for the management of conflicts of interest are in place.

Non-UCITS retail schemes that are umbrellas

5.6.24

R

- (1) In relation to a *scheme* which is an *umbrella*, the provisions in this section apply to each *sub-fund* as they would for a *non-UCITS retail scheme*.
- (2) A *sub-fund* may invest in or dispose of *units* of another *sub-fund* of the same *umbrella* (the second *sub-fund*) only if the following conditions are satisfied:
 - (a) the second *sub-fund* does not hold *units* in any other *sub-fund* of the same *umbrella*;

- (b) the conditions in ■ COLL 5.2.16 R (Investment in other group schemes) and ■ COLL 5.6.11 R (Investment in associated collective investment schemes) are complied with (for the purposes of this rule, ■ COLL 5.2.16 R and ■ COLL 5.6.11 R are to be read as modified by ■ COLL 5.6.11 R (2));
- (c) not more than 35% in value of the investing or disposing *sub-fund* is to consist of *units* of the second *sub-fund*; and
- (d) the investing or disposing *sub-fund* must not be a *feeder NURS* to the second *sub-fund*.

Guidance on syndicated loans

5.6.25

G

- (1) ■ COLL 5.2.35 G (Guidance on syndicated loans) is equally applicable to investment by a *non-UCITS retail scheme* in a syndicated loan.
- (2) Where a loan falls within the *Glossary* definition of a *transferable security*, investment in such a loan in the case of a *non-UCITS retail scheme* is subject to the spread requirements in ■ COLL 5.6.7 R (Spread: general). *AFMs* also need to bear in mind that where such a *transferable security* does not meet the requirements of ■ COLL 5.6.5 R (1) (Eligibility of transferable securities and money-market instruments for investment by a *non-UCITS retail scheme*), the *scheme's* overall exposure to such loans will count towards the limit in ■ COLL 5.6.5 R (2).

Qualifying collective investment schemes for feeder NURS

5.6.26

R

The *authorised fund manager* of a *feeder NURS* must ensure that the *feeder NURS* does not invest in the *qualifying master scheme*, unless the *qualifying master scheme* meets the requirements in (1) to (3):

- (1) the *qualifying master scheme*:
 - (a) is a *UCITS scheme* or satisfies the conditions necessary for it to enjoy the rights conferred by the *UCITS Directive* as implemented in the *EEA*; or
 - (b) is a *recognised scheme*; or
 - (c) is a *non-UCITS retail scheme*;
- (2) where the *qualifying master scheme* is an *umbrella*, the provisions in ■ COLL 5.6.7 R (Spread: general) apply to each *sub-fund* as if it were a separate *scheme*; and
- (3) the *qualifying master scheme*:
 - (a) is not:
 - (i) a *feeder UCITS* or an *EEA UCITS scheme* or a *sub-fund* of an *EEA UCITS scheme* which has been approved by the *overseas regulator* of the *UCITS Home State* to invest at least 85% of its assets in the units of a single *EEA master UCITS*; or
 - (ii) a *feeder NURS*; or
 - (iii) otherwise *dedicated* to *units* in a single *collective investment scheme*; and
 - (b) does not hold *units* in:

- (i) a *feeder UCITS* or an *EEA UCITS scheme* or a *sub-fund* of an *EEA UCITS scheme* which has been approved by the overseas regulator of the *UCITS Home State* to invest at least 85% of its assets in the *units* of a single *EEA master UCITS*; or
- (ii) a *feeder NURS*; or
- (iii) a *scheme otherwise dedicated to units* in a single *collective investment scheme*.

5.6.27

R

An *EEA UCITS scheme* that is not a *recognised scheme* is not a *qualifying master scheme* for ■ COLL 5.6.26R(3) for a *pension feeder fund* that is a *feeder NURS*.



