

## Chapter 15

# Long-term asset funds

## 15.6 Investment and borrowing powers

### Application

15.6.1

R

This section applies to:

- (1) the *authorised fund manager* of an *AUT*, *ACS* or an *ICVC*;
- (2) the *depository* of an *AUT*, *ACS* or an *ICVC*; and
- (3) an *ICVC*,  
which is a *long-term asset fund*.

15.6.2

R

- (1) Where this section refers to 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 the feeder *scheme's* master *scheme*.
- (2) Where this section refers to 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 *long-term asset fund* 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.

### Prudent spread of risk

15.6.3

R

An *authorised fund manager* must ensure that, taking account of the investment objectives, policy and strategy of the *long-term asset fund* as stated in its most recently published *prospectus*, the *scheme property* of the *long-term asset fund* aims to provide a prudent spread of risk.

15.6.4

G

For the purpose of ■ COLL 15.6.3R, an *authorised fund manager* should consider the risks to which the *LTAF* is exposed, including:

- (1) whether the assets or *investments* held in the *scheme property* provide a sufficient diversification of exposure including, for example, in respect of the underlying assets or *investments* held by any holding company or other *collective investment scheme*;

- (2) the spread of any other risks arising from the assets or *investments* held in the *scheme property* of the *LTAF* such as *market risks*, *credit risks*, *liquidity risks* and *counterparty risks*.

[**Note:** Article 44 of the *AIFMD level 2 regulation*.]

### Investment powers: general

- 15.6.5 **R**
- (1) The *scheme property* of a *long-term asset fund* may, subject to the *rules* in this chapter, comprise any assets or *investments* to which it is *dedicated*.
- (2) The *instrument constituting the fund* and the *prospectus* may further restrict:
- (a) the kinds of assets in which the *scheme property* may be invested;
  - (b) the types of transactions permitted and any relevant limits; and
  - (c) the borrowing powers of the *scheme*.

### Long-term asset funds: investment strategy

- 15.6.6 **R** The investment strategy of a *long-term asset fund* must be to invest mainly in long-term illiquid assets.

- 15.6.7 **G** The *FCA* expects the investment strategy of a *long-term asset fund* to be to invest at least 50% of the value of the *scheme property* in unlisted *securities* and other long-term assets such as interests in immovables or other *collective investment schemes* investing in such *securities* or long-term assets. However, a *long-term asset fund* could have a strategy of investing mainly in a mix of unlisted assets and listed but illiquid assets.

### Long-term asset funds: general

- 15.6.8 **R** The *scheme property* of a *long-term asset fund* must, except where otherwise provided by the *rules* in this chapter, consist only of one or more of the following to which it is *dedicated*:
- (1) any *specified investment*:
    - (a) within articles 74 to 86 of the *Regulated Activities Order*;
    - (b) within article 89 (Rights to or interests in investments) of the *Regulated Activities Order* where the right or interest relates to a specified investment within (a);
  - (2) (to the extent not within (a)) an interest in a loan, provided that the loan was not originated to:
    - (a) a natural person;
    - (b) the *authorised fund manager* of the *long-term asset fund*;
    - (c) the *depository* of the *long-term asset fund*;
    - (d) an *affiliated company* of the person in (b) or (c); or
    - (e) a person who intends to use, or uses, the credit for the purpose of investing in a *derivative*, *cryptoasset derivative*, an *unregulated*

*transferable cryptoasset, precious metals or a commodity contract within (5);*

- (3) an interest in an immovable under ■ COLL 15.6.18R (Investment in property);
- (4) *precious metals*; or
- (5) a *commodity contract* traded on an *RIE* or a *recognised overseas investment exchange*.

[**Note:** *Full-scope UK AIFMs* are subject to specific requirements relating to conflicts of interest (see articles 30 to 36 in the *AIFMD level 2 regulation* and ■ SYSC 10.1.23R to ■ SYSC 10.1.26R (Additional requirements for an AIFM)).]

[**Note 2:** In relation to (2), a borrower who receives *money* by way of *deposit* from a *person* who is not a *bank* may (if the borrower is acting by way of business) be carrying on the *regulated activity of accepting deposits*, but an exclusion in the *Regulated Activities Order* may be available. See also article 2 of the *Business Order*.]