5.7 Investment powers and borrowing limits for NURS operating as FAIFs

Application

5.7.1

R

- (1) This section applies to the *authorised fund manager* and the *depository* of a *non-UCITS retail scheme* operating as a *FAIF* and to an *ICVC* which is a *non-UCITS retail scheme* operating as a *FAIF*.
- (2) Where this section refers to:
 - (a) a *rule* or *guidance* in ■ COLL 5.1 to ■ COLL 5.6, these *rules* and *guidance*, and any *rules* and *guidance* to which they refer, must be read as if a reference to a *UCITS scheme* or *non-UCITS retail scheme* were a reference to a *non-UCITS retail scheme* operating as a *FAIF*;
 - (b) a second *scheme*, and the second *scheme* is a *feeder scheme* which (in respect of investment in *units* in *collective investment schemes*) is *dedicated* to *units* in a single *collective investment scheme*, the reference in this section to the second *scheme* must be read as if it were a reference to any *scheme* into which the *feeder scheme's* master *scheme* invests; and
 - (c) a second *scheme*, and the second *scheme* is a *master scheme* to which (in respect of investment in *units* in *collective investment schemes*) the relevant *non-UCITS retail scheme* operating as a *FAIF* is *dedicated*, the reference in this section to the second *scheme* must be read as if it were a reference to any *scheme* into which that master *scheme* invests.

Purpose

5.7.2

G

- (1) This section contains *rules* on the types of permitted investments and any relevant limits with which *non-UCITS retail schemes* operating as *FAIFs* must comply. These *rules* allow for the relaxation of certain investment and borrowing powers from the requirements for *non-UCITS retail schemes* under ■ COLL 5.6 .
- (2) One example of the different investment and borrowing powers under the *rules* in this section for *non-UCITS retail schemes* operating as *FAIFs* is the power to invest up to 100% of the value of the *scheme property* in *schemes* to which ■ COLL 5.7.7 R (Investment in collective investment schemes) applies. A *non-UCITS retail scheme* operating as a *FAIF* is not able to hold more than 50% of its *scheme property* in *units* of *long-term asset funds* unless it operates *limited redemption arrangements* in accordance with ■ COLL 5.7.7R(3)(c) (Investment in

collective investment schemes) and ■ COLL 6.2.19R (Limited redemption).

- (3) In order to ensure adequate *unitholder* protection, the *authorised fund manager* is required to implement certain due diligence procedures in respect of investment in second *schemes*.

Applicable rules in COLL 5.6

5.7.3

R

The following *rules* and *guidance* in ■ COLL 5.6 (Investment powers and borrowing limits for non-UCITS retail schemes) apply to the *authorised fund manager* and the *depository* of a *non-UCITS retail scheme* operating as a *FAIF* and to an *ICVC* which is a *non-UCITS retail scheme* operating as a *FAIF*:

- (1) ■ COLL 5.6.3 R;
- (2) ■ COLL 5.6.5 R to ■ 5.6.6 R;
- (3) ■ COLL 5.6.8 R to ■ 5.6.9 R; and
- (4) ■ COLL 5.6.11 R to ■ 5.6.24 R.

Investment powers: general

5.7.4

R

- (1) The *scheme property* of a *non-UCITS retail scheme* operating as a *FAIF* may, subject to the *rules* in this section, comprise any assets or *investments* to which it is *dedicated*.
- (2) For an *ICVC*, the *scheme property* may also include movable or immovable property that is necessary for the direct pursuit of the *ICVC*'s business of investing in those assets or *investments*.
- (3) The *scheme property* must be invested only in accordance with the relevant provisions in this section that are applicable to that *non-UCITS retail scheme* operating as a *FAIF* and within any upper limit specified in this section.
- (4) The *instrument constituting the fund* may restrict the investment powers of a *scheme* further than the relevant restrictions in this section.
- (5) The *scheme property* may only, except where otherwise provided in the *rules* in this section, consist of any one or more of:
 - (a) *transferable securities*;
 - (b) money market instruments;
 - (c) *units* in *collective investment schemes* permitted under ■ COLL 5.7.7 R (Investment in collective investment schemes);
 - (d) *derivatives* and forward transactions permitted under ■ COLL 5.6.13 R (Permitted transactions (derivatives and forwards));
 - (e) *deposits* permitted under ■ COLL 5.2.26 R (Investment in deposits);

- (f) immovables permitted under ■ COLL 5.6.18 R (Investment in property) to ■ COLL 5.6.19 R (Investment limits for immovables); and
- (g) gold up to a limit of 10% in value of the *scheme property*.

Spread: general

5.7.5

R

- (1) This *rule* does not apply in respect of a *transferable security* or an *approved money-market instrument* to which ■ COLL 5.6.8R (Spread: government and public securities) applies.
- (2) Not more than 20% in value of the *scheme property* is to consist of *deposits* with a single body.
- (3) Not more than 10% in value of the *scheme property* is to consist of *transferable securities* or *approved money-market instruments* issued by any single body subject to ■ COLL 5.6.23 R (Schemes replicating an index).
- (4) The limit of 10% in (3) is raised to 25% in value of the *scheme property* in respect of *covered bonds*.
- (5) In applying (3) *certificates representing certain securities* are to be treated as equivalent to the underlying *security*.
- (6) The exposure to any one counterparty in an *OTC derivative* transaction must not exceed 10% in value of the *scheme*.
- (7) Except for a *feeder scheme* which (in respect of investment in *units* in *collective investment schemes*) is *dedicated* to the *units* of a *master scheme*, not more than 35% in value of the *scheme* is to consist of the *units* of any one *scheme*.
- (8) For the purpose of calculating the limit in (6), the exposure in respect of an *OTC derivative* may be reduced to the extent that collateral is held in respect of it if the collateral meets each of the conditions specified in (9).
- (9) The conditions referred to in (8) are that the collateral:
 - (a) is marked-to-market on a daily basis and exceeds the value of the amount at risk;
 - (b) is exposed only to negligible risks (e.g. government bonds of first credit rating or cash) and is liquid;
 - (c) is held by a third party custodian not related to the provider or is legally secured from the consequences of a failure of a related party; and
 - (d) can be fully enforced by the *non-UCITS retail scheme* operating as a *FAIF* at any time.
- (10) For the purpose of calculating the limit in (6), *OTC derivative* positions with the same counterparty may be netted provided that the netting procedures:

- (a) comply with the conditions set out in Part Three, Title II, Chapter 6, Section 7(Contractual netting (Contracts for novation and other netting agreements)) of the *UK CRR* and
 - (b) are based on legally binding agreements.
- (11) In applying this *rule*, all *derivatives* transactions are deemed to be free of counterparty risk if they are performed on an exchange where the *clearing house* meets each of the following conditions:
- (a) it is backed by an appropriate performance guarantee; and
 - (b) it is characterised by a daily mark-to-market valuation of the *derivative* positions and an at least daily margining.
- (12) For the purposes of this *rule* a single body is:
- (a) in relation to *transferable securities* and money market instruments, the *person* by whom they are issued; and
 - (b) in relation to *deposits*, the *person* with whom they are placed.

Guidance on spread: general

5.7.6

G

- (1) ■ COLL 5.7.5R (8) to ■ (11) replicate the provisions of Article 5 of the Commission Recommendation 2004/383/EC of 27 April 2004 on the use of financial derivative instruments for undertakings for collective investment in transferable securities, so as to enable *non-UCITS retail schemes* to benefit from the same flexibility.
- (2) The attention of *authorised fund managers* is specifically drawn to condition (d) in ■ COLL 5.7.5R (9) under which the collateral has to be legally enforceable at any time. It is the *FCA's* view that it is advisable for an *authorised fund manager* to undertake a legal due diligence exercise before entering into any financial collateral arrangement. This is particularly important where the collateral arrangements in question have a cross-border dimension. The *depository* will also need to exercise reasonable care to review the collateral arrangements in accordance with its duties under ■ COLL 6.6.4 R (General duties of the depository).
- (3) In applying the spread limit of 20% in value of *scheme property* which may consist of *deposits* with a single body, all uninvested cash comprising *capital property* that the *depository* holds should be included in calculating the total sum of the *deposits* held by it on behalf of the *scheme*.