### Investment in collective investment schemes

15.6.9

R

- (1) Subject to (2) and (3) (where applicable), a *long-term asset fund* may invest in *units* in a *scheme* (a '*second scheme*') only if the *second scheme* is:
  - (a) a *regulated collective investment scheme*; or
  - (b) a *scheme* not within (a) where the *authorised fund manager* has taken reasonable care to determine that:
    - (i) it is the subject of an independent annual audit conducted in accordance with international standards on auditing;
    - (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) it (and any *master scheme* to whose *units* it is *dedicated*) is prohibited from investing in the *long-term asset fund*, or, if there is no such prohibition, the *authorised fund manager* is satisfied, on reasonable grounds and after making all reasonable enquiries, that no such investment will be made by either the *second scheme* or any *fund* in which the *second scheme* invests.
- (2) A *long-term asset fund* must not invest more than 20% in value of the *scheme property* in *units* in *second schemes* which are *unregulated schemes, qualified investor schemes or long-term asset funds* unless the *authorised fund manager* has carried out appropriate due diligence on each of the *second schemes* and has taken reasonable care to determine that, after making all reasonable enquiries and on reasonable grounds, the *second scheme* complies with relevant legal and regulatory requirements.
- (3) The *authorised fund manager* of a *long-term asset fund* with more than 20% in value of the *scheme property* invested in one or more *second schemes* which are *unregulated schemes, qualified investor*

*schemes or long-term asset funds* must carry out appropriate due diligence on those *schemes* on an ongoing basis.

- 15.6.10 **G**
- (1) The *authorised fund manager* of a *long-term asset fund* carrying out due diligence for the purpose of ■ COLL 15.6.9R should use reasonable efforts to make enquiries and obtain the information needed to be able to consider the matters specified in ■ COLL 5.7.11G(1) to (12), as if that *guidance* related to ■ COLL 15.6.9R.
  - (2) Where ■ COLL 5.7.11G(10) refers to ■ COLL 6.3 (Valuation and pricing), that reference should be read as if it were a reference to ■ COLL 15.8.2R (Valuation, pricing and dealing).
  - (3) In addition to the *guidance* at ■ COLL 5.7.11G the *authorised fund manager* should, as part of its due diligence process, consider whether 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* and, if not, what controls over the property of the second *scheme* are in place to protect investors.
  - (4) Further specific requirements relating to due diligence apply to the *authorised fund manager* of a *long-term asset fund* under the *rules* in this chapter and in articles 18 to 20 of the *AIFMD level 2 regulation*.

**Investment in a collective investment scheme that is an umbrella**

- 15.6.11 **R** Where the second *scheme* in ■ COLL 15.6.9R is an *umbrella*, the provisions apply to each *sub-fund* as if it were a separate *scheme*.

**Delivery of property under a transaction in derivatives or a commodities contract**

- 15.6.12 **R**
- (1) An *authorised fund manager* must take reasonable care to determine the following when entering into any transaction in *derivatives* or any *commodity* contract which may result in any asset becoming part of the *scheme property*:
    - (a) if it is an asset in which the *scheme property* could be invested, that the transaction:
      - (i) can be readily closed out; or
      - (ii) would at the expected time of delivery relate to an asset which could be included in the *scheme property* under the *rules* in this chapter; or
    - (b) in any other case, that the transaction can be readily closed out.
  - (2) An *authorised fund manager* may acquire an asset within (1) if its determination has proved incorrect and if it determines that acquisition is in the interests of the *unitholders*, provided it has the consent of the *depository*.
  - (3) Any asset within (1) acquired in accordance with (2) may form part of the *scheme property* despite any other *rule* in this chapter until the position can be rectified.

**Cover for transactions in derivatives and forward transactions**

- 15.6.13 **R**
- (1) A transaction in *derivatives* or a forward transaction may be entered into only if the maximum exposure, in terms of the *principal* or *notional principal* created by the transaction to which the *scheme* is or may be committed by another *person*, is covered globally under (2).
  - (2) Exposure is globally covered if adequate cover from within the *scheme property* is available to meet the *scheme's* total exposure taking into account any reasonably foreseeable market movement.
  - (3) The total exposure relating to *derivatives* held in a *long-term asset fund* may not exceed the net value of the *scheme property*.
  - (4) No element of cover may be used more than once.

**Valuation of an OTC derivative**

- 15.6.14 **R**
- A transaction in an *OTC derivative* must be capable of valuation which it will only be 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:
- (1) on the basis of the pricing model; or
  - (2) on some other reliable basis reflecting an up-to-date market value, which has been agreed between the *authorised fund manager* and the *depository*.

**Continuing nature of limits and requirements**

- 15.6.15 **R**
- (1) An *authorised fund manager* must, as frequently as necessary to ensure compliance with ■ COLL 15.6.13R(2) and ■ COLL 15.6.13R(4), recalculate the amount of cover required in respect of *derivatives* and forward transactions in existence under this chapter.
  - (2) *Derivatives* and forward transactions may be retained in the *scheme property* only so long as they remain covered globally under ■ COLL 15.6.13R.
  - (3) An *authorised fund manager* must use a risk management process enabling it to monitor and measure as frequently as appropriate the risk of a *scheme's derivatives* positions and their contribution to the overall risk profile of the *scheme*.