Investment in collective investment schemes

5.7.7

R

- (1) A *non-UCITS retail scheme* operating as a *FAIF* must not invest in *units* in a *collective investment scheme* (second *scheme*) unless the second *scheme*:
 - (a) is a *scheme* which satisfies the criteria in ■ COLL 5.6.10R(1)(a) to ■ (d);
 - (b) meets each of the requirements in (2)(a) to (d); or
 - (c) provided the conditions in (3) are satisfied, is a *long-term asset fund*.

- (2) A *non-UCITS retail scheme* operating as a *FAIF* may invest in a second *scheme* under this paragraph if:
- (a) the second *scheme* operates on the principle of the prudent spread of risk;
 - (b) the second *scheme* is prohibited from investing more than 15% in value of the property of that *scheme* in *units in collective investment schemes* or, if there is no such prohibition, the *non-UCITS retail scheme's authorised fund manager* is satisfied, on reasonable grounds and after making all reasonable enquiries, that no such investment will be made;
 - (c) the participants in the second *scheme* must be entitled to have their *units* redeemed in accordance with the *scheme* at a *price*:
 - (i) related to the net value of the property to which the *units* relate; and
 - (ii) determined in accordance with the *scheme*; and
 - (d) where the second *scheme* is an umbrella, the provisions in (2)(a) to (2)(c) above and ■ COLL 5.7.5R (Spread: general) apply to each *sub-fund* as if it were a separate *scheme*.

A *non-UCITS retail scheme* operating as a *FAIF* may invest in *units* in a second *scheme* which is a *long-term asset fund* provided:

- (a) the *long-term asset fund's* liquidity, *redemption* policy and *dealing* arrangements are sufficient for the *non-UCITS retail scheme* to be able to meet its obligations in respect of *redemptions*;
- (b) if relevant, the *authorised fund manager* ensures that the *non-UCITS retail scheme's* holdings of *units* of different *long-term asset funds* are diversified enough so that it can meet its obligations in respect of *redemptions*; and
- (c) where the *non-UCITS retail scheme* invests more than 50% of the value of the *scheme property* in *units* of second *schemes* that are *long-term asset funds*, the *non-UCITS retail scheme* operates *limited redemption arrangements* that:
 - (i) enable it to meet its obligations in respect of *redemptions*; and
 - (ii) are consistent with (a) and (b).

Investment in long-term asset funds: guidance

5.7.7A

G

- (1) Under ■ COLL 5.7.7R(3)(c), a *non-UCITS retail scheme* operating as a *FAIF* will need to operate *limited redemption arrangements* where it invests more than the 50% of the value of the *scheme property* in second *schemes* that are *long-term asset funds*. The *FCA* expects this to be where:
- (a) the investment objective and investment policy set out in the *non-UCITS retail scheme's prospectus* aim to invest at least 50% of the value of the *scheme property* in *units* of *long-term asset funds*; or
 - (b) at least 50% of the value of the *scheme property* of the *non-UCITS retail scheme* has been invested in *long-term asset funds* for at least 3 continuous *months* in the last 12 *months*.

- (2) (a) In order to comply with ■ COLL 5.7.7R(3), the *non-UCITS retail scheme's authorised fund manager* must be satisfied that the *long-term asset fund's liquidity, redemption policy and dealing arrangements* are sufficient for the *non-UCITS retail scheme* to be able to meet its own *redemption* obligations.
- (b) In determining whether (2)(a) is satisfied, the *authorised fund manager* should have regard to the liquidity of the other assets in which the *scheme property* is invested, particularly where such assets are *inherently illiquid assets*. This includes having regard to the *redemption policies and dealing arrangements* for other *second schemes* in which the *non-UCITS retail scheme* holds *units*.
- (3) In practice, and having regard to the liquidity of other assets, compliance with this *rule* may require the *non-UCITS retail scheme* to operate *limited redemption arrangements* even in circumstances where less than 50% of the value of the *scheme property* is invested in *second schemes* that are *long-term asset funds*.

Feeder scheme dedicated to units in a collective investment scheme

5.7.8

R

Feeder schemes which (in respect of investment in *units* in *collective investment schemes*) are *dedicated to units* in a single *collective investment scheme* must, in addition to the investment in the master *scheme*, only hold cash or *near cash* to maintain sufficient liquidity to enable the *scheme* to meet its commitments, such as *redemptions*. *Feeder schemes* may also use techniques and instruments for the purpose of *efficient portfolio management*, where appropriate, such as forward foreign exchange transactions entered into for the purpose of reducing the effect of fluctuations in the rate of exchange between relevant currencies.

Due diligence requirements

5.7.9

R

- (1) A *non-UCITS retail scheme* operating as a *FAIF* must not invest in *units* in *schemes* in ■ COLL 5.7.7R(2)(a) to ■ (2)(c) ('*second schemes*') unless the *authorised fund manager* has carried out appropriate due diligence on each of the *second schemes* and:
 - (a) is satisfied, on reasonable grounds and after making all reasonable enquiries, that each of the *second schemes* complies with relevant legal and regulatory requirements;
 - (b) has taken reasonable care to determine that:
 - (i) the property of each of the *second schemes* is held in safekeeping by a third party, which is subject to prudential regulation and independent of the investment manager of the *second scheme*;
 - (ii) the calculation of the net asset value of each of the *second schemes* and the maintenance of their accounting records is segregated from the investment management function; and
 - (iii) each of the *second schemes* is regularly audited by an independent auditor in accordance with international standards on auditing.
- (2) The *authorised fund manager* of a *non-UCITS retail scheme* operating as a *FAIF* invested in one or more *second schemes* must carry out

appropriate due diligence as detailed in (1) on those *schemes* on an ongoing basis.

5.7.10 **R** The *authorised fund manager* of a *non-UCITS retail scheme* operating as a *FAIF* which is a *feeder scheme* must ensure that:

- (1) its *master scheme*; and
- (2) where its *master scheme* is itself a *feeder scheme*, any *scheme* into which that *master scheme* invests;

operates on a basis that is consistent with the *rules* in this section notwithstanding any due diligence previously carried out which suggested that those *schemes* would so operate.

5.7.11 **G** An *authorised fund manager* carrying out due diligence for the purpose of the *rules* in this section should make enquiries or otherwise obtain information needed to enable him properly to consider:

- (1) whether the experience, expertise, qualifications and professional standing of the second *scheme's* investment manager is adequate for the type and complexity of the second *scheme*;
- (2) the adequacy of the regulatory, legal and accounting regimes applicable to the second *scheme* and its investment manager;
- (3) whether the second *scheme*, its investment manager and administrator have complied with their legal and regulatory obligations, including but not limited to an evaluation of the investment manager's written policies with respect to such compliance;
- (4) the extent to which the second *scheme's* investment manager adheres to guidance and codes which amount to good practice in the industry;
- (5) the adequacy of the second *scheme's* systems, controls, governance, accounting, administration, business continuity, disaster recovery, safekeeping, custody and trading and execution arrangements;
- (6) the extent to which the property of the second *scheme* may be rehypothecated and the potential impact of such rehypothecation on the *non-UCITS retail scheme* operating as a *FAIF*;
- (7) the adequacy of the second *scheme's* risk management process, in particular:
 - (a) the methodology by which risk is measured and its practical adequacy in the light of the limitations inherent in risk measures (such as value at risk), including where appropriate, reference to market risk, credit risk (including counterparty credit risk), liquidity risk, operational risk and outsourcing risk;
 - (b) the extent to which the second *scheme's* investment manager carries out stress testing and backtesting, to determine how potential changes in market conditions could impact on the value of the second *scheme's* portfolio;