**Permitted stock lending**

- 15.6.16 **R**
- (1) 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*, may enter into a *repo* contract or a *stock lending arrangement* within section 263B of the Taxation of Chargeable Gains Act 1992 (without extension by section 263C).

- (2) The *depository* must ensure that the value of any *collateral* for the *stock lending arrangement* is at all times at least equal to the value of the securities transferred by the *depository*.
- (3) In the case of the expiry of validity of any *collateral*, the duty in (2) is satisfied if the *depository* or the *authorised fund manager*, as appropriate, takes reasonable care to determine that sufficient *collateral* will be transferred by close of business on the *day* of expiry.

### General power to borrow

15.6.17

R

- (1) The *ICVC* or *depository* of an *AUT* or *ACS* (on the instructions of the *authorised fund manager*) may borrow money for the use of the *authorised fund* on terms that the borrowing is to be repayable out of the *scheme property*.
- (2) The *authorised fund manager* must ensure that the *authorised fund's* borrowing does not, on any *day*, exceed 30% of the net value of the *scheme property* and must take reasonable care to ensure that arrangements are in place that will enable borrowings to be closed out to ensure such compliance.
- (3) In this *rule* "borrowing" also includes any 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) Where the limit in (2) is breached, the *authorised fund manager* must take action in accordance with the principles set out in ■ COLL 15.7.3R(3) to ■ COLL 15.7.3R(5) (Duties of the *authorised fund manager*: investment and borrowing powers) to deal with that breach.

### Investment in property

15.6.18

R

- (1) Any investment in land or a building held within the *scheme property* of a *long-term asset fund* must be in an immovable within (2).
- (2) For an immovable:
  - (a) it must be situated in a country or territory identified in the *prospectus*;
  - (b) the *authorised fund manager* must have taken reasonable care to determine that the title to the interest in the immovable is a good marketable title; and
  - (c) the *authorised fund manager* of an *AUT* or *ACS* or the *ICVC* must have received a report from an *appropriate valuer* that:
    - (i) contains a valuation of the interest in the immovable (with and without any relevant existing mortgage); and
    - (ii) states that in the *appropriate valuer's* opinion the interest in the immovable would, if acquired by the *scheme*, be capable of being disposed of reasonably quickly at that valuation;
  - (d) unless (c) is satisfied, the *authorised fund manager* of an *AUT* or *ACS* or the *ICVC* must have received a report from an *appropriate valuer* valuing the interest in the immovable and stating that:

15

- (i) the immovable is adjacent to or in the vicinity of another immovable included in the *scheme property*; and
  - (ii) in the opinion of the *appropriate valuer*, the total value of the interests in both immovables would at least equal the sum of the price payable for the interest in the immovable and the existing value of the interest in the other immovable; and
- (2) it must not be bought:
- (e) if it becomes apparent to the *authorised fund manager* that the report in either (c) or (d) could no longer reasonably be relied upon; or
  - (e) at a price more than 105% of the valuation relevant to the interest for that immovable in the report in either (c) or (d).
- (3) Any contents of any building may be regarded as part of the relevant immovable.
- (4) 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 an *authorised fund* 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 been engaged, and whose *associates* have not been engaged, 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**

15.6.19

**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 section 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.

15.6.20

**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

15.6.21 **R** The following limits apply in respect of immovables held as part of the *scheme property*:

- (1) the amount secured by mortgages over any immovable must not exceed 100% of the latest valuation by an *appropriate valuer* under ■ COLL 15.6.18R(2)(c) or ■ COLL 15.6.18R(2)(d) or ■ COLL 15.6.22R, as appropriate;
- (2) no option may be granted to a *person* to buy or obtain an interest in any immovable comprised in the *scheme property* if this might unduly prejudice the ability to provide *redemption*; and
- (3) the total of all premiums paid for options to purchase immovables must not exceed 10% of the *scheme* value in any 12-month period, calculated at the date of the granting of the option.

#### Standing independent valuer and valuation

15.6.22 **R**

- (1) In relation to the appointment of a valuer the *authorised fund manager* must:
  - (a) at the outset appoint the *standing independent valuer* with the approval of the *depository* and likewise upon any vacancy; and
  - (b) ensure that any immovables in the *scheme property* are valued by an *appropriate valuer (standing independent valuer)* appointed by the *authorised fund manager*.
- (2) The following apply in relation to the functions of the *standing independent valuer*:

- (a) the *authorised fund manager* must ensure that the *standing independent valuer* appointed under (1), procures the valuation of 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 and value 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 matter which appears 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 2 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 any provisions of the *instrument constituting the fund*.
- (3) In relation to immovables:
- (a) any valuation under this *rule* has effect, until the next valuation under this *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.

## 15.6.23

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 15.6.22R(2)(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 Council.