- (c) the reporting, escalation and review processes within the second *scheme's* governance structure;
- (d) the manner in which risks arising from services provided by third parties are managed, including where those third parties provide prime brokerage, administration, auditing, valuation, risk monitoring, business continuity and disaster recovery services; and
- (e) the management of key person risk;
- (8) the adequacy of the second *scheme's* investment strategy and trading philosophy;
- (9) the implications of currency convertibility (if any);
- (10) whether the second *scheme* produces a valuation that is sufficiently accurate for the *authorised fund manager* to be reasonably satisfied that the price of the *FAIF's units* can be calculated in accordance with ■ COLL 6.3 (Valuation and pricing), including but not limited to an assessment of:
 - (a) the roles and responsibilities of each of the parties involved in the second *scheme's* valuation process and the extent to which these are defined;
 - (b) the extent to which the valuation process is segregated or is functionally separate from the second *scheme's* investment manager where the second *scheme* is not subject to completely independent valuation by a third party;
 - (c) the methods used by the second *scheme* for the valuation of each part of its property including those assets which are difficult to value or which are not subject to independent market pricing;
 - (d) the extent to which the investment manager of the second *scheme* does not rely on prices from external sources, and its written policies relating to this;
 - (e) the manner in which the investment manager of the second *scheme* selects and monitors the adequacy of its pricing sources;
 - (f) the extent to which the investment manager of the second *scheme* operates a valuation policy that is consistent and fair to both subscribing and redeeming investors from the second *scheme*;
- (11) the level of liquidity, redemption policy and *dealing* arrangements offered by the second *scheme* and whether they are sufficient for the investing *scheme* to be able to meet its obligations in respect of redemptions; wherever appropriate the *authorised fund manager* may need to consider how many second *schemes* the investing *scheme* should invest in to ensure that that *scheme* can meet its redemption obligations; and
- (12) any relevant conflicts of interest that may arise out of the relationships of the second *scheme's* investment manager with other relevant parties and in particular detract from the integrity of the second *scheme's* decision-making process, including:
 - (a) relationships with brokers or service providers;
 - (b) conflicts that may be generated by fee structures;

- (c) use of dealing commission to purchase goods or services;
- (d) conflicts that may arise from the second *scheme's* investment manager managing that *scheme* alongside other business; and
- (e) the conflicts of interest that may arise (if any) between the second *scheme's* investment manager and any *person* instructed to carry out due diligence on the *authorised fund manager's* behalf.

Non-UCITS retail schemes that are umbrellas with FAIF sub-funds

5.7.12

R

In relation to a *non-UCITS retail scheme* which is an *umbrella* comprised of *sub-funds* which are:

- (1) *FAIFs*; or
- (2) a mixture of *FAIFs* and standard *non-UCITS retail schemes*;

the provisions in this section apply to each *sub-fund* operating as a *FAIF* as they would to a separate *scheme*.

5

5.8 Investment powers and borrowing limits for feeder UCITS

Application

- 5.8.1** **R** (1) This section applies to:
- (a) the *authorised fund manager* of a *feeder UCITS*;
 - (b) the *depository* of a *feeder UCITS*; and
 - (c) an *ICVC* which is a *feeder UCITS*;
- where the *scheme* is a *UCITS scheme*.
- (2) Where this section refers to a *rule* or *guidance* in ■ COLL 5.1 to ■ COLL 5.5, those *rules* and *guidance*, and any *rules* and *guidance* to which they refer, must be read as if a reference to a *UCITS scheme* were a reference to a *feeder UCITS*.
- (3) Where the *sub-fund* of a *UCITS scheme* is a *feeder UCITS*, the provisions in this section apply to each *sub-fund* as they would for an *authorised fund*.

Permitted types of scheme property

- 5.8.2** **R** A *feeder UCITS* must invest at least 85% in value of the *scheme property* in *units* of a single *master UCITS*.

[Note: article 58(1) of the *UCITS Directive*]

- 5.8.2A** **R** The *authorised fund manager* of a *pension feeder fund* that is a *feeder UCITS* must ensure that the single *master UCITS* is:

- (1) a *UCITS scheme*; or
- (2) an *EEA UCITS scheme* that is a *recognised scheme*.

Balance of scheme property: investment restrictions on a feeder UCITS

- 5.8.3** **R** A *feeder UCITS* may hold up to 15% in value of the *scheme property* in one or more of the following:

- (1) cash or *near cash* in accordance with ■ COLL 5.5.3 R (Cash and near cash);

- (2) *derivatives* and forward transactions which may be used only for the purposes of hedging and in accordance with the *rules* set out at ■ COLL 5.8.7 R (Other provisions applicable to a feeder UCITS); and
- (3) (for an *ICVC*) movable and immovable property which is essential for the direct pursuit of the business.

[Note: article 58(2) first subparagraph of the *UCITS Directive*]

Exposure to derivatives

5.8.4

R

In calculating the global exposure of a *feeder UCITS* to *derivatives* and forward transactions in accordance with ■ COLL 5.3.3A R (Cover for investment in derivatives and forward transactions), the *feeder UCITS* must combine its own direct exposure under ■ COLL 5.8.3R (2) with either:

- (1) the *master UCITS*' actual exposure to *derivatives* and forward transactions in proportion to the *feeder UCITS*' investment into the *master UCITS*; or
- (2) the *master UCITS*' potential maximum global exposure to *derivatives* and forward transactions provided for in the *master UCITS*' *instrument constituting the fund* or its *prospectus* in proportion to the *feeder UCITS* investment into the *master UCITS*.

[Note: article 58(2) second subparagraph of the *UCITS Directive*]

Prudent spread of risk

5.8.5

R

An *authorised fund manager* must ensure that, to the extent that the *feeder UCITS* invests in assets other than *units* of a *master UCITS*, the *feeder UCITS* complies with ■ COLL 5.2.3 R (1) (Prudent spread of risk).

Investment powers: general

5.8.6

R

The *scheme property* of a *feeder UCITS* must be invested only in accordance with the relevant provisions in this section and up to any maximum limit so stated, but the *instrument constituting the fund* may restrict the investment and borrowing powers of a *scheme* further than the relevant restrictions in this section.

Other provisions applicable to a feeder UCITS

5.8.7

R

The following *rules* and *guidance* in ■ COLL 5.1 (Introduction), ■ COLL 5.2 (General investment powers and limits for UCITS schemes) and ■ COLL 5.5 (Cash, borrowing, lending and other provisions) apply to the *authorised fund manager* of a *UCITS scheme* which is a *feeder UCITS* and to an *ICVC* which is a *feeder UCITS*:

- (1) ■ COLL 5.1.1 R (Application), ■ COLL 5.1.2G (1) (Purpose) and ■ COLL 5.1.3 R (Treatment of obligations);
- (2) ■ COLL 5.2.1 R (Application), ■ COLL 5.2.2 R (Table of application) and ■ COLL 5.2.2A G;
- (3) ■ COLL 5.2.5 R (Valuation) and ■ COLL 5.2.6 G (Valuation guidance);

- (4) ■ COLL 5.2.10 R (Eligible markets: requirements);
- (5) ■ COLL 5.2.11R (7) (Spread: general);
- (6) ■ COLL 5.2.11B R (Counterparty risk and issuer concentration);
- (7) ■ COLL 5.2.15R (1) (Investment in associated collective investment schemes);
- (8) ■ COLL 5.2.19 R (1), ■ COLL 5.2.19 R (2) and ■ COLL 5.2.19R (4) (Derivatives: general);
- (9) ■ COLL 5.2.20 R (Permitted transactions (derivatives and forwards));
- (10) ■ COLL 5.2.20A R (Financial indices underlying derivatives), ■ COLL 5.2.20BG (1) and ■ COLL 5.2.20BG (4) (Guidance on financial indices underlying derivatives);
- (11) ■ COLL 5.2.21 R (Transactions for the purchase of property);
- (12) ■ COLL 5.2.22 R (Requirement to cover sales) and ■ COLL 5.2.22A G (Guidance on requirement to cover sales);
- (13) ■ COLL 5.2.23 R (OTC Transactions in derivatives), ■ COLL 5.2.23A R and ■ COLL 5.2.23B R);
- (14) ■ COLL 5.2.23C R (Valuation of OTC derivatives);
- (15) ■ COLL 5.2.26 R (Investment in deposits);
- (16) ■ COLL 5.5.1 R to ■ COLL 5.5.7A G (Cash, borrowing, lending and other provisions); and
- (17) ■ COLL 5.5.9 R (Guarantees and indemnities) and ■ COLL 5.5.10 G (Guidance on restricting payments).